Public serv

AND RISK

The climate is right for a big step forward

The Australian public service is poised for successful transition to best practice risk management, says COLIN VASSAROTTI. But, some formidable hurdles need to be overcome if the transformation is not to lose momentum. They include changes in attitude and perception among politicians, public servants and the Australian public.

Colin Vassarotti is National Director, Commercial Services Division, Australian Customs Service. He was a member of the committee which formulated the Australia-New Zealand risk management standard (Risk Management Standard AS/NZS 4360), the world's first standard for risk management.

This article is edited from one which appeared in the May 1997 issue of the Canberra Bulletin of Public Administration *and is reprinted with permission.*

Until recently, successive generations of public sector administrators worldwide have enjoyed the luxury of conservatism and avoidance in managing risk. This has been possible mainly because of the willingness of taxpayers to accept unquestioningly the cost involved.

Elaborate checks and balances and comprehensive scrutiny of all transactions, characterise the risk-averse bureaucratic tradition. Unfortunately, for those paying the bills this approach is more expensive than activity tailored to the true level and nature of the risks. Risk avoidance is more comfortable and far safer for public administrators.

Economic imperatives, particularly human resources costs, have led governments in many countries to seek greater public sector efficiencies. Budgetary constraints and performance targets have encouraged risk management as one means of achieving better productivity with fewer resources. Risk management has also been adopted to verify accuracy and quality in large volumes of transactions. Some governments have encouraged entrepreneurial management, recognising the opportunities presented by well-judged risk-taking.

Despite this prolific usage and tacit endorsement by governments there are no widely accepted professional ice

MANAGEMENT

standards for the management of risk. An Australian Customs Service study of risk management in customs administration confirmed the central importance of the technique in several countries, but noted the absence of agreed standards or practices.

Australian public service managers have adopted risk management practices in much the same ways as their international counterparts and there has been lively debate on aspects such as methodology, accountability, probity, perceptions that risk management is simply common sense, and even parliamentary doubts about the commonality of common sense.

Nevertheless, until recently the net effect on Commonwealth government agencies has been negligible. Managers in several agencies have developed in-house risk management solutions to a myriad of bureaucratic problems in the interests of satisfying expenditure restraints and demands for improved performance. None of these has systematically dealt with all the issues.

Opportunity and challenge

Two recent major developments have combined to set the scene for a leap forward into the realities of more comprehensive risk management:

- Risk Management Standard AS/NZS 4360, published in November 1995, which is designed to apply to management of risk in private and public sectors.
- In a parallel initiative, the Commonwealth public service Management Advisory Board (chaired by the Secretary of the Department of the Prime Minister and Cabinet, Max Moore-Wilton) and the Management Improvement Advisory Committee, commissioned a review of public service risk management practices (*Guidelines for managing risk in the Australian public service*, published in October 1996).

The two documents are of high quality, written in plain language and easy to understand. They are complementary in theme, terminology and methodology. Together they provide for the public sector the formerly missing elements - framework and methodology - for achievement of professionalism in risk management. They also constitute a powerful management tool.

Australia therefore has a splendid opportunity to attain best practice in public sector risk management. The question is, can the momentum be sustained? There are formidable obstacles.

Consider the key players: the Parliament; the watchdogs (the Commonwealth Auditor-General and the Commonwealth Ombudsman); the minister responsible for the public service; the private sector; the general public; and, not least, public servants.

The Parliament has given no endorsement to risk management practices engaged in by its public servants. There have been encouraging signs, such as comments of the Senate Standing Committee on Finance and Public Administration which, in 1989, expressed concern about lack of guidance to departments. The House of Representatives Standing Committee on Finance and Public Administration tacitly endorsed risk assessment as a key element of Customs border activities in 1990. In 1996, the National Commission of Audit cited Customs border management as a guide to best practice in risk management.

Vital encouragement is in the 1996 discussion paper *Towards a best practice Australian public service*. This seminal document, issued by the Minister for Industrial Relations and Minister Assisting the Prime Minister for the Public Service, Peter Reith, endorses a "strategic approach to the systematic management of risk" as part of the vision for an Australian public service for the next century.

Continued over page

The most crucial signal came in November 1996 from Alexander Somlyay, Chair of the Joint Committee of Public Accounts. Addressing the Public Sector Accounting Convention, he made it clear that the committee considers "the systematic application of risk management principles will be an essential element of good public administration".

The Commonwealth Auditor-General, Pat Barrett, is a respected and outspoken proponent of responsible risk management. He says the Australian National Audit Office "itself applies the concepts and principles referred to in the Risk Management Exposure Draft [the Guidelines] and recognises the real issues and challenges which the public sector must deal with in managing risk". Ethics and probity are high on the agenda within the Australian risk management debate.

Outsourcing offers a deceptively attractive means to contract out risk. Behaviour or service a contractor might consider acceptable by normal business standards may fall well short of what government expects of the public service.

The Commonwealth Ombudsman, Phillipa Smith, has placed public sector managers on notice that she will not look kindly on "sharp business practice" in the transference of risk to third parties. Probity and accountability are also key issues for Mr Barrett, as evidenced by his comments when Deputy Secretary of the Department of Finance and more recently in a 1996 address to senior executives of the Australian Customs Service.

Public sector corporate governance is coming under increasing attention from the Auditor-General. A draft ANAO Public Sector Corporate Governance Statement argues that "The principles of corporate governance and the energy being applied in the private sector to strengthen governance can be harnessed and used during the current regeneration of the Australian public service". The paper postulates that "A sound governance framework within an agency provides the structure for CEOs to make decisions and drive their agencies forward with the assurance that all proper controls are in place and that risks are well managed".

The private sector is also feeling the pressures for change in risk management. Australian Stock Exchange Listing Rule 3C (3)(j) requires, from 30 June 1996, all listed companies to include a statement of their main corporate governance practices in their annual reports. Appendix 33 of the Listing Rules indicates corporate governance matters, including risk management, which a company may take into account in meeting this rule. Significantly, 42 per cent of the top 100 Australian companies in their 1995 annual reports stated their approach to identifying areas of significant business risks and their procedures to manage them.

Board members of private companies therefore are conscious of the importance of sound risk management practices and could be expected to support adoption of comparable standards by the public sector. It could be reasonably argued they might expect government ministers as well as senior public servants to be subject to similar accountabilities.

However, fundamental differences between the private and public sectors influence their respective attitudes to risk. Jenny Stewart, writing in the *Canberra Bulletin of Public Administration* (February 1996), highlights this dichotomy in commenting on the discussion paper *Towards a best practice Australian public service*. She notes the different dynamics and accountabilities between the "marketplace for goods and services" and the "political marketplace" and contrasts the extent to which politicians and public servants will tolerate the risk of failure with the more entrepreneurial philosophy of their private sector counterparts.

The main concern of taxpayers is that public servants do the job expected of them by Parliament, at minimum cost and with high standards of ethics and probity. In this context, uncontroversial risk management by public servants is unlikely to excite public interest.

Public servants will certainly recognise the potential benefits of managing risk within a set of rules approved by Parliament. The potential sticking point will be the increased exposure to scrutiny of their decision-making flowing from implementation of the Standard and adherence to the Guidelines.

Public servants will certainly recognise the potential benefits of managing risk within a set of rules approved by Parliament. The potential sticking point will be the increased exposure to scrutiny.

The dilemma

Simply following the steps of the risk management cycle — setting the context, identifying, analysing and prioritising risks, then proceeding logically to treat them — is a surprisingly powerful process when properly and accurately documented. Practitioners are finding that it puts to the test conventional wisdom about the relevance and accuracy of activities and resources allocation.

Here lies the dilemma: thorough adherence to the process will inevitably reveal deficiencies which must be documented, prioritised and addressed.

Unfortunately, such clarity facilitates critical comment by external scrutineers. A sensible balance will need to be struck to allow responsible risk managers sufficient lead time to correct such deficiencies. Premature or undue criticism of managers who conscientiously follow the risk management process will most certainly be counter-productive.

At the very least, the misfortune of any such managers will be a disincentive for others to apply the process assiduously. It would be an understandable human reaction for them to pursue the seemingly safe path of risk aversion. This would be most undesirable, given the associated public expense of no-risk management practices, let alone the cruel reality that over-management of risk does not guarantee success. Even more undesirable would be an outcome where managers are tempted merely to pay lip service to risk management and resort to obfuscation in documenting their activities.

There are conundrums and, indeed, risks as well for ministers and agency heads. Pressure to do more with less will remain a feature of the public sector in Australia and elsewhere.

Ministers will continue to be accountable for efficient and effective discharge of their portfolio responsibilities regardless of funding restrictions. They will be criticised if extravagant resource allocation to manage particular risks is revealed publicly. Agency heads acting on behalf of ministers share these problems. How can these conflicting demands be balanced?.

Successful sound risk management in the Australian public service is achievable. The task will not be easy. But the climate is right and the tools are at hand for a giant step forward.

Risk management is an attractive solution. It is extensively used already. But there is an underlying problem: risk management does not have any standing in parliamentary terms. Like all management techniques, it is regarded as the concern of the public service and has no status in the context of parliamentary accountability.

This deficiency is also identified in a recent study of public sector risk management in the United Kingdom, the United States, Canada, Australia, New Zealand, Japan and Argentina. (Managing Risk in public services, by J. Vincent, in *International Journal of Public Sector Management*, Vol. 8 No. 2, 1996). The study concludes that the contemporary literature reflects constitutional rather than managerial concerns and language. The focus on risk issues is seen as "more likely to be handled indirectly, by consideration of public servants' and organisations' *accountability* and the means of their control".

The problem is, if things go wrong and risks are inadequately managed, it is the minister who has to answer to Parliament. This is uncomfortable for ministers and more so for agency heads and other senior public servants.

International experience shows that proper risk management is not something that can be tacitly accepted or conveniently ignored by those accountable to the people or, in the private sector, shareholders. The UK Government, for example, has announced a requirement for risk assessments to be provided to ministers to assist them in reaching their decision on any regulatory proposal affecting business. The requirement extends to ministers personally signing-off these assessments.

Financial risk management disasters in the private sector, such as the collapse of the Barings banking group in February 1995, exposed dangerous deficiencies in the finance industry. One of the important contributing factors was identified as the link between bonus structures for executives and "a pervasive impact on risk taking at the trading desk". There is a distinct parallel here for the public sector in cases where agencies are encouraged or driven by budgetary pressures to achieve high performance through risk-taking.

Where an organisation manages risk on behalf of other organisations, a further complication arises. Generally, more than one portfolio minister will have accountability concerns in the event of misfortune or mismanagement. Public servants in the client agency have a vested interest in assuring themselves that their risks are being managed adequately. Equally, the minister and senior executives of the managing agency need to protect themselves against unrealistic expectations by the client. Private sector solutions in such circumstances are usually based on contracts, penalties and insurance arrangements. These are not normally viable in the public sector environment. The answer is to arrive at mutually satisfactory risk treatments and to formalise these by some form of sign-off procedure.

Risk management is becoming a major factor in the business of government, reinforced by concurrent developments in the private sector. These create expectations in the corporate world that governments will seek the cost efficiencies and operational benefits of sound risk management. Government risk management is well and truly in the public domain. It is not the exclusive purview or problem of the agency managing the risk. Ministers and the Parliament are caught up in, and increasingly reliant upon, its practice.

Continued over page

Two threshold questions arise. Firstly, can the constitutional responsibilities of Parliament be reconciled with managerialist imperatives in the form of risk management? Seven years ago Senator John Coates, Chairman of the Senate Standing Committee on Finance and Public Administration, was doubtful that adoption by Parliament of such a rational managerial approach to the public service would be possible. Given the developments over the intervening years, the prognosis seems more positive provided risk is seen by Parliament to be managed in ways that reflect recognised best practice and meet parliamentary approved standards of probity and accountability.

Secondly, will Australian Public Service managers accept the greater transparency and increased accountability inherent in the application of the Standard and Guidelines? Again, this seems to be an achievable outcome provided Parliament responds in the way suggested in answer to the first question.

The way through

The primary requirement for furthering risk management as legitimate and responsible for public service managers is a strong signal from the Government of its acceptance. This will require some concession by the Government towards recognising the need to reconcile managerial realities with the constitutional authority of Parliament.

The Management Advisory Board was established under the Public Service Act to advise the Commonwealth Government, through the Prime Minister, on significant public service management issues. The board's commissioning of the review of risk management practices led to development of the Guidelines and ensured applicability of the Standard to the public service environment. Official launching of the Guidelines has reinforced their status and added impetus to their acceptance by Parliament. *Towards a best practice Australian public service* is a further powerful thrust towards adopting risk management.

Other important signals are essential. Sustained positive reinforcement and strong leadership will be needed from the board and the Management Improvement Advisory Committee, the Auditor General, and Public Service agency heads. Further encouragement will be needed by the scrutiny process of parliamentary committees. These signals will need to promote adoption of the Standard and Guidelines, recognition of such progress and criticism of inertia.

The Management Advisory Board and the Management Improvement Advisory Committee, the Australian National Audit Office and central agencies should encourage, recognise and reward sound risk management as well as taking counter measures against inadequate practices. For its part, the Public Service and Merit Protection Commission should foster public sector risk management competency training and education. Departments and agencies should be required to implement corporate risk management policies in accordance with the Standard and Guidelines.

The increased transparency of proper risk management will reveal otherwise invisible shortcomings. It will be vital for all concerned to handle these with finesse in audit terms - not only the ANAO and parliamentary committees, but also agency heads. Pragmatism and fine judgement will be needed in assessing when to recognise, reward, caution or castigate those responsible for particular risk management programs. Importantly, avoiding risk management when it would have been appropriate must be brought to account.

Alex Somlyay has acknowledged these issues and sought to reassure managers who feel adoption of risk management strategies may leave them exposed to parliamentary censure in the event of mistakes. He warns that risk-averse managers are less likely to receive a sympathetic hearing.

Another key requirement is adequate training in risk management competencies. Ideally, there should be a central mechanism for developing training packages to an accredited standard. There is potential here for the Public Service and Merit Protection Commission to assume leadership and coordination. The main onus for ensuring officials' competency must rest with individual agencies and their chief executives.

All these elements for successful implementation of sound risk management within the Australian public service are achievable. The task will not be easy and there are hazards to be negotiated. On the positive side, the climate is right and the tools are at hand for a giant step forward.

Successful transition to best practice in risk management will encourage Australian state and local governments and their administrations to adopt the Standard. Internationally, there is growing interest in it. Australia and New Zealand have achieved a world first in producing a standard for managing risk. Standards authorities in Australia and New Zealand are seeking adoption of the Standard by the International Standards Organisation or its related body the International Electrotechnical Commission. Certainly, the availability of an international standard would provide the final ingredient needed to elevate risk management to new levels of acceptability and professionalism.