

**Board**



**Date:** 19 July 2016

**Item:** Strategic Risk Management and Assurance Annual Report 2015/16

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## **This paper will be considered in public**

### **1 Summary**

- 1.1 The purpose of this paper is to summarise the key Strategic Risk Management activity in TfL up to March 2016. This report was considered and noted by the Audit and Assurance Committee on 14 June 2016.

### **2 Recommendation**

- 2.1 **The Board is asked to note the report.**

### **3 Background**

- 3.1 The objective of Strategic Risk Management is to bring together and simplify Strategic Risk activities across the organisation. This enables management to focus on the agreed key Strategic Risks which should in turn help to provide benefits that include:

- (a) greater likelihood of achieving strategic objectives;
- (b) more systematic decision-making leading to better quality decisions;
- (c) improved allocation of resources; and
- (d) prioritised investment in the control infrastructure.

- 3.2 We are adopting a continuous improvement approach to risk management and embedding this across the organisation as good business practice. In doing this we are improving our awareness and understanding of Risk Management across the business and ensuring that a consistent approach is taken.

### **4 Changes to the Strategic Risk Management Process during 2015/16**

- 4.1 During the first half of 2015/16 and prior to this, the business and corporate strategic risks were aggregated and consolidated into seven Pan-TfL Risks:
- (a) TFL01 – Maintaining a long term strategic, balanced plan;
  - (b) TFL02 – People Risk;

- (c) TFL03 – Delivery of Capital Investment Portfolio;
- (d) TFL04 – Technology Risk;
- (e) TFL05 – Disruption to Quality of Service;
- (f) TFL06 – Targeting Continued Improvement; and
- (g) TFL07 – Major / Catastrophic Incident.

4.2 It was considered that this consolidated view did not best represent the true risks facing TfL, and information in these reports could be improved to aid decision making in the organisation.

4.3 In the second half of 2015/16, we began a review of the overall Risk Management process in TfL, and noted the following:

- (a) The procedure document should be the guide to all risk management across the business, but while the current document is concise and covers all of the main concepts, in certain areas it is incomplete, out of date or confusing;
- (b) Strategic Risk is not well understood, certain concepts are muddled and key documents need refreshing and updating;
- (c) The link between Operational, Programme, Project and Strategic Risk needs to be better understood; and
- (d) Our approach was benchmarked against the industry standards listed below, and although the basics are covered, there are a number of key areas that need redefinition and refinement: - (International Standard ISO 31000 - considering our process, procedures and methodology), the Treasury 'Orange Book' (checking our approach compared to public sector guidelines); and the UK Financial Reporting Council (FRC) Risk Management Guide (2014) (looking at the themes and concepts used in larger commercial entities).

4.4 In the context of Strategic Risk Management, we noted that the following areas need improvement:

#### **Categorisation**

4.5 Some individual Strategic Risks were masked in the larger Pan-TfL categories. Since these individual risks have different risk assessments and mitigating activities, it becomes difficult to focus attention on these areas.

#### **Risk Assessment**

4.6 Risks were assessed on a residual basis (after taking existing control activities into account), both quantitatively and qualitatively. Although the approach provided a "target" assessment, which should be an assessment of the amount of risk that the organisation is willing to take to meet its strategic objectives, the assessment was a future control status – i.e. the status of the risk after improvement actions have been implemented. This is technically incorrect and consequently caused confusion.

## **Quantitative Assessment**

- 4.7 Strategic Risks were quantified by assessing the financial impact of the risk against the Business Plan forecast; these specific amounts associated with each year of the Business plan forecast were aggregated to form a definitive quantitative value for each Strategic Risk. This mechanistic approach resulted in an estimated exposure that was not tangible or useful for decision making.

## **Strategic Risk Management: New Approach**

- 4.8 We proposed adopting a new approach; changes are summarised in the following areas:

### **Categorisation**

- 4.9 The new categorisation aims to draw out the Strategic Risks which were previously masked in the broader Pan-TfL Risk categories. It is important to draw out these underlying risks to make them more visible so that we can ascertain whether these are in fact the true risks facing TfL. It is important to focus attention on the risk assessments and mitigating activities for each of the individual Strategic Risks.

### **Risk Assessment**

- 4.10 The new approach continues to assess risk both quantitatively and qualitatively, but Strategic Risks will also be assessed on an overall inherent basis – an approach that follows recognised best practice. Risk appetite is also being established for each of the Strategic Risks, to ensure that the planned actions are aligned with the risk appetite level.
- 4.11 Inherent risk is the assessment with no controls or other mitigating factors in place, which is the only way to assess the actual impact and reliance on controls and the strength of the control environment. By assessing our inherent risks and identifying controls, it is easier to check how much dependence there is on control activities, especially when determining the key or essential controls (those that may cover a critical risk or cover a number of risks).

## **Quantitative Assessment**

- 4.12 Traditional risk management processes (outside of the sophisticated scenario planning undertaken in large financial institutions), struggle to determine a precise financial impact for all risks. Even a one-off catastrophic event will bring a range of hidden, unforeseen and reputational-based costs, as well as lost revenue opportunities.
- 4.13 The new approach considers the financial impact but under each assessment criteria ('Very Low' up to 'Very High') a range of financial or cost parameters are set (from less than £50m [Very Low] up to over £1bn [Very High]). Consequently, the approach has moved from time spent trying to achieve a precise figure to a position of estimating an overall worst case scenario, by applying practical assumptions and building in a degree of realistic flexibility.

## **Reporting Documentation**

- 4.14 The new reporting presentation aims to show the different relationship between inherent and residual risk. The risks will be reported visually in a new 'heat map' presentation so that the results of the risk assessments (i.e. likelihood and impact ratings) are represented in a graphical and concise way. The heat map shows the risk rating of different risks, and the reliance on or strength of controls.

## **5 Risk Management Governance**

- 5.1 A Strategic Risk Management update report is provided to the Audit and Assurance Committee each quarter. At the March 2016 Audit and Assurance Committee, we emphasised the importance of improving education and awareness of risk management and providing a common framework for communication of risk management throughout the organisation.
- 5.2 The "Risk Management in TfL" procedure document will be updated to include the revised Strategic Risk Management approach. An updated risk terminology has been summarised to help ensure that risk related terms used in the methodology are properly understood and used consistently, and this will be included in the procedure document.
- 5.3 Group Risk hold and chair a monthly risk meeting with risk managers from the Business and Corporate areas as well as key representatives from Internal Audit and Insurance. This is the forum where key issues relating to risk management are highlighted, and updates are provided in our respective areas.

## **6 Risk Management and Assurance Framework**

- 6.1 Risk Management within TfL supports the assurance function. The internal audit planning process and Integrated Assurance Plan are based on the seven pan-TfL risks outlined in 4.1. We have engaged with senior members of the Internal and External audit teams to ensure they are kept up to date with our revised Strategic Risk Management approach. Our longer term plan is that Internal Audit prioritisation is driven by the risk assessments detailed in the Strategic Risk Management reports.
- 6.2 Going forward our objective is for risk management to work closely with the Internal Audit and Assurance functions, ensuring an integrated approach.
- 6.3 Risk managers attend and actively participate in the ADG (Assurance Delivery Group) meeting, which is held on a quarterly basis. One of the functions of the Audit and Assurance committee is to provide oversight of the operation of strategic risk management and ensure adequate integration with assurance activities.
- 6.4 To check that adequate and appropriate assurance exists for its strategic risks, TfL has started to adopt the use of Assurance Maps. The objective of Assurance Maps is to provide a means of mapping sources of assurance to risks, indicating the strength of available assurance. We aim to work closer with Assurance to determine how Assurance maps can practically add value to our strategic risk management processes going forward.

## **7 Next Steps – post March 2016**

- 7.1 The suggested changes to the Strategic Risk Management approach and reporting documentation as noted above were endorsed at the Executive Committee and Audit and Assurance Committee meetings.
- 7.2 An interactive Strategic Risk "workshop" session facilitated by Ernst & Young (EY), was held at the Executive Committee Away Day on 3 March 2016. It was agreed that going forward we will follow a "top down" approach to determine the most significant Strategic risks facing TfL and the key purpose of the session was to engage the Executive Committee in agreeing this list.
- 7.3 After consolidating output from this workshop, Group Risk and EY worked together to draft the updated set of Strategic risks facing TfL. These risks are closely linked with TfL's Strategic Priorities. This updated list of Strategic Risks was submitted for the Executive Committee and to the June Audit and Assurance Committee.
- 7.4 A Strategic Risk workshop, facilitated by EY, will be held with the Audit and Assurance Committee in October 2016, to discuss the updated list of Strategic Risks, as well as detailed reports for each of these risks.
- 7.5 Assuming the Audit and Assurance Committee agree with this information, our two year plan will involve working with EY and the Business Areas to ensure that TfL achieve an "advanced" risk maturity target state which is comparable with external organisations. The longer term objective is to develop a clear understanding of Strategic, Operational, Project and Programme Risk throughout the business and how they fit together.

### **List of appendices to this report:**

None

### **List of Background Papers:**

None

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