Report by the
Comptroller and Auditor General

Supporting innovation: Managing risk in government departments

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Executive summary

What is risk?

In this report 'Risk' is defined as something happening that may have an impact on the achievement of objectives as this is most likely to affect service delivery for citizens. It includes risk as an opportunity as well as a threat.

1 Government departments are responsible for a range of diverse services for citizens such as the payment of social benefits, support for business, the provision of health care and education, regulating industry and protecting the environment. All involve some degree of risk[1] – the risk in particular that as a result of unplanned events or circumstances arising, services are not delivered on time, or cannot respond to sudden changes in demand for them, or are of poor quality, or are not cost effective.

Figure 1

Typical risks which departments face:

- Anything that poses a threat to the achievement of a department's objectives, programmes, or service delivery for citizens.
- Anything that could damage the reputation of a department and undermine the public's confidence in it.
- Failure to guard against impropriety, malpractice, waste, or poor value for money.
- Failure to comply with regulations such as those covering health and safety and the environment.
- An inability to respond to or to manage changed circumstances in a way that prevents or minimises adverse effects on the delivery of public services.

Source: National Audit Office

2 Risks can also arise from not taking opportunities to deliver better and more cost effective public services. For example, advances in computer technology make it possible to deliver more services electronically, such as applying for driving licences and submitting tax returns, so that citizens can access public services more quickly - often 24 hours a day. Citizens and businesses can lose out if departments are slow to adopt new forms of cost-effective service delivery made possible by innovation and technological advances. But there are risks involved with doing things differently and new forms of service delivery need to be implemented in a way that minimises the risk of them failing or the quality of public services not being maintained or improved.

1 The Treasury's 'Orange Book' - Management of Risk - A Strategic Overview (February 2000) defines 'Risk' as the uncertainty of outcome, within a range of potential exposures, arising from a combination of the impact and probability of potential events.

What is risk management?

3 Risk management means having in place a corporate and systematic process for evaluating and addressing the impact of risks in a cost effective way and having staff with the appropriate skills to identify and assess the potential for risks to arise.

Risk is not a new concept

4 Risk is not a new concept to government departments. There is a well known need for sound controls to minimise financial risks, impropriety and malpractice, to safeguard public assets and to manage health, safety and environmental risks. Similarly much attention is also being given to the development of project management skills to ensure that government departments have the capacity to become purchasers and providers of public services. This is evidenced for example in the growth in Private Public Partnerships, such as contracts under the Private Finance Initiative which has highlighted the importance of identifying key risks and allocating responsibility for managing them to the party best able to do so. Underlying these developments is the need to assess and manage those risks which could prevent key objectives and programme outcomes from being achieved and consequently having an adverse effect on service delivery for citizens. This aspect of risk management is the main focus of this report.

5 In the private sector the importance of risk management is often better understood. The research paper – Business Risk Management in Government: Pitfalls and Possibilities which we commissioned Professor Christopher Hood and Dr Henry Rothstein of the London School of Economics and Political Science to produce identified three lessons which government departments could learn from the experience of the private sector (Figure 2).

6 Civil service culture – that is the values, ethos, ethics and training underpinning departments' management approaches – has traditionally been risk averse. This is partly because departments have tended to associate risk taking with increasing the possibility of something going wrong, of project failure or financial loss which could lead to Parliamentary and public censure. Conversely, in successful private sector companies well managed risk taking is considered to be important because companies have an incentive to improve service delivery to customers which is key to them maintaining and extending their competitive advantage.

7 The Modernising Government programme seeks to encourage departments to adopt well managed risk taking where it is likely to lead to sustainable improvements in service delivery. In pursuit of this the Cabinet Office and the Treasury are acting with departments to promote better risk management across government, including the requirement for all departments to produce by September 2000 frameworks setting out their approach to risk management in

Applying the private sector experience of risk management to the public sector

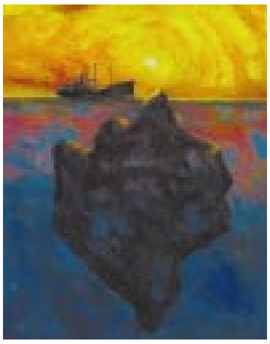
Figure 2

Private sector risk management lessons	Pitfalls of inappropriate application of risk management in the public sector	Possible solution
1. The main focus of private sector risk management is on maintaining and enhancing profitability - in contrast in departments the focus is on the implementation of objectives and service to the citizen.	■ Responsibility gets pushed on to the bodies that are not best placed to manage the risks.	■ Responsibility for risks should rest with the body best placed to manage them. Where departments are jointly working with other bodies the risks and the responsibility for managing them should be clearly identified.
2. Risk is assessed in terms of how it might adversely affect the value of the business as perceived by shareholders and financial markets. In the public sector risk is more about failure to deliver services to citizens.	■ Risk management should highlight key risks to public services. A short term focus on what might seem to suit the department could lead to inaction or inflexibility.	■ Develop risk management as part of the planning and decision making process. Focus on the risks to public services rather than the department.
3. Risk identification, assessment and management are linked to business objectives. The implication for departments is that risk management should be integrated into planning and key decision processes.	■ If departments do not make risk management an integral part of their planning and decision making processes they will not realise the benefits of improved risk management.	■ Avoid 'tick box' culture. Risk management requires careful thought and deliberation.

Source: Business Risk Management in Government: Pitfalls and Possibilities by Professor Christopher Hood and Dr Henry Rothstein of the London School of Economics and Political Science (Annex 2)

their areas of responsibility. Since 1997 the Treasury has been developing improved governance accountabilities. Statements on Internal Financial Control were introduced for the year 1998-1999, and work is underway on the appropriate method of adopting the principles of internal control reporting for listed companies to the central government sector. A key element of this work is the drive to have strategic risk identification and management processes in place in all government organisations, encompassing the whole range of risks relating to objectives which organisations face.

8 As the external auditor of government departments the National Audit Office support well managed risk taking intended to result in tangible benefits for taxpayers. This report is intended to help promote improvements in risk management by departments by identifying examples of good practice from both the public and the private sector. The report sets out (i) why risk management is important; (ii) how well risk management is understood and implemented by departments, agencies and non departmental public bodies (NDPBs) – collectively referred to as 'departments'; and (iii) what more needs to be done to improve risk management.



Part 1: Why risk management is important

9 Risk management can help departments improve their performance in a number of ways. It can lead to better service delivery, more efficient use of resources, better project management, help minimise waste, fraud and poor value for money and promote innovation. Citizens and businesses can waste time and lose out financially if public services are inadequate or inefficiently delivered. And the reputation of departments can suffer where services fail to meet the public's expectations. Assessing the risk of such circumstances arising can help departments ensure that they have adequate arrangements in place to deal with them or with something coming out of the blue.

Part 2: How well risk management is understood and implemented by government departments

10 With the assistance of PricewaterhouseCoopers we carried out a survey in February 2000 of 257 departments, agencies and non departmental public bodies (NDPBs) of which 237 (92 per cent) responded (Appendix 2). The purpose of the survey was to provide an overview of the extent and practice of risk management across organisations responsible for delivery of public services. The survey asked them about their understanding of risk management and its importance to their performance, how they identify and assess risks, and the action they take to deal with them. The survey results reflect the make-up of the organisations surveyed. We supplemented this with interviews with twelve departments and two focus groups with representatives from departments. The results of the survey indicate that:

- **On departments' understanding of risk management.** While 82 per cent of departments agree that risk management is important to the achievement of their objectives, and recognise its role in preventing fraud and impropriety and safeguarding assets, they say they have less understanding of how it can help address the risks which threaten the delivery of services to citizens. Twenty per cent say they use a common definition of risk throughout the department. Twenty-five per cent of departments say, however, that they have set clear risk management objectives. Fourteen per cent of departments say that they have provided training on risk and how to manage it.

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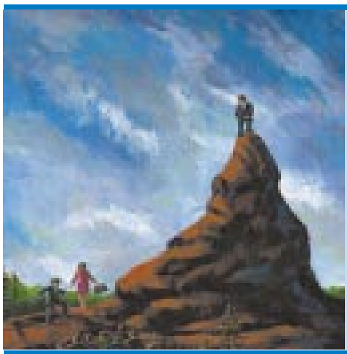
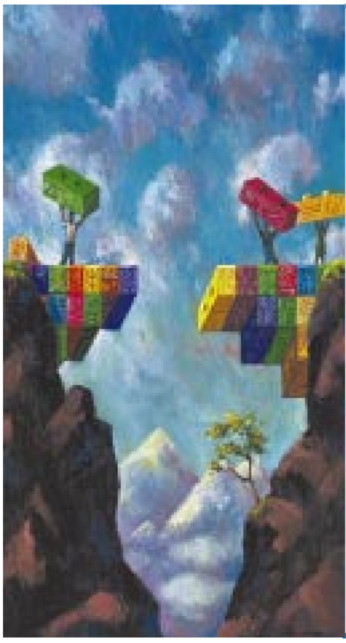


There is some inconsistency in departments' approach to risk management in that while many recognise that it is important to the achievement of their objectives they are less clear on how risks should be managed and few provide training on how to do so. Risk management will only become standard practice in government departments if there is better understanding of what it involves and the benefits which it can help to secure in terms of improved service delivery and achieving key objectives. Our survey suggests there is a need to raise staff's awareness of their department's risk management policies including their approach to risk taking and innovation. More training is also needed to equip staff with risk management skills.

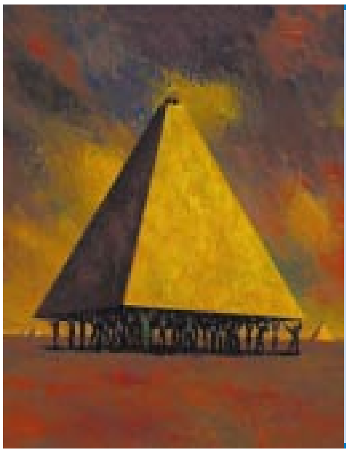
- **On how departments identify and assess risks.** Thirty-eight per cent of departments did not routinely assess risks. The risks most commonly identified by departments are **financial risk** (91 per cent) – the risk of financial loss or impropriety; **project risk** (89 per cent) – the risk of project failure, cost overrun or time delay; and **compliance risk** (85 per cent) – failure to comply with regulations for example, health and safety or environmental. Eighty-nine per cent say they assessed the risks to their organisation's **reputation** from failure to deliver a key service to the public. Well over half (56 per cent) of departments say that they identify the main risks relating to each of their main objectives. The risk of **missing an opportunity** to improve the delivery of organisations' objectives through for example, innovation is identified by 61 per cent of organisations. Only a small proportion – one in eight (13 per cent) know about the strengths and weaknesses of the risk management systems of other departments, agencies and private sector organisations which they work with. Forty-two per cent of organisations regard themselves as more risk averse than risk taking, but conversely 82 per cent say that they support innovation to achieve their objectives. Departments and agencies have identified a number of barriers which prevent risk taking and have suggested a number of incentives which might help overcome them (Figure 3). Departments use a range of tools to record and assess risk including risk analysis and sensitivity analysis to assess the probability of risks leading to an adverse impact. Most departments say that they find it relatively straightforward to prioritise risks, and assess their potential impact.



While departments recognise that missing an opportunity to deliver services in new and imaginative ways for the benefit of citizens is a risk in itself which needs to be managed, they believe that they are more risk averse than risk taking. If departments are to realise opportunities to improve service delivery, they need to understand how well managed risk taking can contribute to innovation. Initiatives by the Cabinet Office and Treasury such as the Invest to Save Budget have been designed to help promote innovation based on effective risk management.

One way of improving service delivery which is central to the Modernising Government programme is more joint working between departments which provide complementary services to citizens. Joint working involves different types of risk for example, if part of the service provided by one department is delayed or of poor quality the success of the whole programme is put at risk. It is important that departments who are involved in delivering joined up and innovative programmes jointly assess and manage the risks which might prevent them from being successful. As a first step in doing this, departments should know about the risk management approaches of the different partners including private sector organisations they work with and the types of risk which they cover.

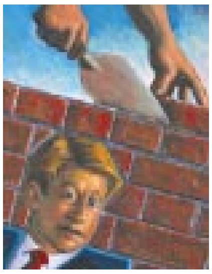
- **On the action departments take to manage risks**. Departments say they use a range of methods to manage risks including action plans for implementing decisions about identified risks, evaluations of controls to prevent or minimise the likelihood of risks materialising, and assessing the costs and benefits of addressing risks. Fifty-seven per cent of departments say they have procedures for reporting risk to senior management and 85 per cent say that their senior management is receptive to all communication about risk, including bad news. But only 34 per cent say that regular risk reports to senior management are an effective component of risk management in their organisation (Figure 4). Departments' responses to risk include action plans, reviewing existing controls, and prioritising risks requiring action. But the absence of early warning indicators for alerting senior managers to changing risks, and regular risk reports to senior management may mean that key risks are not identified, or are identified too late for effective action to be taken.



Most departments say they report risks to senior management and that management are receptive to such reports. Conversely, few departments say that these risk reports are an effective means of enabling the department to manage the key risks they face. To make most use of the range of work departments do to identify and manage risks, risk management should become an integral part of departments' business planning and management processes. It should include: (i) coherent approaches for identifying risks, assessing and reporting risks and action to deal with them; (ii) assigning to named individuals responsibility for managing risks and reporting them to senior management; and (iii) quality assurance arrangements so that the approach to risk management reflects current good practice.

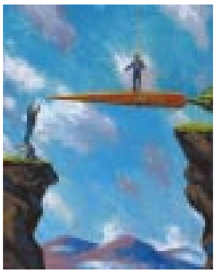
Figure 3

The main barriers and incentives for risk taking



Barriers

- Risk averse organisation - "It is not in our culture".
- Lack of expertise in risk management.
- Little information about risk faced by departments and what is appropriate risk taking.
- Lack of formal systems, processes and procedures for managing business risks.
- Unclear responsibilities for the management of risks.
- The status and activities of public bodies limits the risk departments can take with public services.
- Time, funding constraints and fear of project failure reduce scope for innovation.

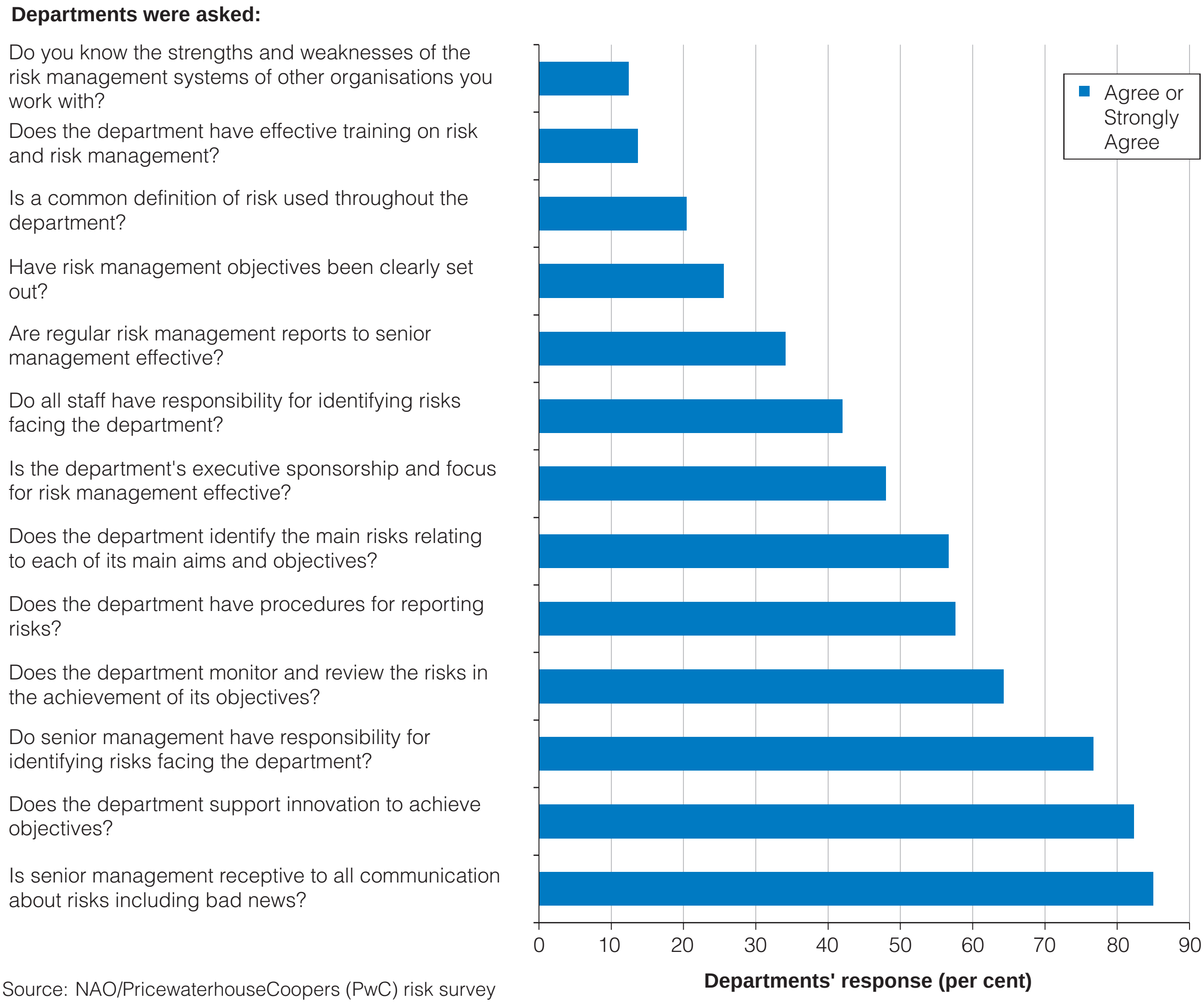


Incentives

- Senior management support of risk taking and innovation even where it is not fully successful (shift away from blame culture).
- Provide training on risk management.
- Improve communication about risks and the department's approach to risk taking (what risks can staff take in practice).
- Provide guidance and advice on risk management.
- Clarification of individual responsibilities and accountabilities for key risks.
- Dissemination of good practice on business risk management with examples where it has added value.
- Make more use of pilot projects to test innovative solutions.

Source: NAO/PricewaterhouseCoopers (PwC) risk survey and focus groups

Figure 4 Departments' approach to risk management



Source: NAO/PricewaterhouseCoopers (PwC) risk survey

Part 3: What more needs to be done to improve risk management

11 While our survey of departments found growing recognition of the importance of risk management and how it can help to promote innovation, departments were less sure as to how it should be implemented in practice. The Cabinet Office and the Treasury are addressing this through a number of different initiatives, including training events and guidance in support of innovation, creativity and risk management as part of the wider Civil Service Reform programme; funding innovative public service delivery projects through the Invest to Save Budget; and encouraging innovation and risk management through the PricewaterhouseCoopers sponsored Innovation and Risk Management Awards.

Our examination based on case studies of good practice adopted by four departments and agencies[2] and the experience of six private sector companies[3] suggests that six essential requirements need to be in place if risk management is to be effective and innovation encouraged. These requirements are summarised in Figure 5.

Figure 5

Key requirements of risk management

Requirement	Illustrated by
■ **Risk management policies and the benefits of effective risk management should be clearly communicated to all staff** (only 20 per cent of departments in our survey say that a common definition of risk management is used throughout their department, Figure 4).	■ The Home Office's Home Detention Curfew Scheme (electronic tagging) costing £28 million provides for the early release of prisoners – the overall aim of the scheme is to ease the transition of prisoners from custody back to the community. It has also had the effect of relieving pressure on the prison population. To ensure that all parties involved in the scheme were aware of their responsibilities for risk management, the Home Office discussed with them the risks posed by the scheme – such as risks of prisoners breaking their curfew or reoffending while on release, the technical risk of the electronic monitoring equipment not working and the operational risk from contractors failing to deliver the service. The Home Office together with those agencies responsible for administering the scheme developed a risk strategy and put contingency arrangements in place to minimise the impact of something going wrong or the unexpected happening. ■ **Benefits secured:** Risk assessment has enabled the Home Office to limit the potential adverse effects of releasing prisoners early into the community by making all parties involved with the scheme aware of the risks and their responsibilities for managing them. Since its introduction in January 1999 some 21,000 (as at 31 May 2000) prisoners have been released on Home Detention Curfew with about 94 per cent of curfews successfully completed; most of the prisoners recalled to prison have been because they had breached curfew conditions and less than two per cent have been notified as having been convicted or cautioned or are awaiting prosecution for committing a further offence while subject to the scheme. So far, only eight prisoners have been recalled to prison because they posed a risk to the public.

continued ...

2 (i) Electronic Tagging, Home Detention Curfew - Home Office and HM Prison Service, (ii) Crime Reduction Programme - Intervention in Schools - Home Office, Department for Education and Employment and the National Assembly for Wales, (iii) The Yorkshire Link M1-A1 Lofthouse to Bramham Link Road - The Highways Agency and Department of the Environment, Transport and the Regions and (iv) The 1901 Census - The Public Record Office.

3 Associated British Ports Holdings PLC, Glaxo Wellcome plc, Allied Domecq PLC, Nomura International plc, Prudential plc, and Reuters Limited.

Figure 5 **Key requirements of risk management**

Requirement	Illustrated by
Senior management need to support and promote risk management (48 per cent of departments in our survey say that senior management sponsorship for risk management is effective, Figure 4).	The Home Office, Department for Education and Employment and the National Assembly for Wales are supporting 38 projects in 110 schools, as part of the £250 million Crime Reduction Programme, to pilot and evaluate which approaches are likely to be most cost effective in reducing youth crime. With the support of their senior management the Departments adopted a portfolio type approach to risk management. For example, senior management accepted that some of the approaches being piloted such as home-school liaison workers appointed in schools to develop links between school and families with pupils at most risk of truancy and offending, were more experimental and more risky than others. But overall the success of the programme to reduce youth crime was not put at any greater risk because the portfolio of projects funded included a range of both lower and higher risk projects. This approach did, however, allow the Departments to consider and test more innovative ways to reduce crime. **Benefits secured**: Senior management support has enabled the Departments to test a range of pilot approaches all involving different types and degrees of risk to improve behaviour in schools and at home. This in turn should also improve school attendance by, for example, training local employees to act as mentors for young people having difficulty at school. The Departments' approach should enable them to evaluate which pilot projects work best in reducing crime and promote their use in more schools.
The department's culture should support well thought through risk taking and innovation (42 per cent of departments say they tended to be risk averse but 82 per cent say that they support innovation to achieve objectives, paragraph 10).	The Highways Agency's £200 million contract for the M1-A1 link road encouraged innovation by allowing contractors to suggest alternative road designs and specifications which had the potential to reduce maintenance and disruption to road users. **Benefits secured**: The M1-A1 link road is one of the Highways Agency's largest Design, Build, Finance and Operate contracts. It was delivered safely and opened five months ahead of schedule in February 1999. Improved road design and specification have contributed to early benefits from the new road including relieving traffic congestion and improvements in road safety.
Risk management should be embedded in management processes (only 34 per cent of departments say that regular risk management reports to senior management are an effective component of risk management in their department, Figure 4).	Glaxo Wellcome have made risk management a standard feature of all of their business planning, control and quality assurance processes and reports to senior management. Risks are routinely considered in managing all aspects of the company's business and in particular in conducting clinical trials to test new products. **Benefits secured:** Risk assessment has enabled Glaxo Wellcome to target and improve activities such as maintaining continuity of production, ensuring suppliers products are of appropriate quality and minimising any clinical failures which could affect patients and reduce revenue and company performance.

continued ...

Figure 5

Key requirements of risk management

Requirement	Illustrated by
■ **The management of risk should be closely linked to the achievement of objectives** (56 per cent of departments say their department identifies the main risks relating to each of their main aims and objectives, Figure 4).	■ Reuters Limited assess risks in terms of the likelihood of them maturing and their potential impact on company profitability and performance. Managers at all levels in the company have specific responsibility for assessing and managing risks. There is regular risk reporting to Reuters' Group Executive Committee which takes a wider strategic view of the risks faced by Reuters Limited which might affect the company's profitability and performance. ■ **Benefits secured**: The company have a £300 million investment programme in e-commerce. Risk management is helping to look at Group wide risks to ensure the investment is successful in improving the capability of Reuters to deliver services electronically to clients.
■ **Risks associated with working with other organisations should be assessed and managed** (only 13 per cent of departments say they know about the strengths and weaknesses of the risk management systems of other organisations which they worked with, Figure 4).	■ The Public Record Office has an internal budget of £1.2 million to manage the project to make public 1.5 million pages of information from 1901 Census Returns. This must be made available in January 2002, the statutory date. The success of the project depends on the Public Record Office working with the Defence Evaluation and Research Agency who are responsible for making census data available on the Internet. The two organisations assessed the risks which they were jointly and separately responsible for and drew up contingency plans to deal with any potential problems or circumstances arising which might put the success of the project at risk – For example, if data cannot be accessed immediately on the Internet information will still be available on microfiche. A pilot project is planned for 2001 to identify any potential problems which users might encounter in accessing information through the Internet so that they can be addressed by the Public Record Office and the Agency before the census information has to be available to the public in 2002. ■ **Benefits secured**: Based on progress so far the Public Record Office is currently on target to achieve its objective to make census information available publicly on the Internet by 2002. Schools and other users will have access to historical information without having to use the Public Record Office in London. In the event of problems there are contingency arrangements in place to provide information manually.

Recommendations

12 We recommend that the Cabinet Office, Treasury, and departments should:

For the Cabinet Office

- **Continue to encourage departments to adopt a coherent approach to managing risks which is likely to lead to sustainable improvements in public services**. Our February 2000 survey revealed that at the time departments were unclear about what the risk management frameworks they are required to produce by September 2000 should cover in terms of helping to deliver their key programmes and improve the quality of public services. In June 2000 the Treasury and Cabinet Office built on earlier Inter-Departmental Liaison Group on Risk Assessment advice and issued joint guidance on the requirement for departments to produce a progress report to Treasury towards preparing Statements of Internal Control and on what the published risk management frameworks which only need cover risks affecting the public should contain and how the two reporting exercises fit into the development of the department's overall risk management.

- This report highlights good practice examples which have been followed by a number of government departments and agencies and the approaches to risk management adopted by the private sector which we believe are equally applicable for government organisations. This good practice can help departments as they develop and take forward their risk management frameworks. It can also assist in benchmarking how departments perform in implementing sound risk management. **We encourage the Cabinet Office to disseminate these messages in a useful and easily understood form across government and to gain assurance from departments that they have an appropriate framework in place for managing risk.**

For the Treasury

- **Press ahead with work already underway to improve risk management and corporate governance in government departments**. A key requirement is that all departments should have strategic risk identification and management processes in place covering the main risks relating to the achievement of their objectives. The Treasury should gain assurance from departments that they are developing a strategic risk management process in preparation for the Statement of Internal Control to be made from 2001-2002.

For departments

- **Ensure that the principles of sound risk management are understood and widely adopted**. It is important that risk management is understood by staff so that they are committed to and focused on managing the key risks to the achievement of programme objectives and improvement of public services. Risk frameworks are only the initial step in establishing sound risk management across government. Once frameworks are in place departments and agencies will need to develop action plans for implementing them and ensure that their staff understand and accept the importance and the benefits of risk management and innovation and how to apply it.

- We suggest below some key questions for departments to address (Annex 1 to the Executive summary).

Annex 1

Key questions for Departments to consider when reviewing their approach to risk management

1. Do senior management support and promote risk management?

- Does a formal risk policy exist and is this documented, endorsed by the head of the organisation, readily available to all staff and subject to regular review?
- Does senior management have a good understanding of the key risks facing the organisation and their likely implications for service delivery to the public and the achievement of programme outcomes?
- Is senior management routinely in a position to be aware of the key risks and does it have systems in place to ensure that this is up to date?
- Are contingency arrangements in place to maintain standards of service to the public and the delivery of programmes in the event that risks result in adverse consequences?

2. Does the department support well thought through risk taking and innovation?

- Is there an explicit policy to encourage well managed risk taking where it has good potential to realise sustainable improvements in service delivery and value for money and is this policy actively communicated to all staff?
- Is individual success rewarded and support given by management when things go wrong so as to avoid a blame culture?
- Are staff encouraged to take responsibility for risks when they are best placed to do so rather than transferring it to other organisations?
- Are staff encouraged to report bad news to senior officials as well as good?

- Are staff encouraged to challenge existing practices, to identify new ways of doing things and to be innovative?

3. Are risk management policies and the benefits of effective risk management clearly communicated to staff?

- Are there clear statements which set out the organisation's risk policies and its approach to risk taking and innovation, and are staff encouraged to read them?
- Is a common definition of risks and how they should be managed, adopted by all staff throughout the organisation with detailed guidance for staff drawing up or implementing programmes?
- Is it clearly communicated?
- Are appropriate staff clearly assigned responsibilities for assessing, reporting and managing identified risk and are these responsibilities regularly reviewed?
- Do staff receive appropriate guidance and training on the typical risks which the organisation faces and the action to take in managing these risks?

4. Is risk management fully embedded in the department's management processes?

- Are there well established approaches for (i) identifying risk and (ii) assessing and reporting risk which are fully understood by staff?
- Are arrangements in place, such as reviews by internal audit and benchmarking with other organisations, to ensure that risk management approaches reflect current good practice?
- Has management sought advice from internal and external audit on good practice in the development, implementation and maintenance of robust risk management processes and systems?

- Has professional advice been taken to ensure that the most appropriate tools and techniques are used to assess risk and the likelihood of it maturing?

- When practicable is a monetary or other numerical value put on risk to emphasise to staff the potential loss or missed opportunity which could occur if risks are not well managed?

- Is the action planned to deal with consequences of risks maturing such as the impact on the delivery of services to the public regularly reviewed to ensure that it remains appropriate, sufficient and cost effective?

- Is risk management ongoing and integrated with other procedures so that staff accept it as a standard requirement of good management and not a one-off or annual activity?

5. Is the management of risk closely linked to the achievement of the department's key objectives?

- Are the risks which could result in key objectives or service delivery responsibilities not being met identified and the likelihood of them maturing regularly assessed?

- In assessing risks are the potential implications for key stakeholders – citizens as both taxpayers and consumers of government services and specific client groups such as business – taken account of?

- Are early warning indicators in place – covering for example, quality of service or seasonal increase in customer demand not being met – to alert senior management of potential problems in service delivery or that the risk of planned outcomes not being met is increasing?

- Are reliable contingency arrangements in place so that if problems arise services to the public will be maintained and the adverse impact on key programme outcomes such as late delivery or reduced quality will be minimised?

- Is there a reliable communications strategy in place so that if risks mature those most affected by the potential adverse consequences fully understand and have confidence in the remedial action which the department may need to take?

6. Are the risks associated with working with other organisations assessed and managed?

- Are all those organisations which are likely to have some influence over the success of a programme or service to the public identified?

- Is consideration being given to the need for a consistent and common approach to managing risks which cut across departmental boundaries, for example cross-departmental projects?

- Are the risks associated with joint working not being successful jointly identified and assessed, with responsibility for managing them by all those involved in the joint working or partnership clearly assigned and understood?

- Do organisations understand and have confidence in the risk management arrangements of all those involved in the joint working or who could influence the success of the programme?

- Has the extent to which risks can be transferred to organisations – both public and private – best placed to manage them been considered and acted upon?

- Is there reliable and regular information to monitor the risk management performance of all those organisations involved in a joined up programme and partnerships?

- Are there adequate contingency arrangements to minimise the adverse effects on public service delivery of one or more party failing to deliver?

Annex 2

Business Risk Management in Government: Pitfalls and Possibilities – paper by Professor Christopher Hood and Dr Henry Rothstein of the London School of Economics and Political Science

1. Introduction

1.1 Business risk management, taking a variety of forms, has been a growth point in corporate management in recent years. That change in emphasis is said to stem from responses to high-profile disasters like Bhopal and Exxon Valdez, increasing legal and regulatory pressure on risk management and a search for new approaches to formulating corporate strategy.[4]

1.2 Risk management of many types is well-established in the public sector, in domains as various as the management of offenders, health-care systems, tax audits and the operations of weapons systems.[5] Risk management has always been central to strategic planning in defence, internal security and foreign affairs.[6] But risk management systems in government tend to be policy-domain-specific. Most are directed towards policy rather than 'business' risks[7] and some are focused on risks to third parties rather than risks to producer organisations[8]. Accordingly, if the various private-sector business risk approaches raise issues for the design of institutional routines in government, the issue concerns how far a generic approach to factoring risk into decision-making at senior managerial level is appropriate across government.

4 See Andersen 1999; Tritton 1999; Power 1999; ICAEW 1999.

5 The variety of ways in which different government organisations assess risk and set standards has been documented by ILGRA in several reports (HSE, 1996, 1998).

6 See Frei and Ruloff 1989.

7 There are exceptions to this pattern. One is the generic focus on risk management introduced by the Regulatory Impact Assessment Unit and its predecessors. Another is the focus on business risk management and organisational controls developing in the NHS (NHS 1999). A third is the traditional policy-advisory craft skill of higher civil servants and political advisers in spotting political risks, based on unwritten lore rather than explicit procedures.

8 By policy risk we mean risks relating to the achievement of public policy objectives (like economic policy aimed at stable growth without inflation). By business risks we mean risks to the continued existence or financial status of a particular organisation (like risks of insolvency or fraud). By systemic risk we mean risks affecting an industry or set of organisations (like risks of general banking collapse), as distinct from risks to the position of any individual organisations.

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1.3 In principle a case could be made for a more generic approach that involved the integration of business risk management techniques into management control and organisational strategy in the public sector. Many of the environmental and technological changes causing risk management to assume greater importance in business strategy (like increased litigation risks, risks of IT failure, financial risks arising from global markets) affect governments as well as business. There is evidence that the 1999 Turnbull ICAEW report on internal control has influenced public as well as private sector developments. Inquiries into government decision making often produce examples of risks being taken with public money or the quality of public services without adequate strategic consideration at senior management level or careful contingency planning. Yet public servants are almost equally often berated for being too risk-averse and not sufficiently entrepreneurial.[9] A business risk management approach offers the possibility for striking a judicious and systematically argued balance between risk and opportunity in the form of the contradictory pressures for greater entrepreneurialism on the one hand and limitation of downside risks on the other that are experienced by contemporary public sector managers.[10]

2. Equivalences between Private and Public Sector Risk Management

2.1 If a generic business risk management approach for the public sector is needed, how should it be developed? Should it be 'home-grown', building on public-sector-specific experience and problems? Or should it be read across from developing business models? The latter 'read across' option is not straightforward, for two reasons. One, what counts as 'business risk management' in the private sector varies across different business domains and professionals (like bankers, insurers, accountants). Two, to the extent that risk management models in business have common features, translating them for government may be problematic. Most risk management approaches in business include at least three features for which no exact equivalence is found in government (see Figure A1):

a) They are aimed at the enterprise (or profit centre) as the primary decision unit.

9 More specifically they are sometimes accused of tending to commit 'Type II' rather than 'Type I' errors in risk management, ie to prefer errors of commission to errors of omission, especially in regulation (see Brennan 1992; Durodie 1999; and contrast Shrader-Frechette 1991. For a definition of these types of errors see Royal Society 1992: 139-40).

10 The institutional processes required would belong to a family of systems designed to balance rival desiderata that are commonly found in public sector management (cf. Dunsire 1978; Hood 1996).

Equivalences between Private and Public Sector Risk Management

Figure A1

Source Domain: Private Sector Risk Management	**Target Domain: Public Sector Risk Management**
Primary focus on enterprise/profit centre	**Possible Equivalent** Agency, bureau or budget centre as focus of business risk management **Alternative or Difference** Focus on services or hazards involving several organisations
Risk mainly conceived in relation to shareholder value of enterprise	**Possible Equivalent** Focus on risk to each organisation's financial viability, operational capacity, reputation etc. **Alternative or Difference** Focus on Public Value and on Systemic Risk as well as ‘Organisational Risk’
Business Risk Management approaches developing as heuristic frameworks to aid corporate strategy (mostly in top-down mode) within an information regime of commercial confidentiality	**Possible Equivalent** Focus on developing business risk management at management board level or equivalent in public organisations within an information regime of Freedom of Information **Alternative or Difference** Focus on developing business risk management at multiple levels (starting with the cabinet) and through multiple routines (e.g Procurement Regime, Regulatory Impact Regime etc.)

b) They conceive risk mainly in terms of shareholder value to the organisation and the various factors that can either add to or detract from that value (like reputation, operations, etc.).[11]

11 Less sophisticated business risk approaches deal only with compliance, prevention, crisis aversion or general operating performance.

c) They seek to develop decision aids and tools of discovery (like risk webs and risk maps) to assist risk identification, assessment and management and link it with general corporate strategy.[12]

2.2 To read across feature (a) above to government, we might equate agencies, bureaus or other budget centres with business firms. Those organisations certainly have important business risks (like IT failure or litigation risks) to manage and some strategic management routines and units to which business risk approaches can be applied. At the same time, many public services delivered to citizens involve several public-service organisations. Accordingly, if the 'business' on which the risk focus is laid is on the service to citizens or clients rather than on the well-being of any one organisation, there is a case for a cross-organisational approach to risk management concerned with services or particular hazards. An example of the latter focus is found in the management of risk (of reoffence) posed by registered sex offenders on release from custody, a risk which is assessed and managed through multi-organisational committees convened by the police and also involving probation services and local authority housing and social services.

2.3 To read across feature (b) above to government, it has become conventional in public management to equate shareholder value with 'public value'[13] in the sense of 'results citizens value'.[14] Public value so defined is more diffuse than shareholder value in business in that it relates to substantive public wants as well as conventional 'value for money considerations',[15] and gauging public value is not like painting by numbers.[16] Moreover, a focus on public value rather than shareholder value also tends to move the business-risk emphasis away from potential damage to, or opportunity for, particular organisations and towards risks

12 A range of approaches is available (at least in part responding to the 1999 ICAEW Turnbull report), including 'bottom-up' processes to identify organisational risks (as in KPMG's risk self-assessment approach) and top-down approaches (see Hanley 1999). The latter include risk mapping (as in PwC's business risk management framework), scenario planning and a variety of approaches intended to identify risk factors across different parts of an organisation (as in the integrated process approach used by Arthur Andersen and AIRMIC or Zurich International's portfolio-management approach).

13 Moore 1995.

14 Barzelay 1992.

15 In parliamentary democracies it is conventional to regard the final arbiters of public value as voters and elected representatives. Beyond that, public value might be equated with general public values relating to public services as revealed by opinion polling or focus group discussions.

16 For instance, there is a difference between informed and uniformed public opinion, between deliberative and non-deliberative opinion surveying, and (most difficult in ethical analysis) between what gains popular support or opposition and what deserves to. Such differences are often crucial to what is to be counted as public value in the management of technical risks that are unfamiliar to the general public.

to services or from particular hazards. More generally, it raises the question of how far the accent on risk management in the public sector should be laid on systemic risk (little considered in private-sector corporate risk management in practice) as against risks to the survival, financial position or reputation of individual organisations.

2.4 To read across feature (c) above to government, business risk management needs to be incorporated into planning routines and key decision processes. But decision-making over business risk in government often differs from that applying to the conventional company board setting in at least two ways. First, strategic decisions affecting risk in the public sector are frequently dispersed across multiple organisations and routines. Arguably that feature makes the need for 'integrated process' approaches to business risk management if anything more potentially relevant to government than to private firms, but it implies a multi-organisational rather than single-enterprise focus. Second, whereas company board decisions over high-level strategy are normally made behind the screen of commercial confidentiality,[17] government decision-making is subject to strong and rising expectations of transparency and public accountability. This feature raises tricky questions of how public-sector business risk management can be conducted in a way that secures frank consideration of potential threats and opportunities.

3. Potential Pitfalls of Inappropriate Risk Management in Government

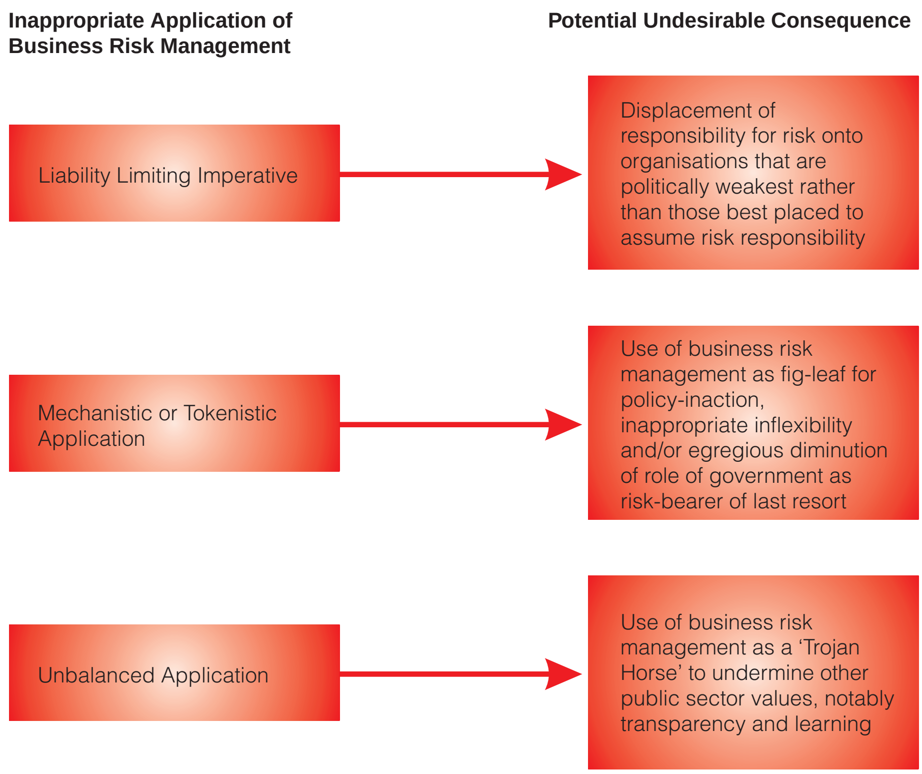
3.1 It was suggested earlier that business risk management approaches could be used as a systematic way of balancing the pressures on public managers to be entrepreneurial risk-takers and the pressures on them for prudence and risk-avoidance. But if inappropriately applied, risk management could produce negative side-effects by accentuating already strong blame-avoidance imperatives in public organisations[18]. Among the potential pitfalls of inappropriately applied risk management, three are identified below (see Figure A2), and are illustrated in the 'street festival' example shown in Figure A4.

17 It is possible that the development of risk management approaches, associated with regulatory changes and the guidance on reporting on the effectiveness of internal control systems to shareholders, may increase the transparency of private-sector decision processes. If so, it would mean a two-way transfer of routines and styles between government and business rather than a one-way transfer.

18 There is also increasing awareness in the business sector of the pitfalls of inappropriate risk management (for instance, mechanistic quantification and aggravation of blame cultures).

Three Potential Pitfalls of Inappropriate Business Risk Management in Government

Figure A2



3.2 Business risk management primarily designed to limit liability or avoid blame to particular public organisations could obstruct appropriate systemic risk management. Risk management systems need to be carefully designed if they are not to encourage public service organisations to shuffle blame on to others. Effective policy delivery in many domains requires different public organisations to work together – a theme that has been much stressed by the current UK government and requires cross-organisational trust and managerial 'craftsmanship' of a high order.[19] Systems that put too much stress on limiting downside business risk at organisational level can trigger risk-displacement processes among different organisations that create nil (or negative) 'public value'. Such processes can result in the greatest exposure to risk being borne by organisations that are politically weakest rather than those best placed (through knowledge or resources) to assume responsibility for risk[20].

19 See Bardach 1999.

20 As in the classic use of 'unacknowledgeable means' where states have traditionally used disavowable instruments in high-risk operations.

3.3 Risk management can also be used to deflect blame without creating public value if it is applied in a mechanical or tokenistic way. Public organisations often respond to disturbances in their environment by applying new procedures in ways that reflect what is readily do-able or protects existing operations, rather than what adds public value.[21] A classic example is Blau's case of US welfare agencies that encouraged dependency rather than independence in their clients in order to boost their performance ratings.[22] Risk management if inappropriately applied can serve as a fig-leaf for policy inaction (for example where a business risk assessment paper trail can be used as a procedural defence for lack of substantive action), or as an excuse for sticking to procedural rules that may be ill-adapted to particular problems. And what may in some cases be the proper role of public organisations as risk-bearers of last resort in society may be hard to fit into conventional business-risk management ideas.

3.4 Inappropriately applied business risk management approaches could also be used to undermine other public sector values, notably transparency and learning from experience. Contemporary business doctrine on risk management stresses obligations to report system audits to stockholders, increasing pressures for transparency in one sense. But risk management approaches that were designed to induce public organisations to behave more like private corporations in limiting blame or liability for errors could exacerbate existing tendencies by public authorities to restrict the publication of information about errors or malfeasance.[23] To the extent that that happened, it would also further obstruct processes of learning from mistakes that need to build on such information.

4. Implications for Good Practice

4.1 Business risk management in government needs to be designed to minimise negative side effects such as those discussed earlier, because the risks from poorly conceived or applied risk management systems are not trivial. No authoritative guide to good practice in public sector risk management yet exists, but at least three implications for good practice can be tentatively identified (see Figure A3); and they are also illustrated in the 'street festival' example in Figure A4.

21 See Clay and Schaffer 1984; Bardach 1979.

22 See Blau (1955).

23 As it is, outsourcing of services to commercial suppliers and the use of commercial insurers of risks rather than the tradition of self-insurance by public authorities means that the release of information is frequently attended by considerations of business risk.

Implications for Good Practice

Figure A3

Pitfall to be avoided in application of business risk management in government	Possible solution
Blame-shifting rather than overall problem-solving	Develop procedures to 'get the whole system in the room'
Excessive concentration on organisational risk at the expense of government-wide or social risk	Develop procedures to focus on systemic risk as well as organisational risk
Mechanistic or tokenistic application of business risk management	Develop procedures for intelligent deliberation considering second-order effects as well as first order effects

a) **'Getting the Whole System in the Room.'** One is the need for procedures aimed at 'getting the whole system in the room' (Bunker and Alban 1997) rather than having risk management dictated by partial bureaucratic geography and associated imperatives of institutional blame avoidance.[24] 'Getting the whole system in the room' is a recipe often applied to the handling of complex and conflictual policy issues. It means going beyond the integrated business risk management approaches used in corporations to a cross-organisational focus, bringing together all the systems and organisations responsible for setting targets, for gathering information and for affecting behaviour or enforcing rules. It is often difficult to achieve, since as noted above public-policy risks are typically handled at different institutional and constitutional levels.[25] A risk management system that cannot 'get the whole system in the room' is unlikely to be more than a palliative.

24 The relatively integrated approach to managing risks associated with released sex offenders mentioned earlier is an example of an attempt to follow this practice.

25 For example, it is commonly said that many inappropriate military purchasing decisions in the USA (over-ordering of materiel that is not needed) tend to stem from the horse-trading in Congressional committees designed to bring work to key electoral districts rather than errors by senior military professionals. 'Getting the whole system in the room' is impossible to achieve in this case.

b) **Focusing on Systemic Risk.** Second is a need for procedures focusing on the management of systemic risk to public services rather than organisational blame-avoidance through excessive emphasis on risk to particular organisations. As noted earlier, 'systemic risk' (a term often used in financial management) means risk affecting a whole industry or service, as distinct from risks to the position of any individual organisation. In some cases a service focus will neatly - or nearly - map onto the boundaries of an organisation, but frequently that will not be the case. In some cases (like health care) policy responsibility over systemic risk is placed at a different organisational level from responsibility for the risk faced by individual public organisations, and information-sharing among the different organisations is consequently crucial to the effectiveness of risk management at both levels. Risk management systems that sideline systemic risk issues may unintentionally weaken rather than strengthen overall risk management in government.

c) **Focusing on Intelligent Deliberation.** Third is a need for business-risk management procedures that foster intelligent and sustained deliberation over risk rather than unreflective routinization in a tick-the-box style. That means designing deliberative procedures that require careful attention to be paid to likely second-order effects as well as first-order effects of risk management, and to 'reflective practitioner' processes.[26] Procedures for assessing clinical systems and processes in health care are examples of routines aimed at intelligent deliberation among reflective practitioners, and the same goes for procedures like HAZOP[27] in the chemical and engineering world. Such procedures to be effective need time, trust and local commitment. They require careful thought about the balance between open and confidential discussion, between discussion restricted to professionals and wider public participation, and between proceduralized or legalistic approaches and more informally-structured risk management discussions.

26 By second-order effects we mean the obligation and capacity to think about unintended side or reverse effects of risk management decisions, and to think at the system level. For example, the possibility that system engineers might deliberately choose to turn off all the plant's safety systems was not on the fault tree for the ill-fated Chernobyl nuclear power plant.

27 HAZOP (Hazard and Operability Study) is a systematic and critical procedure for identifying hazards that might arise through the malfunction of any component of a system under investigation (see Kletz 1986).

Annex 2

4.2 Business risk management is emphatically not a panacea for solving all the intractable polyvalent policy problems faced by government (sometimes referred to as 'wicked problems').[28] Nor is it something that can effectively be done by numbers in an unreflective way. Top business leaders often stress that risk management is an art or craft. And in some conditions, as argued earlier, risk management procedures could unintendedly exacerbate blame-avoidance tendencies in public bureaucracies. Achievable successes are likely to be limited and in the middle range. But as was suggested earlier, intelligently applied business risk management approaches have the potential to increase public value by helping to ensure continuity and quality of public services.

Risk Management of Street Festivals

Figure A4

Ethnic and other street festivals are common events in big cities across the world. They can bring immediate economic benefits to the host city as well as less tangible or longer-term benefits (like putting the host city on the cultural map, inter-ethnic bonding, or simply collective pleasure). But they also present financial risks to organisers and funders, since parades on public streets are free for anyone to watch. And they present other interrelated risks too, like risks of crowding, crime and public order, transport congestion and public health. Those upside and downside risks form part of the business risks faced by the many different public organisations involved in such events, for instance funding and local development bodies, police and emergency services, transport utilities and municipal authorities.

Events of this type pose a particular challenge to risk management, since in many cases they have grown up incrementally over time from informal or spontaneous beginnings. If each of the public organisations involved applies a standard business risk management approach to its part in such events in isolation from the others, the result may be efforts to pass financial or other risks from one institution to another (for instance if subway stations are closed to prevent crowding, the result may be increased congestion above ground or for other transport operators). Moreover, measures taken by one organisation to limit its downside business risk (for instance, insistence on levying a substantial bond on festival organisers by other public organisations) may unintentionally produce a broader system failure, in preventing the event from taking place at all or causing it to migrate to another location. Considerations of short-term blame-avoidance may outweigh longer-term benefits or lead to restriction on information about decisions and processes.

To avoid such potential pitfalls of business risk management in public services, it is necessary to conduct a risk analysis at the level of the project or event as a whole as well as at the level of the various public organisations involved. That involves an interactive forum or network permitting mutual adjustment of the business risks faced by the various players. It also requires the development and use of ways of intelligently mapping the interactions among the different elements of the overall system, for instance by use of the sort of 'soft systems methodology' developed by Horlick-Jones and Rosenhead (2000). Careful attention needs to be paid to possible second-order effects of risk management decisions, such as the possible emergence of alternative free festivals springing up in response to measures to control the risks of established festivals (for instance, by making them secure all-ticket events).

28 See Churchman 1967.

Annex 2

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