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Architects for Productivity and Risk

28 March 2014

Dr Andrew Southcott MP
Chair
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

Dear Dr Southcott

Thank you for the opportunity to make a submission to the Committee's inquiry into the rules relating to the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

The attached submission from ScottCromwell canvases a number of issues relevant to the progressive implementation of the revised financial management framework and provides comments on what we perceive as a strategic vulnerability affecting the implementation of the PGPA Reforms.

We would be pleased to discuss our submission with the committee and the Department of Finance.

Yours sincerely

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John Scott
Director

Dr Larry Cromwell
Director



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Architects for Productivity and Risk

SUBMISSION

JCPAA Inquiry into the rules relating to *the Public Governance, Performance and Accountability Act 2013 (PGPA Act)*

Précis

We are in an era of changing relationships not just between departments, not just between the public and private sectors, not just nationally but also internationally. The increasing development of across-organisation, across-government and across-sector participation and direct involvement in the delivery of public services has introduced totally new risks and raised risk profiles in areas which have not had to be considered in the past. Nonetheless, new and unforeseen risks need to be recognised and ways of managing those that can be managed need to be found or worked out. Enterprises responsible for delivering on objectives are increasingly responsible for identifying risks that lie beyond their power to act, yet obliged to manage the effects of these risks once the effects are felt.

Standard risk management approaches have not kept up with these rapid global changes. They have tended to concentrate on the management of “effects”, as once earlier standards focused on consequences. The result is that enterprises who relied on standard guidelines were often surprised by unmanageable consequences arising from risks that, though outside their traditional scope, could nonetheless have been foreseen.

The International Standards Organisation and its ISO 31000 Standard has recognised the need to transition to something beyond causality, and has flagged the need to consider uncertainty. But it does not properly address the relationships between Uncertainty, Opportunity and Risk that modern enterprises must understand and deal with. Nor has it addressed the pressing issue of systems and how enterprises are to deal with ‘systemic risks’, where causes are notoriously subtle, complex and unmanageable, and effects can be catastrophic.

Without a proper appreciation of these new factors, enterprises relying on standard guidelines such as ISO 31000 are vulnerable to errors of focus which can fundamentally impact their strategies for addressing risks. Enterprises can remove these vulnerabilities by enhancing their risk management strategies.

ScottCromwell makes two recommendations to the JCPAA:

1. Note that a strategic vulnerability exists for the PGPA Reforms associated with the Draft Risk Management Policy Guidelines provided by the Department of Finance; it is located in the ISO 31000 notion of risk as “the effect of uncertainty on objectives”; and,

2. Note that an enhancement is available that addresses this strategic vulnerability by enabling and facilitating an implementation approach which utilises a more mature appreciation of risk management. This enhancement recognises the longer-term objective of appreciating risk identification as a necessary step in improving performance.

Background

ScottCromwell understand the stated objectives of the reform of the financial framework are extensive and include:

- a. Improved quality of information to Parliament to support its constitutional role in relation to Commonwealth expenditure;
- b. A more mature approach to risk management across the Commonwealth;
- c. Improved productivity and performance of the Commonwealth public sector with concomitant benefits for a broad range of stakeholders; and,
- d. Reduced red tape within the Commonwealth and for partners who contribute to the delivery of Australian Government programs and services, including grant recipients.

We understand that Finance has articulated the following guiding principles for the resource management framework as follows:

1. Government should operate as a coherent whole;
2. Public resources are public resources, and a common set of duties should apply to all resources handled by Commonwealth entities;
3. Performance of the public sector is more than financial; and,
4. Engaging with risk is a necessary step in improving performance.

We note also that the Auditor General has suggested the following guiding principle to be applied in developing the remaining elements of the framework:

- The financial framework, including the rules and supporting policy and guidance, should support legislative requirements of the government and the parliament in discharging their respective responsibilities.

We understand that Finance has stated that “the objective of the proposed Earned Autonomy model is to implement a targeted and risk based approach to financial framework regulation that establishes a core set of streamlined obligations that appropriately reflects an entity’s risk profile, including an objective view on its performance.

Rather than applying a one-size-fits-all approach to the resource management framework regulation, the nature and extent of the Department of Finance and Deregulation’s (Finance) engagement with entities under an Earned Autonomy model would be dependent on an entity’s risk profile and/or performance.

Importantly, an earned autonomy model will not mean less focus on compliance, rather better targeted compliance. Earned autonomy will allow the regulatory burden imposed on entities to be tailored based on the risk and performance of entities.”

We understand that the major focus of the Reforms is on improved performance and accountability, as indeed have previous Reforms. One significant difference with these proposed Reforms, however, is the marked emphasis on the importance of risk management in achieving better program outcomes, both in the supporting documentation and, notably, in the new legislation replacing the former FMA and CAC Acts.

‘Earned Autonomy’ and reduced ‘Red Tape’

Two Reform initiatives are of particular significance—developing the concept of “earned autonomy” and the minimisation of so-called “red tape”. The issue of reducing “red tape” is not a new focus of reforms. Previous governments and reform initiatives have recognised the costs of unnecessary bureaucratic processes on efficiency and effectiveness in both the public and private sectors—but also have been conscious of the need for adequate control mechanisms as a necessary part of accountability.

Of particular interest are the links between these two initiatives and the role that risk management can play in achieving the Reform focus on improved performance and accountability for that performance. There is no doubt that the Government, Parliament and the general public will need to be assured that there is “real” accountability for performance, and be clear about where improvements have been made. Therefore systems will need to be put in place which provide that clarity, and are regularly subject to evaluation and audit. This also puts greater pressure on the publication of meaningful performance measures (assessments). It is part of the quid pro quo for greater flexibility and less process to provide for greater accountability. Not surprisingly, effective risk management strategies will be integral to both the necessary governance framework and the operational arrangements to meet those expectations.

New Risks require New Knowledge

Those responsible for implementing the Reforms will need to have the necessary knowledge and understanding to ensure that there is effective management of risks both foreseen and unforeseen, as well as the necessary management support systems. Unforeseen risks have become much more demanding of early identification and effective management in an era of changing relationships not just nationally but also internationally. The increasing development of across-organisation, across-government and across-sector participation and direct involvement in the delivery of public services has brought entirely new risks and raised the risk profile in areas which have not had to be considered in the past.

Stakeholders, both internally and externally, need to be assured that there are well developed plans and processes to deal with such foreseen and unforeseen risks and that those responsible for governance regularly address and understand the organisation’s risk

“vulnerability” and take strategic decisions to address their assessment of such vulnerability. Performance and accountability depends on a shared understanding of such factors throughout the organisation and the professional knowledge and capability to provide such assurance.

Focus of ScottCromwell Contribution

ScottCromwell recognise that the Joint Committee of Public Accounts and Audit has limited time for hearings and reporting and will necessarily be focusing on the framework and concept endorsement at this time. Implementation, however, is the key.

The ScottCromwell submission is a contribution to achievement of the reform objectives by focusing on their *implementation* using an approach that utilises *a more mature appreciation of risk management*.

Assessment of Vulnerability

It is our considered view that the proposed Reforms are strategically vulnerable due to inherent ambiguities and a lack of guidance on implementation. This strategic vulnerability arises from the Finance guidance regarding alignment with existing standards and guidance, such as *AS/NZS ISO 31000:2009-Risk management – principles and guidelines*, but where the guidelines are confusing or unclear or do not address critical relationships.

The International Standards Organisation has begun the obviously necessary shift to include and be able to deal with *uncertainty* as a basis for a new world view regarding risk management; but importantly it has not completed this task. Moreover, it will be some time until new guidelines may be available. In a practical sense, enterprises responsible for implementing Reform initiatives will have to do so in the absence of mature guidelines around the important considerations of Uncertainty, strategies that rely on factors other than causality, and unforeseen risks and risks arising beyond the enterprise.

To be more specific:

1. Presently there is a lack of guidance on how to translate the new notion of risk as the ‘effect of uncertainty on objectives’ into guidance for action; and,
2. There is a need to formally begin addressing the fact that we are more interconnected and interdependent than ever before.

In practice, there is a global transition underway where leaders are having to deal simultaneously with historical evidence (e.g. trends) as a basis for the management of risk, and somehow come to terms with uncertainty as a new driving factor. Increasingly to address uncertainty organisations need to shift their thinking about risk from causality to predication. We can no longer depend almost exclusively on historical evidence as the basis for managing risks.

ScottCromwell Enhancement: Rediscovering Vulnerability

Over a decade ago, with the obvious rise in unforeseen consequences impacting global systems, and the reality of an increasingly networked world, ScottCromwell recognised the need to develop a new practical basis for the next generation of risk management. To do so we went back to the basics of conventional risk management, to examine where the traditional paradigm of Risk = Likelihood x Consequence did apply to these new and systemic risks, and where it did not. We found that the old paradigm was of no help where consequences might arise from unidentified risks, was often misleading in its insistence on an assessment of probability or likelihood where even a rough guess was not possible; and offered no guidance whatsoever in the face of profound uncertainties.

In going back to the basic assumptions of risk management, we found that Consequences are not so much caused by risk, but rather by *vulnerabilities* that are impacted by threats or circumstances that have not been addressed. Vulnerability is actually the key to a more mature appreciation of risks: If we are not vulnerable then a supposed threat is an empty threat. And where we do not have an appreciation of our vulnerability, we remain essentially blind to new threats and the risks they represent. Risks predicated on Vulnerabilities became the basis for a new notion of risk, and our New Risk Equation: $R = V \times T$, or Risks are Vulnerabilities impacted by Threats.

Interestingly, vulnerability has strong presence in common sense, and vulnerability-based risk assessment is compatible with existing historical knowledge of risk. Vulnerability, and the application we developed for conducting Strategic Vulnerability Assessments, is simply more precise in articulating the nature of risk, its origin and timing, and potential real consequences. And with its inherent flexibility to change as situations change, vulnerability is much more useful in a world full of uncertainties. Over the past decade we have been applying and proving vulnerability-based solutions in real-world situations, working with leading edge organisations, often out of the public glare, to tackle some of the most difficult challenges facing the public and private sectors. (See below for a better appreciation of these challenges.)

ScottCromwell's strategic vulnerability assessment is an enhancement (to standard risk management) that both removes the obstacle to implementation of the risk management reforms proposed under the Public Governance, Performance and Accountability Act, and enables strategic vulnerabilities to be identified and a considered strategic response choice determined and implemented in the time allowed.

Demands on Leadership, Knowledge and Interconnectedness

The emergent issue for leadership is associated with our interconnectedness and interdependence. Leaders need to reconcile an increasingly broader system-view with the organisational view. The system-view is akin to creating a virtual organisation and establishing a risk policy and risk governance over the system. The organisations which benefit from the system then contribute to the protection of the system. A narrow focus

on the enterprise—as legally defined—inhibits purposeful action to address this new reality. This has implications, in the first instance, for government operating as a coherent whole but more broadly for the increased development of across-organisation, across-government and across-sector participation and direct involvement in the delivery of public services. This is equally applicable to the more demanding era of changing relationships not just nationally but also internationally. Our enhancement addresses this issue as well.

We are entering new territory with change gathering pace. We need to think anew about the role that governments might play recognising the power of governments to regulate also implies an obligation that it be responsible and responsive. A necessary corollary of uncertainty is the need to be mindful that the knowledge and assumptions upon which any current strategy is based remain correct in changing conditions. We need a solid foundation upon which to build the ship that will carry us across these troubled waters. To mix metaphors, the key issue is to ensure that our pathway to a more mature management of risk is based on solid foundations.

While government may not always succeed, the virtue is to try and say we have done our best.

Benefits

Adoption of this enhancement would enable a more mature approach to risk management that could address the need to focus more attention on across-organisation, across-sector and across-country relationships and involvement. It would also enable improved visibility of potential risks hitherto considered “unforeseen”. The result would be the development and placement of policies and practices to cope if, or when, strategic vulnerabilities were threatened or the risk materialised.

The result of adoption of this enhancement would be a risk management approach in two octaves—at the strategic and operational levels. This would recognise and reinforce fundamental risk management approaches that address the most common issues faced by public sector managers, such as the difference between insurable and non-insurable risk and processes to “guard” public moneys and prevent fraud.

The big issues of risks to program outcomes have to be broadly identified to encourage public service managers to at least be aware of them and, hopefully, think about how to address them. The identification of strategic vulnerabilities goes to the heart of this issue.

Further, the Reforms are looking at a 3-4 year implementation period, which is the right direction if there is to be lasting reform and changed thinking and approaches. Again, the proposed enhancement, particularly the ability to surface strategic vulnerabilities associated with the Reforms to anticipate and avoid unintended consequences would be beneficial to the whole public administration.

Recommendations

ScottCromwell recognises and applauds the work of the Department of Finance to consult more broadly in regard to the proposed Reforms.

ScottCromwell makes two recommendations to the JCPAA:

1. Note that a strategic vulnerability exists for the PGPA Reforms associated with the Draft Risk Management Policy Guidelines provided by the Department of Finance; it is located in the ISO 31000 notion of risk as “the effect of uncertainty on objectives”; and,
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ScottCromwell Background

ScottCromwell is a boutique firm specialising in human social networks and how their communications lead to action. Our focus and the development of new approaches and new tools are designed to address productivity and risk for the knowledge and service economy. Our work is largely away from the public glare and we have been turned to by organisations and indeed whole sectors in the following areas:

1. Improved safety, quality and efficiency in the Australian health care sector
2. Identification and Assessment of Environmental Risks to the Victorian Economy and State Budget
3. An Information Sharing Infrastructure to Minimize Technology Surprise
4. An Information Sharing Infrastructure for the Protection of Critical Public Infrastructure
5. A Strategic Risk Assessment for the Australian Grains Industry
6. Port of Melbourne Channel Deepening Project Risk Assessment Review
7. Independent Expert Opinion on Warnings to the Community

We would be pleased to discuss our submission and our work with the JCPAA and Department of Finance.

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