

# Supporting Innovation: Managing Risk In the Insolvency Service

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## **The background to the management of risk**

### **Risk is not a new concept**

Risk is not a new concept, Government has always placed an emphasis on the need for sound controls to minimise financial risks, impropriety and malpractice, to safeguard public assets and manage health, safety and environmental risks for business, users, staff and the public alike.

### **What is risk?**

The Service is responsible for the successful delivery of a range of business processes and services for its users. All involve some degree of risk – the risk in particular that as a result of unplanned events or circumstances arising, services are not delivered on time, or cannot respond to sudden changes in demand for them, or are of poor quality, and are not cost effective.

Risks can also arise from not taking opportunities to deliver better and more cost effective services. For example, advances in technology will make it possible to deliver more services electronically in the future.

There are also risks in changing the way we work and new systems, processes and ideas need to be implemented in a way that minimises the risk of them failing or the quality of the service not being maintained or improved.

### **So how do we define risk? :**

The Service defines risk as:

*Any action or event (either internally or externally\*) that may have an impact on The Service's ability to achieve its objectives or that affects the delivery of services for users.*

\*Where internally refers to risk arising from our processes, systems, technology, resources and the way we work and externally referring to changes in economic, political or financial circumstances that impact on the way The Service delivers its range of services to users.

## **What is risk management?**

Risk Management means having in place a corporate and systematic process for evaluating and addressing the impact of risks in a cost effective way and having staff with the appropriate skills and awareness to identify and assess the potential for risks to arise

### **The Service's aim and objective in managing risk**

- The service's aim in managing risk is not to eliminate all risks but manage those risks effectively.
- The service's objective is for sections and regions to accept and discharge their responsibility for reducing, to an acceptable level, the effect that potential risks have on the achievement of their objectives.

The effective management of risk supports two key Governmental themes

### **Risk and Modernising Government**

The Modernising Government agenda encourages the adoption of well-managed risk taking where it is likely to lead to sustainable improvements in service delivery.

The Service through the review of its central risk register (see Page 13) may well identify areas where by introducing, improving or revising controls real improvements in areas of service delivery may be made.

### **Risk and Corporate Governance**

Since 1997 the Treasury has been developing systems to improve both internal controls and financial accountabilities through the development of statements of internal financial control and the introduction of strategic risk identification and management.

For the first time in 2001-2002 senior managers within The Service will have to sign corporate Governance statements to the effect that The Service has in place effective systems for the identification and management of risk. The Service will also have to provide the assurance to the National Audit Office (NAO) by demonstrating that these are in place.

## **Business Risk**

### **What is a 'business risk'**

This can be defined as any action or event that affects a sections or region's ability to successfully achieve an objective, this risk can be both inherent and residual and can arise internally or from external influence.

Inherent risks arise from having no effective controls in place, residual risks being risks that the region/section is exposed to after taking account of all existing relevant controls already in place.

### **Types of risk that face The Service**

There are broadly three kinds of 'business risk' (although some may fall into more than one category):

- Financial risks – which are those events and actions that have a direct financial impact on The Service leading to increased expenditure (e.g. increased case numbers leading to the employment of more casual or STA's) or nugatory spending (e.g. the costs involved of a failed IT project).
- Operational risks - which are those events or actions which could disrupt our ability to provide a service or which could result in The Service acting in a way contrary to its objectives.
- Reputational risks – which are events or actions, which could cause embarrassment to our stakeholder, (the Minister), The Department (the DTI), senior management or The Service in general.

### **The response to risk – control**

"Control" is any action or process undertaken or put in place by a section or region to increase the likelihood that activities and procedures achieve their objectives. Simply put control is a response to risk.

Controls can be classified in four ways:

- Directive Controls - these controls are designed to ensure that a particular outcome is achieved. They are particularly important when it is critical that an undesirable event should be avoided (e.g. the non protection of assets). An example of a directive control would be to train staff giving them the required skills to undertake a function or role before allowing them to work unsupervised.
- Preventive Controls – These controls are designed to limit the possibility of an undesirable outcome being realised. The more important it is that an undesirable outcome should not arise, the more important it becomes to implement appropriate preventive controls. An example of a preventative control is the separation of duties (e.g. the person who authorises payment of an invoice is separate from the person who ordered the goods thus preventing one person securing goods at public expense for their own benefit).

- Detective Controls – These controls are designed to identify occasions when undesirable outcomes have occurred. These types of control, by definition, occur ‘after the event’. An example of a detective control is a PAR review (which identified actions that had not been carried out on a case).
- Corrective Controls – These controls are designed to correct undesirable outcomes, which have occurred. They provide a route of recourse to achieve some sort of recovery against loss or damage. An example of a corrective control is putting in place systems or guidance for staff in dealing with a particular type of asset after a complaint from a third party.

### **Why we need to effectively manage the risks facing the Service**

The Service’s capacity to tolerate risk is limited. We have limited financial resources which must be used with due regard to regularity and propriety. Our users and stakeholders expect the range of services provided to be readily available. As part of the DTI and Government we have a reputation to protect and accordingly The Service considers it sound business practice to manage risk effectively. The Senior Management and DTI need to have confidence that significant risks, which could impact on the achievement of The Service’s objectives, are identified at an early point and that appropriate action is taken to manage those risks.

### **The potential benefits of effective risk management to the Service**

The development of a more structured approach to the management of risk can be beneficial to The Service in that it can at both local and national level:

- Identify new opportunities to improve the delivery of services
- Help implement change initiatives
- Provides an internal focus on doing the right things properly
- Reduce the management time spent ‘fire fighting’ and
- Provide a better basis for setting out new strategies for service delivery

### **Our Approach to the effective management of risk**

This is based around a process called risk self-assessment and depends on sections/regions obtaining the commitment and contribution of their staff at all levels to identify and categorise the risks for their processes and work flows and systems through risk management workshops.

## Self-Assessment

### What is risk self-assessment?

This is a technique that enables staff, which operates or work within a business process, to jointly identify the key business risks they face in achieving their objectives and to develop a strategy to ensure that these key risks are effectively managed.

### The advantages of risk self-assessment

The Service has identified a number of advantages in using self-assessment as part of the business planning process:

- o Self Assessment ensures and demonstrates that controls are directed towards the effective management of risk
- o The level of knowledge of risk assessment and controls skills of staff are raised
- o An audit trail of assurance activity is created within the section/region
- o Attention is focused on key issues that need to be addressed within the section/region and identified within the business plan
- o It provides an opportunity for all staff to contribute ideas and suggestions to address their own concerns.
- o Acts as a forum for staff in the identification of issues that may prevent the achievement of section/region goals and objectives
- o Ensures responsibility for implementing the action plan is assigned to named individuals

### Holding a self assessment

When planning a risk self-assessment, it is suggested that it is covered over two half-day sessions. These two sessions should preferably be held a week apart. The first session should cover phases 1-3 while the second session should cover phases 4 & 5. You may wish to use the following indicative timings as a guide.

<b>Session 1</b>	<b>Phase 1 – 15 mins – 30 mins</b> <b>Phase 2 – 15 mins – 30 mins</b> <b>Phase 3 – 1 hour – 2 hours</b>
<b>Session 2</b>	<b>Phase 4 – 1 hour – 2 hours</b> <b>Phase 5 – 30 mins – 1 hour</b>

Template worksheets are provided at Annexes A-G that you may wish to use to record the various stages of the process.

The Service has a number of trained facilitators who are able to run risk self assessment workshops, Finance and Planning and OROS are able to provide you with the names of the facilitators that may be able to assist you in running your workshop, a link that provides details of facilitators will also shortly be found on the Finance and Planning Intranet site.

## THE SELF-ASSESSMENT PROCESS

### PHASE 1 - DEFINE BUSINESS OBJECTIVES AND CRITICAL SUCCESS FACTORS

#### Scope of the Risk Assessment

1.1 The first step in the process is to agree the scope of the review. Your initial risk assessment exercises must be targeted at your key business processes. Where the key business process covers a wide area you may wish to break it down into a number of subsets in order to make the risk assessment more manageable.

#### Objectives

1.2 To agree within the workgroup what you consider the primary objectives of the business process to be. When setting objectives you should try and reflect a desired end-result that you wish to achieve for the business process you operate. A worksheet for listing your objectives is at Annex A.

#### Critical Success Factors

1.3 Once you have agreed your objectives consider whether there are any critical success factors, which you need to achieve in the next 12-18 months. A worksheet for listing your critical success factors is at Annex B.

### PHASE 2 - UNDERSTANDING THE CURRENT BUSINESS PROCESS

#### Determining the Business Process

2.1 Once you have established your objectives, the next step is to agree on what the business processes operated within your area are. Each participant will have a different perspective on the process and it is essential that there is a common reference point for the subsequent consideration of risks. In doing this you should take into account the external and internal influences that affect the process, the needs of customers, business strategy and key performance indicators.

### PHASE 3 - DETERMINING THE KEY BUSINESS RISKS

#### Identifying Key Business Risks

3.1 Now that you have agreed your objectives and the key stages of the business process, you are ready to begin identifying the key business risks that could impinge on that process. **Remember that a risk is any action or event that affects a sections/regions ability to achieve its objectives**

The best way to identify risks is to relate them to the likely obstacles that might stand in the way of you achieving your objectives. In doing this, you will need to take account of external and internal influences, customer needs, your business strategy and key performance indicators.

3.2 This is a two-stage process. Firstly, you should undertake a short brainstorming session to identify risks. Try and concentrate on the inherent risks that exist within the business process (i.e. the level of risk that exists without any

control mechanisms in place). The matrix below gives examples of various risks that might be relevant. These risks, however, are only given as examples and are not meant to be exhaustive. You should try and identify the risks that are relevant to your particular circumstances. The risks identified should be recorded on either "Post it" notes or a flipchart.

<b>Risk Matrix</b>	
<p><b>Operational</b></p> <ul style="list-style-type: none"> <li>Business process not aligned to objectives</li> <li>No performance indicators to measure actual performance against objectives</li> <li>Changes in Government policy</li> <li>Failure of a change initiative</li> <li>Skills shortage</li> <li>Lack of equipment e.g. IT</li> <li>Physical Disasters (including fire and explosion)</li> <li>Loss of key people</li> <li>Failure of outsource provider to deliver</li> <li>Lack of employee motivation or efficiency</li> <li>Inability to implement change</li> <li>Inefficient/ineffective management process</li> <li>Lack of clarification over procedures and priorities</li> <li>Missed opportunities</li> <li>Lack of proper records</li> <li>Lack of training/guidance</li> </ul>	<p><b>Financial</b></p> <ul style="list-style-type: none"> <li>Misuse of financial resources</li> <li>Occurrences of types of fraud to which the business process is susceptible</li> <li>Breakdown of accounting system</li> <li>Unrecorded liabilities</li> <li>Unreliable accounting records</li> <li>Failure to comply with Government Accounting regulations</li> <li>Poor Budgetary control</li> </ul> <p><b>Reputational</b></p> <ul style="list-style-type: none"> <li>Breach of confidentiality</li> <li>Failure of major projects</li> <li>Failure to satisfy customers</li> <li>Failure to comply with rules and regulations</li> </ul>

3.3 Once you have assembled your list of risks you need to filter these down to your key risks. You may not get consensus about what the key risks are so you may need to use a technique such as majority voting. **While there is no limit to the number of key risks that you may identify, please bear in mind that more than 10 key risks are generally considered exceptional.** A worksheet for recording the key business risks is at Annex D.

**Prioritising the Key Risks:**

3.4 You now need to consider which of these key risks are the most significant. For this exercise you need to assess the inherent risk associated with an event, that is the significance and likelihood but ignoring the effect of any controls that may be in place. The aim is to assign them to one of three categories High Medium or Low and we would suggest that you use the worksheet at Annex E for this purpose (using the letter associated with the risk in Annex D to represent this risk on the diagram).

3.5 It may be that you fail to reach agreement about where a risk should be placed in the diagram. If this is the case, then you may want to introduce a simple scoring mechanism where each member of the workshop gives a score between 1 & 5 for the potential significance (1 being low significance and 5 being high significance) and a score between 1 & 5 for likelihood (again 1 being low likelihood and 5 being high likelihood). From this you can obtain an average score, which allows you to position each risk in the diagram.

<b>Significance</b> -The impact that risk would have on the Business Process	<b>Likelihood</b> - The probability that the risk and its associated impacts could occur
1 - No significant impact on achievement of objectives	1 – Risk is unlikely to occur
2 – Has a small impact on achievement of objectives	2 – Risk may occasionally occur
3 – Has a limited impact on achievement of objectives	3 – Risk is likely to occur
4 – Has a large impact on achievement of objectives	4 – Risk may often occur
5 – Has a serious impact on the achievement of objectives	5 – Risk could easily, or does, occur

### Interpreting the Prioritised Risks

3.6 You have now prioritised the key risks in the above matrix according to their impact and likelihood. They will have fallen into three categories – High, Medium and Low. The ratings can be interpreted as follows:

- **High:** Assess controls and take immediate action if considered inadequate. Develop action plan to manage the risk and review regularly.
- **Medium:** Assess controls, consider what action may be needed and develop action plan to manage the risk. Review periodically.
- **Low:** No specific action required.

**Try to use your judgement when interpreting the ratings. For example, you may identify a risk as unlikely to occur (1) but have a large significance if it did (4) and therefore rate the risk as low. However, this should not stop you from taking action to manage the risk should you feel it is required.**

Should you have categorised all your key risks as low, you may want to review again your prioritisation of key risks.

## PHASE 4 - DEVELOPMENT OF CONTROL STRATEGIES FOR MANAGING KEY RISKS:

### Action to Take

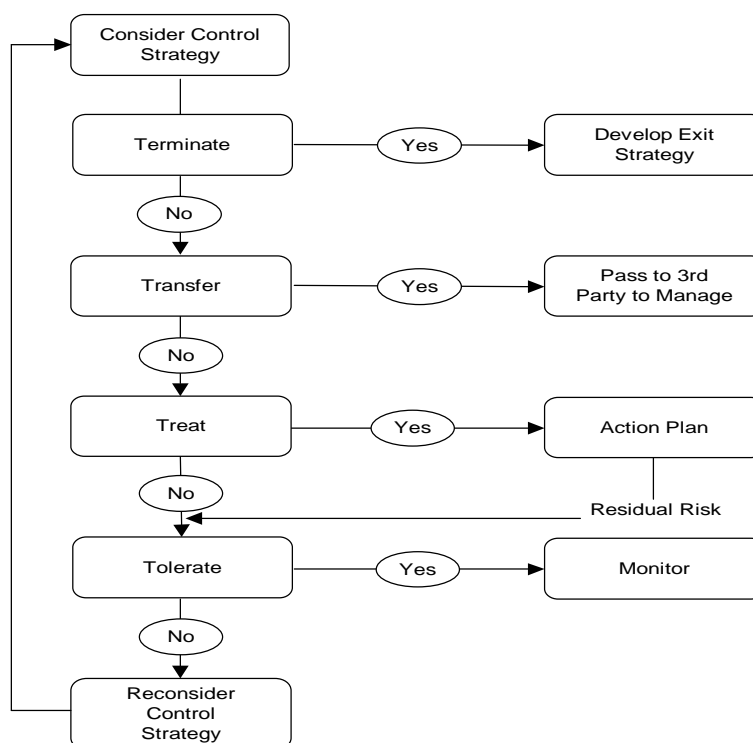
4.1 Having identified and prioritised the significant risks, in this stage the aim is to look more closely at those assessed as being of High (or Medium) Risk and establish:

- The controls currently in place to manage the risks and decide upon their adequacy.
- Whether anything more is required to manage the residual risk (i.e. the level of risk that still exists in spite of the controls already in place).

### The Four Control Strategies

4.2 There are essentially four control strategies available to you to manage these risks. They are:

- Tolerate the risk (where there is no cost effective control but you can adequately monitor it);
  - Transferring the risk (e.g. passing it to another party by changing contractual terms. You will still need to ensure that the transferee is properly managing the risk);
  - Terminate the risk (by adopting an exit strategy);
  - Treat the risk (by building control into the operational process, additional quality control, involving your best people managing it).
- A decision tree to help you decide the action you wish to take is set out below:



4.3 For those risks that cannot be terminated or transferred it is necessary to decide what balance should be struck between the other two options. A key point to note that is that it is **not** possible to eliminate risk entirely. However, the residual risk that remains needs to be sensible and not reckless or ill considered. The completion of a control strategy will help to your decision making in managing the risks more effectively.

4.4 When completing this form the three key boxes that will influence your strategy are the "Ability to Manage", the "Identified Controls" and your assessment of the "Control Effectiveness". These will enable you to decide what action should be taken.

A worksheet for drawing up a control strategy is at Annex F.

Under each of the headings put the following:

- **Stage** - Indicate which stage of the process (see Annex C) the risk relates too. If you think the risk is common to more than one stage then indicate this in the action plan
- **Key Risk** - Indicate what the key risk is. Also, indicate the letter associated with the risk in (Annex D).
- **Impact** - Indicate what the consequence of the risk are if it were to occur. An example would be political embarrassment if the Department's competence were to be questioned as the result of a particular event.
- **Responsible** - Indicate who in your Management Unit has been assigned to manage the risk
- **Risk category** - Based on where you positioned the risk in Annex E indicate the risk rating you have given High, Medium or Low.
- **Identified Controls** - Indicate here the controls you already have in place to manage the risk.
- **Control Effectiveness** - Indicate here whether you think your identified controls are (i) Effective (ii) Partially Effective or (iii) Ineffective.
- **Ability to manage** - Indicate here whether you think the risk is (i) Within Your Control (ii) Partially Within Your Control or (iii) Outside Your Control (where you may need to eliminate or accept the risk).
- **Actions Proposed/Agreed** - Indicate what further action you plan to take to manage these risks based on the interpretations provided for each rating and the particular control strategy you wish to apply. For example, if you have given a risk a rating of "High" you need to indicate what immediate action you plan to take. This might include possible opportunities for strengthening the level of control such as the introduction of early warning mechanisms that could be built into the process. Alternatively, you might judge that you are already managing the risk appropriately and that no further action is necessary for now.

## PHASE 5 - DEVELOPMENT OF ACTION PLAN FOR MANAGING KEY RISKS IN THE BUSINESS PROCESS

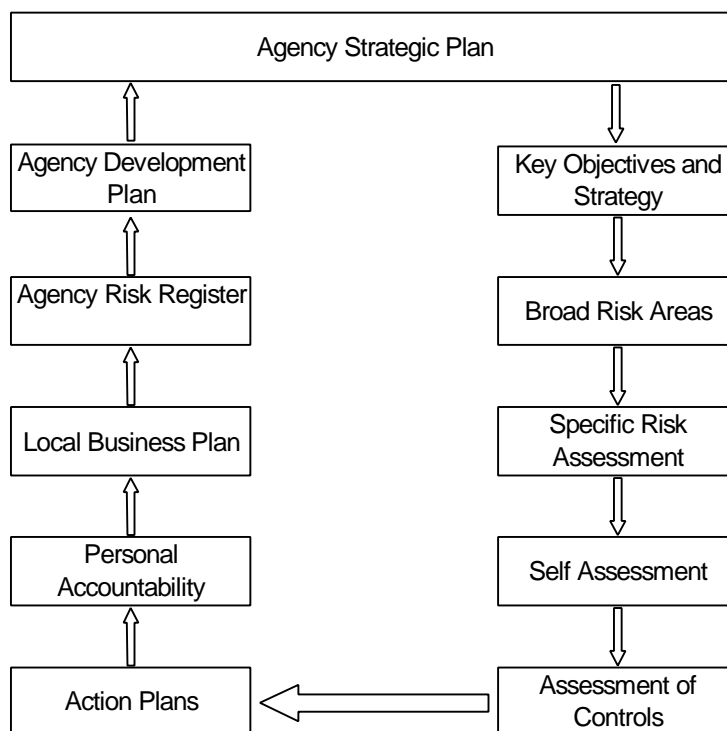
5.1 Once you have agreed upon your control strategies for managing each of the key risks, you should develop a consolidated action plan for your business area. A worksheet for drawing up a consolidated action plan is at Annex G.

5.2 Having developed a formal strategy for managing the key risks that exist within your business areas you now need to implement that strategy by completing the tasks in the consolidated action plan. You also need to have a mechanism in place to review progress against the action plan at regular intervals.

5.3 Further self-assessments must be undertaken on an annual basis and in line with The Service's business planning timetable. This will enable you to consider whether the risks you have identified are still relevant in light of any changes that might have occurred in the internal or external environment.

### How risk assessment fits into business planning

The following diagram shows the relationship and importance that risk management plays in The Service's business planning process and how it contributes to the continuing development of the Agency.



**You will need to integrate the management of risk into your sections/regions business plan and must submit your risk register; action plan and business plan to your director/OROS for approval by the 28<sup>th</sup> February each year.**

The key risks identified will contribute to the revision and development of the Agency's Risk Register.

## **The Agency Risk Register**

Your sections/regions risk register will contribute to the development of an Agency Risk Register, which will provide senior managers with a top-level assessment of the risks facing The Service. The Corporate Governance Group will review and consider all key risks identified and the development of the controls needed to minimise these key risk areas.

## **Improving the Guidance**

### **Feedback**

We seek to improve the guidance given to section heads for the risk management process each year. To do so we need your feedback on how you feel we could develop the guidance in the future. Please E mail the Corporate Governance Team at Corporate.Governance with your suggestions for improvement.

### **User Survey**

Please take the time to complete the attached user survey and E mail it to [corporate.governance@insolvency.gsi.gov.uk](mailto:corporate.governance@insolvency.gsi.gov.uk). This will give us feedback on your satisfaction with the present guidance and set a benchmark score for any future guidance issued.