A practical guide to strategic risk management

Introduction
The Civil Service Reform Plan, Lord Browne’s first annual report as Lead Government NEBM and NAO work have highlighted a number of desirable improvements in the management of risk, including:

- Better strategic risk management and leadership of change;
- Recalibrating tolerance for well managed and calculated risk taking;
- Improving capabilities in managing risk;
- Better horizon scanning and ability to address uncertainties and emerging risks;
- More emphasis on culture and behaviour;
- Board focus on the things that matter;
- Clear ownership/accountability for risks;
- Evaluation costing;
- Feedback of lessons learned;

The culture of the CEO and the Board towards risk is one of the biggest drivers of success or failure and quality of decision making within an organisation. Top down strategic risk management is therefore critical.

This is now recently reinforced and codified in Annex 4.3 of Treasury’s Managing Public Money (July 2013). Effectively, this requires a traditional bottom-up operational Risk process followed by the Executive, combined with a new top-down strategic risk analysis at board level supported by an escalation mechanism aligned to both.

One Possible approach, to top-down risk management and alignment
One possible approach, in concept, for the Board to achieve the necessary focus on strategic management of risk is by:

i) Clearly defining and articulating their risk tolerance (as per the NAO’s 2011 review) - this could be most easily achieved by linking it to “outcomes”. For example intolerance of departmental “failure” or being branded “not fit for purpose”.

ii) Identifying the possible causes of these bad outcomes (these causes are often labelled “risks”).

iii) Understanding the likelihood of these outcomes occurring and the impact of steps taken, or those which could be taken, to reduce their likelihood.

iv) Reviewing these regularly at each Board meeting together with lessons learned.

v) Alignment with bottom-up operational risk management through risk tolerance analysis and an escalation process.

Each of these areas is discussed further below.

i) Risk Tolerance
This is the threshold to go beyond which is unacceptable to the Board. It may need expressing as more than one threshold depending on strategic priorities and objectives e.g. separately in respect of financial or reputational outcomes as well as for both the delivery of projects and “business as usual” activities.
For example, the financial tolerance could be about missing budgets (or missing by more than £x), reputation could be about a Minister stating “not fit for purpose”, etc. Good practice would be to ensure there is a clear measurable definition. Typically, at a strategic level there may be 12 or fewer such outcomes on which the Board should be focussed.

ii) Identifying Causes
This is the identification and understanding of the causes that may result in risk tolerances being exceeded (these causes may traditionally be termed “risks” and may form the basis
of delegated risk tolerances at lower levels of an organisation). These causes include natural events, mis management etc. but also cover combinations of events and contagion issues.

**iii) Likelihood of Occurrence**

In order for informed decision making to take place, it is necessary for the Board to be able to evaluate the benefits of different actions. It is therefore beneficial to assess the likelihood of risk thresholds being breached in a quantifiable way (rather than an unclear high/low etc.). Rather than being precise (which is often spurious accuracy) one option is for this to be done in bands – e.g. under 3%, 3% - 10%, over 10%. It doesn’t need sophisticated analysis but it does benefit from justification. Decision making can then consider the impact of actions on the likelihood of bad outcomes. The key is not to reduce the likelihood of one bad outcome such that the likelihood of another bad outcome (e.g. exceeding the budget) increases by more than by an acceptable amount.

**iv) Review**

Because there are only a (relatively) small list of outcomes on which the Board is focussed, these can all be summarised on one page. It is then easy for these to be reviewed at each Board meeting – indeed the list could form part of the Board agenda since the list drives the performance of the organisation. If it is felt desirable to report on whether the likelihood has increased, reduced or stayed level since the previous meeting (e.g. through a ↑,↓, ↔ mechanism), this is surprisingly easy even within the same band. What is remarkable is how easy it is to be precise on such changes even if the absolute likelihood is unclear – this can deliver real value in Board discussion. At the same time, lessons learned – positive and negative – should be discussed.

**v) Alignment with bottom-up operational risk management**

A typical bottom-up process will have a (long) list of causes of risk e.g. fraud, weather, IT etc. Each cause might be rated low, medium, high for impact. One method of alignment would be completion of the following table on a regular basis:

<table>
<thead>
<tr>
<th>Cause</th>
<th>Can it result in an outcome beyond tolerance?</th>
<th>If yes, what is likelihood in current year?</th>
</tr>
</thead>
</table>

Any figures or assessments in the final columns above a certain threshold (specific to the organisation) need to be escalated to the Board.

**Benefits of a Strategic Top Down Approach**

There are many potential benefits including:

- Greater focus on what really matters (consistent with the headline messages in the introduction) to minimize risks of the organisation failing to deliver
- A freeing up of acceptance of little risks being taken
- A change in decision – making by the addition of an extra test “which of the options under consideration increases the likelihood of breaching our tolerance limit?”
- Greater engagement and involvement of Non Executives to maximize their value to the organisation.

For more information, follow: [http://www.gad.gov.uk/Knowledge_Centre/Strategic_Risk_Management.html](http://www.gad.gov.uk/Knowledge_Centre/Strategic_Risk_Management.html)

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