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Architects for Productivity and Risk

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Ms Sandra Kennedy
Inquiry Secretary
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

Development of the Commonwealth Performance Framework

Dear Ms Kennedy

Thank you for the opportunity to make a submission to the Committee's inquiry into the *Development of the Commonwealth Performance Framework* and its aim to "ensure an effective, integrated performance management system".

Our submission is divided into two parts. The first part is concerned with ***fatal flaws*** associated with the public sector's predisposition to deal with risk in a '*process-oriented fashion*'; not in any strategic framework addressing unforeseen risks in a changing environment.

The second part of our submission is concerned with ***a strategic vulnerability*** affecting the implementation of the Public Governance, Performance and Accountability (PGPA) Act 2013 reforms. It is located in the ISO31000 notion of risk as "the effect of uncertainty on objectives".

Part 1: Fatal Flaws

For many public servants, risks are seen as threats to "process" and not to the "outcomes" envisaged in the strategy being managed. This focus on process is often reinforced by Parliamentary committees, individual Parliamentarians and often by Ministers. Our aim should be to address risk management at two levels—at the level of overall strategy and at the operational level.

In regard to the '***fatal flaws***' it doesn't matter how good the process is if the INPUTS and the ASSUMPTIONS are flawed.

- The main flaw in ASNZ4360 and ISO31000 is the ***reliance on Likelihood*** when determining the consequences of risks to be addressed. This reliance on Likelihood amounts to a fatal flaw because it has the effect of 'reversing' the scale of the impact of the assessed Risks. That is, the less likely the event, the lower the 'likelihood' factored into the equation. This results in reducing the calculation of the consequences, often to much less than the actual consequences if the threat occurs. The most damaging catastrophic risks are the most infrequent, hence the least likely in any time period. The application of Likelihood to

Consequences effectively reverses the scale of the impact of the assessed risk and in the process obscures it from executive view.

- The second flaw is the assumption that the risks will be spotted, that they will get on the risk register at all. In fact, most of the major risk events in the past two or three decades were not properly identified and were never assessed by ASNZ4360 or ISO31000 or any other risk management process.

Examples abound, but here are two recent events:

- The Fukushima nuclear reactor cooling system was 'protected' by seawalls that were built to an assumption of wave height. Had the designers applied even the most rudimentary engineering rule of thumb, they would have realised that the integrity of the entire operation depended on *an assumption that was unproven*, hence they would have done what engineers generally do, which is to build in a 50% margin 'just in case'.
- The recent Germanwings suicide crash arose from the risk management 'treatment' of locking the cockpit door from the inside, based on a risk assessment that assumed only terrorists would be trying to get into the cockpit. The strategic fatal flaw which that incident has exposed was the assumption that the (risk management) processes would be able to identify a suicidal mental state in a pilot.
- The most striking flaw in so-called 'standard' risk management processes is the absence of any built-in systematic self-correction process. So while the processes enshrined in the dominant standards, ASNZ4360 and ISO31000, become more widely understood and adopted, the most unthinkable horrific risks events continue to occur, and without any urgent correction, revision and improvements in the standards.

Part 2: A Strategic Vulnerability

The second part of our submission is concerned with a **Strategic Vulnerability** affecting the implementation of the Public Governance, Performance and Accountability (PGPA) Act 2013 reforms.

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 ISO31000 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.

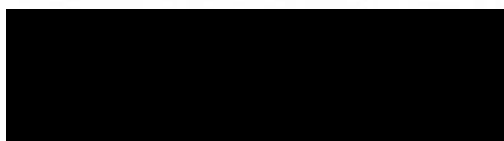
Without a proper appreciation of these new factors, enterprises relying on standard guidelines such as ISO31000 are vulnerable to errors of focus which can fundamentally impact their strategies for addressing risks. Enterprises can remove these vulnerabilities by enhancing their risk management strategies.

ScottCromwell makes three recommendations to the JCPAA:

1. Note that **a strategic vulnerability** exists for the PGPA Reforms associated with the Risk Management Policy Guidelines provided by the Department of Finance; it is located in the ISO31000 notion of risk as "the effect of uncertainty on objectives";
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; and,
3. There are a number of concrete steps that can be taken now to address the **'fatal flaws'** issues raised in our submission.

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

Yours sincerely



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