Aligning risk and the pursuit of effectiveness, efficiency and accountability

Risk transformation

Know the worth of risk.
http://www.deloitte.com/au/risk-transformation
Transformative change is needed as public sector organisations strive to enhance the effectiveness and relevance of their risk management functions.

As they respond to new challenges and demands in their operating environment, many public sector organisations are revisiting their operating models to find further improvements in efficiency, accountability, operational effectiveness and service delivery. As part of this, many are assessing their risk management capabilities and challenging those responsible for the organisation’s risk function to step back and critically review their relevance, impact, value and cost.

These challenges affect senior executives and the boards of many public sector organisations. They demand a shift in management focus: from funding growth to funding efficiency; from resource-intensive business models to more-efficient and agile models; and from risk management as a corporate function to risk management as a discipline embedded across the enterprise as an enabler of agile decision-making.

In a corresponding (and necessary) technological shift, public sector management must move from bolted-on risk and compliance ‘solutions’ that add cost and headcount to ones that provide an integrated view of risk regardless of its source or nature. The increasing variety of risks and potential shocks to which the public sector is exposed also demands information management and analytical capabilities able to support the embedding of risk management into business processes. This must occur while simultaneously sustaining delivery obligations, meeting reform objectives, managing costs, and complying with evolving regulation and policy directions.

However, experience shows that an ad hoc or piecemeal response to managing risk and compliance may not be equal to the challenges many face in areas such as service delivery optimisation and cost management in changing economic and budgetary conditions. Sustained and significant expectations for efficiency dividends drive the need to optimise human resource and infrastructure spending, and improve operational efficiency.

Government, the public and a growing number of international bodies continue to scrutinise public administration and service provision and demand ever-increasing standards for the monitoring, reporting, and mitigation of risk.

As senior departmental and agency executives survey the progress they have made to date and the challenges before them, the following questions frequently arise:

- How, specifically are changing demographics, macroeconomic conditions, technologies and international obligations affecting our ability to meet the expectations of government, and how are they likely to do so in the future?
- How can we provide the right information at the right time to the right people across the organisation to enable them to make responsive, risk-aware decisions?
- How effective is our organisation in terms of risk management and governance, and where do we need to improve?
- What do we need to do to maintain stakeholder confidence, and achieve strategic goals and reform objectives while controlling costs?
- How do we pursue, sustain, and communicate an organisation’s risk profile that is responsive to external stakeholders, including regulatory and public expectations?
- How do we drive risk management into the daily activities of our people?

Questions like these are impossible to answer without an organisation-wide perspective. This Deloitte paper presents such a point of view. It also highlights cornerstone issues that public sector executives and senior committees must address in this transformative environment. We begin with an overview of forces having an impact on the key drivers of public sector value.
The business case for risk transformation

The business case for risk transformation addresses the following key drivers:

- **Sustained and significant expectations for cost reduction**: 2014 will see renewed expectations for reductions in the cost of key government programs. Coming in the wake of years of efficiency dividends, further cost reduction will, in many cases, need to be systemic rather than incremental. These needs are compelling and require organisations to rethink and reconfigure their operating models, governance processes, and risk-management capabilities.

- **Increasing service delivery expectations**: Many public sector organisations are experiencing ‘expectation creep’. New environmental challenges, and increased standards of care and expectations for service delivery, require public sector agencies to continually pursue new strategies and capabilities. Such responses can, however, introduce new, potentially dangerous concentrations and combinations of risk, and add new costs.

- **Increasing regulatory requirements**: The level and scale of regulatory requirements are increasing. Many public sector agencies find out too late the true impact of changes to legislative, regulatory and policy frameworks and international obligations. Too often, these requirements result in increased compliance costs, new delivery expectations, and—ultimately—risk. Addressing these requirements calls for strong coordination between the various assurance activities within an organisation.

- **Legacy infrastructures**: Legacy systems and platforms present high barriers to effectively and efficiently managing an organisation, including its compliance and risk management functions. A well-implemented enterprise risk data architecture can help overcome these barriers by making it possible to build appropriate data repositories and to avoid bolted-on or ad hoc solutions. An integrated enterprise solution specific to the organisation can improve data quality, accessibility, and analysis, setting the stage for improved overall management, including for risk.

**Impacts on effectiveness, efficiency and accountability**

Public sector value is determined by an organisation’s ability to balance its obligations to meet delivery expectations, manage costs, and understand and manage risk. This balance is required, regardless of whether an organisation has a focus on policy development, coordination, service delivery, revenue collection, law enforcement, security or defence. As Exhibit 1 illustrates, this balance is being affected by a range of internal and external factors – some sustained and predictable and others quite volatile. The need to meet evolving external requirements, while simultaneously improving efficiency and the management of risk, is the balancing act at the heart of the concept of ‘earned autonomy’ enshrined in the Public Management Reform Agenda (PMRA).

**Exhibit 1. Contributors to Public Sector Value**

<table>
<thead>
<tr>
<th>Key Influences and forces</th>
<th>Deliver Outcomes</th>
<th>Manage Cost</th>
<th>Manage Risk</th>
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<tbody>
<tr>
<td></td>
<td>Public, stakeholder and government expectations increasing</td>
<td>Funding reductions</td>
<td>More complex and extended enterprises</td>
</tr>
<tr>
<td></td>
<td>Evolving government policy positions</td>
<td>Funding uncertainty</td>
<td>Increasing internal and external interdependencies</td>
</tr>
<tr>
<td></td>
<td>The standard of care is increasing</td>
<td>Inefficient legacy infrastructure</td>
<td>More stakeholders and more inherited risks</td>
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<td></td>
<td>Significantly reduced tolerance for negative outcomes</td>
<td>Salary growth, competition for talent</td>
<td>Strengthened expectations, e.g. WHS compliance</td>
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<tr>
<td></td>
<td>Growing compliance obligations</td>
<td>Challenges in understanding true cost to serve</td>
<td>Pervasive digitisation, automation &amp; inter-connection increases vulnerabilities</td>
</tr>
<tr>
<td></td>
<td>New requirements for more diverse, accessible and customer centric services</td>
<td>Increased cost associated with higher standards of care</td>
<td>Complex outsourcing and collaboration challenges control frameworks</td>
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<td></td>
<td>Regulatory volatility</td>
<td>Capital project cost overruns</td>
<td>Localised issues have strategic effects</td>
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<td></td>
<td>Tighter media and public scrutiny</td>
<td>Reporting and compliance costs</td>
<td>Focused media and social media scrutiny</td>
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<td></td>
<td>High decision velocity</td>
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</tr>
<tr>
<td></td>
<td>Changing public demographics</td>
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<td></td>
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<td></td>
<td>International obligations</td>
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</table>

By taking this more organisation-wide view of public sector value, it is possible to transform the need to meet external and evolving policy requirements into opportunities to fundamentally improve core capabilities. It further integrates risk-management practices within internal processes and activities to better meet evolving delivery expectations, and expanding efficiency and risk-management expectations.
Case in point #1 – Major Commonwealth Integrity Regulatory and Enforcement Authority

Situation/challenge
Over the last few years, this major integrity regulator has experienced a significant increase in the complexity and public profile of its work. There has been notable growth in the diversity and contestability of the issues it deals with and focused media attention on its activities and perceived limitations. The organisation wanted to understand how its risk profile had changed and what opportunities existed to use this insight to proactively drive real change in the manner in which it discharged its responsibilities.

To achieve this, Deloitte worked with this organisation to understand:

• How the entity’s operating environment had changed and how the expectations levied upon it were driving new performance requirements
• How this had affected the entity’s organisational risk profile
• What common causal factors were contributing to the significant deterioration in the entity’s risk profile
• The extent to which the entity’s current organisational and operational model was contributing to or permitting severe risks.

Lessons learnt:

• Regular and comprehensive reviews of an entity’s risks can produce a significantly more insightful picture of evolving exposures than repeated incremental updates to an existing risk profile alone
• Looking at the risk profile in its entirety, and analysing common risk causal factors, can point to mitigating actions which can cost effectively treat many risks, rather than considering each in isolation
• A steadily worsening strategic risk profile can highlight that an entity’s organisational or operating model is becoming misaligned internally or with its operating environment. Transformational refresh may be required.

Needs vary by organisation, and tailored approaches will more likely be successful in meeting the expectations of government, stakeholders and the public for improvements in efficiency and effectiveness. Generally, successful approaches embed risk management into operational units and functions at the level of people’s daily responsibilities. When that occurs, risk management is no longer considered just the responsibility of the ‘risk management function’, but an integral part of the job of all officials.

This said, public expectations built up over decades are changing rapidly in today’s uncertain conditions, which is creating challenges for meeting delivery obligations. Thus, management should take a holistic approach to these challenges, which may represent a break with the past. In many organisations, siloed responses to external challenges, fiscal conditions, public demands, and reform programs have caused a lack of alignment, with results that can resemble aspects of the structure depicted in Exhibit 2. In such organisations, although they are centred on risk, organisational and operating models are not aligned, nor are the business units and functional areas. Risk management lacks coordination and integration, and business units and functions may see risk as the responsibility of the risk management function rather than being intrinsic to their jobs. Managing risk is outsourced to the risk management ‘department’.
Misalignment and gaps develop over time, sometimes over decades, as public sector organisations adapt their roles, priorities and activities to evolving public needs, government policy positions, and new legislation and regulation. Some operating groups, divisions and branches come to see the organisation’s risk management function as being responsible for managing risk while the risks actually reside with everyone in the organisation.

The resulting lack of alignment may leave organisations unintentionally exposed to unidentified, poorly understood or excessive risk and unable to efficiently design or employ responses. Lack of alignment also results in fragmented information architectures and internal processes, further inhibiting the organisation’s ability to cost-effectively deal with enterprise risk and respond to regulatory demands.

Exhibit 2. Lack of alignment in an organisation

Current and emerging trends will further impact this reality. Particularly, new regulations are driving structural changes making Risk Transformation imperative.

Illustrative corporate or shared services
Illustrative operational activities or business units
Risk transformation: A path to alignment

Deloitte believes the desired state is best achieved through a process of risk transformation.

Risk transformation integrates risk management into everyday conduct, driving excellence in risk management by improving practices throughout the entire organisation. This integration aligns the daily activities of staff and the management of risk and the broader organisation with its strategy.

Risk transformation takes changes in the operating environment as an opportunity to strengthen not only the management and governance of risk, but also management of agency and administered funding, operations and the supporting IT infrastructure. For instance, a changing operating environment affects service delivery expectations, driving management to critically assess how they manage these, and how to manage risk.

Those choices are best made from a holistic point of view, with due consideration given to the enabling data and analytical resources.
In an aligned organisation, risk management and governance acknowledge both portfolio (the ‘upward view’) and business unit (‘looking within’) objectives and the risk profile required to achieve those objectives. This aligns operational and risk management and risk governance policies, practices, roles, and responsibilities. The risk management function then supports each area in operating within agreed risk limits and actively takes on and proactively manages the risks needed to meet objectives and expectations.

This alignment between the organisation and the risk management function is neither formulaic nor easily achieved, but a continual, dynamic work in progress. The resulting approach to risk builds on the traditional ‘three lines of defence’ risk-governance model – the business units, risk management functions, and the audit function – in three ways:

- First, this approach involves a proactive rather than a defensive posture toward risk management
- Second, it more fully recognises and supports operating divisions and business unit risk-taking and management
- Third, it aligns the three lines of defence, which have often lacked coordination, leading to unpleasant, often very heavily publicised ‘surprises’ for many public sector organisations.

Rather than over-reliance on the risk management function, risk transformation implements enterprise risk management capabilities in concert with organisational objectives and supports the people responsible for achieving those objectives.

The past several years have shown that clarifying risks (and the seizure of opportunities) calls for reliable data on the full range of risks and rewards posed by all organisational activities. With that information in the right hands and with an effective analytical infrastructure and decision-making protocols, managers can effectively balance their costs and the delivery of outcomes. This results from a synergistic approach to strategy execution, operational efficiency, risk management, and regulatory compliance. This approach enables the organisation to leverage risk and regulatory compliance projects strategically to meet business needs.
Transformational moves
In a misaligned organisation, risk management practices tend to be siloed and separated from the ways in which the organisation’s core business is conducted and performance is managed. (See Exhibit 4.)

Exhibit 4. Pre-transformation Relationship between Risk Management and the Organisation

<table>
<thead>
<tr>
<th>Key Business Activities</th>
<th>Shared and Corporate functions</th>
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<tbody>
<tr>
<td>Infrastructure Management</td>
<td>Governance</td>
</tr>
<tr>
<td>Capital Projects</td>
<td>Finance</td>
</tr>
<tr>
<td>Demand Management</td>
<td>Corporate Development/Strategy</td>
</tr>
<tr>
<td>Supply Chain Management</td>
<td>Human Resources</td>
</tr>
<tr>
<td>Policy Development</td>
<td>Technology</td>
</tr>
<tr>
<td>Product and Service Development</td>
<td>Communications</td>
</tr>
<tr>
<td>Service and Program Delivery</td>
<td>Compliance</td>
</tr>
<tr>
<td>Logistics</td>
<td>Internal Audit</td>
</tr>
<tr>
<td>International Engagement</td>
<td>Ministerial Liaison</td>
</tr>
<tr>
<td>Engineering</td>
<td>Knowledge Management</td>
</tr>
<tr>
<td>Reform Initiative Implementation</td>
<td>Risk Management</td>
</tr>
<tr>
<td>Contract Management</td>
<td>Legal</td>
</tr>
<tr>
<td></td>
<td>Security and Resilience</td>
</tr>
</tbody>
</table>
In the target state, risk is identified at its source and managed within individual operational, policy or service delivery activities. (See Exhibit 5.) To the appropriate extent, accountability for risk management shifts to operating divisions, business units and functions while responsibility for risk is shared appropriately among the business units, functions, and risk management. This enhances the business units’ and functions’ visibility into risk and the visibility of aggregate risk profiles, improving decision-making at the organisational level.

Exhibit 5. Post-transformation Relationship between Risk Management and the Organisation
Risk management shifts from being a functional responsibility (of the risk management function) to an ingrained management discipline. Accountability becomes clearer. People throughout the organisation manage risk as part of their jobs. They are evaluated and rewarded on their management of risk as well as on their operational performance. They have goals for risk management as well as for delivery, cost management, and organisational stewardship.

Risk transformation expands the traditional view of risk. It equips people across the organisation to better recognise emerging, potentially disruptive or non-traditional threats and opportunities. Examples include advances such as social media, cloud computing, novel outsourcing and partnership strategies and other developments. Risk transformation enables the holistic view of risk embodied in Deloitte’s concept of the Risk Intelligent Enterprise.

It provides a context for implementing risk management and regulatory compliance solutions in an integrated, but flexible, manner.

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1 Putting risk in the comfort zone: Nine principles for building the Risk Intelligent EnterpriseTM, Deloitte, 2012
Four Cornerstones of Risk Transformation

To translate the overall goal of achieving alignment as described here into actionable terms, Deloitte has identified four organisational components – or cornerstones – of risk transformation. These cornerstones highlight cross-functional, risk-related elements and activities that help determine an organisation’s approach to risk.

If the executive firmly establishes these cornerstones, risk management and compliance efforts can be implemented in an efficient, coordinated manner within the diverse and complex structures common in the public sector:

- **Strategy**: Strategy puts the organisational vision and mission into action. The executive team should consider the risks of the strategy and to the strategy. Enterprise risk management and governance infrastructures should support execution of the organisation’s policy framework and operating and service delivery models. The service delivery/cost management balance is determined based on extant expectations, risk capacity and appetite, and the risk profile acceptable to government.

- **Governance and culture**: Governance is intended to ensure that plans and programs are executed properly and in appropriate alignment with: legislation; regulations; risk considerations and strategy; and operating strategies. Culture embodies the shared values, principles, and beliefs that guide the organisation. Governance and culture set expectations regarding risk taking and risk management, enabling people to discern acceptable and unacceptable risks, even when not explicitly addressed by policies and procedures. In considering governance and culture, the executive might assess the organisation’s level of risk intelligence, its risk management and governance frameworks, and its risk governance operating model.

- **Organisational and operating model**: The organisational model defines the policy and delivery relationships between the organisation and its service delivery ‘customers’, key operating partners (including those in both the public and private sectors), and those with which it has international relationships or obligations. The operating model structures the ways in which the organisation conducts its activities with its stakeholders. Within both models, risk should be managed with clear accountabilities, authority, and decision rules at all levels, and well-defined handoffs between organisational risk and control functions. Both models require standardised structures, processes, and controls for shared, co-sourced and outsourced services as well as for business units and support functions.

- **Data, analytics, and technology**: Management should determine the key data required to address risk-management needs and oversee development of a data-management and sourcing strategy to address those needs. Management should also facilitate integration of finance and risk data to enable common and reconciled risk and compliance reporting. The business units need near-real-time processing and reporting of aggregated risk data to monitor volatile operating costs. An enterprise risk data and architecture strategy can deliver the right risk-related data to the right points and enable the organisation to respond to changing operating environments and to public and regulatory demands consistently and efficiently, rather than through ad hoc or ‘bolted-on’ solutions. A streamlined set of business intelligence solutions can support risk and regulatory needs while analytics enable scenario analyses of volatility in funding, delivery and performance expectations, and operating costs.

In incorporating and addressing these cornerstones, senior executives can create a unifying context for risk management and risk governance, operational enhancements, and regulatory compliance activities. Note, however, that an organisation need not work on every cornerstone to the same extent or at the same time. Depending on needs, priorities, and resources, management can select a single cornerstone or an element of a cornerstone to address, rather than launching change along all four.
Assessing needs
As noted, the risk transformation journey differs for each organisation. In defining the future state, executives might assess the current state in terms of these cornerstones. (See Exhibit 6.) They can then decide which capabilities related to strategy, governance and culture, organisational and operating models, data, analytics, and technology require what degree of enhancement. As the exhibit indicates, risk transformation helps leaders define subjects for analysis across the organisation against a maturity continuum. Five distinct maturity states are defined for each cornerstone, with the ‘optimised’ state corresponding to the practices of a Risk Intelligent Enterprise.

Risk transformation recognises that risk management can be organisationally aligned even if parts of the whole stand at various maturity levels. The maturity continuum is only one tool by which risk transformation assists management in identifying, categorising, and prioritising activities for enhancement. Primarily, the cornerstones – and the concept of risk transformation – aim to elevate senior-level discussions regarding risk management, risk governance, and regulatory compliance.

Exhibit 6. Illustrative Maturity Continuum
Here are the key points, corresponding to the four cornerstones, to consider, framed as questions to be answered in senior-level discussions of risk management and regulatory compliance:

• **Strategy:** How clear are our organisational and risk strategies to government and the public, and to other internal and external stakeholders? How can we improve that clarity? How can we bring our risk strategy more in line with our organisational strategy so they support one another? How can we allocate funding more efficiently while managing the risks to delivery and resilience that may result?

• **Governance and culture:** Do our governance systems and culture support the implementation of our strategy? What values are – and are not – expressed in our culture? Are we truly practicing good governance and adhering to our values? How can we best align our governance goals and our organisational culture with our values and mission? To the extent that we see misalignment, what is the cause? How can we drive positive values throughout our culture?

• **Organisational and operating models:** To what extent have we rationalised, synchronised, and optimised risk management and regulatory compliance mechanisms? How could we enhance these attributes? How can we best drive awareness of and accountability for risk throughout the organisation? Is it possible for a sub-element of the organisation (or a key service delivery partner) to engage in risky activity without the organisation or portfolio executive’s knowledge? If so, what measures need to be put in place to provide better oversight?

• **Data, analytics, and technology:** How can we leverage our investments in risk management, internal control, and data management and analysis? How can we better align these across our organisation, portfolio or sector? How well do our data management and analytical capabilities support our risk management and regulatory reporting efforts? How can we develop an integrated data storage and aggregation infrastructure to support financial, operational, regulatory, and risk reporting?

Other questions abound, but these are a good start. And the time to start is now.

**Three steps to consider**

Like the issues it seeks to address, risk transformation can be all-encompassing and complex. The following three steps can help executives approach the matter in an organised way:

• **Start the conversation.** Virtually every organisation, across both the public and private sectors, is wrestling with risk management, cost management, and regulatory and operational demands. Any senior executive or director in a financial, operating, communications, compliance, risk management, or other role can raise the subject of alignment and transformation, because virtually every area of the organisation faces similar challenges. These challenges are, however, best addressed in a team setting.

• **Assess the current state.** Consider the factors affecting your organisation’s strategic execution through variables such as funding, cost, risk, and delivery expectations. What is the current state of alignment in the organisation? What is the level of maturity – fragmented, integrated, comprehensive, or optimised – in specific organisational elements and functions?

• **Consider the possibilities.** Which opportunities to enhance alignment of risk and operational management seem obvious? How might we respond to policy and environmental changes and new risks in a coordinated manner? What are our highest priorities? How can we more clearly define our desired enterprise risk profile and ways of achieving, maintaining, and communicating it?

**Begin the journey**

Risk transformation can position organisations and management teams to address organisational challenges and to meet future expectations in a prudent, efficient and accountable manner. It’s a transformation that only the executive team can lead. Given the current and foreseeable environment, it is a transformation well worth leading.
Aligning risk and the pursuit of effectiveness, efficiency and accountability

Risk transformation

Aligning risk and the pursuit of shareholder value

Risk transformation