

SCRIPT FOR STEVE FREER, SOUTH AFRICA – 23 JULY 2002

Can I begin by saying how pleased CIPFA is to be associated with this event and to apologise – I've flown in earlier today – for not being here for the Conference opening yesterday.

As it happens yesterday CIPFA was hosting a meeting of the six organisations who make up the accountancy profession in the UK in London. And as you know there are some very significant issues facing the profession throughout the world at the moment.

Now let me turn to the issue I have been invited to address: the role of internal audit in relation to risk management.

First of all [slide 1(a)] right around the world public services are engaged in a struggle to modernise – to deliver more services, to deliver higher quality services, to deliver more efficient services, to give better value for the taxpayers £, dollar or rand.

But there is an important question which we all need to ask ourselves in relation to this struggle. Are we [slide1 (b)] part of the solution or part of the problem.

This is a particularly important question for internal auditors. If they are part of the problem [slide 2] they will be disengaged from the organisation's ambitious agenda to reform; they will be working quietly away in their own comfort zone, lacking any real visibility or stature in the organisation. As far as the people who exercise power, influence and leadership are concerned internal audit may be tolerated but it will certainly not be admired.

Of course, the world does not have to be like that. [Slide 2] Internal auditors can and frequently are part of the modernisation solution. In these circumstances they are very engaged with the big agenda; they are close to the leaders and influencers who drive the organisation; they make recommendations that have real impact and they are highly regarded because their work is acknowledged to add real value.

We can talk about internal auditors playing a key role in risk management in the organisation – but only if internal audit has first of all positioned itself as part of the solution.

Now [slide 3] let's focus on RM which has an increasingly high profile in organisations of all types. We all know that RM makes sense, that it is the right thing to do. We all sign up to the theory but how many of us have really made it happen in practice?

Now let me be clear it is not internal audit's role to make it happen. RM is clearly a Board/senior management responsibility. But how can internal audit legitimately help the organisation to make a reality of good RM which in turn adds real value to decision making and to the success of the organisation?

There is no single right answer to this question. [Slide 4(a)]. Yes the two ends of the spectrum are clear. Whatever internal audit does it must remain objective and independent; and it cannot become responsible for the organisation's RM strategy or for managing risks.

But between these extremes [Slide 4(b)] there is space for all sorts of ideas, innovation and creativity. It is not an option for internal audit to stand so far back that it fails to add value.

To be very practical it can begin by asking the right searching questions [Slide 5].

Asking the Right Questions

- **Is the approach systematic? Does it apply throughout the organisation?**
- **Is it embedded? Do the people who are doing it understand it?**
- **Is it identifying all of the important risks? Are we thinking 'outside the box' as well as inside the organisation?**
- **Are risk management/mitigation strategies actually being implemented?**
- **Are the right people doing the right things? Are the Board and the senior managers really owning the risk management process?**

Internal audit can help the organisation to understand the strategic importance of RM. In particular [slide 6] if Risk is mismanaged it can seriously damage confidence in the organisation. And if confidence is damaged, reputation is threatened. We already know about many of the classic risks which can trigger this very damaging domino effect [slide 7].

Major IT systems attract very bad publicity when they don't work. So do professional services. Isn't that the lesson of Andersen's? They have been blown away because the public simply cannot accept that a professional service provider could act, it appears, so unprofessionally.

Failure in high profile services which are right in the public eye is always likely to be very damaging. We also know that disaffected employees and customers are likely to be a source of significant damage to the organisation. But how many of us have clear policies which recognise and try to mitigate these risks.

Finally, in the public sector, there are particular risks associated with significant commercial judgements because if the commercial bet loses, it is public money which has been wasted.

In the UK we frequently see risk being undermanaged or perhaps not being clearly identified. Sometimes the consequences are devastating. [Slide 8] Group 4 were a very successful company offering a range of security services. About 10 years ago they took on a new contract ferrying prisoners

to and from court. It was a controversial contract because this was the first time this service had been privatised.

In the first weeks of the contract several prisoners escaped. Group 4 became a national laughing stock. Their reputation did eventually recover but it took a very long time.

Railtrack are also a product of privatisation – this time of the UK's railways. Their failure was to poorly maintain the railway network, the track. This was largely unnoticed until a couple of very serious derailments with significant fatalities led to a sudden and unexpected loss of public confidence in the safety of the system. The company's reputation was so badly managed that it is now being wound up.

Unfortunately these problems are not exclusive to the private sector; they happen in the public sector too. The Passports Agency is a story of an unsuccessful IT project. Suddenly people were waiting months for passports to be issued or renewed. Again the loss of public confidence was swift and complete.

The same was true of the Scottish Qualifications Authority who completely mismanaged one set of school examinations in Scotland. If students received their exam results they were invariably late and they were invariably wrong. This became a front-page story in our newspapers.

Finally the Millennium Dome became the UK Millennium Fiasco. Built at huge expense to the taxpayer – more than £600m £ sterling – it attracted massive visitor numbers – more than 6.5 million people in one year. But this was only half the number of visitors predicted in its wildly over optimistic business plan. This is a tale of a commercial judgement which went desperately wrong. Instead of being a symbol of UK achievement to mark the new millennium, it is now a shorthand for catastrophic failure.

I have deliberately chosen some examples of public sector failure to demonstrate that this risk to reputation is not just a private sector phenomenon [Slide 9]. It is a big issue for public services and that means that “managing reputation” is an increasingly important challenge for public sector organisations. There are many increasingly strong pressures in the public services – from customers and public expectation, and from inspectors of services, for example – which mean that there is no hiding

place if risk is badly managed. Poor performance will be exposed and the organisation will be damaged.

So let me return again [slide 10] to my theme – how can the auditors help?

We can help by developing real deep knowledge and understanding of RM which may not exist elsewhere in the organisation. We can position ourselves as the experts on RM.

We can help the organisation to answer some of those key questions about RM which I mentioned earlier. I know more than one large public sector organisation where internal audit have facilitated Board discussions around strategic risks facing the business.

We can help the organisation to learn from other organisations. We can be the doorway through which information is brought into our organisation about others good practice, and – equally important – we can share case studies like those I mentioned earlier where RM has been weak or unsuccessful. Better that we should learn from someone else's disaster rather than our own.

We can also encourage and help the organisation to train for its handling of emergencies. An important dimension of RM is how the organisation responds when emergencies arise. If it manages well a risk will be minimised. If it manages poorly a difficulty may become a catastrophe.

I now want to conclude by challenging you to think about RM in your organisations. Earlier I encouraged you to consider whether you are part of the solution or part of the problem in your organisation. That is such an important question. Now let me pose another : are you able to say with confidence [slide 11] what the key strategic risks are which are facing your organisation? If you are able to answer this question quickly it will be a very positive indicator that RM is beginning to establish its proper profile in your organisation, that consideration of risk is high up the strategic agenda. If you are not able to answer it quickly or confidently it will suggest that there is still much more work to do. If that is the case I hope that you will make every effort to play your part to make the improvements which are needed.