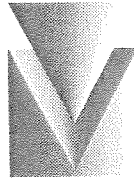


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The Committee Manager
Public Accounts Committee
Parliament of NSW
Macquarie St
Sydney NSW 2000

26 April 2005

Dear Sir / Madam,

RISK MANAGEMENT IN THE NSW PUBLIC SECTOR

Thank you for the opportunity to submit information to your committee on this subject. I have enclosed 2 copies of our submission for your use.

My approach has been simple and is based on experience in conducting risk and value management studies in the private and public sectors. It is directed at maximising the benefits to the community of risk analysis whilst optimising the inputs required of participants in such studies.

I should be pleased to provide further information should this be required.

Yours faithfully,

John Bushell
Director.

PUBLIC ACCOUNTS COMMITTEE
RISK MANAGEMENT IN THE NSW PUBLIC SECTOR
SUBMISSION TO INQUIRY

Closing date 29 April 2005

Submission by John Bushell Value Management Pty. Ltd.

This report addresses the NSW Audit Office's Performance Audit Risk Report: Risk Management in the NSW Public Sector, 2002.

This report is presented from our viewpoint as conductors of risk and value management studies in the public and private sectors and from our practical experience gained from this work. This report assumes that the majority of the risk management studies performed in the NSW public sector will be performed in accordance with AS/NZS 4360:2004 (and, where applicable, the RailCorp Safety Risk Management Framework, 1 February 2005).

The Audit Office considered that:

- *there is clearly a role for greater consistency in the way risk management is considered and applied*
- *agencies need to take a broader view of risk which goes beyond the insurance focus*
- *agencies need to recognise that being risk averse can deprive them of opportunities to improve efficiency and effectiveness*
- *there is a role for Treasury to oversight risk management practices in agencies and encourage the adoption of better practice where necessary.*

This report proposes that the identification and management of risk is a key element of **resource allocation**: an understanding of risk and its management will improve resource allocation by assisting the realisation of opportunities and the reduction of losses. Hence the need for Treasury oversight of the process.

This report suggests a series of recommendations focussing risk analysis activities on selected areas of an agency's activities. This is based on the "Pareto principle"; it would not be effective use of staff resources to address all areas of possible risk plus the necessary follow-up activities.

To maximise effectiveness of risk management in the NSW public sector even focus areas proposed are as follows:

1. Understanding the broad risk categories applicable to the agency's operations;
2. Targeting subject areas, and subject matters for risk analysis;
3. Use of existing data with regard to risk where possible;
4. Two step process – understand present risks before identifying risks related to a proposed management change, new project, etc.;
5. Take the viewpoint that risks will be eliminated or reduced and will only need to be managed if this cannot be achieved;
6. Risk analysis follow-up;
7. Return on investment.

1 Understanding the broad risk categories applicable to the agency's operations

Each agency needs to identify the broad category of hazard to which it is exposed and all employees should be aware of these. In a risk analysis these categories need to be considered and hazards ranked with regards to the agreed categories. Examples may be:

- Death or serious injury to a person or persons (agency and third party).
- Serious operational failures and their impact on the agency and the community.
- Financial or economic loss sustained by the agency or third parties.
- Catastrophic system loss resulting in an extended recovery period (eg: explosion, major fire, loss of records).

The agreed categories will form the basis of the agency's risk management plan and key risk performance indicators.

2 Targeting subject areas, and subject matters for risk analysis

Rather than try to cover all aspects it is probably best to proactively apply risk management to areas of activity that senior management (with employee input) believe that the agency and its customers (duty of care) are exposed to hazard.

This could include existing processes, procedures and physical activities and proposed new projects and change processes. It should be noted that virtually all information technology projects should be subject to risk management (and VRM see item 5 below) as there is evidence that some do not result in cost-effective investments when expectations are compared to actual performance and costs.

Use of a capital cost threshold as a criterion for risk analysis (say \$5 million) may not necessarily be suitably as even a low cost project might expose the organisation or its customers to risk.

The focus needs to be on running risk analysis studies and the follow-up activities thoroughly so that the benefits are achieved, rather than necessarily running a large number of studies, some of which may have marginal benefits.

3 Use of existing data with regard to risk where possible

Many agencies have a wealth of existing information on the hazards they and their customers face, eg: incident statistics, reliability reports, customer complaints etc. This information should be sourced, and where relevant, analysed prior to any risk analysis. Without hard data there is a risk that both the likelihood and consequences of current risks may be over or underestimated by the risk analysis group. This may lead to an over or under investment in risk mitigation – a potential waste of scarce resources.

4 Two step process – understand present risks before identifying risks related to a proposed management change, new project, etc.

On the basis that knowledge of the present situation is easier to grasp than knowledge of a future situation we recommend that current risks related to a proposed management change, new or changed project or process be clearly identified and ranked prior to looking at the future situation. This will provide a “reality check” to the group’s assessment of anticipated future hazards.

5 Take the viewpoint that risks will be eliminated or reduced and will only need to be managed if this cannot be achieved

Current Standards related approaches to risk analysis are based on the identification of hazards, converting the hazards into “rated” risks (in which the likelihood of occurrence and possible consequences have been identified) and identifying methods and responsibility for **managing** the risks. (This is analogous to approaching waste management without first addressing methods of waste minimisation or elimination.)

In the last five years or so however there has been a change in emphasis in industry and in some public sector areas to use the risk analysis process to firstly target areas for **risk reduction** or **elimination** initially, before considering management initiatives. These have proved to be very effective, particularly in the reduction or elimination of high or extreme risks, see Jain, Davinder, 2002 & Phillips, Martyn R., 2002.

This risk reduction / elimination process is achieved by combining a value management study and a risk management study on a project into a single value / risk management (VRM) study. Results to date have resulted in some interesting, counter intuitive, results: reductions in both life cycle cost **and** risks. Importantly, through this innovative process it is often possible to reduce or eliminate the higher rated risks that would clearly have more serious consequences should they eventuate. Since NSW Treasury mandates application of value management studies and risk management studies this combined application has the promise of delivering significantly improved results to the community associated with a marginally lower cost to conduct the combined study.

This is also an important approach when addressing risk reduction and management as the costs incurred should a risk eventuate need to be compared with the cost to mitigate the risk on the basis of a realistic return on investment.

Agencies should not be afraid of setting a high target: one of Australia's key process engineering organisations has the well publicised target of "**No accidents to anyone, ever.**"

6 Risk analysis follow-up

Follow up of risk analyses and VRM studies is essential to ensure the benefits are realised for the agency and the community. This follow-up and achievement of results needs to be under the control of senior management.

It is important to ensure that in the risk analysis all actions to eliminate, reduce, or manage risks are allocated to individuals or organisations that have the capability, responsibility and appropriate delegation to perform the actions. Otherwise there is a risk that the benefits of the analysis will not be achieved.

The overall results of all resource management studies should be summarised in the Agency's Annual Report measured against the agency's risk management plan and key risk performance indicators.

7 Return on Investment

There is clearly a need to ensure that, whilst addressing risk, it is carried out cost-effectively. There is a possibility that, following a highly publicised accident or incident a judicial recommendation is made or an agency may initiate legislation to reduce the risk of a similar incident or occurrence. Without a risk analysis, this well-meaning initiative, may in fact divert resources from activities which could have a much higher return on investment. (For example the inquiry into the 18 November 1987 King's Cross Railway

Station fire in which 20 people died produced 157 recommendations. In practice, very few of these recommendations were implemented because the risks of an individual dying in a fire in a western subway system is incredibly low and investment in expensive technology for this purpose alone cannot be supported.)

This leads to one of the reasons to combine risk and value management studies. If a low cost solution can be developed to address a clearly identified and quantified risk then that risk can be cost-effectively reduced or eliminated and the legislation or recommendation can be confidently implemented. (For example, some 30,000 people per year become incapacitated in toilets and small bathrooms in Australia and require rescue. The Building Code of Australia requires that the door must be able to be opened outwards for rescue purposes. One of the solutions is a cost-effective \$150 adaption to the door jambs to permit this.)

References

Phillips, Martyn R., "A Value and Risk Management Approach to Project Development" *Value*, Winter 2002 Vol 11, Issue 44.

Jain, Davinder, "Using Value Management Technique with Risk Analysis to Build Value", *The Value Times*, Vol 10, Issue 2 December 2002.

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26 April 2005