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Architects for Productivity and Risk

4 November, 2015

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

### **Development of the Commonwealth Performance Framework**

Dear Dr Southcott

At the Committee's recent public hearing with the Department of Finance and ANAO, Mrs Prentice MP asked the Department of Finance how it responded to submissions, specifically including the one from ScottCromwell highlighting deficiencies in the management of unforeseen risk. The Department sidestepped the substance of the Member's question about listening to, confirming and responding to warnings. And, in the process missed an opportunity to strategically engage with Parliament about the true nature of the Federal Government's risk management challenge.

It is not clear to ScottCromwell that the Department appreciates that the true and correct focus of risk management must be on *systems*. As we said in our submission:

In our present turbulent and unpredictable world, making the systems within which we live and operate our business, our economy and our society more resilient is the challenge we all face. By resilience we mean reducing vulnerability so that our systems are better able to deal with increased pressures from sudden shocks and the inevitable challenges from our interconnectedness and interdependence as well as our scientific and technological advances. We also mean being able to take the most of the opportunities--some of which can arrive just as unexpectedly and are too often missed.

This is the context for the development of Risk Policy and the application of the principle of 'fitness-for-purpose' when selecting the right approach for the identification, confirmation and management of risk. We emphasized that this context must focus on the *unexpected* pressures and the *sudden shocks* to our vulnerabilities.

The Federal government has a critical role, extending well beyond the boundaries of a department or agency, in this challenge to our resilience. Further, most of the programs and services provided by government are embedded in systems involving contributions from a few to many stakeholders. The healthcare system is a high profile example.

It is this strategic appreciation of the importance of *vulnerability* that has motivated ScottCromwell to engage with the Department of Finance and the JCPAA to help inform and contribute to risk policy in various ways since 2011 (see attached for details). We have:

1. contributed a strategic analysis of the limitations of the former risk management standard AS4360 and the implications for risk management;
2. alerted the Department of Finance to the High Court of Australia's *Perre vs Apand Pty Ltd* decision in regard to Vulnerability of third parties as the basis for the Duty of Care; and,
3. contributed a proposed Risk Rule to complement a revised Audit Rule as part of the PGPA Act implementation.

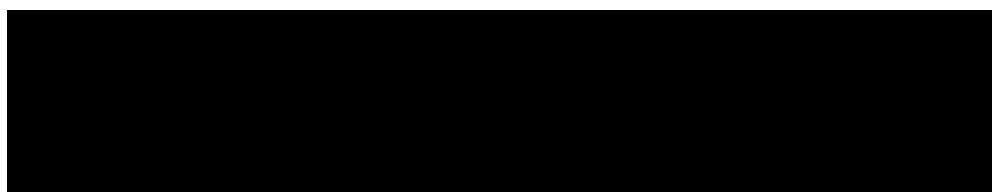
Further, ScottCromwell, in alliance with the Australian Risk Policy Institute (ARPI), created the Risk Policy Model in an effort to elevate risk policy to focus on whole-of-system and systemic risks, and shift risk management onto solid footings. Our shared aim was for Australia to continue its global leadership role in risk management and take the lead in setting a vision for risk policy and risk management to address systemic risk. The World Economic Forum in the immediate aftermath of the GFC called on society to 're-think, re-design and re-build' risk management to address systemic risk.

ScottCromwell's leadership is based on an original contribution to knowledge and the application of this new knowledge over the course of the last decade to help address complex risk management challenges affecting our systems. In the process ScottCromwell developed Predictive Enterprise Risk Management (P-ERM). This new approach includes:

1. a new risk equation and new approach to risk identification and assessment called Predictive Risk Assessment and Early Warning (designated PR/EW for short). This approach can be used to overcome the methodological rigour limitations of current approaches to Risk Management (e.g. AS4360) as well as the strategic vulnerability inherent in ISO 31000 in its approach to uncertainty.
2. a new approach to collaboration extending beyond organizational boundaries called Risk Knowledge Exchange Networking. This Model and the approach to the development of purposeful collaborations addresses the core issues currently impeding the exchange of highly sensitive knowledge – knowledge necessary to anticipate and avoid potentially catastrophic situations.

Our aim has been and continues to be to bring this new knowledge and these innovations to the benefit of government and business recognizing that protecting our systems intrinsically enhances trust in government and delivers significant benefits to the Australian public.

Yours sincerely,



John Scott  
Director

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Director

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## **Attachment: ScottCromwell Engagement with Department of Finance and JCPAA**

### **27 July, 2011:**

John Scott and Tom McDonald, under the aegis of the Australian Risk Policy Institute (ARPI), met with the Commonwealth Financial Accountability Review (CFAR). ScottCromwell provided the department with a copy of its strategic assessment of the Risk Management Standard AS4360. The document entitled: Limitations of AS4360 and Implications for Risk Management (copy available on request) came to the following conclusions:

1. current approaches to risk management, such as the Australian National Standard AS4360, were adequate in simpler environments;
2. globalisation, global terrorism, concerns about environmental protection and the increasing scale and interdependence of public infrastructures are increasingly calling into question the capability of current approaches to risk management. Upon close examination of both the limitations and the implications of those limitations for the proper management of risk it is no longer a question of whether the current national risk management standard AS4360 is fit for purpose. It simply isn't.
3. the time has come for a new generation of risk management policy and practice to enable society to move forward safely and with confidence.

### **November, 2012:**

John Scott and Tom McDonald, on behalf of ARPI, contributed to a joint ARPI – Risk Management Institute of Australia (RMIA) submission to CFAR. The submission fully supported recognition of, and increased focus on, the importance of risk management as an integral part of the financial reform landscape. It stated in part that:

risk awareness, risk policy and risk management represent arguably the “*golden thread*” that will enable effective and efficient delivery of the CFAR objectives, not the least because *it is the risk equation that permeates the stated objectives* of efficiency, innovation, flexibility and transparency in financial management and service delivery.

### **15 October, 2013:**

John Scott was invited by the Department of Finance, as the representative of the Australian Risk Policy Institute, to join the Governance and Risk Management Steering Committee and the Earned Autonomy and Risk Management sub-committee providing advice to the Project Board guiding the Implementation of the PGPA Act reforms.

### **18 October, 2013:**

John Scott provided the Project Management Office with copies of:

1. Limitations of AS4360 and Implications for Risk Management; and,

2. A document entitled: Liability, Culpability and Vulnerability Transfer drawing attention to the High Court's *Perre v Apand Pty Limited* [1999] decision. In this decision, the High Court made it abundantly clear: "it is the concept of vulnerability ... which is the relevant criterion for determining whether a duty of care exists" (see *Perre v Apand Pty Limited* [1999] HCA 36 at para 125 per McHugh J). It is absolutely vital that all third party vulnerabilities are identified before the risk assessment process is finalised. Once the vulnerabilities are identified, they can be subjected to early negotiation and contract. Engagement, based on the vulnerability of the third party rather than the risk to the project, engenders trust and full disclosure.

#### **November, 2013:**

As part of the out-of-session consideration of the Draft Audit Rule, John Scott proposed a complementary Risk Rule to address the differences between the CAC and FMA Acts in regard to their handling of risk management. The proposed Risk Rule elevated risk policy to recognize the need to anticipate and avoid major risk events that imperil the agency and had the intention of shifting risk management onto solid footings using the principle of "fitness-for-purpose" in regard to the methodology for the identification, confirmation and response to significant risks.

Under the terms of the proposed Risk Rule, the Audit Committee would provide independent assurance to the accountable authority on the performance of the Risk Policy in assisting the accountable authority to meet their obligations under the provisions of the PGPA Act.

#### **January/February, 2015:**

John Scott's participation in the Implementation Group activities was terminated without notice or explanation.

#### **28 March, 2014:**

ScottCromwell made a submission to the JCPAA in regard to the Committee's *inquiry into the rules* relating to the Public Governance, Performance and Accountability Act 2013 (PGPA Act). This submission made two recommendations that 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 utilizes a more mature appreciation of risk management. This enhancement recognizes the longer-term objective of appreciating risk identification as a necessary step in improving performance.

**30 April, 2015:**

ScottCromwell made a submission to the Committee's *inquiry into the Development of the Commonwealth Performance Framework* with its aim to "ensure an effective and integrated performance management system".

**18 June, 2015:**

John Scott and Tom McDonald, on behalf of ScottCromwell, appeared before the Committee to give evidence.

**6 July, 2015:**

ScottCromwell provided a Supplementary Submission following the Committee's stated interest in how the Commonwealth's performance framework can be changed or amended among other things to improve the management of risk, recognizing that the starting date was the 1st of July, 2015 and the first corporate plan is required by October, 2015.

The Supplementary Submission makes three recommendations and proposes a Risk Rule to complement (the Audit Rule) to address the already mentioned flaws in the present risk management frameworks:

1. The key risk metric must be Vulnerability, as opposed to Likelihood or Uncertainty;
2. A Risk Rule be developed and incorporated into the performance framework as a complement to the Audit Rule;
  - a. A Draft Risk Rule is attached;
  - b. A Risk Policy-based approach would beneficially anchor the requirement for some statement by Departments and Agencies in respect of Risk Appetite and Risk Tolerance recognizing that these concepts are largely irrelevant absent the concept of Vulnerability and the ability to identify risk chains and the 'real' risks and the 'real' consequences that they are supposed to relate to.
3. Departments and Agencies to develop a tool to identify-and-track signs of "a thing that may be starting to go off the rails" as a first step toward recognizing and deploying vulnerability as the key risk policy metric.