Bringing Risk Management Together – What the Future Holds

Future Challenges for Risk Management in the Australian Public Sector

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I Introductory Comments

I thank the ACT Chapter of the Risk Management Institution of Australasia for the opportunity to give the opening address at your inaugural conference on this important issue, one that I, personally, have been championing for some time — the key role that risk identification and management plays in a robust management and governance framework. As you would be aware, my term as the Auditor-General for the Commonwealth has recently concluded. However, I propose to draw on my experiences in that role in providing some thoughts on the current ‘state of play’ of risk management and to highlight future challenges, particularly in a public sector context.

In a previous paper¹ that I gave to the then ARIMA, I noted the evolution of risk management in the public sector from a ‘fairly woolly’ concept that lacked any real level of sophistication or maturity in its application to one where it was generally accepted, indeed almost being axiomatic, that business processes, risks and controls across an organisation are interrelated and, that, the traditional insular, or ‘silo’, approaches were far from effective in dealing credibly with the resulting demands. In short, there were too many gaps with no reliable way of evaluating an organisation’s overall risk position and establishing appropriate risk treatments for both assurance and performance purposes.

The adoption of an enterprise risk management type approach illustrates just how far our thinking has advanced in this field, particularly in the public sector, where risk management was first canvassed as a significant issue for organisations in the latter part of the 1980s. Indeed, a measure of the maturity of risk management in the Australian public sector is the extent to which entities have embraced organisation-wide risk management (enterprise risk management) and integrated it with their strategic objectives and operational culture.² The ANAO has played an important part in shaping a more contemporary risk management approach through participation in risk management forums, related addresses and publications, Better Practice Guides, and importantly, highlighting risk management issues in our financial statement and performance audits.

Notwithstanding this evolution in thinking and approach, there continues to be a generally heightened concern and focus on risk management, particularly in light of the series of high-profile business scandals and failures, here in Australia and overseas. Indeed, Stuart Fagg, in his Editor’s Note, in Risk Management, makes the point that
‘2004 was the year that risk management was etched into the public consciousness once and for all’.3 These failures have resulted in calls for enhanced corporate governance and risk management, new laws and standards, and the requirement for public companies to maintain systems of internal control. In the United States, this has extended to requiring management to certify, and the independent auditor to attest to, the effectiveness of those systems (the Sarbanes-Oxley Act).4 I include these observations because I consider that what is happening in the private sector will continue to impact on the considerations and approaches being taken in the public sector, particularly if there is a continuing increase in the former sector’s participation in the delivery of public services.

Closer to home, Principle 7 of the ASX’s ‘Principles of Good Corporate Governance and Best Practice Recommendations’ is aimed at ensuring risks are recognised and managed by including the recommendation that Company boards establish a sound system of risk oversight/management and control, and calling for the Managing Director and the CFO to certify to the Board that:

a) the integrity of financial statements is founded on a sound system of risk management, internal compliance and control which implements the policies adopted by the board; and

b) the company’s risk management, internal control and compliance system is operating efficiently and effectively in all material aspects.5

Faced with these increased compliance obligations, a dynamic business and information technology (IT) environment, fragmented risk, and exposure to criminal liability, organisations are becoming more focussed on implementing a formalised approach to managing enterprise risk and compliance. Indeed, there is now a general consensus that corporate governance and risk management issues run across all areas of an organisation and are key drivers that contribute to organisational performance whether the entity is in the public or private sectors. My long time friend, Ted Dahms, recently observed that Standards Australia’s Guide to Controls Assurance and Risk Management (HB254 – 2003):

‘…is the first guide to link risk management with corporate governance in a proactive manner and to include a methodology for developing the critical underlying value system. For this reason, it is an essential supporting guide for Standards Australia’s Corporate Governance Standards, and a companion for the revised Risk Management Standard AS/NZ 4360 – 2004.6

In my view, by now, most of the ‘low-hanging fruit’ has been picked by agencies, recognising that an effective risk management strategy and
control environment must be in place and that organisations must continually refine their risk management requirements to actively manage their changing risk profiles. However, risk is a strategic issue which needs to be aligned to strategic objectives, corporate governance arrangements, and integrated with business planning and reporting cycles. This approach, in turn, provides the appropriate assurance to shareholders, Government and other stakeholders that the organisation or agency has a formal, systematic and pro-active approach to the identification, management and monitoring of risk. 7 This has, perhaps, been the most significant challenge for public sector entities and is likely to continue to be so.

Given that formal risk management is no longer discretionary and is now considered an essential component of sound management as well as of sound corporate governance, 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. Greater accountability is the price for ensuring stakeholder confidence and support, not least of all from the general public. As always, the proof of the pudding is in the eating, and I intend to explore this aspect by drawing on examples from recent ANAO audit reports. In this respect, I offer this initial observation taken from the latest ANAO ‘Control Structures’ audit report:

‘Entities need to continue to build risk awareness; strengthen business practices and systems of authorisation…as part of the development of performance measurement frameworks’;8 and ‘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’. 9

Having briefly sketched the move toward a fuller and more robust risk management process, I propose to devote the remainder of my address to two broad themes—an overview of the current state of play (predominately in the Australian public sector) and identification of some challenges and trends for risk management, looking ahead.

II The Current State of Play

Despite the increasing attention given to risk management many public servants are still quite risk averse. This is not really surprising given that the public service culture, its values, ethos and ethics has traditionally been risk averse, due I expect, to the tendency to associate risk-taking with increasing the possibility of something going wrong which, in turn, usually leads to Parliamentary and public censure. The public sector requirements for accountability, probity
and emphasis on ethics combined with the scrutiny over the activities of public sector officials (in the APS exercised by the parliamentary committee processes) have, indeed, reinforced a risk-averse culture.

This is in sharp contrast to successful private sector companies where well-managed risk taking is considered key to their maintaining and extending their competitive advantage and achieving required results. Indeed, interesting tensions in balancing conformance and performance with increasing private sector involvement in the public sector have raised issues about accountability and risk management, not least in areas of insurable risk covering areas such as professional and public risk. However, on a more positive note, the tension that is created by the public sector culture vis-à-vis the need to operate using modern risk management principles is now well recognised within the public sector and increasingly by our Parliamentarians, particularly the Joint Committee of Public Accounts and Audit. Indeed, this point was also recognised 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’.  

Effective risk management is the corner stone of good corporate governance and can lead to improved performance—resulting 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. Applying the principles and practices well is no guarantee of success, as other factors can determine outcomes. Nevertheless, not to do so is most likely to lead to less than required results and, perhaps, even failure.

However, it is also likely that much of the approach in the public sector 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). 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. More about that later. Another public sector inhibition is the treatment of risk as an opportunity for achieving better results.
Risk Management and Governance

I reiterate that sound risk management is an essential component of good corporate governance. Therefore, we should not be surprised that there has been an increased profile in recent times of the relationship between corporate governance and risk management. The role of risk management in corporate governance, and specifically, in determining organisational exposures, opportunities and priorities, creates the need for risk to be considered during strategic and business planning activities. That is, risk management strategies should be fully integrated with the strategic and business planning approaches of entities.

The creation of a sound governance environment involves robust risk-management, and internal control, ensuring that it is part of the strategic-planning approach taken by the entities’ leadership. In turn, that has to be conveyed to all levels of the entity to encourage real ownership and commitment to its implementation. That is, while the strategy is being developed, the organisation should be addressing such questions as: What are the major risks to the plan? How much risk exposure is the organisation willing to take? What mitigating controls need to be in place to effectively limit these risks? How will management know that the controls are working?  

Put succinctly, risk should be treated as a strategic issue so that:

a) planned business outcomes, outputs and activities do not expose the organisation to unacceptable levels of risk;

b) use of resources is consistent with organisational priorities; and

c) 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.

Risk management is central to the development and operation of an organisation’s control structure and, therefore, of its corporate governance. To ensure that organisational objectives are being met, and priorities are being addressed in the manner agreed, an organisation-wide view of risks and controls is necessary. In turn, such a view will reflect the culture, or ‘tone’, that has been set for the organisation by its leadership within its governance framework, based on a strong values/ethical commitment.

The priority imperative requires the organisational planning timetable to allow for risk identification and treatment to be contemplated ahead of the traditional strategic and business planning processes. Risk
management and business planning should also be directly linked, as business objectives and strategies provide the structure and context for identifying risks and related opportunities\textsuperscript{17}. Strategic risk management is a means of coordinating, overseeing and modelling the interrelationship of important risk factors across the business, or organisation, functions.

Against this backdrop, let me now draw some observations from recent ANAO audit reports which bear on the issues that I have identified.

**Selected Observations from Recent ANAO Audit Reports**

The management of risks is an integral part of the prudent administration of programs involving the expenditure of public funds. It should include a framework for cost effectively treating, or minimising, the risks to a program such as the realisation of the program’s objectives or value for money outcomes. It is both an accountability and a management tool and should be part of the initial program design to assist Ministers and agencies in their decision-making.\textsuperscript{18}

Improving risk management has ostensibly been a public sector priority for some time now. While good progress has been made in putting the machinery of risk management in place, there is still some distance to go before we can say that all public sector organisations have made effective risk management a central element of their day-to-day general management approach. The ability of agencies to capably manage risk can result in better delivery of government services through: improved efficiency (using a risk-based approach to organisational procedures/service delivery mechanisms); more reliable decision-making; and supporting innovation.\textsuperscript{19} As the ANAO observed recently:

\begin{quote}
Risk management is important because it allows the identification, assessment and treatment of risks that may, if untreated, prevent an agency achieving its objectives or not achieving them to the level required.\textsuperscript{20}
\end{quote}

Looking at the risk management comments in a selection of recent ANAO audit reports we can identify some common themes. Brief overviews of the risk management issues in these reports follow.

**National Action Plan for Salinity and Water Quality \textsuperscript{21}**

The report noted that, while a risk management plan had been developed, its focus was at the national but, substantial technical and information challenges (that needed to be addressed as part of the ongoing management of risks) remain. The ANAO recommended that
the agency, as part of the quarterly update of the risk management plan, give priority to facilitating the documentation and management of key risks at the regional level, and ensuring that all significant risks to the objectives of the program emerging from research and practice are documented and considered within the ongoing implementation of the program.

Regulation of Non-prescription Medical Products

The audit report makes the point that sound and structured risk management is central to performing a regulator’s function as well as the assessment of risk being an important element in its operational procedures. For example, in the Therapeutic Goods Administration (TGA) case, risk considerations influence the setting of audit frequency and product testing.

The audit found that aspects of risk management for non-prescription medicines required better articulation and structure to support targeting and monitoring of risk treatments. The ANAO recommended that the Department review and enhance the TGA’s risk management framework (for non-prescription medicinal products) with the revised framework being systematic, structured and integrated with the TGA’s overall risk management strategies. In addition, resources need to be allocated to the various risk treatments, and to ensure new or targeted strategies are based upon structured risk assessments and their outcomes are evaluated for lessons learned for future management of compliance.

‘Wedgetail’ Airborne Early Warning and Control Aircraft: Project Management

Defence’s Wedgetail project is at the leading edge of technology with significant risks in system engineering and contingency management requiring concerted efforts to identify and manage them. Indeed, a whole chapter of the report dealt with risk and issues management. The audit found that Defence and the contractor had placed considerable emphasis on risk management by focusing on risk sharing arrangements and pre-contract risk reduction strategies by seeking to define and reduce project risks as far as possible before contract signature. Post-contract risk reduction activities were addressed through prototyping and incremental build and testing strategies. At the time of this audit, the ANAO found that the key elements were in place for the successful management of this project. The ANAO plans a further review of this project in its 2005-06 audit work program.
Management of the Detention Centre Contracts

This audit focused on whether the risks associated with contracting out detention services were identified, assessed and treated appropriately. The audit found that DIMIA’s management of the program, together with the delivery of services under the contract and the prioritisation of tasks, was reactive rather than proactive. That is, it focused on risks that arose, rather than pursuing systematic risk analysis, evaluation, treatment and monitoring. The report made the point that a systematic approach to risk management, including the establishment of an appropriate and documented risk management strategy, should be an integral part of contract management.

Although DIMIA acted appropriately to deal with program and other risks as they occurred, the majority of risks were managed in response to an incident or event. Clearly, it is better practice to put in place, preferably on an enterprise-wide basis, effective preventative action or at least action that minimises or ameliorates, an adverse risk event. This applies not just to financial risks but also, importantly, to strategic and operational risks associated with delivery of the services.

Additionally, the audit found that DIMIA had not developed treatment plans to reduce unacceptable risks. In particular, there was no mechanism for monitoring and reviewing the risk profile—for example, there was no provision to allocate responsibility between DIMIA and contractor to control new risks that emerged during the course of the contract.

National Marine Unit (NMU)

The audit report made the point that, while the integrated risk management strategy allows Customs (and the NMU) to effectively identify, analyse, treat, monitor and communicate potential risks, risk management should be an integral part of the overall planning process, particularly where there are limited resources and competing priorities. This would help the NMU to ensure that all potential risks are identified, assessed and, where necessary, treatment strategies developed.

Management of Citizenship Services

The audit found that while a risk assessment for the provision of citizenship services had been undertaken, consideration should have been given to broadening the focus, so that this assessment not only covers risks that are largely internal to the department but also those which have a more external focus. For example, the risks associated with client service that may eventuate by variable demand, limited resources in achieving client service standards, and those that arise
from any further outsourcing of aspects of citizenship services. Risks will need to be assessed and treated on an ongoing basis.\textsuperscript{33}

\textit{Research Project management Follow-up Audit} \textsuperscript{34}

The audit recognised that the CSIRO had enhanced its approach to project risk management since the last audit by now requiring all projects to have a risk assessment, as well as mandating that projects be managed in a manner that is commensurate with their size, complexity, sensitivity and associated risks. Importantly, and consistent with better practice, project plans must address project risk assessment and that during planning, staff should ‘...undertake a detailed Project Risk Assessment and integrate risk treatment strategies into the Project Plan’. The CSIRO also encourages staff to undertake a preliminary risk assessment prior to preparation of a detailed project plan. \textsuperscript{35}

However, only about half of projects examined by the ANAO had a documented project risk assessment. While this is a substantial improvement compared to the findings in the previous audit, when no projects had such an assessment, compliance was uneven in its application.

\textit{Commonwealth Entities’ Foreign Exchange Risk Management} \textsuperscript{36}

Finance’s role, at the whole of government level, includes monitoring, analysis and reporting of foreign exchange exposures, gains and losses but does not extend to a detailed analysis of their entities’ management practices, although it is expected to review entity practices and advise Government accordingly.\textsuperscript{37} As a review activity, and not an audit, this process can be expected to provide assurance that documented procedures have been developed and promulgated, but not that they are necessarily being implemented. In this context, Finance’s Guidelines require entity Chief Financial Officers (CFOs) to certify that proper risk management practices, as set out in Finance’s Guidelines, are being followed. \textsuperscript{38}

The development and implementation of a foreign exchange risk management program are specialist activities that require appropriate knowledge and expertise in financial markets, robust systems and rigorous internal controls. \textsuperscript{39} In two reports to Government (March 2003 and March 2004)) Finance, commenting on a number of agencies reviewed, advised Government that the entities had adequate risk management processes/plans in place. \textsuperscript{40}

\textit{The Management of Risk and Insurance} \textsuperscript{41}

The report observed that the initiatives, such as the establishment of Comcover and other developments in risk management practices, as well as changes in the insurance market, have resulted in a number of
organisations introducing organisation-wide risk management practices and general insurance activities since 1998. Despite the stimulus that this provided for sound management practices, the maturity of risk management and insurance practices across the five organisations audited (and of the 50 organisations surveyed) generally needed to be improved. 42

Overall, the ANAO concluded that general insurance frameworks and practices had the greatest potential to be improved, notwithstanding the training, education and consulting support provided by Comcover. Organisations audited had at least applied basic occupational health and safety (OHS) and workers’ compensation frameworks and, in some cases, had sound frameworks and practices in place. The quality of risk management frameworks and practices tended to be better than for general insurance practices but were often not as sound, or as well supported, as OHS and workers’ compensation frameworks. 43

Despite the divergence of activities undertaken by the organisations audited and surveyed, consistent principles and objectives were established, by those organisations, for the management of risk and insurance. However, the level of maturity of the practices of these organisations varied significantly. A major factor that contributed to a lack of maturity in risk management practices was the dominance of management ‘silos’, which limited their ability to take an organisation-wide perspective. 44

While Comcover provides guidance to its client organisations regarding risk profile, level of insurance and deductibles, the ANAO found that the cost of insurance and level of deductibles was generally not being considered by organisations in relation to their risk profile, nor to their incidents and claims experience. The audit also concluded that, based on the organisations audited, and in most cases the organisations surveyed, improvements are required in relation to:

- better understanding and articulation of the links between risk and insurance;
- better utilising risk management in business planning;
- consistently applying the risk and insurance frameworks in a timely manner;
- improving record-keeping and reporting of risk management and insurance activities;
- reviewing risk and insurance practices and performance on a regular basis;
- better resourcing of risk management and general insurance activities; and, most importantly; and
- an improved level of promotion and participation in applying the risk management framework by senior management. 45
Recent audits and studies conducted by State Audit Offices and CPA Australia identify similar findings and opportunities for public sector organisations in Australia.46

**Drawing the threads together**

While most APS organisations seem to have reasonable risk management frameworks in place, they generally need to do more to prevent, or minimise, risks and/or make the most of the opportunities presented. They need to be more proactive in managing risk by ensuring risks controls and treatments are in place across the organisation, rather than focusing on a ‘silo’ approach within individual units and/or programs (outcomes). As well, it needs to be recognised that the management of insurance is not simply a financial issue. It is a broader organisational management issue that is addressed by the managing of risk at the enterprise-wide level. It is about finding the most cost-effective solution to the management of costs associated with risk management and risk events occurring.

Sir John Bourn, the Head of the UK’s National Audit Office (NAO), made the following observation, it is one that I consider equally applies to the Australian environment:

> ‘Today’s public service delivery environment constantly presents new risks to the provision of public services, and robust risk management can help departments respond effectively. Just as importantly it opens up opportunities to develop innovative policies and delivery mechanisms. ... I have identified a number of ways in which departments can make further progress in developing cultures that place active, explicit and systematic risk management at the heart of their business so that decisions are routinely based around accurate and well informed judgements about risk. It is critical that departments continue to build on the momentum achieved so far in developing their risk management...’47

Sir John identified five key aspects of risk management which, if more widely applied, 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;**
- **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. 48

To sum up, most organisations have reasonable risk management processes in place but many still need to take a more strategic integrated approach to risk management. Moreover, they generally need to do more to prevent or minimise risks and/or make the most of the opportunities presented. For example, in outsourcing arrangements, robust governance arrangements should be put in place to ensure ‘the metrics and service level agreements are reviewed on a regular basis’ 49 to mitigate the risks involved. Organisations generally need to be more proactive in managing risk and this means involving managers at all levels of the organisation to encourage ownership and commitment. In relation to insurance, organisations need to be in a position to recognise where existing controls or other treatments sufficiently mitigate insurable risks; where they are insufficient, appropriate controls and treatments need to be used to address the risk exposure.

III Existing and Future Challenges

In more recent times, governments at both the federal and state levels 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. Hence, the business of government is increasingly more complex. 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.50

For the remainder of my address, I intend to focus on particular challenges going forward, as I see them at this time. I could talk about the risks associated with an aging public service and/or a loss of corporate knowledge. I could also refer to the various risks associated with our information technology and communication environments (including outsourcing arrangements), our aging legacy systems, the grafting on of new applications and system requirements as well as our attempts at greater systems integration including the need for greater attention to business continuity in increasingly cooperative or “shared” environments. However, I will comment only on a few specific areas of risk that have caught my attention, with the first relating to the greater focus on whole-of-government approaches to public administration.
Extending the Boundaries

Looking ahead, the boundaries of risk management have expanded from the previous ‘silo’ approach to agency (or enterprise)-wide risk plans; and, now, whole-of-government issues are coming into play. The UK’s Strategy Unit paper titled ‘Risk: Improving government’s capability to handle risk and uncertainty’\(^5\), flags this issue as follows:

‘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’.\(^5\)

The Strategy Unit’s paper sees the language of 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 associated with PPPs and PFIs; 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.\(^5\) Taken together, these concerns have forced governments to reappraise how they manage risks in all its forms. The ANAO has also commented on the whole of government impact in at least one recent audit report:

‘The ANAO considers that a more consistent approach to risk management is required to appropriately address program risks. This would require more systematic risk management planning by DIMIA, consistent with its approach to agency-wide risk plans, as a means of ensuring consideration of risks from both an enterprise-wide and a whole-of-government perspective’.\(^5\)

Within this broader context, governments need to handle risks at three main levels—Strategic, Program and Operational. This is illustrated in the following diagram.

**Figure 1—Hierarchy of Risk**

![Hierarchy of Risk Diagram](source: UK Strategy Unit Paper on Risk)
The UK Strategy Unit’s paper makes the point that governments also have three clear roles in managing risk. Where individuals or businesses impose risks on others, government’s role is mainly as regulator, setting the rules of the game. 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.  

In each of these areas, there are no simple, nor indeed wholly reliable, formulae for defining risk. 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. Some risks are insurable but most are not. Whatever the treatment, the basic management imperatives still present the same challenges for both accountability and performance.

**Record-keeping – the impact of the web**

The issue of record-keeping is currently receiving quite a lot of what I would regard as ‘deserved’ attention, including comment in latest financial statement audit report which made reference to the requirement to keep proper records. Records are necessary for us to function properly. It has recently been observed that ‘Just as we need insurance, companies of size and substance need a records program to ensure that they are covered if, and when, trouble strikes’. Integral to that imperative:

‘Organisations must take a proactive and holistic approach to compliance that ensures the business, technological, and legal challenges of records management are addressed’.

In a relatively recent audit report, the ANAO noted the importance of record-keeping as ‘a key component of any organisation’s corporate governance and critical to its accountability and performance’. Among a number of recommendations for improvement in record-keeping practices, it was suggested that:

‘The risk assessments should also review record-keeping from an operational perspective so that organisation’s record-keeping priorities do not pose any legislative or business risk to the organisation’.

Three obvious risks that need to be considered are reputation, legal and security (including privacy) risks but there are also considerable operational and financial risks involved that have to be addressed,
such as business continuity, electronic discovery\textsuperscript{62} and copyright issues. The latter are still not well understood in the public sector in a difficult legal framework. It is a topic for discussion in itself. I will only repeat some good advice by an expert on the subject, ‘lower risk does not mean no risk’ and ‘lower risk may not keep you from being sued.’\textsuperscript{63} It is no exaggeration to suggest that a solid comprehensive records management program can be an effective insurance policy and business facilitator.\textsuperscript{64} Nevertheless, the benefits of electronic records management have to be ‘sold’ to program managers. It has been suggested that:

\begin{quote}
\textit{The records manager who takes incremental, low-cost high-value steps will contribute significantly to a successful outcome}.\textsuperscript{65}
\end{quote}

Associated with the above risks is the growing importance of Web sites as sources, and in some cases the only sources, of many organisational records. The risks of not properly capturing these in a record-keeping system is a new and growing concern. In a recent article ‘Web Sites as Recordkeeping & Recordmaking Systems’\textsuperscript{66}, Rick Barry makes the point that web sites produce official representations to the public and, while they make records, they do not keep records in ways that are consistent with sound record requirements.\textsuperscript{67} That is, web sites are among the key organisational record-making systems that are not record-keeping systems—this places organisations at risk.

Clearly, the rapid uptake of e-business and e-government applications using Web publishing systems has outpaced the ability of many organisations to properly manage the records produced in these systems. Often this is accompanied with a lack of appreciation in the organisations that websites produce records. So long as this technology is used for business, and interacting with the public, the content and transactions on these sites constitute organisational records and therefore must be captured, preserved, and managed into a paper-based or electronic records system.\textsuperscript{68}

Rick Barry makes the important point that, for most organisations, the integration of Web content and electronic records management is essential. Failure to do so puts the organisation at considerable legal, regulatory, and even ethical risk, and opens it up to alienation from its client and public base. Moreover, it robs the organisation of one of its vital assets—its corporate memory.\textsuperscript{69} The volume of content, associated with significant business and/or legal risks, places attention on the need for a so-called ‘content management system’ which has to support ‘a solid review and approval process that is enabled via an easy-to-administer workflow component’\textsuperscript{70} It is suggested that the ready availability of high-quality and current
education and training sends a clear message to all in the organisation that content management ‘is a priority and a necessity’.  

**Reputation risk**

A recent edition of the Australasian Risk Management Newsletter noted that reputation risk can be a major risk for all commercial organisations regardless of size, as well as not-for-profit and government bodies. The article went on to observe that little attention is paid to this risk by management boards except when an incident arises that negatively impacts on an organisation’s reputation. I suspect the same might be said about many government bodies. Nevertheless, if asked, all Chief Executive Officers (CEOs), and boards in particular, and staff in general, would recognise an organisation’s reputation as critical to its successful governance and to its credibility with all stakeholders. Therefore, it needs to be driven by every part of the organisation. The article makes two other key points—reputation risk should be managed as part of an organisation’s normal risk management process, and, second, the risk should be totally integrated with the operational risk processes.

Because of its pervasive nature, reputation risk will have non-insurable and insurable dimensions. There is no better illustration of the need to be pro-active and take preventative measures aimed at eliminating, or at least substantially reducing, the likelihood of such risk eventuating. The damage caused by failure to act, including any incapacity for remediation, could be catastrophic and threaten the very existence of the organisation or, at the least, its governance team as well as those immediately responsible.

The Arthur Andersen situation related to the Enron collapse in the United States (as well as in other countries) clearly demonstrates the amount of damage the can be done to an organisation once its reputation is damaged. It is particularly significant because the more diverse and physically spread the organisation, the more becomes exposed to the possibility and consequences of damaging its reputation. Reputation damage is the most misunderstood and ill-managed of an organisation’s risk management activities and no amount of crisis management can usually repair the damage—as was the case with Arthur Andersen, where clients and staff were looking to leave before any allegations were proven.

That said, my aim is to stress the positive aspects of sound risk management, including the treatment of risk, as a means of promoting the credibility and value of an organisation, as well as its performance, which will, in turn, only enhance its reputation and confidence in its governance.
**Joined-Up Government—Public-Private Partnerships (PPPs)**

Increasingly, governments here and overseas have been exploring the potential benefits that can flow from private sector involvement with the delivery of government programs. One of the forecast benefits flowing from PPPs is the planned transfer of risk from the public to the private sector, although the guiding principle in allocating risk is that risk goes with the party best placed to control and manage it.

> ‘The fundamental objective of the partnerships procurement process is to achieve an efficient allocation of risk, not simply to transfer as much risk as possible in order to achieve an operating lease classification.’

In the final analysis, government obviously pays for risks allocated to the private sector. It is widely accepted that attempting to transfer risk inappropriately to the private sector will add unnecessary cost to a PPP, thereby undermining value-for-money in determining the best procurement method. The proper allocation of risk has been a key feature in successful PPP/PFI initiatives. Professor Graeme Hodge, in a recent article titled ‘The risky business of public-private partnerships’ assesses risk in terms of governance arrangements as well as of the commercial arrangements for PPP type arrangements. He points to the use of using highly complex contracts in relation to PPPs which, usually, provide only limited opportunity for meaningful levels of transparency or public participation. This limited transparency and complex adjustment formulae, have also typically led to a lack of clarity of partnership arrangements.

Graeme’s thesis is that, from a strictly commercial perspective, risks appear to be well managed but this is not the case for risks in governing. Citing the Victorian City Link Project, he argues that the separation of commercial and governance roles is not easy; and it is clearly a challenge for governments implementing future PPPs because the governance risks have been inadequately handled to date. For instance, Treasury departments, continue to confuse the roles of PPP policy advocacy, project promoter, manager, planner, legislator, contract developer, contract regulator, financial steward, project assessor, and trusted parliamentary adviser.

While I wish to stress the governance risks in PPPs in this context, there is no doubt that significant risks often still arise from the contractual environment. Participants have become increasingly aware of risk allocation principles involved but the real difficulty, as it often is, occurs with the actual implementation of the contract. A very useful article in this respect stresses the need for careful drafting, pricing and risk transfer in managing risk allocation as well as balancing the objective of more standardised documentation against project-specific requirements and continuous improvement in
contracts. I would also add the imperative of appropriate contract management skills and experience, as well as dealing effectively with the changing nature of accountability requirements with partnering arrangements:

*In a system of shared accountability we need to establish who does what and develop a new common language and concepts. Shared accountability also requires both vertical and horizontal accountability.*

In summary, the real potential risk associated with PPPs is not so much in the commercial domain, where risks are usually carefully defined and managed, but in the governance domain. Commercial and governance risks should not be confused and, when embarking on PPPs contracts, must not only be sound from a commercial, technical sense, but also be subjected to detailed public and parliamentary scrutiny prior to implementation—ensuring that the public sector accountability and transparency imperatives are met.

**Joined-Up Government—Across Agency Arrangements**

Related to the previous issue is the increasing number of whole-of-government, collaborative, or ‘joined-up’ government projects developed to implement the Government’s policies. Examples of ‘joined-up’ government or extensive interaction with other agencies in the APS include:

- Centrelink—provides delivery services for the Department of Family and Community Services (FaCS) and fifteen other Australian Government agencies plus all State Housing Authorities;
- Department of Employment and Workplace Relations—provides information and assistance to small business by acting as lead agency across the Australian Government, State Governments and the private sector;
- AusIndustry (within the Department of Industry, Tourism and Resources)—coordination agency responsible for delivering the Government’s Business Information Service Program which interacts with all three levels of government; and
- Department of Health and Ageing—promotes, develops and funds health and aged care services through partnerships involving the Australian Government and State Governments.

These types of arrangements place additional demands on the capacity of agencies to maintain an appropriate level of corporate governance, including managing ‘shared’ risks. ‘Joined-up’ government inevitably involves at least dual accountability of participants both for their individual organisations and for the ‘joined-up’ arrangements. Robust governance and risk management
arrangements are required to facilitate the management and successful acquittal of those accountability obligations. In particular, in situations where a number of agencies contribute to an outcome, sufficient attention must be paid to identifying and managing the risks in delivering these whole of government programs.

A specific risk associated with agencies acting cooperatively across the APS and/or across levels of government relates to legal issues which can vary across constituencies. For example, not all jurisdictions in Australia have legislation to protect personal information. Any proposed information sharing activity would need to assess the impact of the specific provisions of any legislation. Indeed, in some jurisdictions administrative and policy constraints effectively operate to reduce, rather than enhance, the amount of government information that can be shared.

**Taking risk onto the balance sheet**

From a governance viewpoint, it is not only necessary to ensure that a sound risk management approach is in place, for, both assurance and performance purposes, but also that the associated costs are managed well. Do organisations have a ‘proper handle’ on how much risk is actually costing them? A recent survey by an insurance broker and risk consultant supported ‘the assertion that CFOs are managing these risks through their balance sheets’.

While I am not able to assess whether the survey was representative of the Australian Government’s situation, I suspect that governing bodies, including CEOs, need to engage in more active management of their balance sheets as well as securing better information and control over the organisation’s risks. I stress that it is not just the cost of balance sheet items that require risk management attention per se, such as for millions of dollars of information technology hardware and software, but also the consequences of their failure and/or unfilled expectations. ‘High expectations equate with high risk’.

A CPA Australia publication on balance sheet management in the public sector notes that ‘few are considering what impact these decisions or approaches will have on the balance sheet’. As well, it observed that agency management and executives still consider financial management to be an ‘overhead rather than something that is able to add value to service delivery’. The same comment was made in relation to risk management, in particular in relation to performance improvement and enhancing organisation reputation. In government, balance sheet implications translate into political/budgetary risks rather than risks to shareholders, as in the private sector.
Closely related to this issue of taking risk onto the balance sheet is the question of identifying significant financial reporting risks from an organisation perspective. In my view, this has been well done in a recent book written by two KPMG executives. They list the following questions which I consider are equally applicable to most public sector organisations:

1. What is our tolerance for financial reporting risks? Have we communicated our tolerance to operating and financial management and the internal and external auditors? Does everyone understand and agree? Is “tone at the top” consistent with our risk tolerance?

2. Does our culture encourage open and candid discussion of our financial reporting risks and processes, including expression of concerns by individuals at all levels in the organisation?

3. Do we know what our financial reporting risks are?

4. Have we considered appropriately the incentive/pressures and opportunities for fraud in our company as well as the attitudes/rationalisations of management and employees related to fraud?

5. How does the audit committee define significant financial reporting risk?

6. Do we understand the interrelationships of our financial reporting risks to each other and to other risks facing the company?

7. Do we know who our risk owners are? Do we have controls in place to manage the risks? Do we have processes in place of measuring and monitoring risk?

8. What is the perspective of the person or department overseeing risk?

9. How do our incentive programs affect risk management?

10. Does our understanding of financial reporting risk permeate our organisation and culture?

11. Does each individual understand his or her role and responsibility for managing financial reporting risk?

12. Is financial reporting risk a priority consideration whenever business processes are changed or improved?

This year there was an upsurge in audit qualifications to agency financial statements on a number of areas including nine qualifications reported in the CFS. In relation to the CFS, the two having the most significant impact were the result of disagreements over accounting policies and the associated disclosures that resulted in materially misstating key balances within the CFS leading to a 17 per cent misstatement on the Net Result. The other areas predominately relate to limitation of scope in the audit of asset holdings in the Department of Defence and revenue systems in the Australian Taxation Office. The implications are that large balances
within the CFS are unable to be verified and the actual figures could be substantially higher or lower than those shown. This material uncertainty compromises the integrity of significant components of the CFS and the Net Result in particular. 93

Additionally, there were audit qualifications relating to breaches of section 83 of the Constitution and sections 39 and 48 of the FMA Act.94 As mentioned previously in these specific cases, the failure to keep proper records was a key risk that contributed to these qualifications. ANAO Audit Report No. 21, 2004-05, while noting that progress was achieved in improving the internal control environment across all entities reviewed, continuing refinement was necessary in respect of, amongst other things:

- improving risk management and insurance frameworks by articulating, and documenting, the links between risk management and insurance, and their links with other strategic documents and process; and

- reviewing risk management and insurance frameworks to enhance or develop reporting, monitoring and review requirements to assess both the performance of, and compliance with, the frameworks.

**Expectations in respect of an organisation's tax obligations**

Risk management has, in some respects, a new focus, with the Australian Taxation Office (ATO) entering the debate and demanding that boards get more involved with the management of corporate tax affairs. Tax is an important corporate governance issue due, not only to the possible financial exposure for unpaid tax, interest and penalties, but also due to the potential impact on the risk to reputation (both individual and corporate), and management time and administration spent in resolving issues. 95

The ATO has indicated that it is lifting its expectations of directors specifically in the context of compliance by organisations with taxation laws and the structuring of tax arrangements. On 29 January 2004, the Commissioner wrote to the boards of all publicly listed companies in Australia emphasising the importance of corporate governance in relation to taxation and highlighting the need for boards to take a direct and active role in managing risks associated with the company's tax affairs. In particular, the Commissioner indicated that it is important to identify the taxation risks faced by a company and to determine which risks are acceptable and appropriate, and which are not, and put in place a process for the management of those risks.96

The Deputy Commissioner of Taxation, Jim Killaly, delivered a paper on 9 and 10 February 2004, in which he expressed the view that it is
not appropriate for a board to rely on specialist tax advice without any independent scrutiny on their part. He stated that it is necessary for directors themselves to be satisfied about the legal and factual basis for major tax proposals and the likely implications of following the advice that is tendered. A perceived failure to do this may be considered a failure to take reasonable care or lead to accusations of acting recklessly, which could adversely impact the reputation of the company and the directors involved as well as bearing on any assessment of penalties.\textsuperscript{97}

To reinforce the point, the Assistant Treasurer, Senator Coonan, in a speech on 3 May 2004, indicated that she shares the ATO’s view that boards have responsibility to ensure the proper application of tax laws through good corporate governance.\textsuperscript{98} Indeed, in a recent global survey, eighty-four per cent of Australian companies indicated they expected the tax function’s influence and visibility on executive-level business decisions to increase because of tax risk.\textsuperscript{99}

While my paper has a predominately public sector focus, I have included taxation risk because it is an important emerging issue, and it does impact on those public sector entities that pay tax. As such, the risk needs to be aligned, and preferably integrated, with organisations’ enterprise-wide risk and governance frameworks.

\textit{Preparedness for adoption of International Financial Reporting Standards (IFRSs)}

The adoption of Australian equivalents to IFRSs will bring about a number of changes for all Australian entities, including those in the public sector. The impact of these new standards will differ from entity to entity, depending on their specific business and related financial statements. While it is difficult to identify significant ‘global’ issues that will affect all public sector entities, each entity will need to individually review the changes that will arise and assess how these changes impact upon them.\textsuperscript{100}

Key to implementing IFRSs is having appropriate plans in place that should include: a structured methodology for identifying which issues will impact the organisation and how they will be resolved; and a communication strategy for ensuring the entity’s progress is being regularly reported to the Audit Committee, and to those staff within the organisation who need to be aware of operational implications of the changes required. An important complication to be considered is the requirement for international standards to be applied in a retrospective manner. That is, entities need to prepare two sets of financial statements for the balance date. One set needs to be compliant with current AASs for publication as normal. The second set needs to be compliant with the Australian equivalents to IFRSs and will not be published immediately. These statements will instead
form the comparative data for the following year's financial statements.\textsuperscript{101}

A recent ANAO survey of IFRS readiness of 24 large Australian Government entities showed that the Australian Government's progress towards implementation of these new standards varies greatly across large entities. Whilst it was a positive sign that all entities were aware of the deadlines for the implementation of Australian equivalents of IFRSs, there were some aspects that needed to be addressed. These included: half of the entities surveyed did not have an IFRS or equivalent project team or Steering Team that incorporated functions across finance, operations, IT, strategy and client relations; and about the same number of entities surveyed did not have a staff training strategy in place.\textsuperscript{102}

It is apparent that the IFRSs implementation issue, combined with the potential convergence of Australian Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS) and the increasing demands upon preparers of financial statements to finalise the accounts in shorter time frames, places significant risk pressures on organisations both in terms of reputation and accountability. This raises significant challenges and risks for the public sector. As a consequence, there will be a need for public sector entities to carefully factor these issues into implementation plans and strategies.

\textit{Australian Standard for Risk}

On 31 August 2004, Standards Australia released the latest (2004) version of AS/NZS 4360 \textit{Risk Management} as well as a new handbook to accompany the Standard. In the revised standard there is no change to the basic process and steps of risk management nor to the general philosophy of risk management. However, the positive side of risk is more strongly emphasised by separately discussing negative and positive outcomes.\textsuperscript{103} As was recently observed at the 8\textsuperscript{th} biennial conference of the Australasian Council of Public Accounts Committees (ACPAC), the new standard places greater emphasis on issues of practical implementation,\textsuperscript{104} which has been acknowledged to be a major on-going issue in the public sector. I agree that it is ‘a discipline for dealing with uncertainty’.\textsuperscript{105}

As well as the introduction of a handbook, the revised standard also reinforces the concept that a risk management process is embedded in other management activities rather than being a stand-alone and separate activity. The risk management matrix which, Professor Cross says, many practitioners took to be the core of the 1999 standard, has been removed. It was never meant to be a ‘one size fits all’ and now the standard provides general comments about risk analysis; and the use of different methods and tools are discussed in the handbook.
Importantly, the first step identified is to ‘communicate and consult’ with all stakeholders with an emphasis on analysis and response.

I commend Standards Australia on the revised standard and I support Professor Cross’s comment that:

*Important decisions about an organisation’s risk should not be made simplistically but at the same time the process should not be over complicated or onerous and should mesh with other management activities [my emphasis]*

I was particularly interested, and encouraged, by the highlighting of a number of key principles in the new risk standard at the recent ACPAC conference as follows:

- the need to view risk in both positive and negative terms, that is, risk opportunities as well as risk minimisation;
- the importance of ensuring risk management is ‘owned’ by everyone in the organisation and that it becomes part of everyday decision-making; and
- the need to ensure an internal culture is fostered which is supportive of risk management principles and practice so that risk management becomes embedded in organisational practices and processes.

The Chair of the NSW Public Accounts Committee indicated that the Committee will be undertaking an inquiry in 2005 to examine how public sector agencies are implementing the new risk management standard and the development of risk management practice generally.

**IV Concluding Remarks**

It is quite evident that Risk Management is not a fad and that it still attracts significant coverage and discussion in both the public and private sectors. Indeed, the revised standard issued by Standards Australia in August 2004 emphasises the point that risk management is an important element of an organisation’s corporate governance. It has been observed that fulfilling corporate governance obligations allows organisations to strengthen risk management strategies, and offers a chance to create positive behavioural patterns among employees. The latter require a real understanding of their role and contribution within such a framework.

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.

It seems to me that risk management processes are increasingly well understood across the public sector, but I would like to stress that 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. Additionally, risk management should be part of an organisation’s strategy and planning processes, and an integral component of corporate governance. Importantly, an integrated risk management system develops the control environment, which provides reasonable assurance that the organisation will achieve its objectives with an acceptable degree of residual risk.

The resulting trends in 2005 and beyond have been suggested as: increased interest and adoption of risk management frameworks; managing and measuring compliance as a process as opposed to a project; adoption of governance, risk, and compliance tools; the integration of compliance controls into the enterprise architecture; and for large critical infrastructures, appointment of a chief risk officer to manage enterprise risk and compliance. It is likely that these trends, or some variation of them, will equally apply to the public sector. The question is how well placed are we to deal effectively with them.
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