

PMG510

Fundamentals of Risk Management

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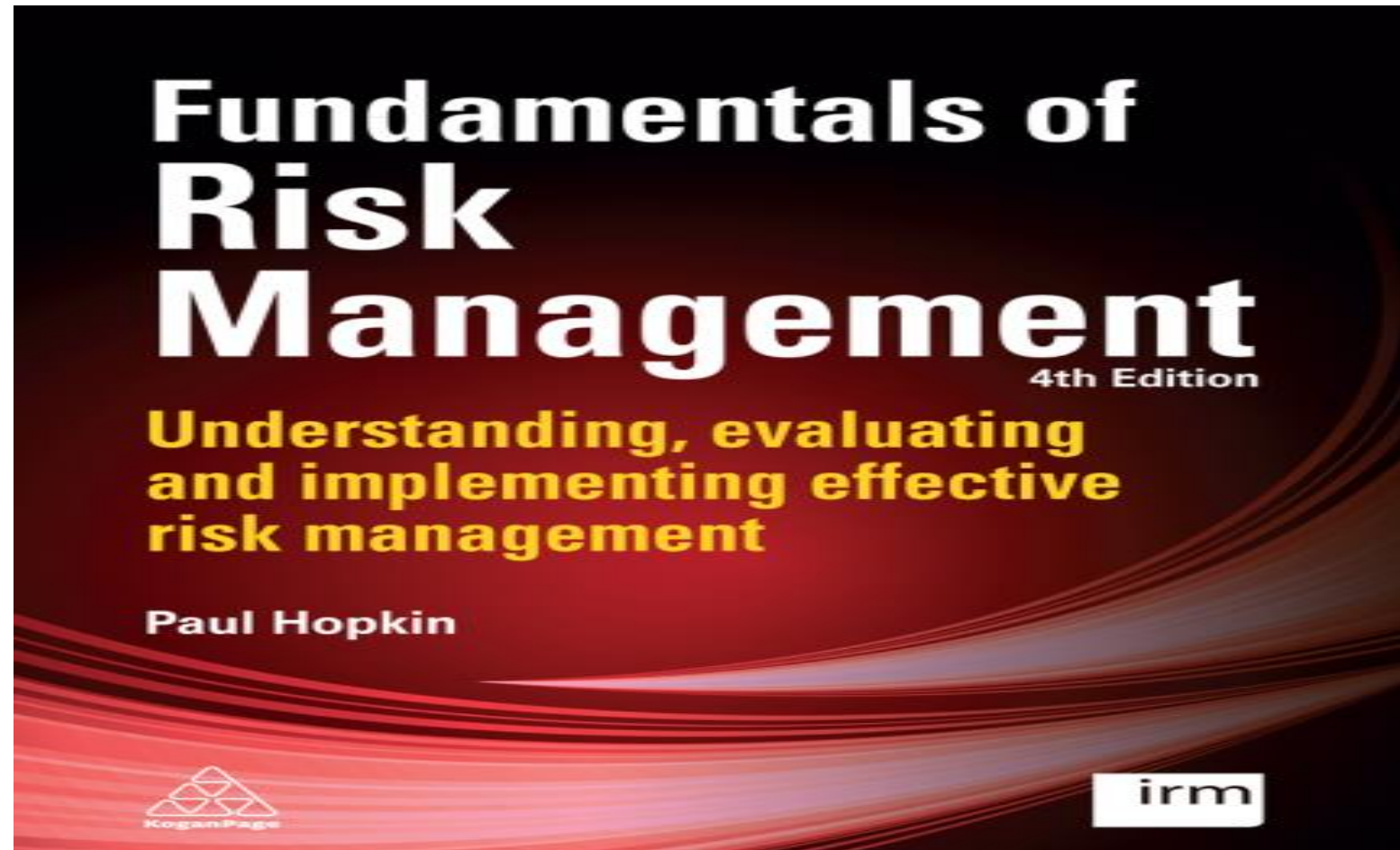
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Approaches to defining risk Lecture 1



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Reference



Course Outlines

- ☐ Approaches to defining risk
- ☐ Impact of risk on organizations
- ☐ Types of risks
- ☐ Scope of risk management
- ☐ Principles and aims of risk management
- ☐ Risk management standards
- ☐ establishing the context
- ☐ enterprise risk management
- ☐ Alternative approaches
- ☐ Risk assessment considerations

Lecture Outlines

- *Risk management in context*
- *Nature of risk*
- *Risk management terminology*
- *Benefits of risk management*
- *Risk management*
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- *Benefits of risk management*
- *Features of risk management*
- *Definitions of risk*
- *Types of risks*
- *Risk description*
- *Inherent level of risk*
- *Risk classification systems*
- *Risk likelihood and magnitude*



Definitions of risk :

- Definitions of risk can be found from **many sources**, and some key definitions are set out in the following table (**Definitions of risk**):

Organization	Definition of risk
ISO Guide 73 ISO 31000	Effect of uncertainty on objectives. Note that an effect may be positive, negative, or a deviation from the expected. Also, risk is often described by an event, a change in circumstances or a consequence
Institute of Risk Management (IRM)	Risk is the combination of the probability of an event and its consequence. Consequences can range from positive to negative.
Orange Book from HM Treasury	Uncertainty of outcome, within a range of exposure, arising from a combination of the impact and the probability of potential events.
Institute of Internal Auditors	The uncertainty of an event occurring that could have an impact on the achievement of the objectives. Risk is measured in terms of consequences and likelihood.

Definitions of risk :

- It is generally accepted that risk is best defined by concentrating on **risks as events**, as in the definition of risk provided in ISO 31000 and the definition provided by the Institute of Internal Auditors
- perhaps a risk can simply be considered to be '**an unplanned event with unexpected consequences**'. Greater clarity is likely to be brought to the risk management process if the focus is on events.
- **Ex.** What could disrupt a theatre performance *“The events that could cause disruption include a power cut, the absence of a key actor, or a substantial transport failure or road closures that delay the arrival of the audience, as well as the illness of a significant number of staff. Having identified the events that could disrupt the performance, the management of the theatre needs to decide what to do to reduce the chances of one of these events causing the cancellation of a performance.”*



Types of risks:

- **Risk** may have positive or negative outcomes or may simply result in uncertainty. Therefore, risks may be considered to be related to an opportunity or a loss or the presence of uncertainty for an organization.
- **Risks are divided into four categories:**
 1. Compliance (or mandatory) risks;
 2. Hazard (or pure) risks;
 3. Control (or uncertainty) risks;
 4. Opportunity (or speculative) risks

Types of risks:

- In general, organizations will seek to minimize compliance risks, mitigate hazard risks, manage control risks and embrace opportunity risks.
- It is important to note that there is **no ‘right’ or ‘wrong’** subdivision of risks. Whatever the theoretical discussions, the most important issue is that an organization adopts the risk classification system that is most suitable for its own circumstances
- There are certain risk events that can only result in **negative outcomes**. These risks are **hazard risks or pure risks**, and these may be thought of as **operational or insurable risks**.
- In general, organizations will have a **tolerance of hazard risks**, and these need to be managed within **the levels that the organization can tolerate**. A good example of a hazard risk faced by many organizations is that **of theft**.

Types of risks:

- There are other risks that give rise to **uncertainty about the outcome of a situation**. These can be described as **control risks** and are frequently associated with **project management**.
- In general, organizations will have an aversion to control risks. **Uncertainties** can be associated with the benefits that the project produces, as well as uncertainty about the delivery of the project on time, within budget and to specification.
- organizations **deliberately** take risks, especially **marketplace or commercial risks**, in order to achieve **a positive return**. These can be considered as opportunity or speculative risks, and an organization will have **a specific appetite** for investment in such risks.
- Opportunity risks relate to the relationship between **risk and return**. The purpose is to take action that involves risk to achieve positive gains. The focus of opportunity risks will be towards **investment**.



Types of risks:

- Hazard risks are the most common risks associated with **operational risk management**, including **occupational health and safety programmes**.
- Control risks are associated with **unknown and unexpected events**. They are sometimes referred to as uncertainty risks and they can be **extremely difficult to quantify**.
- There are two main aspects associated with opportunity risks. There are **risks/ dangers** associated with taking an opportunity, but there are also risks associated with **not taking the opportunity**. Opportunity risks may not be visible or physically apparent, and they are often financial in nature.
- Although opportunity risks are taken with the intention of obtaining a **positive outcome**, **this is not guaranteed**.

Inherent level of risk:

- It is important to understand **the uncontrolled level of all risks** that have been identified.
- This is the level of the risk before any actions have been taken to change **the likelihood or magnitude of the risk**.
- Although there are advantages in identifying the inherent level of risk, there **are practical difficulties** in identifying this with some types of risks
- Identifying the inherent level of the risk makes it possible to identify the importance of the **control measures in place**.
- The IIA has previously held the view that the assessment of all risks should commence with the identification of the inherent level of the risk.
- The guidance from the IIA has previously stated that: **‘in the risk assessment, we look at the inherent risks before considering any controls.’**

Inherent level of risk:

- Often, a **risk matrix** is used to show the inherent level of the risk in terms of **likelihood and magnitude**.
- **The residual or current level of** the risk can then be identified, after the control or controls have been put in place.
- The effort that is required to reduce the risk from its inherent level to its current level can be clearly indicated on the risk matrix.
- The **inherent level** of risk is sometimes referred to as **the absolute risk or gross risk**.
- **The current level** of risk is often referred to as the **residual level, net level** or the managed level of risk.

Thanks



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