

Project Risk Management

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PMG 510
Project Risk Management

Lecture 3



Lecture Outlines

1. **Origins of Risk Management**
2. **Representation of Risk Management**
3. **Enterprise Risk Management**
4. **Levels of risk management sophistication**
5. **Principles of risk management**
6. **Implementing risk management**
7. **Project Risk Management Planning**

Scope of Risk Management

- Organizations realized that purchasing **insurance was insufficient** if there was **inadequate attention** to the protection of property and people.
- Insurance buyers therefore became **concerned with the quality of property protection**, the standards **of health and safety**, product liability issues and other risk control concerns
- This combined approach **to risk financing and risk control** developed in Europe during the 1970s and the concept **of total cost of risk became important**.
- As this approach became established, it also became obvious that there were many risks facing organizations **that were not insurable**. The tools and techniques of risk management were then applied to other **disciplines**

Scope of Risk Management

Definitions of risk management

Organization	Definition of risk management
ISO Guide 73 BS 31100	Co-ordinated activities to direct and control an organization with regard to risk
Institute of Risk Management (IRM)	Process which aims to help organizations understand, evaluate and take action on all their risks with a view to increasing the probability of success and reducing the likelihood of failure
HM Treasury	All the processes involved in identifying, assessing and judging risks, assigning ownership, taking actions to mitigate or anticipate them, and monitoring and reviewing progress
London School of Economics	Selection of those risks a business should take and those which should be avoided or mitigated, followed by action to avoid or reduce risk

Scope of Risk Management

Simple Representation of Risk Management:

- Risk management **has well-established stages** that make up **the risk management process**.
- These stages build into valuable risk management **activities**, each of which makes an important contribution
- This basic explanation of the risk management process is referred to as **the 8Rs and 4Ts** of hazard risk management. The activities associated with risk management are as follows:

Scope of Risk Management

Simple Representation of Risk Management:

- Recognition of risks
- Rating of risks;
- Ranking against risk criteria
- Responding to significant risks;
(Tolerate – Treat – Transfer – Terminate)
- Resourcing controls;
- Reaction (and event) planning;
- Reporting of risk performance
- Reviewing the risk management system

Scope of Risk Management

- **Recognition of risks** - The first step is identifying the risks and their nature and the potential circumstance that could come from the risk.
- **Rating of risks** - The risk needs to be evaluated based of the magnitude and likelihood of it occurring so the full risk profile is understood.
- **Ranking against risk criteria** - The risk then must be ranked based on the level of risk it has compared to the risk criteria/appetite of the organization.

Scope of Risk Management

- **Responding to significant risks** - An organization must respond appropriately and make decisions on what action to take by either tolerating, treating, transferring, or terminating the risk.
- **Resourcing controls** - This involves making arrangements to introduce and sustain control activities to work against the risk.
- **Reaction planning** - Also called event management, this includes disaster recovery if the worst case scenario occurs or business continuity planning.

Scope of Risk Management

- **Reporting of risk performance** - The risk should be monitored for risk performance/actions and communicating on risk issues by the risk architecture of the organization.
- **Reviewing the risk management system** - The risk must be reviewed including an internal audit procedure or arrangements to review and update the risk architecture, strategy, and protocols.

Scope of Risk Management

The 4Ts: Typically seen as part of the Responding area of the 8Rs

- **Tolerate** - An organization can choose to tolerate a risk, and essentially do nothing about it, if it is decided the risk does not need further attention.
- **Treat** - An organization can treat a risk by making and following a treatment plan to lower the chances of the risk. An example of a flooding risk to a house would be to make a retaining wall to lower the risk of flooding.

Scope of Risk Management

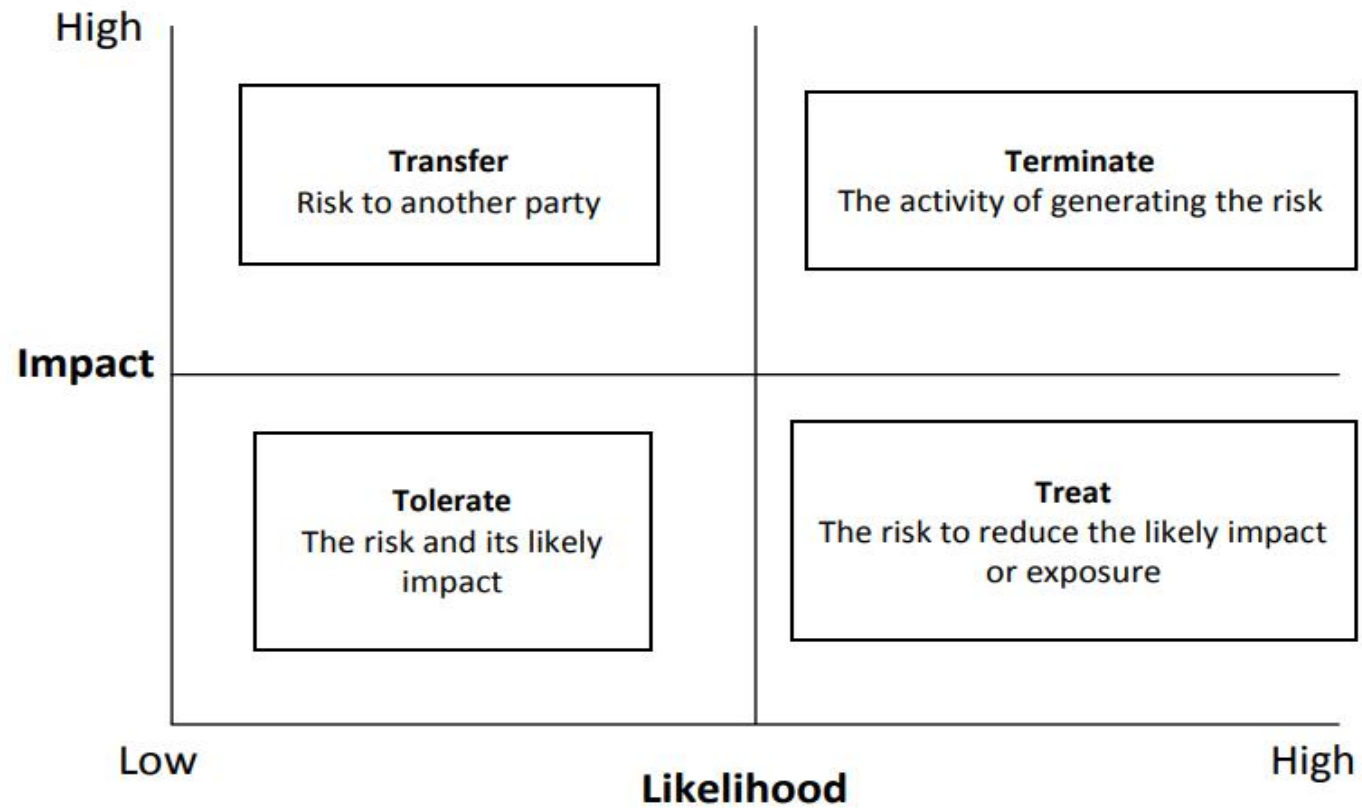
The 4Ts: Typically seen as part of the Responding area of the 8Rs

- **Transfer** - An organization can transfer the risk to someone else, like insurance or a third party, to lower the personal risk of the event.
- **Terminate** - An organization can terminate a risk by removing any attachment to the risk. Again, an example over the risk of a house flooding would be to move to a house that has no risk of flooding, thus terminating the risk.

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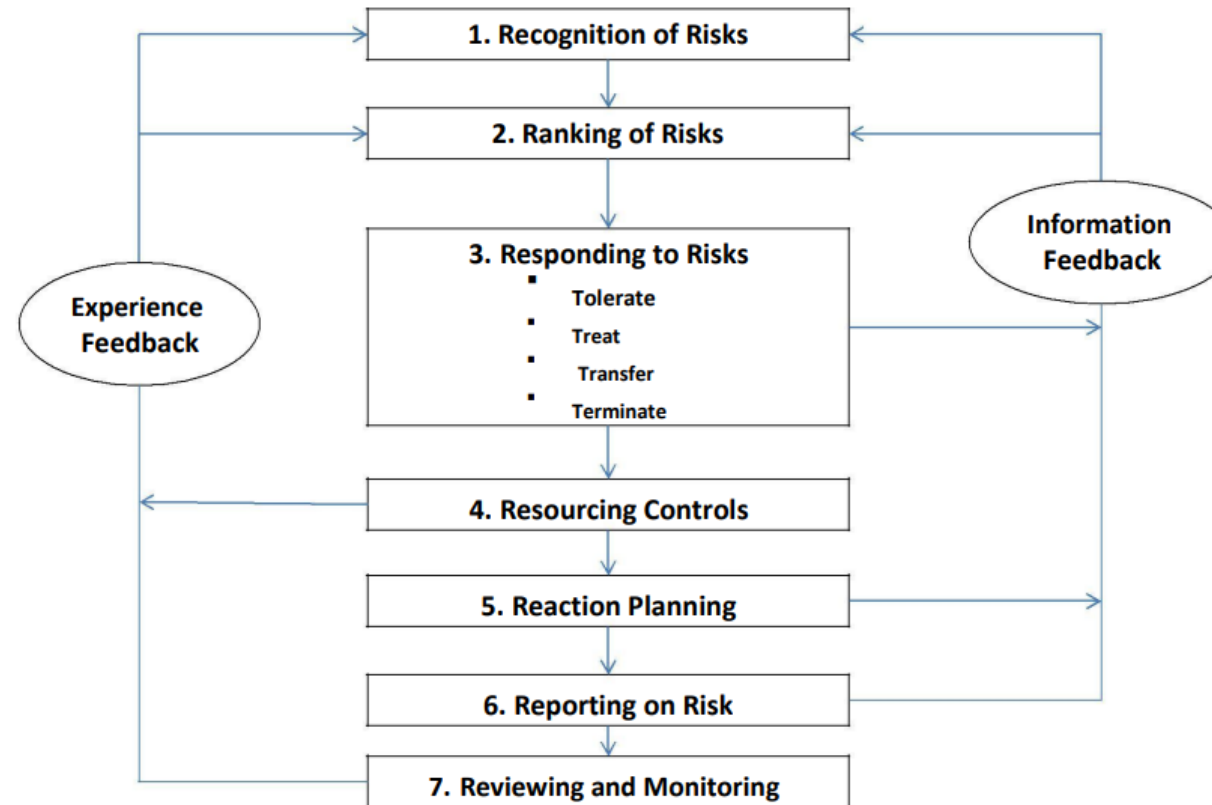
Scope of Risk Management



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Scope of Risk Management



Scope of Risk Management

Levels of risk management sophistication:

- At first, an **organization** may be **unaware** of the **legal and contractual obligations** that it faces. In that case, it will be necessary to **inform** the organization of its obligations in relation to the risk.
- **Risk identification stage**

Scope of Risk Management

Levels of risk management sophistication:

- As the level of sophistication develops, the organization will become aware of the need to comply with obligations and the more general need for improved risk management. Once it is aware of obligations, there will be a need for the organization to **reform** in response to the hazard risks.
- **Risk Treatment or mitigation stage**

Scope of Risk Management

Levels of risk management sophistication:

- As the organization responds to the risk, it will seek to **conform** to the appropriate risk control standards. (Insuring the adherence and commitment to the controls adopted)
- Or the organization will comply to the regulations levied from the authorities.

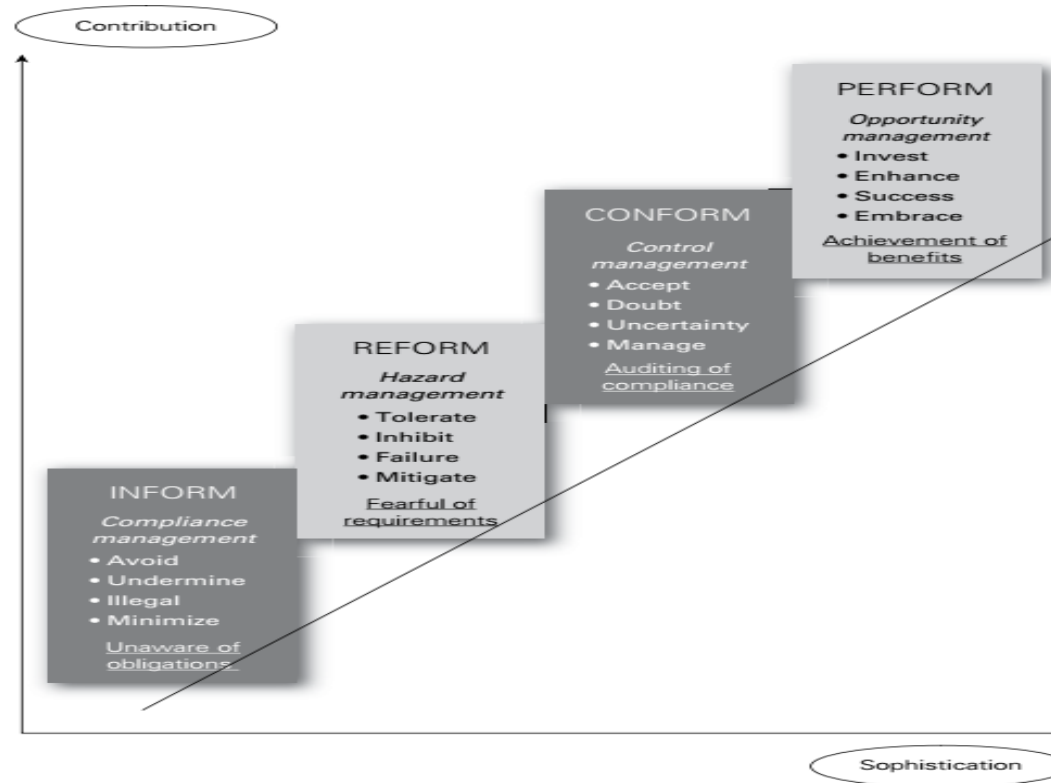
Scope of Risk Management

Levels of risk management sophistication:

- After this stage, the organization may realize that there are benefits to be obtained from the risk. The organization will then have the ability to **perform** and view the risk as an opportunity risk, as illustrated in next Figure.
- A proactive approach that convert the threats to opportunities.

Scope of Risk Management

FIGURE 4.2 Risk management sophistication

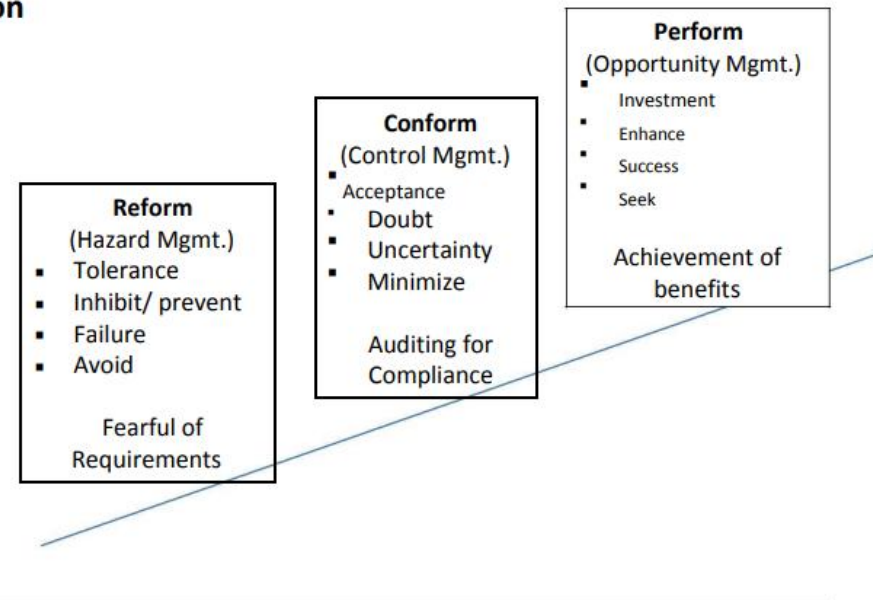


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Scope of Risk Management

Contribution



Sophistication

1. REFORM : Awareness of non-compliance
2. CONFORM : Actions to ensure compliance
3. PERFORM : Achieve business opportunities
4. DEFORM : Inactivity caused by obsession

Scope of Risk Management

Levels of risk management sophistication:

- Although the **four levels of risk management** sophistication represent an improved approach to risk management, there is a danger that organizations will become obsessed with risk management to the point that important decisions are not taken.

At this point, it may be said that **too much attention and concern about risk** and risk management will cause the organization to **deform** its operations.

Scope of Risk Management

Levels of risk management sophistication:

In summary:

1. unaware of obligations – INFORM;
2. awareness of non-compliance – REFORM;
3. actions to ensure compliance – CONFORM;
4. achieve business opportunities – PERFORM;
5. inactivity caused by obsession – DEFORM

Scope of Risk Management

Levels of risk management sophistication:

As the level of **sophistication increases** and risk management professionals become aware of the alternative approaches to risk management, they should value the contribution that can be made by other approaches.

Principles and aims of risk management

Principles of risk management:

It is suggested that a successful risk management initiative (and framework) will be:

- 1. Proportionate to the level of risk within the organization;**
 - 2. Aligned with other business activities;**
 - 3. Comprehensive, systematic and structured;**
 - 4. Embedded within business procedures and protocols;**
 - 5. Dynamic, iterative and responsive to change.**
- This provides the acronym **PACED** and provides a very good set of principles that are the foundations of a successful approach to risk management within any organization.

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Principles and aims of risk management

Principle	Description
Proportionate	Risk management activities must be proportionate to the level of risk faced by the organization.
Aligned	Risk management activities must be aligned with the other activities in the organisation.
Comprehensive	In order to be effective, the risk management approach must be comprehensive.
Embedded	Risk management activities need to be embedded within the organization.
Dynamic	Risk management activities must be dynamic and responsive to emerging and changing risks.

Principles and aims of risk management

What it should deliver by risk management

1. **Mandatory** obligations placed on the organization;
2. **Assurance** regarding the management of significant risks;
3. **Decisions** that pay full regard to risk considerations;
4. **Effective** and **Efficient** core processes

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Principles and aims of risk management

Objective	Description
Mandatory	The basic objective for any risk management initiative is to ensure conformity with applicable rules, regulations and mandatory obligations.
Assurance	The board and audit committee of an organization will require assurance that risk management and internal control activities comply with PACED .
Decision making	Risk management activities should ensure that appropriate risk-based information is available to support decision making.
Effective and efficient core processes	Risk management considerations will assist with achieving effective and efficient strategy, tactics, operations and compliance to ensure the best outcome with reduced volatility of results.

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Principles and aims of risk management

Standard/ Framework	COSO	IRM	BS 31100	FIRM Risk Scorecard	PESTLE
Classification headings	▪ Strategic ▪ Operations ▪ Reporting ▪ Compliance	▪ Financial ▪ Strategic ▪ Operational ▪ Hazard	▪ Strategic ▪ Programme ▪ Project ▪ Financial ▪ Operational;	▪ Financial ▪ Infrastructure ▪ Reputational ▪ Marketplace	▪ P ▪ E ▪ S ▪ T ▪ L ▪ E

Principles and aims of risk management

- **Political** : Tax policy, employment laws, environmental regulations, trade restrictions and reform, tariffs and political stability.
- **Economic** : Economic growth/decline, interest rates, exchange rates and inflation rate, wages, minimum wage, working hours, unemployment (local and national), credit availability, cost of living, etc.
- **Sociological** : Cultural norms and expectations, health consciousness, population growth rate, age distribution, career attitudes, emphasis on safety, global warming.
- **Technological** : Technology changes that impact your products or services, new Technologies, barriers to entry in given markets, financial decisions like outsourcing and supply chain.
- **Legal** : Changes to legislation that may impact employment, access to materials, quotas, resources, imports/exports, taxation etc.
- **Environmental/ Ethical** : Ecological and environmental aspects, although many of these factors will be economic or social in nature

Principles and aims of risk management

Benefits for Implementing risk management:

1. **Financial benefits** arising from better allocation of funds, monitoring of expenditure and reduced exposure to fraud;
2. **Infrastructure benefits** that have included fewer failures of the IT systems and reduced staff absence rates;
3. **Reputational benefits from** ethical sourcing policies and use of organic food in the restaurant, as well as successful niche productions in the theatre;
4. **Marketplace benefits resulting** in 89 per cent occupancy rates, up from 83 per cent three years ago, as well as increased spend in the theatre by patrons.

Principles and aims of risk management

Implementing risk management:

- Using the structure of the **FIRM** risk scorecard, an organization will be able to **demonstrate the benefits that it has obtained** from a risk management initiative.
- It is likely **that the following benefits will have been delivered** to a **theatre** that has been pursuing a structured proactive enterprise risk management approach for about three years:

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Principles and aims of risk management

	Financial	Infrastructure	Reputational	Marketplace
Description	Risks that can impact the way in which money is managed and profitability is achieved	Risks that will impact the level of efficiency and dysfunction within the core process	Risks that will impact desire of customers to deal or trade and level customer retention	Risks that will impact the level of customer trade or expenditure and customer retention
Internal or External Risk	Internal	Internal	External	External
Quantifiable	Usually	Sometimes	Not always	Yes
Measurement (performance indicator)	Gains and losses from internal financial control	Level of efficiency in process and operations	Nature of publicity and effectiveness of marketing profile	Income from commercial and marketing activities
Performance Gap	Procedures Failure in procedures to control internal financial risks	Process Failure of processes to operate without dysfunction	Perception Failure to achieve the desired perception of the organisation	Presence Failure to achieve required presence in the marketplace
Control Mechanisms	- CapEx standards - Internal Control - Delegation of authority	- Process Control - Loss control - Insurance and risk financing	- Marketing - Advertising - Reputation and Brand protection	- Strategic and business plans - Opportunity assessment ¹²



Thank You