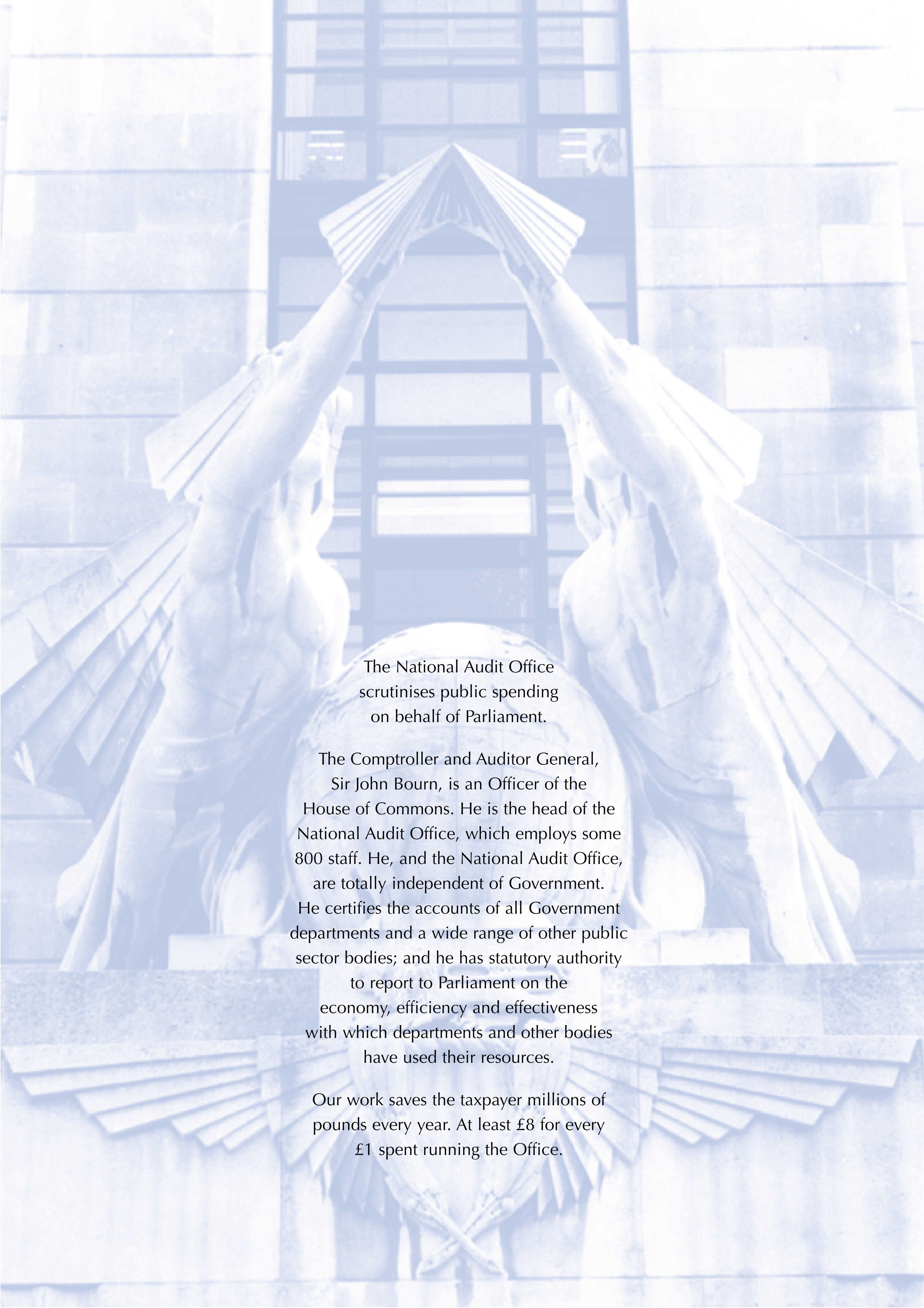
Case Studies

Managing Risks to Improve Public Services

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 1078-II Session 2003-2004: 22 October 2004



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Introduction

1 This volume of the report contains case studies in five government departments and descriptions of risk management in four private sector companies with global operations. While the examples we give of risk management in operation are specific, they draw on risk management principles and practices that can be applied more widely.

Departmental case studies

2 Areas of work in five departments - HM Customs and Excise, the Department for Culture, Media and Sport, the Department of Trade and Industry, National Savings and Investments, and the Office for National Statistics - were selected to represent different types of service delivery. The departmental case studies illustrate how departments can secure the benefits of risk management and how it can help departments to:

i Deliver better public services;

ii Improve efficiency;

iii Make more reliable decisions; and

iv Support innovation.

3 The departmental case studies also demonstrate the five key areas that departments need to address to take risk management forward beyond the end of the Risk Programme:

- **Good risk management requires time and top level commitment;**
- **Responsibility and accountability for risks needs to be clear, backed up by scrutiny and robust challenge to provide assurance;**
- **Departments need to base their judgements about risks 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.**

Private sector comparisons

4 The four private sector companies - insurers Prudential plc, the Japanese investment bank Nomura, pharmaceutical multinational GlaxoSmithKline and international news and financial information provider Reuters - took part in the National Audit Office's (2000) study on risk. Our purpose in revisiting them was to consider how for these companies risk management had progressed over the subsequent four year period and to provide pointers for how departments' risk management may develop.

How the cases studies were conducted

5 In departments, interviews were carried out with key senior managers responsible for the areas of work concerned. These were supplemented by desk research, material gathered from our survey of departments, and by two focus groups for each case study designed to gather views and experiences of applying risk management from wider staff involved in the delivery network. The focus groups were mainly of staff at middle and senior management levels. For Customs and Excise, one focus group consisted of uniformed Customs Officers at the port of Dover and at Coquelles, the UK Customs and Excise base at the French end of Eurotunnel, and the second of their team leaders and managers. For the Department for Culture, Media and Sport's Culture Online programme and for the Department of Trade and Industry's Coal Liabilities Unit, where delivery is outsourced to contractors, one focus group of consisted of staff and one of the Department's contractors.

6 For our private sector comparisons, interviews took place with senior managers of the company with responsibility for risk management.

7 The focus groups and interviews took place between March and June 2004.

HM Customs and Excise

HM Customs and Excise: Law Enforcement Directorate

HM Customs and Excise's Law Enforcement Directorate uses strategies based on risk assessment to combat smuggling operations and uses risk management to minimise loss of revenue from substitution of smuggled for duty-paid goods by:

- using risk assessments to deliver detailed operational strategies designed to deliver results by tackling risks and directing resources to address them;
- applying a clear risk management approach at all levels of the Department;
- making its risk assessments dynamic and responsive to an ever-changing pattern of risks; and,
- establishing clear accountability: officers at ports know their responsibilities, what they should target, and the procedures they must follow to get a successful prosecution.

1 HM Customs and Excise (HMCE) is responsible for collecting Value Added Tax (VAT) revenue and other taxes and customs duties. The Department has a vital front line role of enforcing government requirements relating to the movement of goods into and out of the country, and protecting society from illegal imports of drugs, tax fraud, and alcohol and tobacco smuggling. The Department had 23,000 staff in 2002-03 and expenditure of some £1 billion.

2 Customs operations at ports and airports are the responsibility of the Law Enforcement Directorate, established in April 2002. As an indication of the scale of operations, in 2002 its remit covered 29.3 million international sea passenger journeys, 10.75 million units of freight shipped in lorries and containers, and 558.3 million tons of maritime cargo. Around 5,000 lorries and trailers pass through the port of Dover daily.

3 The establishment of the Law Enforcement Directorate accompanied a shift to a more intelligence based operation with analysis of intelligence data and identification of key risks. Three major strategies designed to tackle specific smuggled goods - tobacco, Class 'A' drugs and oils - are used to deploy law enforcement and intelligence resources.

4 The Department has a stated aim of being the best risk management organisation in the UK public sector.

Key risks

5 Key risks for the Department include:

- failure to achieve key targets, including reductions in the availability of smuggled goods;
- loss of revenue due to failure to reduce the supply of illegal tobacco.

6 For Customs Officers at ports, key risks include:

- failing to follow correct stop and search procedures may result in the collapse of high profile court cases;
- failure to keep up to date with changing legislation, new priorities and new areas of Customs and Excise responsibilities, such as International Trade inspections as part of the International Trade Compliance Strategy, and inspection of meat imports.

How these risks are managed

7 Assessment of risks is the responsibility of the relevant risk owner. A standardised risk evaluation methodology is used across the Department. The Management Committee reviews all 'red' risks from the central risk register on a monthly basis and 'amber/red' risks at least quarterly. Each quarter, an exercise is commissioned to update the central risk register in full. These timescales are repeated for all other lower level risk registers throughout the Department. Outside of the regular review timetable, emerging issues and threats are discussed on an exception basis by the Management Committee.

8 The Board receives risk updates quarterly. The Board has four Non-Executive Directors, two of whom also sit on the Audit Committee, with the longest serving Non-Executive Director appointed as Chair. Independent challenge of how risks are being managed is provided by the Audit Committee and Internal Audit.

9 All staff are encouraged to identify, understand and manage risks, appreciating which risks can be tolerated and which cannot. Managers are expected to understand the risks they face, their causes, probability and impact; to prioritise the management of risks so that those of highest concern are adequately controlled before efforts are directed at lower level risks; and to manage the Department's exposure to these risks at reasonable costs.

10 To achieve its public service agreement targets, the Executive Board takes decisions on resource allocation in the light of key risks and strategies for addressing them; for instance the Tobacco Smuggling strategy or Class 'A' Drugs strategy. Strategies are cascaded through the Department to determine deployment of resources at head office, regional and local level. The strategy-led approach has led to more flexible deployment of resources with the National Deployment Committee and Regional Deployment Committees having at their disposal flexible strike forces to deploy at ports or airports to meet changing risks within and between the Department's strategies.

11 All staff are informed about what the Department's strategies require and what the strategies require of them. Officers are kept informed about changes to risks through daily briefings.

12 Customs Officers at ports of entry receive intelligence reports that target likely smugglers and prioritise these for stopping and searching. Customs Officers are strongly encouraged to report new risks, such as the arrival of new types of smuggled goods, new methods of concealment, or smuggled goods arriving from new destinations, to the Intelligence Division, which distributes the information rapidly, immediately if necessary, to Customs Officers at other ports. Individual reports are collated, new trends analysed and, if sufficiently high risk, are incorporated into the priority indicators used by Customs Officers to stop and search vehicles.

13 The Department is undertaking initiatives to strengthen its use of intelligence and is piloting developments to assist in identifying vehicles to stop and search at ports. At Dover, an intelligence based 'Pre-Selection Hub' became operational in May 2004. The Pre-Selection Hub analyses multiple data sources including lists of stolen vehicles, criminal records data, ships' cargo manifests, ticket-buying patterns and other intelligence to produce the optimum list of vehicles to stop and search. This reflects a move within Customs and Excise from recognition based or intuitive risk decision-making, based on Officers selecting vehicles that on their previous experience are most likely to contain smuggled goods, to risk decision-making based on analysis of data, supported by front line Officers using for stopping and searching vehicles rule based risk analysis based on standard operating procedures (Flin and Crichton, 2004).[1] Dedicated staff have been trained to use the Pre-Selection Hub, selected on the basis of their aptitude for the task.

14 The Butterfield Review (2003)[2] identified two key areas of concern about the Law Enforcement Directorate's assurance systems - that a 'tick box' approach might lead to automatic conformity to a system rather than thought through consideration of whether actions were appropriate; and that lack of compliance with the systems might lead to abuse of process applications and major trial failures. The Law Enforcement Directorate has set up a programme of training seminars 'Managing Risks through Professionalism' for all Customs Officers, team leaders and their managers, to reinforce the value of maintaining high standards in procedures and processes and following and recording them correctly. Customs and Excise is also working with the Police to devise a joint national framework for occupational standards.

15 Following interceptions of smuggled goods, teams are despatched to carry out debriefing of intercept teams to analyse why they did or did not get a successful result and to check prior to prosecutions that all procedures have been correctly carried out and recorded to mitigate the risk of prosecutions failing through minor procedural errors. New tactical and strategic intelligence is fed into the Regional Freight Pre-Selection Hub to update the selection profiles and influence future pre-selection of vehicles.

16 The Department works closely with other law enforcement and is part of a multi-agency approach to serious crime. It has co-operation agreements with UK and international agencies including the Association of Chief Police Officers, the National Crime Squad, National Criminal Intelligence Service, Secret Intelligence Service, Security Service, the Drug Enforcement Administration and Interpol. Customs and Excise is also working closely with the Department for Environment, Food and Rural Affairs to prevent illegal meat imports from entering the UK; with the Home

1 *Risk-Based Decision Making: Mitigating threat - Maximising opportunity, Rhona Flin and Margaret Crichton, 2004, Managing Risks to Improve Public Services, Volume 1, Appendix 2.*

2 *Review of Criminal Investigations and Prosecutions, The Hon Mr Justice Butterfield, HM Treasury, July 2003.*

Office to control radiological material entering the UK; with maritime authorities to implement the new maritime security regime agreed by the International Maritime Organisation; and with airport authorities to improve airport security following recommendations of the Wheeler Review.[3] Transitional programmes are also being developed to manage the moves towards establishment of the integrated HM Revenue & Customs Department, and the new Serious Organised Crime Agency (SOCA).

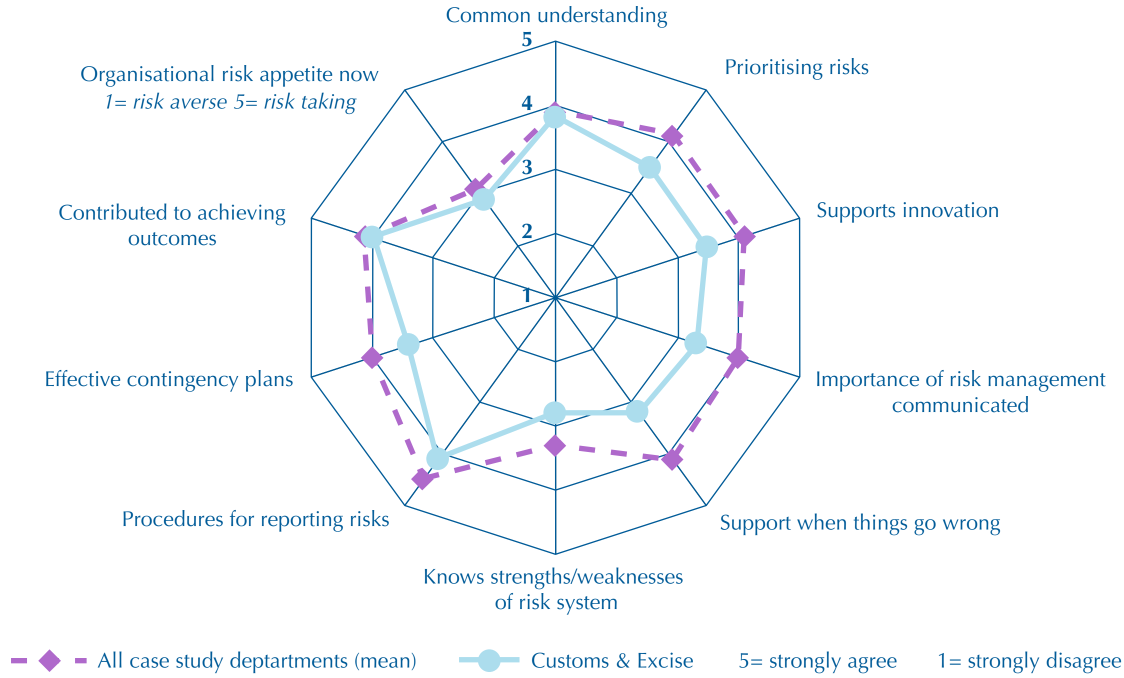
Lessons learned

17 HM Customs and Excise's Law Enforcement Directorate has demonstrated effective risk management by:

- **Using risk assessments to deliver detailed operational strategies designed to deliver results** by tackling and directing resources to address them.
- **Applying a clear risk management approach at all levels of the Department.**
- **Making its risk assessments dynamic and responsive to an ever-changing pattern of risks** - but in a way that does not confuse staff.
- **Establishing clear accountability.** Officers at ports know their responsibilities, what they should target, and the procedures they need to follow to get a successful prosecution.

1 Customs and Excise focus group participants' perceptions of risk management at Dover - Focusing on risk has contributed to delivering results

Customs and Excise Officers in our focus groups considered their department as risk averse, in that they were addressing past failures in risk management that had led to failure of prosecutions. Due to the nature of their role, Officers considered there to be limited room for them to take risks and be innovative in their day-to-day work, but in terms of suggesting better ways of working, Officers considered there to be some scope for them to be innovative.



NOTES

1 Two focus groups were conducted, one with freight anti-smuggling officers or assistant officers (Grades 4 and 5), and one with freight anti-smuggling team leaders or managers (Grades 7 and 9) from Dover Port and Coquelles (UK Customs and Excise based at the French end of Eurotunnel).

2 Participants were asked to complete a short questionnaire on the extent to which they agreed or disagreed with statements about risk management within the Department. The Figure summarises the results of these key measures. The scale ranges from 1 at the centre (the most negative score) to 5 at the edge (the most positive score). The figure compares Customs and Excise responses (plotted in blue) with the average for all participants in the focus groups across the case study departments. The Figure is based on small sample sizes and the results it presents are indicative of the participants' area of work in the Department only.

Source: MORI (All departments refers to all five case study departments).

3 *Airport Security. Report by the Rt Hon Sir John Wheeler, JP, DL, commissioned by the Home Office and the Department for Transport, 2002.*

Department for Culture, Media and Sport: Culture Online

The Department for Culture, Media and Sport's Culture Online programme shows how working with partners to manage risks can help deliver innovative projects by:

- supporting arts bodies to establish risk management processes that increase the likelihood of innovative projects delivering;
- helping commissioned arts bodies to identify risks and put contingency plans in place;
- establishing a blame free culture in which all partners can discuss risks openly; and,
- cascading risk management expertise through the Department so others can benefit.

1 The Department for Culture, Media and Sport (DCMS) has 490 staff located in London. Its expenditure in 2003-04 was some £4 billon.

2 The Department established the Culture Online programme in 2002 with a budget of £13 million (£3 million revenue funding and £10 million Capital Modernisation funding). Culture Online aims to provide funding and project management expertise to bring together cultural organisations and cutting-edge technical providers using new technologies, including Internet (broadband and narrowband), digital TV, mobile devices, CD/DVD and touch-screen kiosks to create innovative projects aimed at adults and children from hard to reach groups.

3 Successful delivery of Culture Online forms part of the Department's PSA targets to deliver ten educationally focused and ten culturally orientated projects. By 2003-04, £6.5 million had been allocated to ten projects and £3.8 million ear-marked against a possible 23 projects in all; the balance to be allocated by the end of 2004. The projects aim to be accessible through individual organisations' websites and through links to Curriculum Online, run by the Department for Education and Skills, and in partnerships with broadcasters, newspapers and other organisations with access to audiences **(Figures 2, 3, 4 and 5)**.

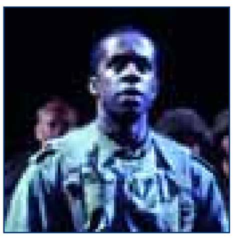
2 Culture Online projects include …

The Dark is a walk-through installation that uses a totally dark interior and a sophisticated 3D sound system to create sounds and narratives of slaves and slave traders to tell the story of Britain's eighteenth century slave trade. *The Dark* opened for a pilot phase at the Science Museum, London before moving to the Magna Centre, Sheffield where many performances played to 100 per cent capacity audiences. It will move to other regional museums and galleries. An experimental website version is at http://www.thedark.net/.

'That's the beauty of this simple and effective installation: you create all the drama and all the horror'.

Hermione Eyre, Independent on Sunday, 21 March, 2004

Stagework is delivered through a website (www.stagework.org.uk) produced by the National Theatre and selected regional theatres. It aims to increase understanding of theatre as a creative industry and to make young people aware of its career possibilities. *Stagework* takes visitors to the website behind the scenes to understand the process of creating a theatre production. Productions include *His Dark Materials, Henry V* and *Beauty and the Beasties*. *Stagework* supports Key Stages 3 and 4 of the National Curriculum in English and Drama, Citizenship, Religious Education, Performing Arts, ICT and Communication Skills.



Adrian Lester as the King in the National Theatre's modern dress Henry V.

3 WebPlay UK

WebPlay UK is an Internet-based project enabling primary school children from urban and rural areas to work with a professional theatre company to create, produce and perform short plays about the area in which their partner school is based. The plays are digitally videoed as the children perform them, and then uploaded onto a specially created secure website for the partner schools to view. The project ends with a celebration in each of the different areas, involving pupils, families and teachers. *WebPlay UK* helps children to learn to build web pages, write about their lives and describe where they live, within the safety of a secure, educational platform. The project was launched with schools in Birmingham and Shropshire and is aimed at Key Stage 2 pupils. It focuses on the English, literacy, ICT and drama aspects of the National Curriculum. For many of the schoolchildren, *WebPlay UK* is their first introduction to the Internet and the project aims to develop their awareness of, and skills in, using the Internet as a means of communication. *WebPlay UK* completed its first year in July 2004, with 180 children from six schools taking part. In the second year of the project, this will rise to 30 schools from Birmingham, Shropshire, Nottinghamshire and Leicestershire. Schools are selected using a Department for Education and Skills' indicator of social deprivation - the number of children receiving free school meals. Children participate in the project twice a week for 45 minutes each session.

4 Project start up was slower than expected, mainly due to the time needed to design processes appropriate to Government, to produce standard contracts and to obtain legal advice on procurement and intellectual property rights issues. These aspects are now in place and can be replicated for other similar commissioning exercises by the Department.

Key risks

5 Key risks for Culture Online include:

- convincing arts bodies to want to work in a new way that involves commissioning products rather than providing grants, with more complex legal requirements and paperwork than they were used to, run by people with industry knowledge who could challenge their budgets;
- allocating its funding in the time available;
- reaching its target audiences - people who would not usually participate in arts and cultural projects;
- developing innovative projects using technology in previously untried ways;
- ensuring the quality and timely delivery of the products it has commissioned; and,
- ensuring that expertise built up within Culture Online is not lost to the Department at the end of programme.

How these risks are managed

6 Risk reporting is through two levels of risk register - individual project registers and a programme register for Culture Online overall. The Culture Online risk register is reviewed fortnightly.

4 MadforArts

MadforArts is a project that aims to give a voice to users of mental health services, among the most marginalised people in society. The project provides access to a microphone, digital camera, web space and structured support to create a website gallery of mental health services users' views and critiques of works of art, music, sculpture and architecture. The project will be launched regionally; with the best twelve contributions being made into films and featured on The Community Channel, which is owned by The Media Trust, a not-for-profit channel broadcast on satellite and cable. Five of the twelve films will also be shown on Channel Five, thereby encouraging more people to take part online.

7 To maximise the likelihood of the arts bodies it contracts with delivering what it has commissioned, Culture Online inputs time and technical expertise at the contracting stage and insists that contractors do a thorough assessment of risks to delivery before the contract is signed. Culture Online vets shortlists of key sub-contractors involved in the project and approves the nature of all subcontracts. The Culture Online team also works with project teams to produce contingency plans to address potential problems, such as broadcasters and other bodies outside the project dropping their support.

8 To secure funding, arts bodies often have to convince potential funders that they are capable of managing the ideas they are proposing. In the development stages, it can be difficult for arts bodies to be open about the risks associated with their projects. Culture Online sometimes has to educate arts bodies in its new way of working, where partners are encouraged to identify risks rather than play them down.

5 Plant Cultures

Plant Cultures is a website about plants that draws on a partnership of botanical experts, museums, libraries and local communities to gather information about the significance of plants in different communities. Taking the communities of South Asia as a starting point, the site uses oral history, fine arts, and demonstrations of arts and crafts to bring to life the different ways in which plants are used. At least 1,500 images of rare prints, paintings and artefacts, many never exhibited before, will be made available on the website. Partner museums will run events and workshops to introduce participants to the Plant Cultures project, including visits to botanical gardens and handling sessions with museum objects. The Plant Cultures project will gather anecdotes, folklore and examples of art and crafts that are becoming less accessible as attitudes change and generations grow up surrounded by other cultures.

Illustration of Mango by Charles Maries 1886 - Kew Library

9 To obtain the products it has commissioned, during the development of the project the Culture Online team has regular meetings with contractors to check on progress and that any products meet 'acceptance tests'.

10 To gear projects towards its target audience of hard to reach users, Culture Online pays projects more for reaching members of the public who do not normally participate in cultural activities. To determine how to reach its target audiences, at the start of the programme Culture Online commissioned a report from the London School of Economics' Centre for the Analysis of Social Exclusion to advise on its intended value for money targets.[4] Culture Online is currently working with City University's Centre for Human Computer Interaction Design on how to make its projects accessible for people with disabilities.

11 Each Culture Online project must include a strategy for reaching its hard to reach audience and one of the partner bodies in the project must have regular access to the target group. *MadforArts*, for instance, reaches mental health service users by working with Rethink, Mental Health Media, drop-in centres and networks for those involved in mental health issues. Plant Cultures reaches older Asian participants in the Midlands by working with small community groups.

12 To increase the likelihood of successful delivery, Culture Online controls the level of risk exposure for each project by aiming to ensure that risks are not taken on all fronts simultaneously by, for instance, avoiding using untried technology in projects that involve complex intellectual property rights and licensing negotiations.

13 The Department's overall approach to risk management is to integrate risk management techniques with project management and to use the project based approach across increasing areas of the Department's work, including policy-making. Culture Online is designed to take this approach forward and to provide a lead in risk management practice in the Department. The risk that Culture Online's expertise will be lost when the programme finishes is being addressed by setting up workshops for staff of the Department for Culture, Media and Sport and of other departments who deal with commissioning from non-departmental public bodies or the procurement of consumer services with an IT or new media component.

Lessons learned

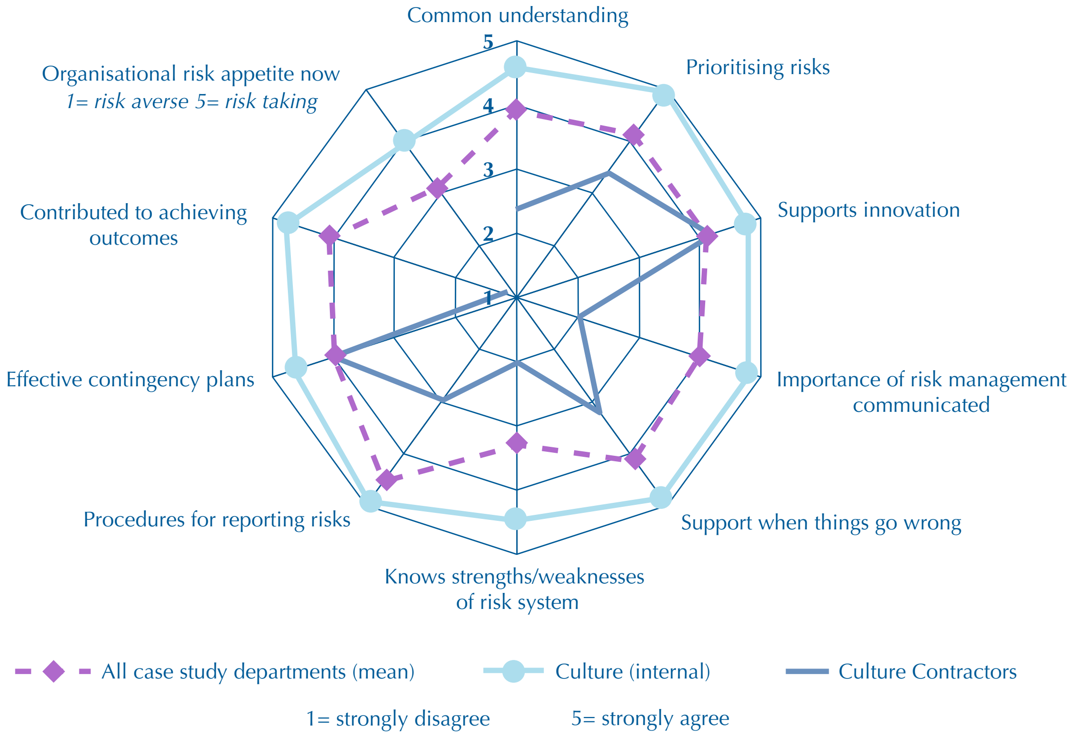
14 Culture Online has demonstrated effective risk management by:

- Supporting arts bodies to establish risk management processes that increase the likelihood of innovative projects delivering.
- Using a thorough risk assessment and project planning process to help commissioned bodies identify risks and put contingency plans in place.
- Establishing a blame free culture in which all partners can discuss risks openly.
- Cascading risk management expertise through the Department so others can benefit.

4 *Culture Online: Removing Barriers to Participation in the Arts and Culture, Francesca Borgonovi, Centre for Analysis of Social Exclusion, London School of Economics, 2003.*

6 Culture Online staff and contractor focus group participants' perceptions of risk management in Culture Online - Risk management supports innovation

Staff at Culture Online see the Programme as risk taking and were positive about all aspects of its management of risk. Contractors were less convinced of the benefits of Culture Online's risk management processes, particularly with regard to achieving outcomes and agreeing that there was a common understanding of risk between themselves and Culture Online. Contractors recognised however that risk management supported innovation and that there were effective contingency plans in place.



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Source: MORI (All departments refers to all five case study departments).

Department of Trade and Industry: Coal Liabilities Unit

The Department of Trade and Industry's Coal Liabilities Unit demonstrates the use of risk management to set up and manage large and novel projects with multiple partners by:

- thinking about risk so that it becomes an integral part of day to day project management and communications between all relevant parties;
- establishing positive and open relationships with key stakeholders;
- allowing time and sufficient resources for risk management; and,
- being prepared to take calculated risks.

1 The Department of Trade and Industry (DTI) works with employers, consumers and businesses, to drive UK productivity and competitiveness by facilitating partnerships between business, employees, consumers, unions, the scientific community and the government. It aims to promote a legal framework encouraging both enterprise and innovation, ensuring consumers, companies and employees receive a fair deal. The Department has 4,300 staff; its expenditure for 2003-04 was £8.3 billion.

2 Following the break up of British Coal, under the terms of Coal Industry Act 1994 the liabilities of British Coal transferred to the Department on 1 January, 1998. Around that time British Coal was found liable in two major court cases for compensation for damage caused to miners through exposure to dust and excessive use of vibrating tools. The courts instructed the Department to work with two co-ordinating groups of solicitors representing the miners to draw up arrangements for handling large volumes of claims. The Coal Liabilities Unit was therefore formed to negotiate Handling Arrangements and to process ex-miners' health compensation claims under two major personal injury schemes covering Vibration White Finger and Chronic Obstructive Pulmonary Disease. The Unit also deals with other health claims outside the two big schemes and with the non-health liabilities of British Coal. The Department experienced significant problems initially due to the complexity of the schemes, which reflect closely what a claimant would be entitled to at common law, the fact that no similar schemes had been run to provide a template, and a general underestimate by all parties involved, including solicitors representing ex-miners, of the volume of potential claims. In the early stages of the scheme, slow processing of claims led to criticism by Parliament and by the media.

3 The Vibration White Finger scheme closed on 30 October 2002 for live claimants, and 31 January 2003 for widows and estates of deceased claimants, and the Chronic Obstructive Pulmonary Disease scheme on 31 March 2004. Rather than generally accepted estimates of tens of thousands of claims, around 684,000 claimants have registered over both schemes and some £2 billion compensation has been paid to claimants so far. The Department is paying compensation of around £2.5 million every working day and expects to pay out some £7 billion in total. These are the biggest personal injury schemes in British legal history and, possibly, the world.

4 The Coal Liabilities Unit retains overall management responsibility for the liabilities, but the schemes are operated by a network of contractors, including Capita-IRISC for the processing of claims and payment of compensation, and Capita Health Solutions and Atos Origin for medical assessments. A national monitoring group, chaired by the Department's Minister with responsibility for coal health liabilities, monitors the delivery of the schemes as seen from the mining communities and advises the Minister on this.

Key risks

5 These include:

- slow processing of claims leads to distress for claimants and their families and damages the reputation of the Department; especially given the age of some claimants and media interest in the issue;
- managing a complex delivery network;
- poor controls lead to delays, fraudulent claims or errors in payments.

How these risks are managed

6 There is a structured risk management process focused around risk registers. Each part of the claims process is treated as a project with its own risk register, which is created through brainstorming and is managed through regular project/contract meetings. Following the initial development of the project risk register, key risks with higher level implications are escalated and placed on the Group level risk register where appropriate.

7 Within the Department as whole, risk champions are responsible for escalating risks up the management line and increasing awareness of the risks and of risk management. The head of the Coal Liabilities Unit is a risk champion.

8 Risk is an item on the agenda of all monthly meetings between the Unit and its main contractors. This prompts both parties to assess their progress on an action log and to think about current and future risks. Every four months, the Unit's senior management meet to go through the combined risk registers to review progress on management of risk and report changes to senior management up the line.

9 The Unit has created a 'no blame' risk management culture that encourages openness and sharing of knowledge and experience.

10 Each new contractor is required to participate in a risks workshop to establish the risk management principles to which the Unit works, to identify and prioritise key risks for the Unit and the contractor, to agree responsibility for managing risks and to identify and assess controls. The Unit also holds regular risk workshops to consider specific risks, such as the identification of fraudulent claims, how partners can work together to share good practice, and identifying new trends.

11 The Unit's claims handler, Capita-IRISC, has Solicitor Liaison Officers among whose key responsibilities are monitoring and managing operational issues associated with individual claimants' solicitors. The Unit hosts solicitor days to update major solicitors about progress with the schemes.

12 The risk, to claimants and to the Department's reputation, of slow processing of claims is being addressed by seeking to reduce the time taken to complete specific stages of the claims process and to speed up the volume of claims processed. The Unit has set up a website to enable claimants' solicitors to complete claims forms electronically, to agree claims details online and to see the progress of claims. This was a calculated risk in that the Unit was ahead of standard practice for solicitors' offices and was advised that solicitors would be unwilling to work through a website - which has not proven to be the case.

13 The Unit has a very close relationship with internal audit in the Department to help ensure that risks are being managed in a transparent and consistent way. The Unit's Strategic Audit Framework is built around the key risks to effective delivery and mitigating actions on key risks are audited to ensure that risk management processes put in place are sound.

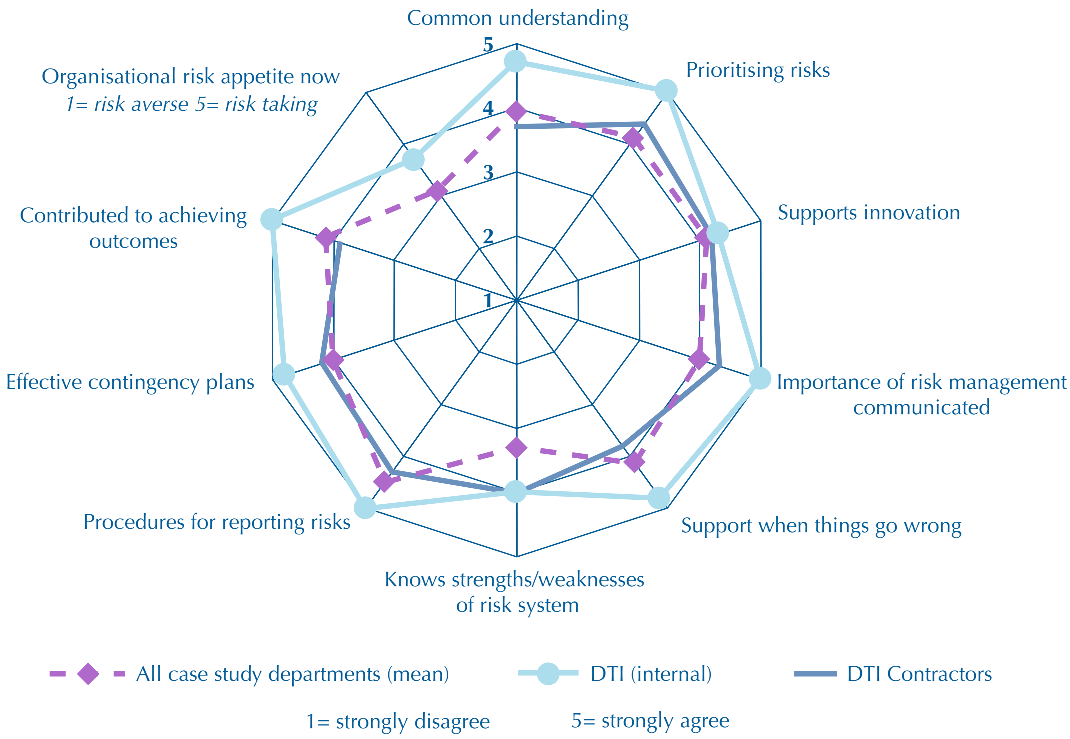
Lessons learned

14 The Coal Liabilities Unit has demonstrated effective risk management by:

- **Thinking about risk** so that it becomes an integral part of day-to-day project management and communications between all relevant parties.
- **Establishing positive and open relationships with key stakeholders** and a culture free of blame, so staff and contractors can highlight their concerns.
- **Allowing time and sufficient resources for risk management** so that risk registers become part of routine management.
- **Keeping risk management simple, user-friendly, and flexible**.
- **Avoiding complacency** and continuing to refine and develop risk management.
- **Being prepared to take calculated risks**.

7 Coal Liabilities Unit staff and contractor focus group participants' perceptions of risk management in the Unit - Staff and contractors have a shared view of risks

Coal Liabilities Unit staff considered their Unit to be risk taking. Coal Liabilities Unit staff and contractors were positive about all aspects of risk management and shared similar perceptions of the Unit's risk management arrangements.



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Source: MORI (All departments refers to all five case study departments).

National Savings and Investments

National Savings and Investments shows how risk management can support well managed risk taking and working with private sector partners by:

- combining the best of private sector risk management with public sector controls;
- assigning clear responsibilities for risks and sub-risks at all levels of the management chain; and,
- conveying commitment to risk management at the top of the Department.

1 National Savings & Investments (NS&I) is one of the largest savings organisations in the UK, offering savings and investment products to personal savers and investors. It is also a Government Department, accountable to the Treasury, and an Executive Agency of the Chancellor of the Exchequer. The money which customers place is used by HM Treasury to help manage the national debt cost effectively; contributing towards the Government's financing needs. NS&I's back office functions are delivered entirely by Siemens Business Services (SBS). Post Office Limited provides NS&I's main distribution channel.

2 The government sets NS&I's objectives. Currently, the single strategic objective is to provide retail financing for the Government that is cost effective in relation to financing raised on the wholesale market. The Chief Executive, as Accounting Officer, assisted by the Board and the Executive Management Team, is responsible for defining and directing NS&I's business strategy and policies to achieve the objective, and for developing a culture and environment that are conducive to the successful implementation of the strategy.

Key risks

3 Key risks for National Savings and Investments include:

- failing to ensure Siemens Business Services are incentivised to deliver the operational service in ways that enable NS&I's business to develop;
- too great a reliance on one product - Premium Bonds;
- too great a reliance on the Post Office as the main distribution channel;
- competition from other financial institutions, especially the Bank of Ireland;
- failing to fulfil ever-changing customer needs and expectations;
- IT modernisation;
- fraud.

How these risks are managed

4 NS&I structures its risk management around a series of risk registers. Each of the '13 key risks' for the business is owned by an Executive Director. Business Unit Leaders at middle management level have recently assumed responsibility for the management of the sub-risks that make up the key risks. Where appropriate, SBS managers can be sub-risk owners and responsible for the delivery of risk mitigation actions. Risks are reviewed six monthly at Board level, every three months by the Executive Management Team and the Audit Committee, and on an ongoing basis at Business Unit Level. Risk is also a standing item on monthly Executive Management Team agendas. Individual projects have their own risk registers, which feed upwards to the main registers. All joint NS&I-SBS projects have joint project teams. Internal Audit is asked to help develop the risk registers.

5 NS&I integrates risk reporting with other performance management information in a 'Balanced Scorecard' tied to its objectives and uses this to highlight emerging risks. To embed risk management further down the management chain, in 2004-05 NS&I is introducing explicit identification of risks within the business planning process.

6 NS&I's risk management structures and leadership from senior management have created openness about risk and a 'no blame' culture that has encouraged staff to alert decision-makers to new risks and to report changes in risks early.

7 NS&I is currently piloting the LEAN business improvement methodology, which will help identify and confirm the risks within operational processes and the mitigation strategies in place.[5] The Audit Committee has agreed that Internal Audit will then review the risks identified.

8 NS&I needs to understand the operating risks identified and managed by Siemens Business Services and to satisfy itself that these are in line with the NS&I business strategy and not out of line with its risk tolerances. To discharge its monitoring role, the Board's primary sources of assurance are the management structures and processes put in place to deliver the business strategy. This is supported and challenged by Internal Audit, directed on behalf of the Board by the Audit Committee. The Joint Audit and Risk Management Committee provides a cross-business forum for sharing information on risk between NS&I and its primary partner Siemens Business Services.

9 A key element of NS&I's joint risk management with SBS is to ensure good communication between the partners at all levels. In addition to day to day working relationships, at the highest level there are contacts with senior members of Siemens AG, SBS UK and the SBS-NS&I account, meets twice yearly to align NS&I and SBS interests; and a range of joint groups and committees, covering all aspects of the NS&I business which together aim to ensure there is good communication and exchange of views and information. In addition, both the NS&I Executive Management Team and the Senior Management Team have SBS representation.

10 The initial SBS contract represented a high risk for NS&I in that it was a pioneering outsourcing operation and remains one of the largest undertaken by a UK government department. The initial contract ran at a loss to Siemens and to mitigate the risk for NS&I of service delivery failure if Siemens withdrew from the partnership, NS&I has worked with SBS to align the interests of both partners so that SBS can benefit from NS&I business growth.

11 To keep abreast of changing financial markets and to keep and increase its customer base, NS&I has a new product development team that is encouraged to take well managed risks to innovate. In 2004, NS&I launched a major new account - the Easy Access Savings Account - and is in the process of closing the National Savings Ordinary Account.

12 To maintain customer satisfaction, Incident Management Teams of staff from NS&I and SBS meet quickly to address any serious customer complaints and to take mitigating action, as well as diagnosing problems so they do not recur.

13 NS&I has contingency plans for scenarios that represent major business risks, such as the end of the contract with the Post Office, IT systems failures and customer service complaints.

14 NS&I is seeking to reduce its dependence on Post Office Limited, whose recent partnership with the Bank of Ireland gives it the potential to market products which would compete with those of National Savings and Investments. NS&I is addressing this risk by developing its website and its call centre to deal with direct sales and is increasing marketing through mail shots through third parties.

15 To address weaknesses in elderly IT systems, the partnership with SBS is enabling NS&I to migrate its products onto a commercial IT system for banking products. The most recent transfer was of the Premium Bonds database with records for 23 million customers, representing an investment value of £24 billion - one of the biggest databases of its kind to be migrated. Internal audit were heavily involved in developing the risk register for the project. To mitigate the risk to its reputation and potential loss of sales if errors were made, NS&I timed the migration for the Easter weekend, when fewer people would be making transactions, held back on marketing campaigns for Premium Bonds to reduce pressure on its partner SBS, and undertook six months of parallel running of the new system before the go-live date.

5 *"LEAN" is a process improvement tool first developed by Toyota and now applied in administrative environments. It focuses on employees identifying and eliminating waste from processes and working practices.*

16 The contract with SBS provides a cap on NS&I's annual exposure to product fraud and until 2004; NS&I considered fraud to be more of a reputational rather than a financial risk. The launch in 2004 of the Easy Access Savings Account and its automated teller machine (ATM) cards has introduced a new level of financial risk. New fraud monitoring arrangements include the use of special software to run checks between the addresses of account holders and debit cards.

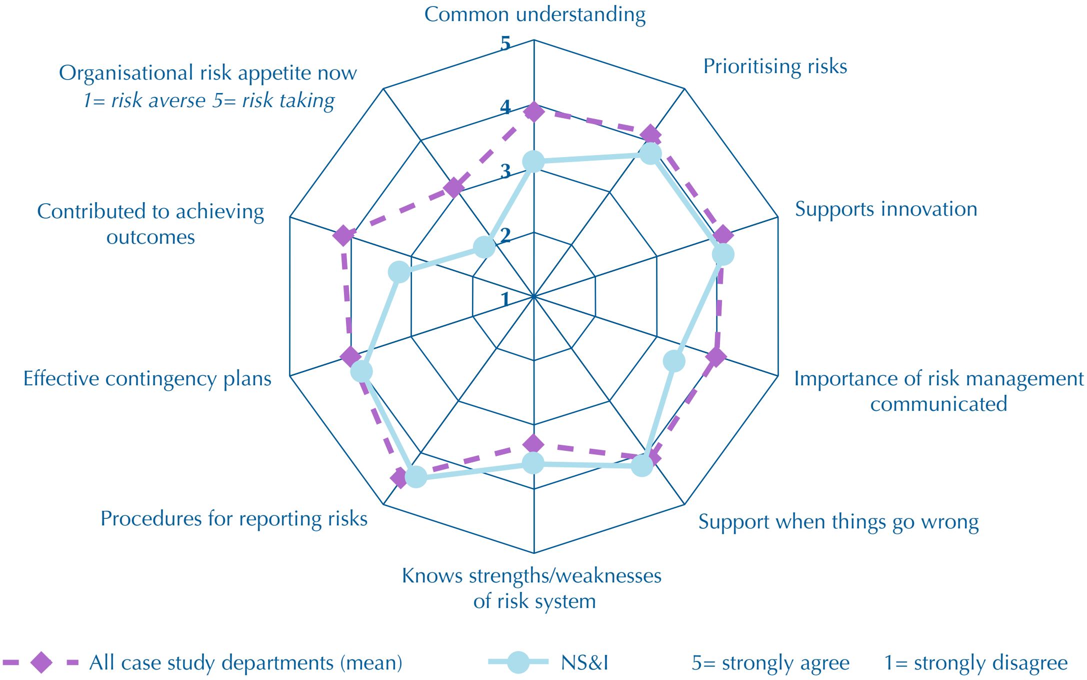
Lessons learned

17 National Savings and Investments has demonstrated effective risk management by:

- **Combining the best of private sector risk management with public sector controls** can change a department's culture from a conservative one to one that takes well managed risks.
- **Using risk as a basis for decision-making** turns risk management from a form-filling exercise to a way of thinking, supported by a reporting structure.
- **Assigning clear responsibilities for risks and sub-risks at all levels** creates personal responsibility and allows risk management to be practised throughout the department - not just at director level.
- **Conveying commitment to risk management at the top of the Department** and implementing it in all Departmental activities is supported when a 'no blame' culture is created that encourages risk reporting.
- **Allocating time** to risk management is necessary if risks are to be identified and managed well.

8 National Savings and Investments focus group participants' perceptions of risk management - Risk management has supported well managed risk taking

National Savings and Investments managers considered that risk management supported innovation and that they had clear procedures for reporting risks and effective contingency plans.



NOTES

1 Two focus groups were conducted at National Savings and Investments, one with staff in the marketing and product development area of the business and one group of staff dealing primarily with provision and continuous development of services to customers.

2 Participants were asked to complete a short questionnaire on the extent to which they agreed or disagreed with statements about risk management. The Figure summarises the results of these key measures. The scale ranges from 1 at the centre (the most negative score) to 5 at the edge (the most positive score). The Figure compares National Savings and Investments' responses with the average for all participants in the focus groups across the case study departments. The Figure is based on small sample sizes and the results it presents are indicative.

Source: MORI (All departments refers to all five case study departments).

Office for National Statistics

The Office for National Statistics shows how risk management can be used to minimise risk in an environment that is highly dependent on accuracy and timeliness by:

- communicating from the top of the Office commitment to risk management;
- creating clear channels of communication about risk; and,
- applying project management risk principles to a wide range of departmental activity.

1 The Office for National Statistics (ONS) is a Government Department and Executive Agency created in April 1996 from the merger of the Central Statistical Office with the Office for Population, Censuses and Surveys. The Office for National Statistics is responsible for producing a wide range of key economic, business and social statistics, including the Census, Index of Services and the Retail Price Index, which are used across government to develop evidence-based policies and to track performance against them. The Office also builds and maintains data sources for its business and research customers, as well as for its own use. The Office also incorporates the General Register Office for England and Wales. The Office employs around 3,800 staff in London, Newport, Southport and Titchfield, plus up to 1,000 field staff working on social surveys. Its net total expenditure for 2002-03 was some £139 million and it publishes some 500 surveys and other data sets each year.

2 The Minister responsible for National Statistics is the Chancellor of the Exchequer. The National Statistician has overall responsibility for the professional integrity and statistical quality of the all the Office's outputs designated as 'National Statistics' and for ensuring that they are produced in accordance with the standards set out in the National Statistics Code of Practice and supporting protocols. Key principles of the National Statistics Code of Practice are that National Statistics will be:

- valued for relevance, integrity, quality and accessibility;
- produced in the interests of all citizens by protecting confidentiality, and balancing the needs of users against the burden on providers; and,
- enhanced through integration, accumulation and innovation, and by efficiency in costs, and fairness in prices.

3 Data services delivered by the Office for National Statistics inform economic policy-making, Bank of England decisions on interest rates, and decisions made by institutions in the financial markets. Other departments also use the Office's data, for example to allocate resources to address the need for housing. The Office also provides data that citizens can use to assess the work and performance of government. The Office for National Statistics is the most published government department.

4 The Office considers itself to be risk averse in its core business of producing statistics, where accuracy is paramount.

Key risks

5 These include:

- **maintaining relevance**: the Allsopp Review (2004)[6] identified that the Office was good at measuring production but less good at measuring the economic impact of service provision, which is now considered to be a more important indicator of UK economic buoyancy; the changing socio-economic climate can impact on the priorities of the Office's customers - for example, migration and pensions data have recently taken on much greater importance;
- **maintaining quality**: the Office for National Statistics' data sets inform significant decisions in government, business and the wider community. Error in a data set can have serious economic and social consequences and creates risk contagion, in that it damages the credibility of the 'National Statistics' brand;

6 *Review of Statistics for Economic Policymaking - Final Report to the Chancellor of the Exchequer, the Governor of the Bank of England and the National Statistician, Christopher Allsopp, HM Treasury, 2004.*

- maintaining objectivity: data are used to make key economic, social and business decisions and any delays in publication are risks to the Office's reputation as a timely provider of data and can raise public and media suspicion that data publication may be subject to political pressure;
- maintaining confidentiality: data collection and publication is based around a high level of public trust which must be seen through protecting the confidentiality and security of individual responses;
- the Office was allocated £75 million in the Spending Review 2002 for a Statistical Modernisation Programme involving putting in place new methods, standards and processes and the IT systems to deliver them. Major risks associated with the project are those for any large IT project - project overspend and overruns, plus risks associated with software innovations needed by the Office's specific statistical needs.

How these risks are managed

6 The Office has established a risk management structure with a database and a common risk register. As well as individual project risk registers, all projects have been brought together on a special database that gives an overview of the Office's project risk portfolio. 'Business as usual' routine surveys are increasingly being treated as ongoing projects, using project management techniques.

7 There is a monthly reporting system from Divisional Director level up to heads of Directorates, which provides channels of communication to raise risks at the top of the Office. This is supplemented by a weekly meeting of Executive Directors at which immediate risks are discussed. Quarterly, the Office management board identifies corporate risks and project progress and includes an analysis of emerging risks.

8 A Risk Task Force co-ordinates cross-cutting risks - financial management, IT, human resources, facilities and business continuity - across the Office. The Task Force has a communication link to the Chief Executive. The Risk Task Force is chaired by an Executive Director and member of the Office Management Board. ONS also has a Policy Board, on which sit three non-Executive Directors, two of whom are on the ONS Audit Committee, one of them chairing it.

9 The Office has appointed a Director of Quality and Risk Management who has a risk management group reporting to him. The risk management group is responsible for risk registers, developing risk management and training. The Director of Quality works with the Finance Director in the preparation of the Office's Statement on Internal Control. If problems emerge, for instance when errors were made on the Regional Gross Domestic Product (GDP) figures, the Director can carry out troubleshooting 'audits' with the staff involved to analyse what went wrong and to work with them to prevent recurrences.

10 The existence of risk registers and leadership from senior management to demonstrate that early reporting of risks is imperative has encouraged staff to be proactive in monitoring how risks are changing and to report any changes so action can be taken promptly.

11 To manage the risks arising from the complexity and size of the Modernisation Programme, which is greater than any change programme previously implemented within the Office, a phased delivery programme has been set up with specific performance targets and each phase is structured into modules or projects to create clear project specifications, milestones and deliverable benefits.

12 A particular risk to the Office is the use of legacy processes where data error is more likely, such as the complex use of spreadsheets that would not now be considered fit for purpose. The Office has identified the processes most likely to be subject to error, and the surveys that are most reliant on them, and is developing new statistical tools to replace them. The first tools are being tested in 2004 and completion of the re-engineering is due in 2006.

13 In terms of users, the Office's website is one of the top ten in the UK public sector. Usage is rising with the Office moving increasingly to making data available to the public electronically, including the data of the latest 2001 Census. The Census has a high profile for the Office as the largest single programme in National Statistics, with Parliamentary scrutiny of delivery and finance. Aware of the overload problems experienced by the Public Record Office when it posted the data of the 1901 Census forms on its website in January 2002, before publishing the Census 2001 data, the Office contracted with the BBC, which has capacity to handle millions of users daily, for use of their website. The Office published the Census 2001 data in August 2002, with some 90,000 users accessing data on the website in its first week, easily within the technical capacity of the BBC site. Usage has since risen to 163,000 users a week (March 2004).

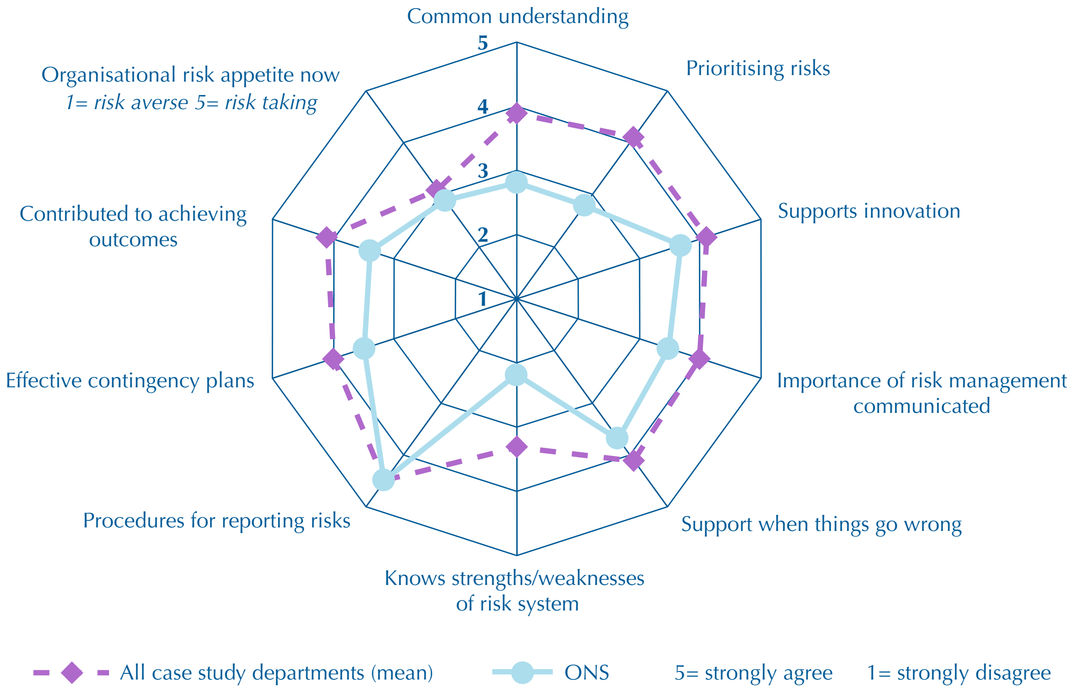
Lessons learned

14 The Office for National Statistics has demonstrated effective risk management by:

- **Communicating from the top of the Office commitment to risk management and creating a climate in which staff are encouraged to report bad news early** so senior management can make decisions and take action.
- **Applying project management risk principles to a wide range of departmental activity**, not just one-off projects.
- **Creating clear channels of communication about risk**.

9 Office for National Statistics staff focus group participants' perceptions of risk management at the Office for National Statistics - Staff are confident about procedures for reporting risks

ONS staff were confident that there were now procedures in place for reporting risks.



NOTES

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Source: MORI (All departments refers to all five case study departments).

PRUDENTIAL

Prudential plc

Prudential's experience shows how risk reporting, as part of routine management information, can help highlight overall risks to the business; and the importance of clear accountability and challenge to test how effectively risks are being managed.

1 Prudential plc is a leading international financial services company with operations in the UK and Europe, Asia, and the United States and some 16 million customers, policy holders and unit holders and 20,000 employees worldwide. The company operates five business areas - Prudential UK, its life and pensions provider; M&G, its fund management business responsible for managing over £111 billion of funds; Egg, its internet based bank with over three million customers; its US operation Jackson National Life, a life insurance company; and Business Asia, incorporating 23 businesses in 12 countries serving some 5 million customers. Total profits for 2003 were £359 million.

Prudential's approach to risk management

2 A significant part of the Group's business involves the acceptance and management of risk. The Group's risk management model requires the primary responsibility for risk management at an operational level to rest with business unit chief executives. The second line of defence of risk comprises oversight functions reporting to the Group Chief Executive together with business unit risk functions and risk management committees. The third line of defence comprises independent assurance from Internal Audit reporting to business unit and Group Audit Committees.

Initiatives to make risk management more effective

3 Since our previous report, the company has developed and deepened its approach to risk and has sought to embed risk management and risk reporting in routine management processes, through:

- **Dedicating senior management time and expertise to build effective risk reporting processes.** The Group Risk Committee is chaired by the Group Finance Director and its members include representatives of the business units and Group functions who have input into the operation of the Group Risk Framework. The Group Risk Committee is the senior management forum responsible for the oversight of the Group Risk Framework across the business units and Group functions, including monitoring operational risk and related policies and processes as they are applied throughout the Group.

- **Establishment of a Group Asset Liability Committee during 2003.** Its membership includes business unit and Group Management involved in the operation of the asset liability, credit and insurance risks frameworks. The Group Asset Liability Committee is the senior management forum responsible for the oversight of asset-liability mismatch, solvency, market, credit and insurance risks across the Group. The Group Asset Liability Committee reports to the Group Chief Executive.

- **Building formal common structures for risk reporting.** The Group Risk committee reports to the Group Chief Executive, who has overall responsibility for the risks faced by the Group. The Group Risk Committee is supported in this role by the Group Risk Function and the Risk Committees and Risk Functions in each business units. Quarterly risk reports from the business units and Group are reported to the Group Risk Committee covering all risks of Group Significance. Regular reports are also made to the Group and business unit Audit Committees by management, internal audit, compliance and legal functions.

- **Assessing risks according to scale and frequency.** Risks are assessed in their scale and likely impact in financial terms, for instance threats to revenue or opportunities for profitability. Assessing risks in financial terms enables risk management effort and resources to be deployed according to the scale of capital involved.
- **Identifying clear accountability for individual risks.** Each of the risks on the company risk register has an owner who is accountable for monitoring and the quality of reporting on individual risks.
- **Testing accountability.** Senior risk owners - at middle management level - are called periodically on a rolling basis to report in person to the Group Operational Risk Committee about the risks, which challenges the adequacy and integrity of risk controls and reporting.
- **Analysing the broad portfolio of risk,** assessing, in particular, the likelihood of *aggregation risks* - risks arising in different areas which may present an overall risk or opportunity for the business, and contagion risks - which may arise in one business area but have the potential to affect the Prudential brand more generally.
- **Recognising the need to promote controlled risk taking.** Prudential has benefited from promotion of good practice across business and product areas to develop its understanding of risk appetite and willingness to take well managed risks.

Lessons learned

4 The Prudential's approach to risk management indicates that:

- **Senior management commitment and time is essential for risk management to be effective.** This commitment provided the bedrock for building awareness and structures needed to encourage risk thinking by all staff. It has taken time (4-5 years) for risk management to become a routine part of management practice.
- **Clear accountability for individual risks helps embed risk management practice.** Accountability involves scrutiny of the 'quality of challenge' about the risks being reported to senior management. Regular testing of accountability helps ensure that it is 'real' for those responsible for individual risks.
- **Risk management reports should be a clearly defined management information requirement.** For risk reporting structures to be adequate and effective, reporting requirements should be included as part of a portfolio of management information routinely provided to senior management, which is recognised as relevant information within business units - a centrally driven, prescriptive approach is unlikely to provide good quality risk reporting.
- **A culture of openness encourages effective risk reporting.** Individual staff need to be encouraged to report risks, not hide them or ignore them. Effective reporting of risks enables senior managers to identify the potential for *aggregation risks*, which may have an impact across the Prudential group even if they do not appear significant in individual business units, and *contagion risks*, which arise in one business unit but have a potential impact on the brand in other business units.
- **Risk taking needs to be promoted by senior managers for it to be encouraged as part of the culture.** Formal reporting processes for risks are a supplement to the ongoing dialogue about risk between the Chief Executive and senior managers. Risk reporting is part of the monthly portfolio of management information provided by senior management, but the paper exercise is supplemented by monthly meetings which provide the opportunity for face to face discussions of risks and how they are being managed.

Nomura

Nomura shows the importance of encouraging staff to be open about risks they are taking and to report accurate information about risks materialising so that senior managers are in a position to make decisions either to increase or reduce corporate risk exposure.

1 Nomura Bank International plc is part of a financial services group comprising subsidiaries in Japan and overseas. Nomura Bank International provides a full range of investment banking services to clients in the public and private sectors. Services include the underwriting, syndication and management of offers of all forms of securities, related products and specialist advisory services across all aspects of corporate finance and investment banking. Its activities extend throughout Europe and into Africa and the Middle East.

Nomura's approach to risk management

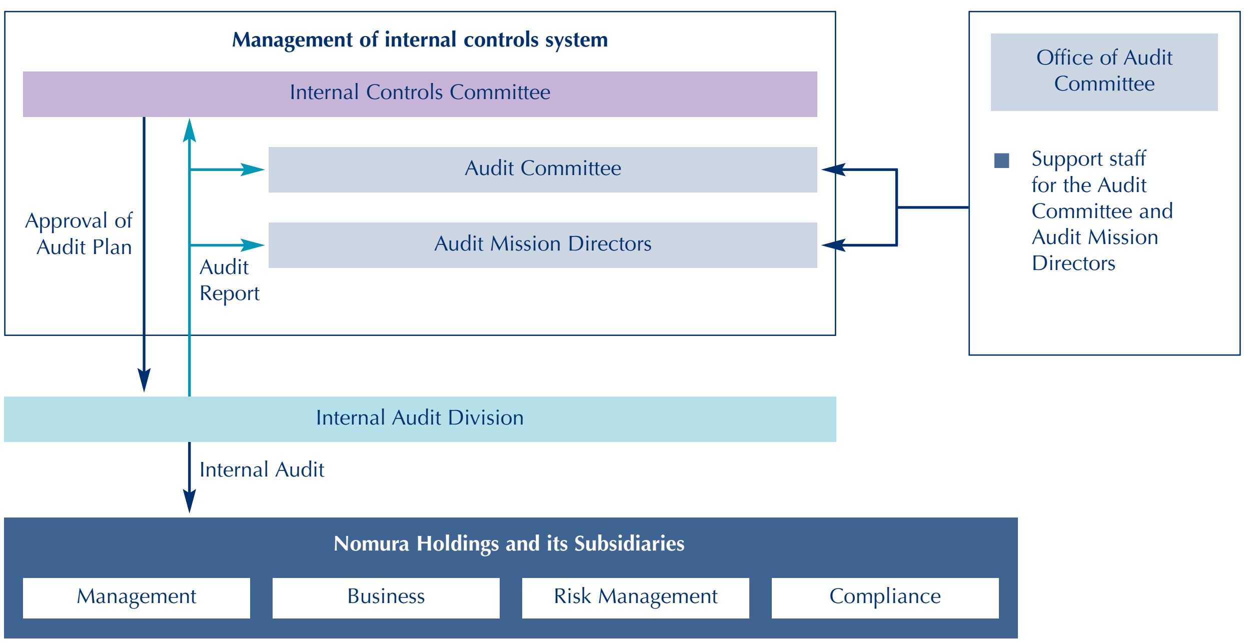
2 As in 2000 when we visited Nomura, risk processes are embedded in Nomura's business. It also continues to use a matrix approach where the organisation is arranged along product and geographical lines, and a capital allocation committee (the Chief Executive, the Risk Manager and one other senior manager) routinely reviews each month as a standard item the main risks the business is facing.

3 Like other financial organisations, Nomura has sought to strengthen its corporate governance with the appointment of Non-Executive Directors and the establishment of an Internal Controls Committee, which includes a Non-Executive Director **(Figure 10)**.

Initiatives to make risk management more effective

4 The business is exposed to three types of risk - market risk, from movements in the financial markets; credit risk - the risk of creditors failing to meet commitments; and operational risks - which may be external, such as complying with regulatory requirements, or internal,

10 Internal controls arrangement at Nomura Holdings



Source: National Audit Office visits

such as trading losses resulting from individual traders' judgements or improved efficiency. The focus of risk management has broadened and developed beyond market risk and increasing attention is being paid to credit risk and operational risks. A portfolio approach is used to monitor daily exposure to the three types of risks. Nomura has developed its approach through:

- **Assessing the impact of unexpected events.** As technology for modelling and assessing risks in financial markets has become more sophisticated, Nomura has recognised the need to become more alive to 'shock' events such as sharp changes in oil prices and tests the resilience of its risk management approaches by developing scenarios and modelling possible market impacts.
- **Continued encouragement to staff to be open about operational risks.** Modelling and analysis of operational risk relies on staff being open about reporting risks that they have taken, for example trading losses. To reinforce from the outset a blame free culture, Nomura's induction training encourages staff to be open about the risks they are running and the mistakes/losses they make so that senior managers can take decisions either to reduce or increase corporate risk, based on reliable and accurate information.
- **Alertness to possible contagion risks.** These can have potentially extremely rapid impacts in financial markets (for example if a major investment fund were to run out of capital this would precipitate adverse market movements). Contagion risks cannot be managed out of the system but exposure to them can be assessed by analysing in detail historical performance of funds and ensuring capital is sufficiently diversified so that no one part of the business is overly exposed to the possible contagion.
- **Using management information about risk as a routine part of business processes and reporting** to assess the efficiency with which resources are being utilised - whether the right resources are directed to where the potential risk exposure is greatest.

Lessons learned

5 Nomura's approach to risk management indicates that:

- **Encouraging a culture which encourages staff to report risks being taken puts managers in a position to make better decisions on whether risk exposure can be increased or decreased**. This commitment is promoted from the outset in induction training for new recruits.
- **Responses to risk should be continually refined in the light of more up to date and relevant information**. Building historical information about operational and credit risk has helped Nomura understand better the portfolio of risks it is exposed to and where it has the opportunity to take on more risk. Capturing data from ongoing risk events occurring has also helped promote learning from experience to inform future action.
- **Testing of extreme or unexpected scenarios can help assess the impact on the business of risks materialising**. Even though the pattern of historical events is not necessarily a guide to the future, 'stress testing' of models and systems can help develop understanding of risk appetite to assess what actions need to be taken in response to different market scenarios, including exposure to possible contagion risks.

gsk GlaxoSmithKline

GlaxoSmithKline

GlaxoSmithKline's approach to risk management demonstrates how risk management is successfully integrated into the business to provide challenge throughout the company.

1 GlaxoSmithKline (GSK) was formed in January 2001 as a result of a merger between GlaxoWellcome and SmithKline Beecham. Headquartered in the UK and with operations based in the United States, GlaxoSmithKline is one of the industry leaders, with an estimated 7 per cent of the world's pharmaceutical market. The company has operations in 117 countries, with products sold in 130 countries. The major markets for the company's products are the USA, Europe and Japan. GlaxoSmithKline is a global leader in several therapeutic areas including respiratory, anti-viral, central nervous system, diabetes and vaccines. In 2003 pre-tax sales were £21.4 billion and pre-tax profit was £6.3 billion and the company invested nearly £2.7 billion in pharmaceuticals R&D.

GlaxoSmithKline's approach to risk management

2 Risk management is central to any large business, but especially to a highly regulated, multinational, science based business such as GSK. A robust internal control environment mitigates but does not eliminate risk. Almost by definition, companies take risk to achieve satisfactory returns for shareholders. This is true for GSK in areas such as investment in acquiring new products or businesses. In these cases, it is the company's responsibility to explicitly identify risks and then apply its expertise in the prudent management rather than the elimination of those risks. After the merger, GSK sought to take the strongest aspects of both companies' corporate governance structures and create an internal control framework that spans operations throughout the world. The internal control framework includes central direction, resource allocation, and risk management of the key activities of research and development, manufacturing, marketing and sales, legal, human resources, information systems, and financial practice.

Initiatives to make risk management more effective

3 Clear principles and procedures designed to achieve appropriate accountability and control are important in every business. GSK has a corporate policy that defines its internal control framework and mandates that business units establish processes for managing risks significant to their businesses and GSK as a whole. Commercial and financial responsibility is clearly delegated to local business units, supported by a regional management structure. These principles are designed to provide an environment of central leadership coupled with local operating autonomy as the framework for the exercise of accountability and control within GSK.

4 In a number of risk areas, specific standards that meet or exceed requirements of applicable law have been established. Specialist audit and compliance groups assist in the dissemination and audit of these standards, while implementation is largely the responsibility of the operating units. Extensive financial controls, procedures, self-assessment exercises and risk mitigation activities are reviewed by internal auditors. All major audit and compliance groups report to the Audit Committee at least annually on the effectiveness of internal controls.

5 GSK's internal control framework also relies on the Risk Oversight and Compliance Council (ROCC), which reports to the Corporate Executive Team and the Audit Committee, as well as on other business unit Risk Management and Compliance Boards (RMCBs), to help identify risks and to provide guidance to the risk management and compliance initiatives at the corporate and business unit levels. The ROCC is chaired by the Corporate Compliance Officer (CCO). Through the ROCC, the company reviews and updates its assessment of the risks affecting the business and the mitigation plans against these risks. While the ROCC has oversight of the risks deemed significant to GSK, each RMCB oversees risks important to its business or function, thus increasing the active management of risks across the company. The CCO assists in the co-ordination of the risk management activities among the various compliance and audit functions across the company.

6 Using regular reports on the company's significant risks and on related internal controls, the Audit Committee reports to the Board annually on the effectiveness of controls.

Lessons learned

7 GlaxoSmithKline's approach to risk management indicates that management at every level must:

- Identify and assess their significant risks;
- Establish and communicate clear standards regarding business conduct;
- Assign individual responsibility for establishing mitigation plans against their risks;
- Ensure that robust risk mitigation plans are in place and operating effectively;
- Actively monitor mitigation plans with appropriate feedback and upward reporting; and
- Continuously improve mitigation plans and processes that control significant risks.

REUTERS

Reuters

Reuters experience shows how focusing on risks that impact on major objectives helps to move away from simple catalogues of potential risks to identifying those risks that need senior management action for the business to succeed.

1 Reuters **(www.about.reuters.com)**, the global information company, provides information tailored for professionals in the financial services, media and corporate markets. Reuters information is used to drive decision-making across the globe and customer trust depends on Reuters ability to maintain its reputation for speed, accuracy and independence. Reuters staff total 14,700 across 92 countries, including some 2,400 editorial staff in 197 bureaux serving approximately 130 countries (July 2004). In 2003, the Reuters Group had revenues of £3.2 billion.

Reuters approach to risk management

2 Reuters has embedded risk management into the company's overall performance management framework. Reuters has implemented a Mission Analysis process which is central to its annual business objective setting process. Risk identification and evaluation is an integral part of defining the mission and objectives for business units. Focusing on those risks that impact on major objectives helps Reuters to move away from catalogues of potential risks to identifying those that need active senior management input if the business is to succeed.

3 Business units are asked to identify risks by considering what factors could prevent them from achieving their objectives. These could be related to resources (financial and human), capabilities (technology, people, processes), and structure/decision-making (availability of information, ability to make timely decisions).

4 Each major business unit is required to prepare and regularly update risk radars that classify risks by impact, likelihood and the effectiveness of management's response. An overall risk profile for the company is compiled on the basis of the key risks identified by the business units. This company-wide risk radar is reviewed by the senior management committee, the Audit Committee and the Board.

5 Focusing on key risks enables Reuters to take strategic decisions about how to deploy resources. A key risk for Reuters, for example, is any failure of service continuity and disruption of services to clients. To address this, Reuters uses contingency and continuity planning to ensure it can maintain delivery of its news and financial information services in the event of a crisis. Investment in back up systems and other contingency investment, such as deployment of staff and arrangements for contingency premises, is assessed and approved by a Reuters investment committee.

Initiatives to make risk management more effective

6 Since our previous report, the company has:

- **Reviewed the risk management process in the context of initiatives to improve business performance.** The analysis of the company's approach to performance management has identified opportunities to position risk as a further means of assuring business units are on track to achieve business objectives.

- **Reviewed its approach to address the view that risk management is a bureaucratic process.** Reuters is reviewing and assessing its risk management approaches against those of other businesses to assess where it can improve and focus its risk management efforts on risks which need most attention, rather than risk management simply acting as a compliance mechanism.
- **Demonstrated its preparedness in an emergency situation.** To maintain its position in the highly competitive news and financial information markets, Reuters devotes considerable resources to ensuring business continuity in the face of disruptions and disaster. On Thursday 13 August 2003, when a sequence of power station failures and overloads caused the biggest power failure in United States' history, Reuters used carefully prepared and tested contingency plans to keep ahead of competitors and maintain news and data service levels by switching operations around its network of global offices.

Lessons learned

7 Reuters approach to risk management indicates that:

- **Focusing on risks that impact on major objectives directs senior management attention to where it is needed.** Reuters has sought to move away from simple catalogues of potential risks to identifying those that need senior management action for the business to succeed. Risks should be concrete and specific, not "the market collapses".
- **Building on risk management strengths and learning from others can help develop a sound approach.** Reuters recognises that it can apply lessons from its own experience, together with learning from other organisations, to develop its approach to risk in a way that does not become bureaucratic.