ACCA

CALCULATED RISK:

An introduction to finance professionals' role in understanding risk and building resilience in the public sector

Think Ahead

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About this report

This guide for finance professionals in the public sector explores what risk means for their organisations. Using survey findings from those working in public sector organisations, it examines how finance professionals can improve how they recognise and address different types of risk to support their organisations in preparing for the challenges that lie ahead. The guide highlights that effective public sector organisations need clear objectives, a strong understanding of the threats and opportunities they face and an effective risk management process. By building on their core skills and being open to new approaches, finance professionals can take a lead in addressing risk and help to build a more resilient public sector.

Risk and resilience in the public sector

WATCH **ACCA'S VIRTUAL PUBLIC SECTOR CONFERENCE SESSION** LAUNCHING THIS GUIDE:

A panel discussion with experts explores how finance professionals in the public sector can support their organisations to better understand and address different types of risk. Panelists also look at how effective financial management can help public sector organisations become more resilient in the face of widespread uncertainty, complexity and volatility.

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Executive **summary**

Risk is inevitable; every day those working in the public sector, delivering services and projects, are managing multiple risks. Indeed, the early years of the 2020s have seen an unusually disruptive succession of shocks to the global economy and society. Those in the public sector have been at the forefront of responding to these crises, addressing their effects on the public, while at the same time managing the consequences for the operation of their own organisations.

In addition to the threats to achievement of individual organisations' objectives from internal and external risks, governments also face significant fiscal risks. The International Monetary Fund's (IMF) *Fiscal Monitor* report, from October 2023, sums up the challenge facing the public sector: 'ever growing demand for public spending, associated with high expectations about what the state can and should do, elevated debts, and high-for-long interest rates and political red lines on taxes' (IMF 2023: viii). The outlook for the public finances in many countries is challenging and addressing these risks will require significant change from 'business as usual'.

Attempting to avoid risk would mean the public sector would be unable to meet its objectives. Understanding and managing the risks the public sector faces is therefore crucial to delivering effective public services. This guide emphasises the importance of public sector finance professionals understanding risk management and being clear about their role in the process. Its conclusions and recommendations draw on responses from those working in the public sector to ACCA's survey on risk.

Intensifying the focus on risk management was one of the three key recommendations for both governments and finance professionals in ACCA's *Rethinking Public Financial Management* report (Bandy and Metcalfe 2021). The survey of those working in the public sector reinforced this message, revealing that almost three quarters of respondents (73.4%) believed risks to their organisations would increase in the future. Responses from the survey also demonstrate that in some organisations there is considerable work to be done to fulfil the potential of finance professionals in the risk management process.

This guide identifies a number of key steps finance professionals can follow to build a more effective approach to managing risk in public sector organisations, as well as highlighting current challenges and understanding the state of play.

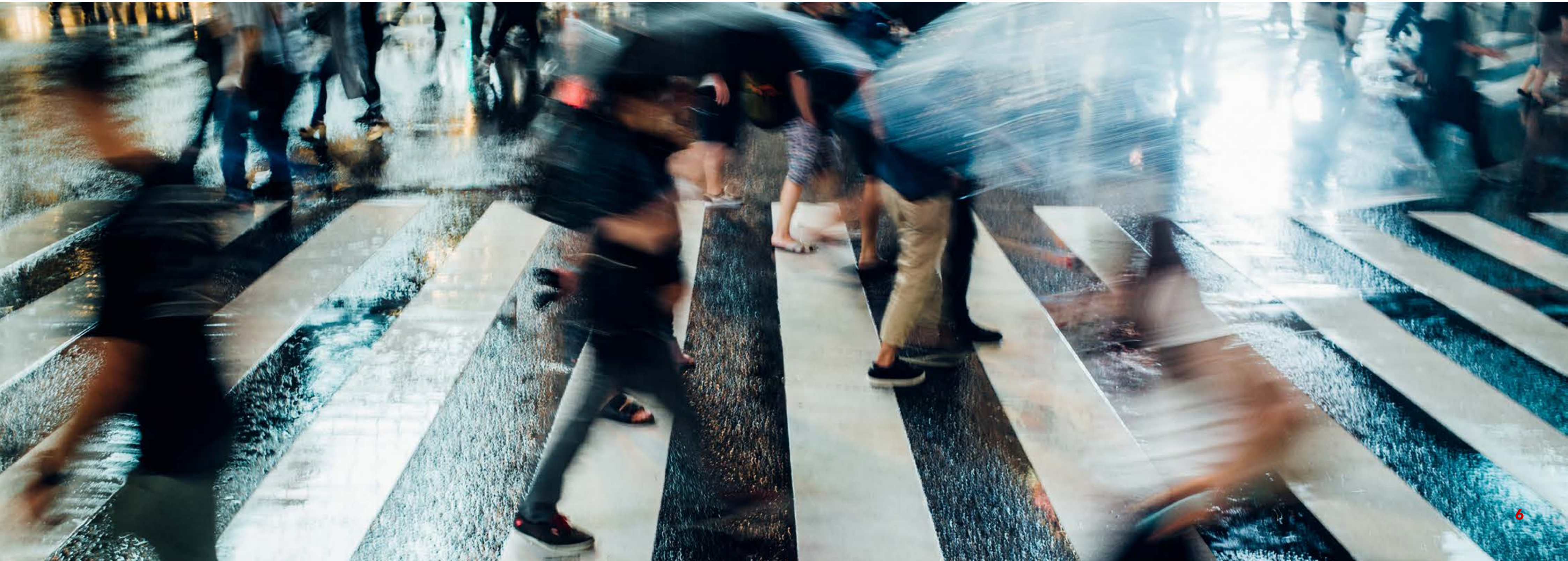
Our research approach

ACCA's survey findings are based on 436 responses from people working in public sector organisations in over 60 different countries worldwide. Almost 9 in 10 respondents were ACCA members or students, working in finance, risk, audit policy and service delivery roles. The survey took place in April 2023.

The examples from the public sector in this report are drawn from several different types of organisations in six different countries. They are based on information publicly available at the time of publication, and references are provided. Their inclusion does not imply endorsement of the report by the organisations identified in the case studies.

1. **Building an effective risk culture and alignment to organisational objectives is a critical first step.**
   The starting point for better risk management in the public sector is for every individual, and the organisation as a whole, to understand what risk means. Finance leaders and staff must share a clear understanding of the organisation's priorities, enabling key risks to objectives to be identified. Given the diversity of services and responsibilities within the public sector, a critical step here is for an organisation to define its goals clearly, and to systematically identify the particular risks that could impact on the organisation's key activities. Linking risks and objectives together helps to develop a healthy 'risk culture' in the public sector where senior management sets the 'tone from the top', but risk is seen as everyone's responsibility. In Chapter 1 we identify the ingredients that help build an effective risk culture within an organisation.

2. **Systematically understanding the risk universe helps risk prioritisation and unsurprisingly, financial pressures in the public sector currently top the list.**
   The huge variety of risks faced by organisations within the public sector is obvious and is brought into greater focus in today's global economy by different economic, financial, social and human capital challenges that must be overcome. Identification of the risk universe, and the unique set of risks a particular public sector organisation needs to address, is key, but there are also a number of core risks that apply across the sector. Our survey revealed fraud and corruption, the ability to finance public services and a talent and skills deficit as top three risks facing the public sector as a whole. But reflecting on their own organisations, it was the sheer scale of financial challenges, in the midst of one of the most challenging inflationary periods over the last four decades, that was unsurprisingly at the top of the agenda.



3. **Finance teams need to be part of the risk horizon scanning process, but our survey suggests many still aren't.** Fewer than half of respondents (47%) agreed that finance staff were regularly and systematically involved in horizon-scanning and assessing external risks. This is a key flaw - the finance function is in a unique position to gain an overarching perspective of how the organisation operates. Finance professionals' strategic view of organisations means they can identify risks across different departments and the links between them. Public sector organisations must ensure finance professionals are integrated into the risk identification process, using their expertise to build a holistic view of risks. This will enable an organisation to better understand its risk profile and shape a culture that helps staff to navigate these risks.

4. **Finance teams should be deploying leading risk management techniques to better evaluate the impact of risks, but most aren't.** Assessing risks, through risk analysis and evaluation approaches, enables the public sector to prioritise risks depending on their likelihood and consequences. A clear understanding of an organisation's risk appetite is vital for prioritising how the risks to its objectives are addressed. As part of the process of determining the risk appetite, the impact and consequences of risks materialising needs to be understood. The finance function can play a central role in risk assessment by identifying the potential costs and benefits of possible scenarios, to underpin decision making on the risks they present. But ACCA's survey identified that only just over a third of respondents (36%) were confident that finance staff in their organisation use techniques such as stress testing or risk analytics to understand the potential impact of particular external risks. Supporting decision-makers with information to be able to prioritise risks should be a core part of a finance professional's role in the public sector.

5. **Risk monitoring practices are falling short, and there are more opportunities for finance teams to bring their skills to drive more robust risk reporting processes.** Our survey highlights that public sector organisations need to do more to strengthen finance staff's involvement in risk monitoring. Less than half (46%) of respondents were confident that the finance function was regularly involved in monitoring non-financial operating risks in their organisation. Senior leaders need to recognise finance professionals' core skills in planning and integrating information and ensure they take a wider role in monitoring and reporting of risks. Increasingly finance functions in the public sector are taking on responsibilities for performance management and including risk within this portfolio is a natural fit.

6. **Upskilling finance teams will help build more resilient public sector organisations for the future.** Building resilience should be a key objective in an organisation's approach to risk management. For public sector organisations to operate effectively in a complex, volatile and uncertain environment, they must be prepared for the potential consequences of a range of scenarios. While the specific nature of external events and shocks cannot always be predicted, developing the skills and capabilities of staff to prepare for their consequences is the most important way of building resilience. The survey identified strengthening staff's risk management skills as the highest priority. In addition, a majority of survey responses highlighted investing more in technology to support organisational resilience as a high priority. Ensuring governance structures are appropriate to building an effective risk culture, use of risk assessments and better use of data held by the public sector were also identified as the key priorities for building resilience. Ultimately, those public sector organisations that are better prepared for the risks they face will strengthen their financial resilience, enabling them to continue to deliver the services that the public expects.

CALL TO ACTION: How finance teams can be supported to help build more effective risk management processes

1. Build an effective risk culture and alignment to organisational objectives

- Understand what risk means to your organisation.
- Bring clarity and communicate organisation objectives.
- Ensure processes are put in place to build a more effective risk culture.
- Governance arrangements should ensure that decision makers are engaged in thinking about and discussing risk frequently, setting a clear 'tone from the top'.

2. Understand your organisation risk appetite

- Senior leadership across the organisation is responsible for articulating its risk appetite.
- Risk appetite needs to be communicated internally and externally.
- Finance teams need to ensure they are aware of the organisation's risk appetite.

3. Understand the risk universe and start to prioritise risks

- Identify and categorise key risks aligned to organisational objectives.
- Build horizon scanning into key planning processes.
- Ensure finance teams build strategic and non-financial risks into their planning activities.

4. Deploy appropriate risk management tools and techniques

- Clearly record how risks can be mitigated on a regular basis.
- Encourage / facilitate senior leadership teams to undertake 'deep dive' reviews on key risks, using audit and risk committees as appropriate.
- Create opportunities for finance teams to better understand non-financial risks across the organisation and their impact.

5. Upskill the finance team to build organisation resilience

- Leverage the skills of finance teams in areas such as stress testing and risk analytics to better assess the impact of different risks.
- Invest in technology for staff and back-office systems to improve the effectiveness of risk management activities.
- Prioritise better data governance and control over information relating to risks.

1. What is risk? The first step in managing risk

What is risk?

The concept of risk is so widespread in both public and private sectors that we rarely stop to consider how risk can be defined. As Michael Power, professor of accounting at the London School of Economics, says, 'the concept remains elusive, contested and "inherently controversial"'(Power 2004).

One of the clearest and simplest definitions for risk comes from the 2009 international standard on risk management, published by the International Organization for Standardization (ISO):

> *Organizations of all types and sizes face internal and external factors and influences that make it uncertain whether and when they will achieve their objectives. The effect this uncertainty has on an organization's objectives is "risk"* (ISO 2009).

This definition highlights three key aspects of risk that need to be taken into account, whether an organisation is in the public sector or private sector, large or small.

- **Objectives:** the definition emphasises the importance of considering how risk affects an organisations' objectives. This focus must be integral to every organisation's approach to risk and this aspect is explored in more detail below.
- **Uncertainty:** while risk is often seen as negative, being a threat to the achievement of an organisation's goals, it also encompasses positive opportunities which can materialise and have a beneficial effect on the achievement of objectives. The key point is that these events and actions may occur, but are not part of 'business as usual'.
- **Internal and external factors:** categorising risks according to whether they originate from internal or external factors helps identify the range of risks faced by an organisation. The way in which risks can be categorised is discussed further in Chapter 2.

Identifying objectives

Before an organisation identifies and plans for risk, through a risk management process, it must have a strong understanding of its objectives. The Scottish Government's *Public Finance Manual*, which provides guidance to government departments in Scotland, makes this point plainly. It states: 'If you aren't clear what your aims are then you can't identify your risks effectively' (Scottish Government 2023).

While identifying objectives may, at first glance, appear to be a straightforward task, public sector organisations usually have multiple objectives and may be delivering a wide range of services or functions. Although private sector organisations can be large and complex, they generally have one or a small number of overarching objectives; moreover, these objectives can generally be aligned in pursuit of the overall goals of the organisation.

In contrast, in the public sector, organisational objectives can sometimes be in conflict with each other, although this is not always recognised or explicitly acknowledged. For example, in response to the rising cost of energy, some governments have subsidised the cost of gas and electricity to consumers, even though this effectively encouraged greater use of energy than otherwise would be the case. This has the effect of increasing greenhouse gas emissions despite government commitments to reduce carbon emissions under the UN's Paris Agreement (United Nations n.d.).

Linking objective and risks

HM Revenue and Customs, United Kingdom

HM Revenue and Customs (HMRC) is the public sector body responsible for operating and collecting taxes raised by central government in the UK. HMRC clearly sets outs its five strategic priorities on its website and at the front of its annual report and accounts (HMRC 2023). Also prominent in the first few pages of its annual report and accounts document is a summary identifying nine key risks to its strategic objectives. In the report's 'performance analysis section', the strategic objectives linked to each of the nine key risks are clearly identified.

Building a risk culture

Building an effective risk culture and alignment to organisational objectives is a critical first step.

Public sector organisations need to develop a shared understanding of what risk means. ACCA's report *Risk Culture: Building Resilience and Seizing Opportunities* describes this as 'thinking of risk as a language that everyone in the organisation speaks' (Johnson 2023: 18). While everyone in the workforce needs to be engaged in the risk management process, it is vital that senior leaders set the 'tone from the top', a phrase often used to describe leaders' role in establishing an ethical culture.

The senior leadership team in a public sector organisation must ensure that the risks associated with the organisation's objectives are clearly identified and communicated. Making this link is critical for engaging staff in understanding the importance of risk to the organisation. Often, public sector organisations have audit and risk committees with external non-executive members to provide challenge to management. These bodies have an important role in scrutinising and questioning the risk-management arrangements, to test the organisation's assumptions in identifying, assessing and addressing risks.

The policies, processes and practices of an organisation all matter in establishing an effective approach to risk management. Structures need to be in place to ensure that decision makers, and all staff, are engaged in thinking about and discussing risk on an ongoing basis. ACCA's *Risk Culture* report (Johnson 2023) sets out how an effective risk culture enables the organisation to develop an environment where risk management is integrated in all functions and processes. Figure 1 below, taken from that report, highlights the key behaviours in an organisation with a good risk culture. Effective governance is a critical component, as the *Risk Culture* report's calls to action make clear. Governance starts with role clarity, ensuring everyone understands who is responsible for what.

FIGURE 1: Behaviours associated with a good risk culture

- Demonstrating a positive attitude towards the management of risk
- Considering risk in every business decision that is made, *before* the decision is made
- A good risk 'nervous system': strong and open communication channels where bad news travels faster than good news and escalation happens as soon as a problem or issue arises
- Taking responsibility for risks and controls, honesty, and clear ownership of risk
- Encouraging and educating others in the management of risk

2. What risks does the public sector face?

Identifying and categorising risks

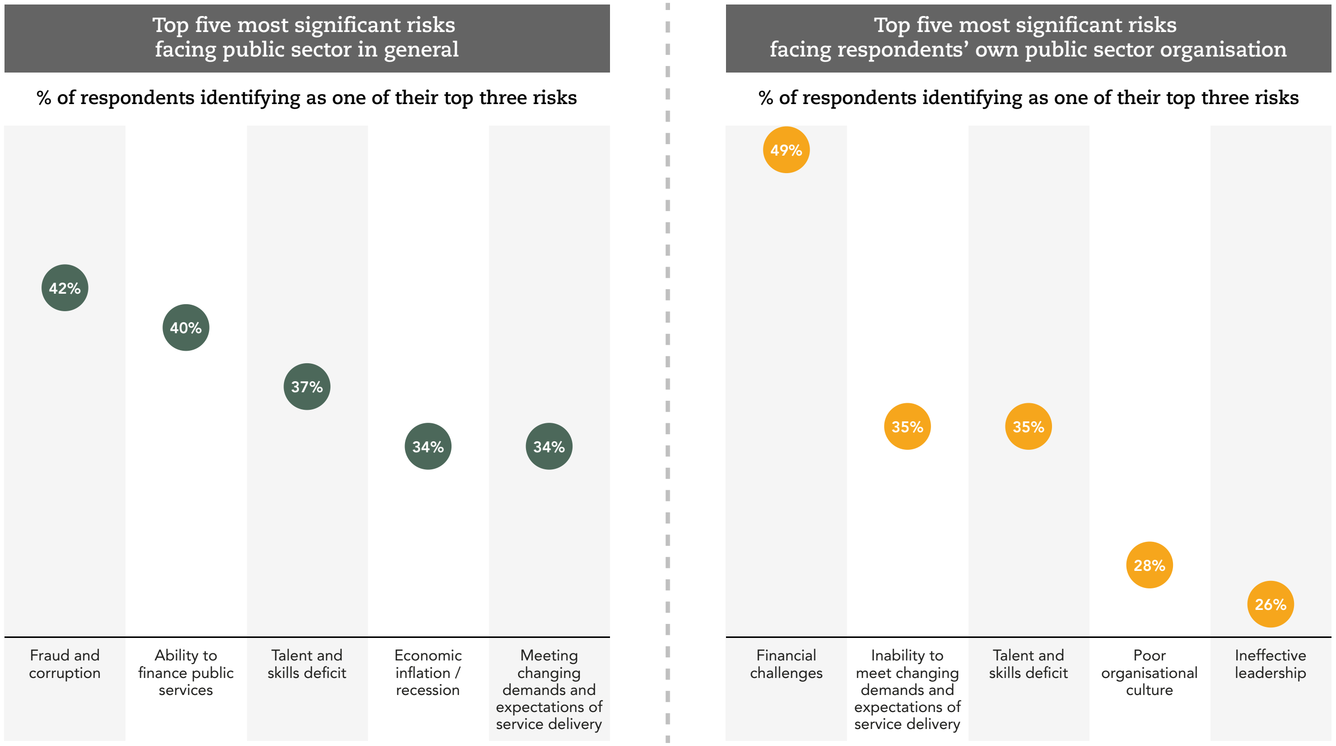
Key risks for the public sector

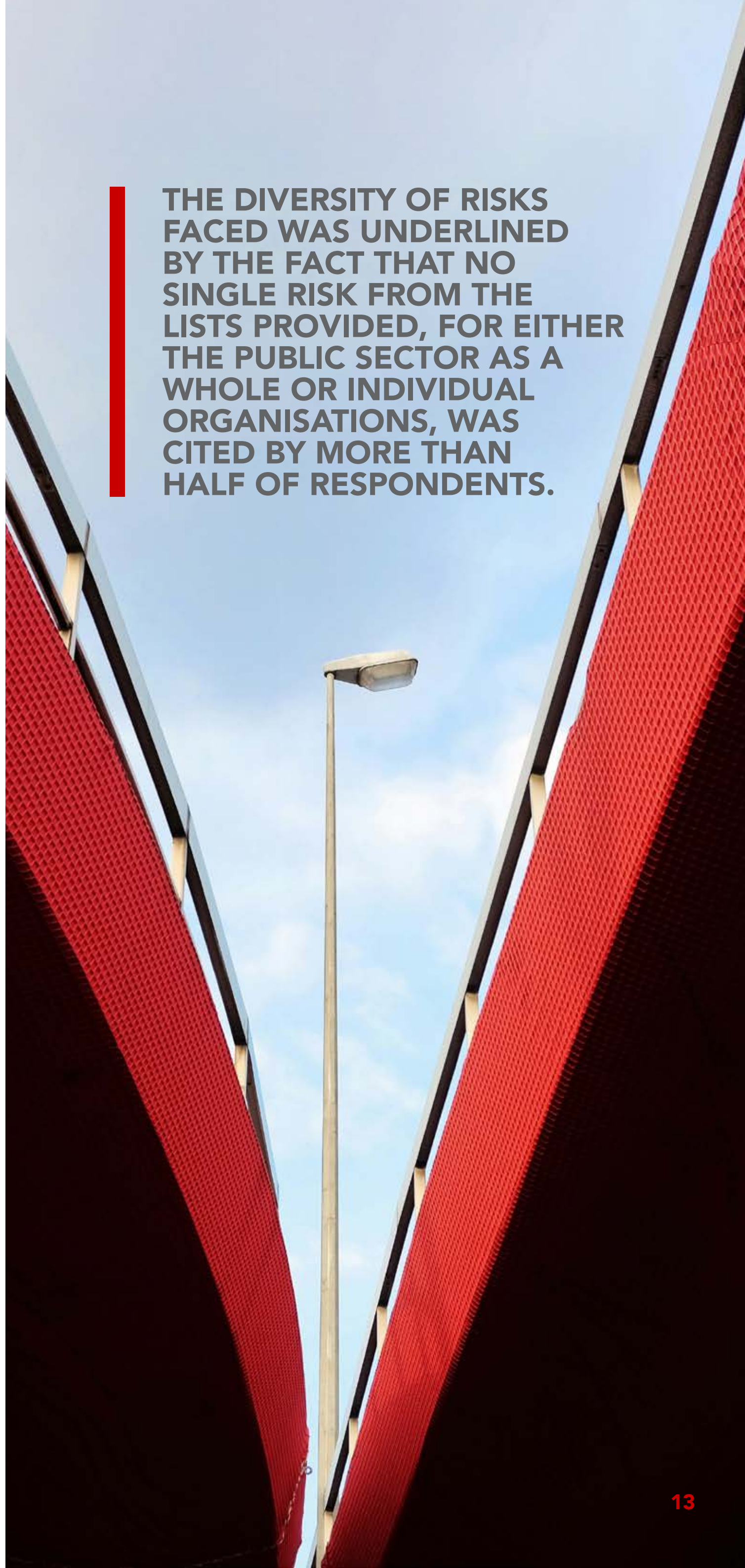
Systematically understanding the risk universe helps risk prioritisation and unsurprisingly financial pressures top the list.

The term 'risk universe' is often used to describe a comprehensive view of all the risks an organisation faces. The phrase highlights the scale of the challenge: each public sector organisation faces its own unique set of risks, dependent on a wide range of factors. Nevertheless, when defined broadly, there are some common risks faced across the public sector. Our survey asked those working in the public sector to identify, from a list of multiple options, up to three of the most significant risks, firstly for the public sector as a whole and, secondly, for their own organisation. When respondents were asked about their own organisation, financial challenges were cited most frequently by a considerable margin.

However, the responses to the survey also highlighted the broad range of risks identified by those working in the public sector. The diversity of risks faced was underlined by the fact that no single risk from the lists provided, for either the public sector as a whole or individual organisations, was cited by more than half of respondents. Nonetheless, both for the public sector as a whole, and individual organisations, five risks were cited by more than a quarter of respondents in their 'top three'. Figure 2 below shows the responses.

FIGURE 2: Risks perceived by survey respondents in public sector organisations





Identifying risks

Before an organisation can begin to manage risks, it must clearly understand the risks it faces. As we have seen, the organisation's objectives are the starting point for identifying risks; organisations need to focus on the risks that could prevent the achievement of these objectives. Here, it is important to highlight that risks include failure to take opportunities, as well as threats. There are two stages in risk identification: initial risk identification and ongoing risk identification.

For the public sector, the identification of risks rarely starts from a blank sheet of paper. However, for new organisations, those that have not previously identified risk systematically or organisations launching a new activity or project, initial risk identification is the first step. But, identifying the risks faced by an organisation is not a discrete, one-off event. Risk identification is a continuous process of identifying new risks as they arise and changes in existing risks, as well as identifying risks that are no longer relevant to the organisation.

Empowering staff

As the UK government's handbook on risk management, *The Orange Book,* states '[e]veryone in an organisation has some responsibility for risk management' (UK Government 2023: 47). All staff working in a public sector organisation should be empowered to play an active part in identifying risks and ensuring these are reported into the risk management process for consideration. ACCA's survey suggested that some public sector organisations need to do more to create a culture where all staff are involved, as Figure 3 highlights.

The survey showed that some public sector organisations are neglecting the valuable insight of staff working on the frontline. Identifying risk is a two-way process: organisations need to be made aware of any risks that are not already formally identified and those working within service areas are often in the best place to identify such risks. Using the knowledge and expertise of staff working in each part of an organisation to build up a profile of risk is critical for a comprehensive understanding of risk.

Working together

In addition, it is important to consider how external expertise can be used to ensure that all risks have been identified. Given the differences between the public and private sectors, engaging with other public sector organisations to review risks can provide valuable insight and be mutually advantageous. It may also help to identify where public sector bodies could work more closely together to manage risks.

Risk identification

Office of the Accountant-General's Risk Management Support Unit, South Africa

South Africa's National Treasury department has a Risk Management Support Unit, within the Office of the Accountant-General. The unit is responsible for providing risk management support to public sector organisations at national, provincial and municipal levels. It has developed a 'Public Sector Risk Management Framework' (National Treasury n.d.) to respond to legislative requirements for public sector bodies to implement and maintain effective, efficient and transparent systems of risk management and control.

Within the Framework, the section on 'Risk Identification' outlines that internal and external factors risk factors should be considered through a systematic process, with three focus points for risk identification:

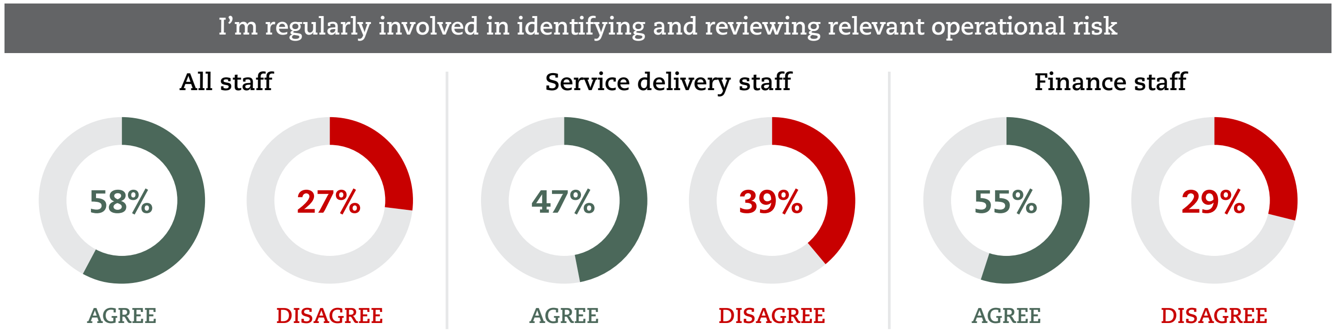
Strategic risk identification: risks associated with the strategic choices, specifically 'whether such choices weaken or strengthen' an organisation's ability to exercise its legal mandate.

Operational risk identification: risks to the public sector organisation's operations, including seeking to establish vulnerabilities relating to 'employees, internal processes and systems, contractors, regulatory authorities and external events'.

Project risk identification: risks inherent to particular projects throughout their whole lifecycle, especially major projects.

The Handbook advises that the risk identification process for all three areas should be repeated at least once a year to identify new and emerging risks.

FIGURE 3: Involvement in identifying and reviewing operational risks



('Don't knows' remain the balancing figure)

Categorising risks

To make the task of identifying risks more manageable, they can be considered in different ways. Commonly, risks are grouped into internal and external risks, as highlighted in the ISO's definition of risk outlined above. In addition, sometimes the most significant risks to an organisation are categorised separately as 'strategic', referring to risks that are fundamental to an organisation's overall objectives. Finally, the risks specifically associated with major projects or change programmes can be separately identified as a category of risk.

Categorising risks

HM Revenue and Customs, United Kingdom

HMRC's annual report and accounts (HMRC 2023: 105) identifies the two main types or categories of risks it manages: strategic risks and process risks.

- **Strategic risks:** risks identified as affecting the management of HMRC and the delivery of its strategic objectives.
- **Process risks:** risks identified as affecting the efficient operation of HMRC's processes.

In line with the ISO's definition of risk, this report uses the broad categories of internal and external to classify the risks that public sector organisations face. Risks that are fundamental to the achievement of an organisation's objectives can have internal and external causes; therefore, when using a definition of external and internal risks, a separate 'strategic' risks category alongside internal and external risk categories could complicate matters. Similarly, organisations may wish to categorise risks associated with projects separately, although many projects will share common features with the internal and external factors explored below.

Internal risks

Internal risks, as the ISO's definition sets out, are internal factors and influences that make it uncertain whether or when an organisation will achieve its objectives. They stem from uncertainties associated with the organisation's day-to-day activities. Internal risks are sometimes described as operational risks, defined by the Basel Committee on Banking Supervision (BCBS) 'as the risk of loss resulting from inadequate or failed process, people and systems' (BCBS 2023). Although this definition was developed for the specific context of the regulation of banks, it provides a helpful focus for the types of internal risks all organisations face: process, people and systems.

In many instances, public sector organisations will face similar risks to organisations in other sectors. Unlike many smaller private sector organisations, however, governments and large public sector bodies are generally very complex organisations. As a result, a wide range of specific internal risks will exist in every organisation; in many cases these will be individual to each organisation, but they can be grouped into some broad categories. The BCBS definition refers to the 'risk of loss'; if instead this is widened to the risk of failing to achieve objectives, the three categories can provide an appropriate framework for the public sector. Figure 4 below shows how these three broad types of risk can be applied in a public sector context.

FIGURE 4: Internal risks in the public sector

PROCESS	A public sector organisation's core purpose is to deliver or facilitate the delivery of a service or services to the public. To do this it needs effective processes for day-to-day service delivery or oversight of delivery, as well as project management. Service failure occurs when services are not delivered within agreed or established terms. Project failure occurs when the project is not completed on time, to the agreed specifications or within budget.
PEOPLE	An effective workforce is critical to successful public services; for many public sector organisations staffing represents a significant proportion of the budget. Organisations' objectives will not be achieved without sufficient staff, with the appropriate capacity, to deliver services. This requires an effective approach to recruitment and retention, to ensure staff have the right skills and relevant and appropriate levels of training. ACCA's *Global Talent Trends* survey highlights in more detail some of the challenges facing the public sector in this area.
SYSTEMS	Effective processes and people are supported by reliable and well-functioning systems, underpinned by technology. These include the organisation's financial systems, data management and security arrangements, as well as performance management and reporting systems. If these systems are not properly established, maintained and resourced, organisations will not be able to deliver effective services. Such problems will consume disproportionate attention and time of an organisation's staff and management which could otherwise be focused on achieving objectives.

External risks

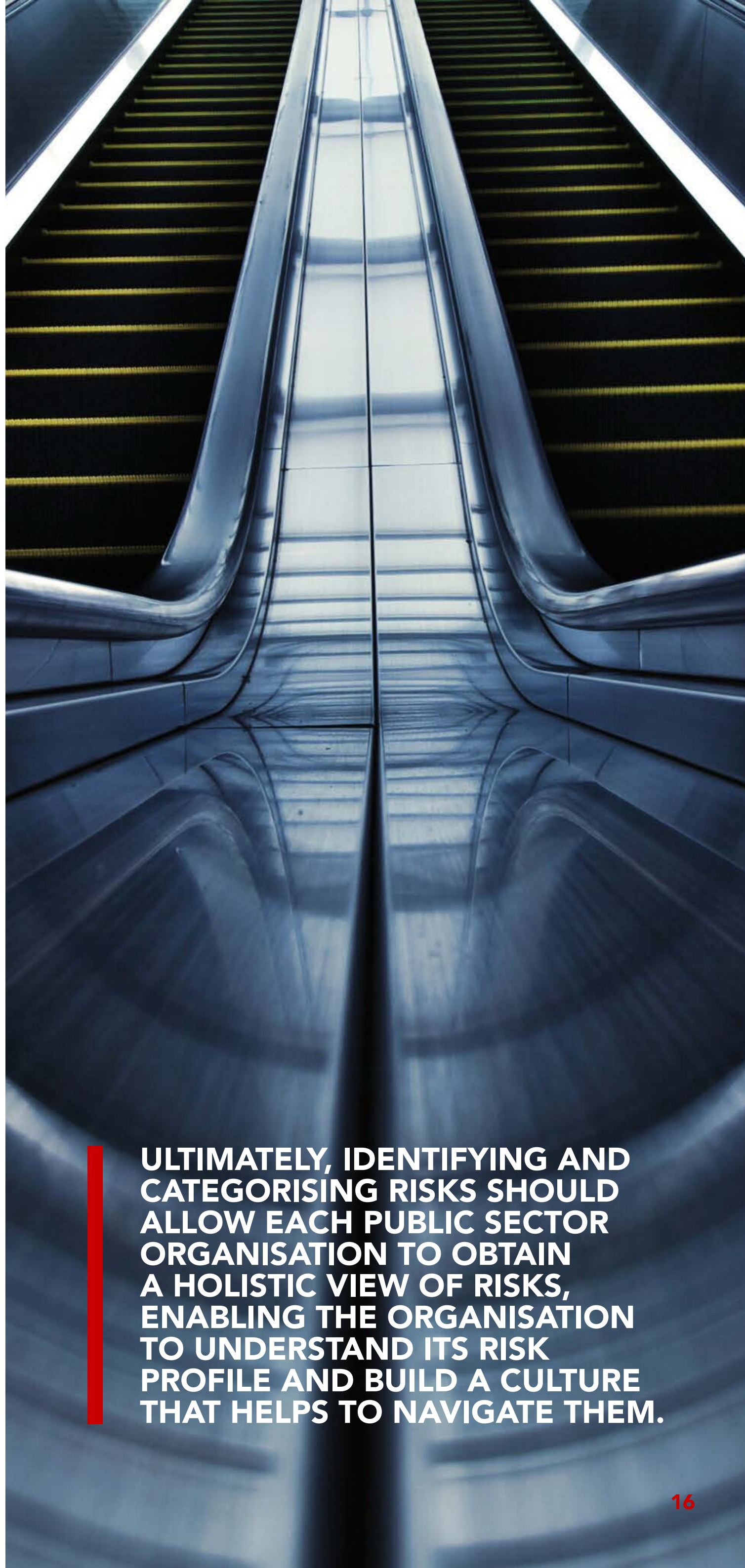
External risks to an organisation arise from any external factors and influences that cause uncertainty about the achievement of objectives. By definition, these risks originate in the external environment and their occurrence is beyond the direct influence of an organisation. Identifying such risks is inevitably more difficult and the potential range of risks is wide, especially for public sector organisations with a broad remit. Nevertheless, recognising these risks, as far as possible, is important, as they can have significant impacts.

A well-established approach for analysing the external factors that can affect an organisation's operations and decisions is PESTLE (Political, Economic, Socio-Cultural, Technological Legal and Environmental) analysis. This framework can equally be applied to risk. Figure 5 below shows how these six types of risk can be applied in a public sector context.

Ultimately, identifying and categorising risks should allow each public sector organisation to obtain a holistic view of risks, enabling the organisation to understand its risk profile and build a culture that helps staff to navigate them.

FIGURE 5: External risks in the public sector

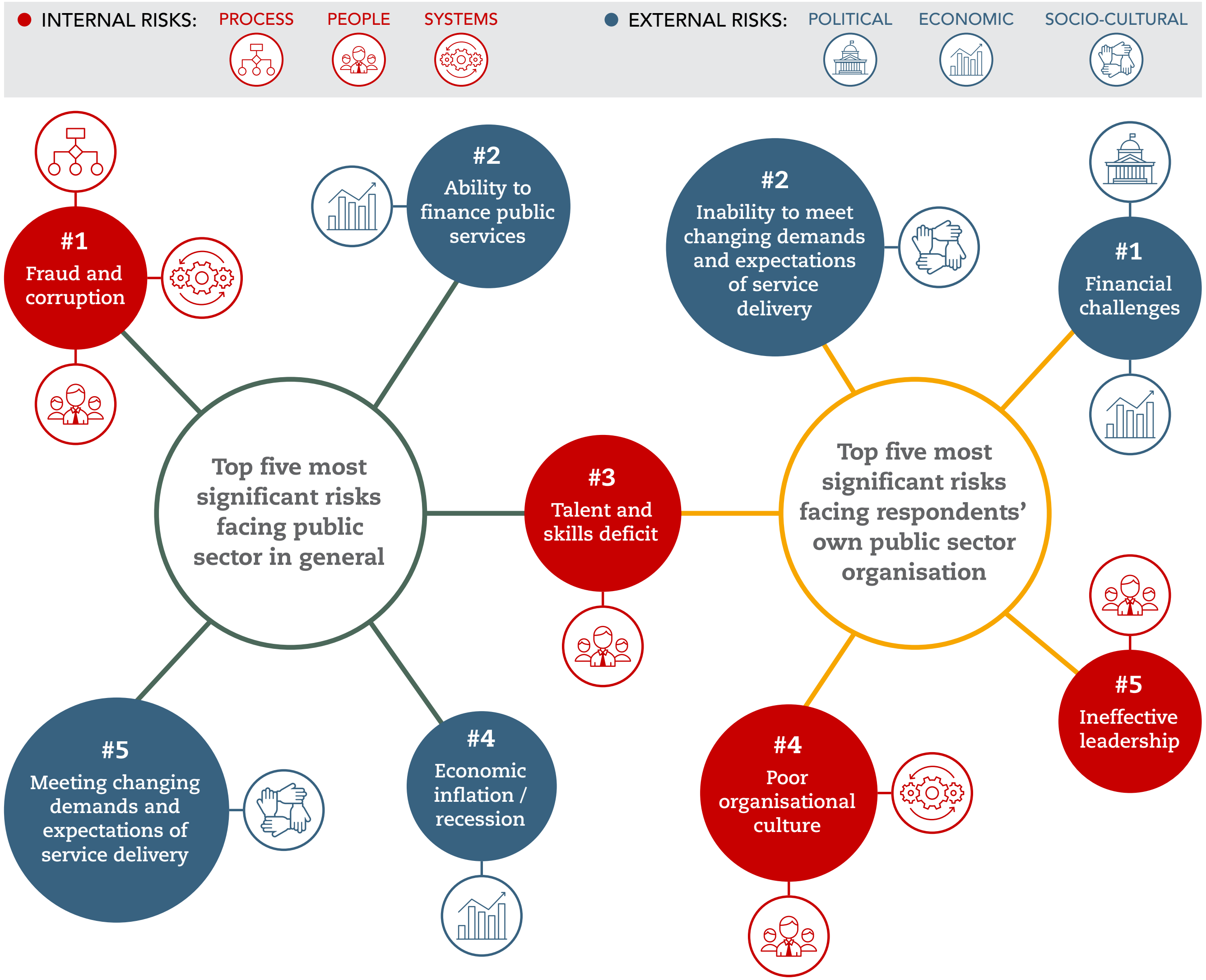
POLITICAL	Public sector organisations are used to operating in a political environment: political decisions, such as changes in political leadership, changes to departmental responsibilities and cross-cutting policy decisions, can all pose risks to existing objectives.
ECONOMIC	Economic risks can take several forms. Economic downturns increase pressure on public services and welfare spending while reducing revenues. For some organisations, currency and exchange rates affect the costs of international transactions.
SOCIO-CULTURAL	Changes in society can affect demand for and expectations of public services. Increases in population generate demands that existing funding allocations may not be able to meet. Growing expectations of citizens for government intervention in the economy also cause pressures.
TECHNOLOGICAL	Rapidly developing forms of technology, notably artificial intelligence, could bring fundamental changes and significant opportunities to the public sector. At the same time, organisations' ability to operate is threatened by obsolescent technology or poor defences against cyber-attacks.
LEGAL	Legal and regulatory requirements at local, national and international level can constrain public sector bodies if undertaking innovative projects. Public sector organisations also sometimes have to fulfil legal obligations to stakeholders as part of their mandate.
ENVIRONMENTAL	One-off weather events or natural hazards can cause severe disruption to service delivery, as well as the associated impact of the response and recovery. The longer-term effects of climate change are wide-ranging and could be catastrophic.



Categorising risks in the way outlined above may not be appropriate for every public sector organisation and therefore each organisation should adopt an appropriate categorisation to reflect its own specific circumstances.

Figure 6 below shows the key risks for the public sector identified in ACCA's survey (see Figure 2) grouped into internal or external risks, and further categorised into the types of risk outlined in this Chapter.

FIGURE 6: Categorising key risks for the public sector



The role of finance professionals in identifying and categorising risks

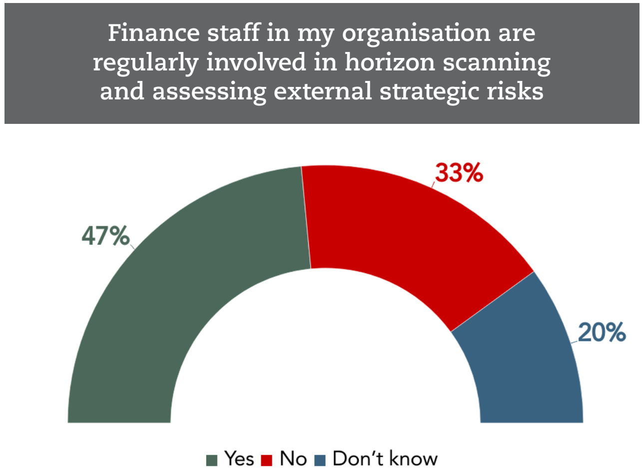
Finance teams need to be part of the risk horizon scanning process, but our survey suggests many still aren't.

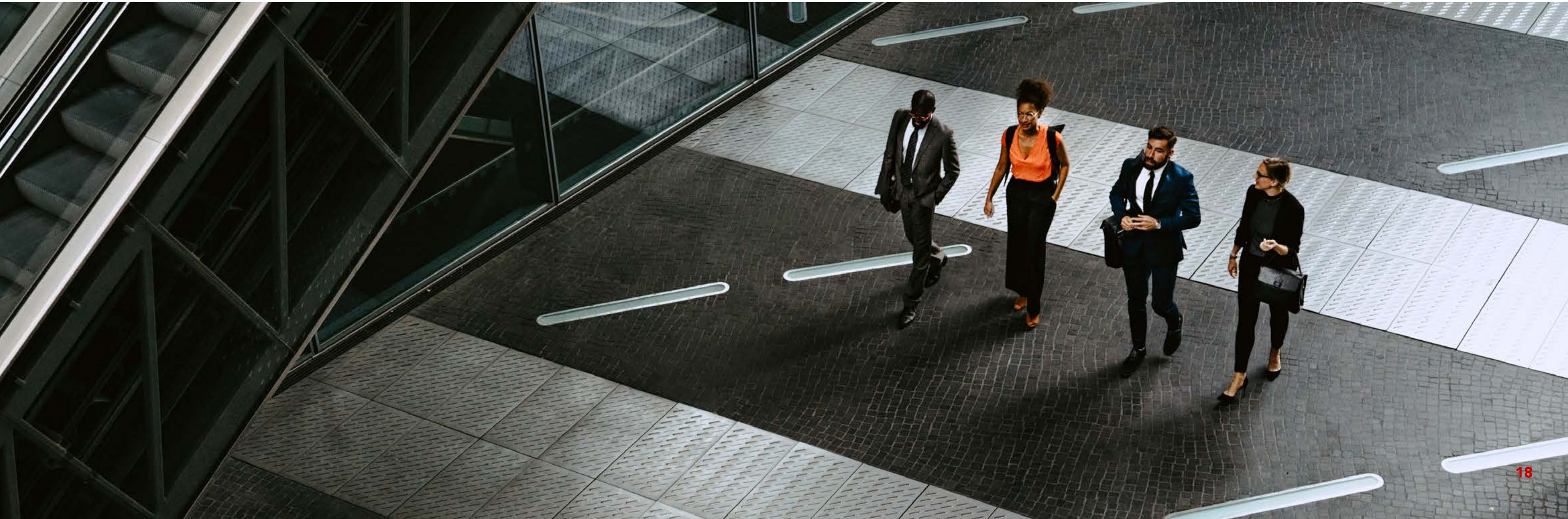
Finance professionals' focus on risk has traditionally been in the context of financial risks. In ACCA's survey, 61% of respondents who worked in finance cited 'financial challenges' as one of the most significant risks facing their organisation. This preoccupation is understandable, reflecting finance professionals' role within organisations. But, in their work supporting those who deliver services in public sector organisations, finance professionals are often better placed than most to identify all types of risks. In many organisations the finance function is in a unique position to gain an overarching perspective of how the organisation functions, given its interactions with staff across different departments.

However, the survey found that finance staff's involvement in identifying non-financial risks, in particular, was often limited. As Figure 3 above highlights, only just over half of finance staff survey agreed with the statement 'I'm regularly involved in identifying and reviewing relevant operational risks'. The survey also found that for strategic risks, fewer than half of respondents (47%) agreed finance staff were involved in 'horizon scanning and assessing external strategic risks' as Figure 7 shows. Further progress is needed to embed the role of finance staff in risk identification, particularly of external risks.

This will require change from the top down and bottom up. Decision makers need to involve the finance function in the whole risk management process, rather than seeing their role as limited to advising on financial risks. At the same time, finance professionals must ensure they are working with colleagues across the organisation to produce relevant and high-quality information, to enable decision makers to understand the consequences of their decisions.

FIGURE 7: Involvement of staff in assessing external strategic risks





3. **Deciding what to prioritise** – assessing risks in the public sector

Assessing risks

Once risks have been identified and categorised, the next stage is to assess them, to determine and prioritise how they are managed. This helps the organisation understand which risks, from the range identified, will have the most significant impact on achieving the organisation's objectives. The UK government's *Orange Book* identifies two key elements of the risk assessment process: risk analysis and risk evaluation (UK Government 2023).

Risk analysis

Risk analysis focuses on defining the level of risk, based on the likelihood that a specific risk will materialise and the impact if it does. It involves applying a consistent set of criteria to all the risks that have been identified and categorised by an organisation. This requires, at a minimum, a process of measurement, assessing both the potential impact and likelihood of each risk materialising. The measurement process results in an overall risk score, which can be expressed either as a qualitative or quantitative measure. Figure 8 below explains the terms used.

The criteria should define both the impact and likelihood on a scale. For instance, whether the probability is unlikely, moderate or almost certain. For impact, definitions will need to consider what level of impact could be assessed as minor, major or catastrophic, for example. This will generally result in a matrix or risk map, which can be used to rank risk scores for the risks identified. Depending on the needs of an organisation, the framework for assessing risk can vary in complexity.

The level of detail in the risk analysis will reflect a combination of factors, including its purpose and the evidence available to make judgements about impact and likelihood. These limitations need to be explicitly acknowledged and understood when reporting risks to decision makers. At the same time, the risk analysis should be understandable by everyone working in the organisation and, importantly, enable meaningful differentiation between risks, to allow effective monitoring, ranking and prioritisation.

FIGURE 8: Measuring risk

Impact	Likelihood	Risk score
The measure of consequences – the severity of an event should it materialise.	The probability that an event will occur during a certain period.	The overall risk score is the product of the two metrics – impact multiplied by likelihood.

Risk assessment

Government of Jamaica Risk Management Guidelines

The Government of Jamica has produced risk management guidelines for central government departments (Government of Jamaica 2021). The guidelines set out the process for assessing risk score, based on the two parameters of likelihood and impact, with risk prioritisation weighted toward impact.

Impact: the guidelines provide a range of four ratings for impact from 1 to 4: minor, moderate, major and catastrophic. It also considers five types of impact: objective delivery, reputation, financial cost, human resources and ability to operate.

Likelihood: The assessment of the likelihood of a risk occurring is similarly scored on a range from 1 to 4: highly unlikely, unlikely, likely and highly likely. The timeframe for scoring is set as three years, to match the strategic planning cycle.

Risk evaluation and risk appetite

The second stage of the risk assessment process is risk evaluation. Before an organisation begins the process of addressing risks, it needs to have a clear understanding of the type and extent of risks it is willing to take. This 'risk appetite' is defined as the 'amount of risk that an entity is prepared to accept or be exposed to at any point in time' (QAO 2020).

As the definition of risk outlined in this report makes clear, risks can be a threat to realising objectives or present an opportunity that can support their achievement. If the risk is a threat, then the risk appetite is effectively the level of exposure that the organisation is prepared to accept and justify if the risk materialises. Conversely, for opportunities, the risk appetite represents the extent to which potential losses can be accepted in order to obtain the benefits of the opportunity.

Understanding and communicating risk appetite

ACCA's report *Risk Culture: Building Resilience and Seizing Opportunities* (Johnson 2023) takes an in-depth look at the subject of risk appetite. It emphasises that even in organisations where there is a good level of understanding of what risk appetite 'is supposed to be', it does not necessarily follow that the behaviours and culture inside an organisation reflect the stated appetite for risk taking. It is critical therefore that the risk appetite for specific risks is clearly communicated to support building a successful risk culture.

Generally the term 'risk appetite' is used to set the overarching acceptable level of risk for particular activities or objectives. The concept of 'risk tolerance' is also sometimes used by organisations to describe the level of variation from the overall level set by the risk appetite, for individual risks. For effective risk management, an organisation must systematically consider its risk appetite and risk tolerance for its different activities and functions, including, where appropriate, its delivery arms or bodies.

The senior leadership need to set the tone by determining the risk appetite for the organisations' key responsibilities; as the UK National Audit Office (NAO) highlights, by 'being clear about where [the organisation] is prepared to tolerate more or less risk, those at the top can drive the right sort of behaviour' (NAO 2011: 8). Clear leadership is required, as defining risk appetite is not a straightforward process for the public sector, given the need to balance achieving objectives with the responsibility for ensuring value for money.

A single overarching statement of risk appetite will not generally be appropriate for public sector organisations, but clear risk appetite and risk tolerance statements for key risks are important. Wherever possible a statement of an organisation's risk appetite should be set out publicly, to provide transparency to taxpayers and service users about an organisation's attitude to its key risks. An example of such an approach is provided in the case study below. This transparency supports broader accountability for delivery and spending in the public sector.

Clear statements of risk appetites encourage a focus on the achievement of objectives, obliging the organisation to consider its attitude to risk in a transparent way and improving awareness and understanding of its priorities. They should be regularly reviewed by senior leaders and the audit and risk committee. Ultimately, a well-defined set of risk appetites should help decision-making to become more consistent across an organisation and minimise the decisions that do not align with its objectives.

Risk appetite

Food Standards Australia New Zealand

Food Standards Australia New Zealand (FSANZ) is an independent statutory agency which develops standards to regulate use of ingredients in food to give consumers confidence in the safety of food.

It publishes a publicly available 'FSANZ Board Risk Appetite Statement' which 'sets the amount of risk the FSANZ Board is willing to accept in order to achieve agency objectives' (FSANZ 2023). For eight of the agency's key activities, it provides a visual indication of the relative level of risk tolerance and a clear, brief statement of its risk appetite. It ranks its risk appetite for its core activities from 'zero tolerance and no appetite for risk' to 'moderate to high'.

Finance professionals' role in assessing risks

Finance teams should be deploying leading risk management techniques to better evaluate the impact of risks, but most aren't.

As part of the risk analysis and risk evaluation process, finance professionals can support the quantification of the likelihood and impact of risks. This will not be possible for every risk, as not every risk has a financial implication. Nevertheless, as far as possible, risks should be costed and finance professionals in the public sector are experienced at producing estimates for costs of differing policy options. Finance professionals can use a range of approaches to model scenarios. However, as Figure 9 shows, ACCA's survey suggests involvement of finance staff in the risk analysis and risk evaluation process is not embedded across all public sector organisations. In particular, only just over a third of respondents were confident that their organisation's finance function uses techniques to understand how external risks might impact the organisation.

The UK NAO highlights that risk management is 'part of the discipline of ensuring the achievement of the organisation's objectives within its available resources' (NAO 2011). Approaching risk analysis in this way should therefore be seen as part of finance professionals' core role, with decisions on risk made on the same basis as investment decisions. As ACCA's *Rethinking Risk for the Future* report highlighted, finance professionals can help public sector organisations 'manage risk better by greater focus on the practicalities, by considering the possible outcomes of a wide range of scenarios but also by forming a plan of action for addressing such analyses' (ACCA 2021: 58).

For risk evaluation, assessing risk appetite involves, in the case of a threat, comparing the financial costs of constraining the risk with the cost of the exposure if the risk materialises. For an opportunity, the value of potential benefits needs to be assessed against the losses that may be incurred, recognising that some losses may be incurred whether or not the benefits are realised. Using all the available quantitative and qualitative data an organisation holds to inform risk evaluation is important; an evidence base helps to build the comprehensiveness and credibility of the risk assessment.

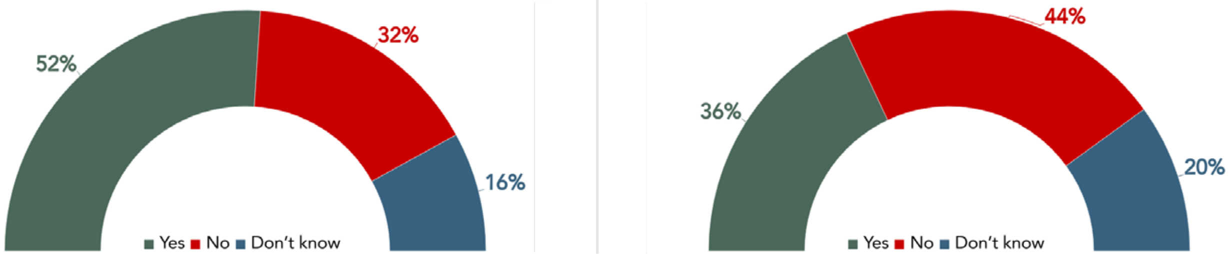
However, it is important to note that when assessing future scenarios, a significant degree of judgement and estimation is often required. It will not always be possible to make accurate financial forecasts of different options or outcomes. Consequently, finance professionals also need to draw on the broader range of capabilities identified in ACCA's Career Navigator. In particular, collaboration with colleagues, as well as external experts where appropriate, is critical to build an evidence base. Likewise, the ability to communicate clearly and influence with impact are also essential in ensuring senior leaders understand the inherent challenges in assessing risks.

FIGURE 9: Extent of involvement of finance staff in risk analysis and evaluation

Finance staff in my organisation are regularly involved in...

...helping the organisation make risk choices and trade-offs relating to the strategic opportunities of the organisation

...using techniques such as stress-testing or risk analytics...to understand the potential impact of particular external risks



4. **How can the public sector address risks?** Responding to, reporting and monitoring risk

Once risks have been identified, categorised and assessed, the next step is to formulate a framework for addressing them. Risk analysis and evaluation will enable the organisation to determine those risks for which additional action is required, taking into account risk appetite. Once a risk is assessed, action needs to be taken to address that risk, together with arrangements for monitoring and future reporting.

Responding: The Four Ts of risk

An approach in widespread use which can be applied to the public sector is known as the 'Four Ts' of risk management: **tolerate**, **treat**, **transfer** or **terminate**. Figure 10 identifies each of these responses in more detail in the public sector context.

For each risk there could be several responses available to the organisation. In some instances, the response will be obvious, but in many cases public sector organisations will need to consider their response carefully, balancing their legal responsibilities to deliver services and perform functions with value for money considerations. In particular, the 'transfer' and 'terminate' options may not always be suitable responses for the public sector. In determining the appropriate response, organisations must weigh up the cost of each option, its potential feasibility and any disadvantages associated with the response.

Even though transferring risk may appear to be an attractive option, ultimately because of its accountability to the public, it may be more pragmatic for a public sector organisation to retain control of a risk. Similarly, an organisation will not always be able to terminate a risk by discontinuing services or activities that pose a threat to its objectives. Expectations from politicians, service users and the public more widely, as well statutory responsibilities to deliver functions and services, mean risks will need to be treated rather than terminated.

Once a decision is made on how to address each risk, it must be clearly recorded, enabling those involved in each risk to understand the response and to facilitate monitoring and review. The method used by each organisation for recording risks must be sufficiently comprehensive to include the reasons for selecting a particular treatment, including the expected benefits and the resources required. It should detail the actions that need to be carried out, the timescales and, importantly, who is responsible and accountable both for approving actions and carrying them out.

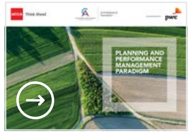
FIGURE 10: The Four Ts: Responses to Risk

OPTION	TYPE OF RISK	DESCRIPTION	OUTCOME
TOLERATE	Usually significant external risks, which may arise as public sector organisations pursue their objectives.	Tolerating risks does not involve a specific response either because the organisation has limited ability to respond or the cost of any action to mitigate it would be disproportionate to the benefit gained. The risk may also be tolerated because there is a potential to pursue an opportunity.	The risk is retained through an informed decision but continues to be tracked, in case the likelihood or potential impact change.
TREAT	The majority of risks faced by public sector organisations are likely to be in this category, including most internal and some external risks.	For internal risks, it is generally possible to identify measures to treat the risk. The actions can focus on the likelihood or impact or both where possible. Taking action should either eliminate the risk altogether or reduce the impact, should it materialise, to a level consistent with the risk appetite. Actions can involve control measures and / or contingency measures.	The risk is mitigated by reducing the likelihood and / or lessening the consequences. Each risk should continue to be monitored to ensure the mitigations remain effective.
TRANSFER	Risks for which this option is available will depend on the market options.	Transferring risk to other parties through commercial contracts and outsourcing activities can enable specialist skills and experience to help mitigate a risk. Risk-sharing through conventional insurance or other partnership mechanisms can reduce the financial impact if a risk materialises.	The risk is transferred or shared through formal arrangements with a third party or through insurance, combined with monitoring.
TERMINATE	Risks where the impact and likelihood are high, and which are not critical to the achievement of the public sector organisation's objectives.	It is likely to be easier to avoid a risk for activities under consideration but not yet started and for risks which are not central to achieving organisational objectives. Many of the public sector's activities and responsibilities cannot simply be terminated by an organisation.	The risk is avoided by stopping an activity altogether or choosing not to start an activity.

Monitoring and reporting risks

Risk management is a dynamic process, not a one-off or periodic event. It is crucial therefore that there is continuous monitoring of risk treatment. Again, an organisation's governance arrangements should reflect this. As part of the plan for treating each risk, appropriate performance measures and control indicators should be established. An established basis for routine monitoring and reporting enables assurance to be provided that the risk management arrangements are effective. Monitoring should also identify whether the risk profile is changing and whether further action is required to address particular risks.

Integrating risk into performance management



ACCA's *Planning and Performance Management Paradigm report* (ACCA and CA ANZ 2022) highlights the key responsibility finance functions have for the planning and performance management process. Finance professionals should enable their organisations to take a broad view of performance, by integrating financial and non-financial information. It emphasises the importance of ensuring that early warning signs that risks may be crystalising are recognised and built into the planning and monitoring process.

Risk registers

A risk register enables an organisation to record identified risks and their treatments; it can also be used as a tool for monitoring risks in the way outlined above. It is crucial that responsibility for monitoring risks is clear within an organisation. By ensuring that risk is regularly reassessed and reported on as part of the flow of management information, assurance can be provided using a tiered approach. This involves each layer of management reporting upwards, identifying the most significant risks or those that require further action and decision making by more senior managers.

The role of leaders

Given the wide range of risks that generally face a public sector organisation, it is not practical for senior management either to be aware of or take responsibility for every risk identified. Internal operational risks are likely to be the responsibility of, and managed by, frontline managers, whereas more significant risks will require greater involvement from senior management. The UK government's *Orange Book* also recommends that the most significant risks should be subject to 'deep dive' reviews by the organisation's senior leadership and, where relevant, its audit and risk committee (UK Government 2023: 25).

Audit and risk committees

As highlighted in Chapter 1, public sector organisations' audit and risk committees can play an important role in reviewing monitoring and reporting of risks. Wherever possible, details of the committee's meetings and papers should be published, to strengthen confidence that the risks with the most significant impacts are understood at the top level of the organisation. In reviewing risk management arrangements, the committee should have appropriate expertise and focus its attention on risks according to their nature and the reported performance. Audit and risk committees should report to management frequently, but their members should be independent of the executive management team.

Audit and risk committees

The Public Governance, Performance and Accountability Act 2013

The Australian government has a legislative requirement for all Commonwealth entities (arms-length bodies of central government) to have an audit committee. Bodies have the option of establishing a separate risk committee or a single audit and risk committee, 'to reinforce the important role of audit committees in supporting accountable authorities in managing and engaging with risk'.

Further functions of the committee are set out in rules, including the responsibility to review 'the appropriateness of the …system of risk oversight and management (Australian Government 2021: 7). Guidance from the Australian government outlines examples of activities that could fulfil this function, including that the committee should satisfy itself that an appropriate approach has been adopted to manage the entity's key risks and whether the organisation's management has adequately developed the necessary risk-management capability including clearly articulated roles and responsibilities.

Risk registers

Chief Risk Office, British Columbia Government, Canada

The provincial government in British Columbia (BC), Canada, has a Chief Risk Office, which provides a central risk management agency for the BC government and provincial public sector.

As part of its responsibility for the adoption of risk management policy, processes and practices, it has a standard risk register, with a publicly available spreadsheet template (BC government, n.d.). For each identified risk, this document brings together information relating to the process outlined in this report, including, causes and impacts, with a risk score.

It also allows for tracking and management of treatment strategies. Bringing together this information in a single document for the organisation enables a consistent approach across different parts of the BC public sector.

Finance professionals' role in addressing risk

Risk monitoring practices are falling short, and there are more opportunities for finance teams to bring their skills to drive more robust risk reporting processes.

Just as in the other stages of risk management, it is vital to ensure that finance professionals in the public sector are integrated into the process of responding to risk. This includes decisions on treatment and the subsequent monitoring and reporting of risks.

Responding to risks

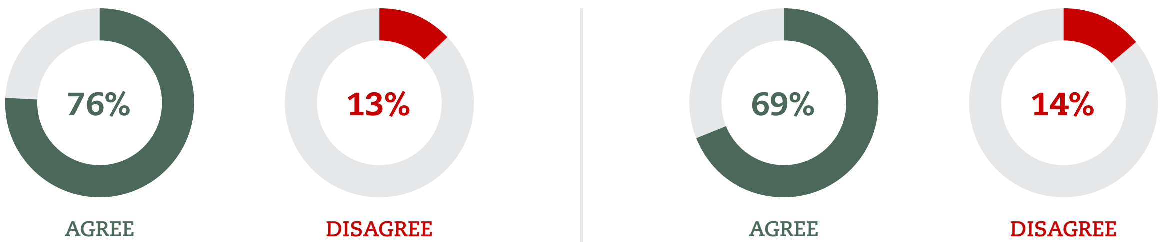
When assessing options for tolerating or treating risks, the costs and benefits of taking different courses of action need to be carefully weighed up. Finance professionals can support this by providing costings for a range of different scenarios, as well as by making estimates of the financial value of potential benefits. Similarly, when considering the transfer of risks, again the financial implications of alternative options are integral to the decision. For example, input of the finance function in the drafting and negotiation of contracts for partnership arrangements and outsourcing is critical to ensuring that implications are properly understood.

The survey results presented an encouraging picture that, in those public sector organisations for which respondents worked, risk governance was understood. As Figure 11 shows, for operational risks, there was generally widespread awareness and understanding of the risk management process, including individuals' role in the process. Nonetheless, these findings are tempered by the quite limited involvement of those we surveyed in the process itself, as Figure 9 above shows. Again, it is crucial that organisation's governance arrangements must embed the role of the finance function in the whole risk management process.

For monitoring and reporting risks, professional accountants can use their experience of gathering together, analysing and then communicating high-quality information for decision makers. As the International Federation of Accountants (IFAC) highlights, 'the finance function is in a good position to be a natural integrator'. Integrating information on risk management with performance and financial information enables risk to be considered as a fundamental part of the decision-making process. The ability of the finance function to work across teams and organisations means finance professionals can take the lead in ensuring risk management is properly considered across all the organisation's functions and processes.

FIGURE 11: Knowledge of role and processes for risk management

I'm clear how I contribute to the overall management of operational risks in the organisation	I'm aware of the different tools and practices to help identify operational risks in the organisation



('Don't knows' remain the balancing figure)

ACCA's survey indicated that finance staff are involved in both monitoring and reporting on financial risks in their organisations. As Figure 12 below shows, involvement in monitoring and reviewing financial risks was fairly widespread, but more limited for non-financial risks. Further progress is needed to embed the role of finance staff in the monitoring and reporting of all risks, not just those specifically identified as financial risks.

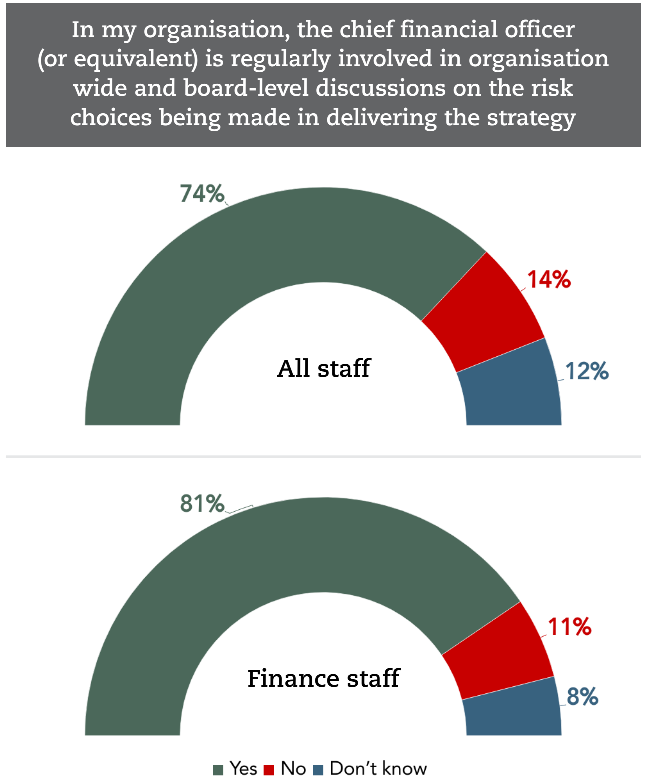
Finance professionals have an important role in supporting the external reporting of risks, which, as the case studies in this guide highlight, can be achieved through a variety of mechanisms. These include annual accounts and reports, publishing audit and risk committee papers and publicly available risk registers. Providing transparency through external reporting is an important element in the broader accountability of public sector organisations. It also enables scrutiny and challenge from those bodies' internal and external auditors, enabling the effectiveness of controls to be assessed.

The leadership role of chief financial officers (CFOs) and other senior finance leaders is crucial for ensuring risks are properly monitored and reported at the top tier management level. Despite the mixed picture on reporting and monitoring, there was a clear recognition that CFOs in public sector organisations are engaged at the strategic level in building awareness on risk. As Figure 13 demonstrates, finance staff indicated the involvement of the CFO even more strongly.

Senior finance leaders' role includes the traditional 'stewardship' role of effective risk management, particularly of financial and compliance risks, as well as clearly communicating the trade-offs between threats and opportunities in meeting the organisation's objectives. This also relates to the broader responsibility, highlighted above in the context of risk appetite, for senior leaders to set the tone for risk management. But, as ACCA's *Risk Culture* report (Johnson 2023) emphasises, these risk conversations should not be happening simply in a vacuum at the top: CFOs must make the case for strengthening the involvement of all staff in risk management.

FIGURE 12: Involvement of staff in monitoring and reporting

FIGURE 13: Involvement of the CFO

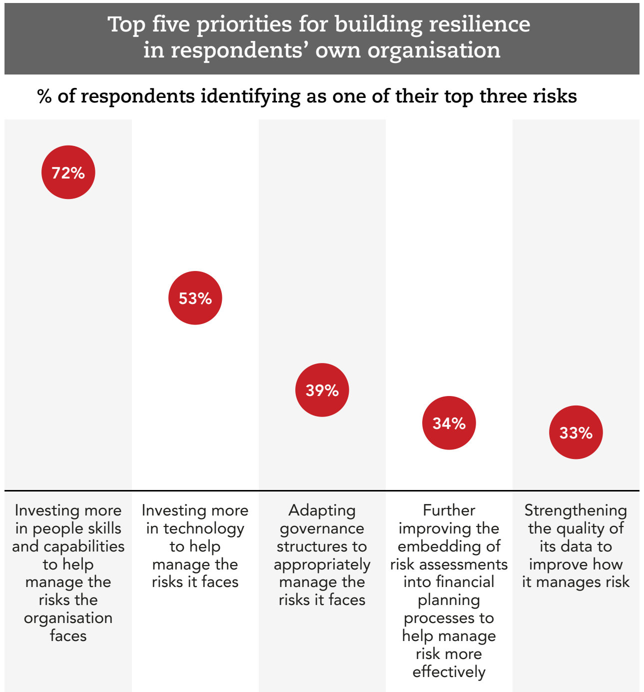


5. Building resilience in a volatile world

This guide has focused largely on those risks that can be treated as part of the risk management process, so that risks remain within a tolerable level. Yet some external risks are simply outside the control of individual public sector organisations and cannot be managed to a particular tolerance level. These risks pose some of the biggest threats to the public sector in achieving its objectives. The response to these risks is to prepare for them by building resilience and ensuring robust contingency plans are in place.

Since 2020, the world has experienced a succession of significant shocks, beginning with the COVID-19 pandemic, followed by supply chain problems and rising inflation and interest rates, as well as regional conflicts. While the likelihood of crises like these can be difficult to estimate, public sector organisations can prepare for their potential consequences. As this guide has shown, ensuring all staff have sufficient confidence in, and understanding of, the risk management process is paramount. This was reflected in ACCA's survey where respondents were provided with a list of priorities for building resilience in their organisation, as Figure 14 shows.

FIGURE 14: Top five priorities for building resilience in respondents' own organisation



Developing the right skills

Upskilling finance teams will help build more resilient public sector organisations for the future.

ACCA's survey found overwhelmingly that the highest priority for building resilience in respondents' organisations was strengthening staff's risk management skills. This response echoes finding from ACCA's *Rethinking Public Financial Management* report (Bandy and Metcalfe 2021). In a survey of over 1,500 ACCA members and affiliates, risk management featured as the third most frequently identified priority area for developing skills, out of 15 choices, with 40% identifying it in their top five. Ensuring all staff have the appropriate skills to play a full part in the risk management process is essential in developing a good risk culture.

Risk management is an important element within the initial training undertaken by professional accountants for their qualification. Developing and updating these skills, by undertaking regular continuing professional development, (CPD) activities ensures accountants' knowledge remains relevant. Professionalisation in public sector finance functions is an important priority for ACCA; ensuring that those working in finance roles have the right skills and knowledge supports strong risk management (ACCA 2022).

Technology supporting organisational resilience

Staff also need to have access to the right technology to enable them to work effectively. As Figure 14 shows, over half of respondents cited greater investment in technology as a priority for building resilience. The experience of the COVID-19 pandemic demonstrated how vital technology was in ensuring robust contingency plans; resilient technology systems are essential in enabling day-to-day activity to continue during a crisis. The public sector must continue to invest in technology for staff and back-office systems; this will improve efficiency and ensure greater resilience.

Adapting governance structures to manage risk

The importance of clear leadership, together with a culture where all staff 'speak the same language on risk', has been emphasised throughout this guide. Creating structures in the public sector to enable those risks with the highest impact to be widely understood underlines the connection between an organisation's strategy, decision-making processes and risk management. Governance arrangements should ensure that decision makers are engaged in thinking about and discussing risk frequently. This includes taking ownership of the most significant risks by appropriate members of the senior management team, as well as empowered audit and risk committees.

Embedding risk assessments

As this report has explored, risk assessments must be used to prioritise the risks that pose the most significant threat to objectives. To ensure an organisation is prepared for every major risk, those that have the most significant impact need to be given the most attention, even if their likelihood is assessed as low. Ultimately, there will always be an element of subjectivity in deciding on the probability that a risk will materialise, but by focusing on consequences, rather than likelihood, organisations will be able to build resilience to face the shocks with most impact.

Strengthening data quality

Finally, the public sector must make better use of the huge quantity of data it already possesses, to provide insights for the risk management process. It is vital that conclusions from evaluations and assessments of previous experience are taken into account when identifying, assessing and responding to risks. The finance function is often the guardian of much of the data within organisations Enabling this data to be better integrated into the risk management process, at both planning and reporting stages, will help to embed finance professionals at the heart of risk management.

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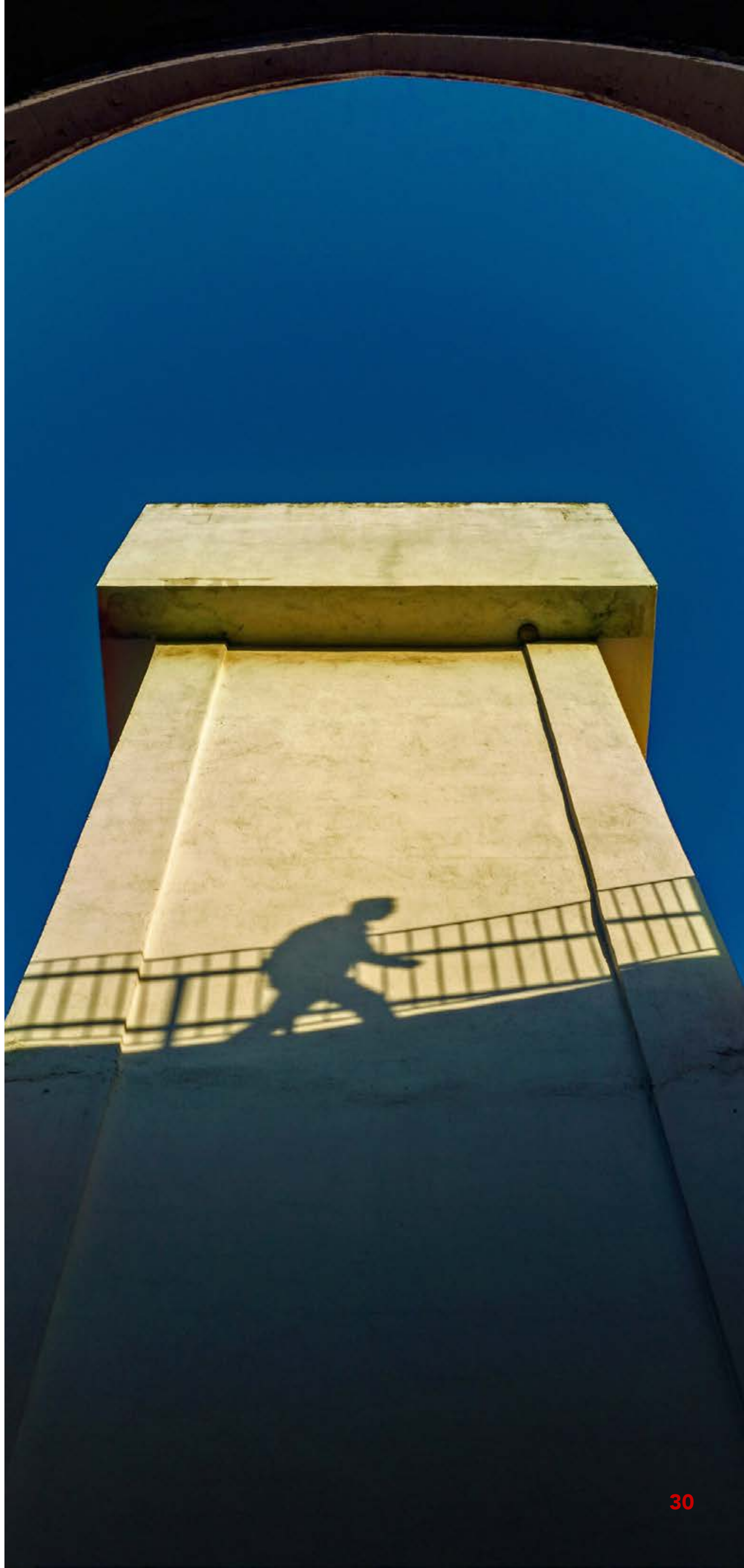

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