INTERNATIONAL MARITIME ORGANIZATION

IMO

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STRATEGY AND PLANNING

(b) Risk Management

Note by the Secretary-General

SUMMARY

Executive summary:	This document contains, as requested by C/ES.23, the Secretary-General's preliminary proposals on the management of financial and other risks in the Organization, and on the establishment of an *ad hoc* Working Group
Action to be taken:	Paragraph 16
Related documents:	C/ES.23/4(a)/1 and C/ES.23/D

Introduction

1 At its twenty-third extraordinary session in November 2005, the Council noted a proposal for the establishment of a Finance and Risk Management Working Group (C/ES.23/4(a)/1) and decided, given the importance of the proposal and the limited time available at the session, that a thorough discussion on the issue should be deferred to its ninety-sixth session. The Council requested the Secretary-General to prepare a substantive document on this matter, taking into account the comments and proposals made by Members during the discussion. At its ninety-fifth session, the Council noted the outcome of the discussions at its twenty-third extraordinary session on the issue.

2 This document reflects on the present risk environment, provides information on the risk management process and the current risk management arrangements of the Organization; and makes preliminary proposals for a governance structure to suit the particular situation at IMO.

Present risk environment

3 There has been an increased focus globally on risk and risk management in recent years. Private sector organizations have suffered well-publicised and catastrophic financial collapses because of uncontrolled risk while the UN system itself has suffered in many ways because of identified lapses in the control of major international programmes.

4 There have been a number of responses to these failures aiming at assisting organizations to more effectively manage risk, including the development of legislation and guidelines. Whilst the detail and the regulatory burden imposed by such developments varies greatly, common themes may be determined, which are consistent with the more structured and rigorous approach to risk management increasingly seen as essential worldwide. Such themes include:

- the importance of identifying risks and related controls across an organization, rather than focusing exclusively on financial risks and controls;

- the importance of an independent (i.e. non-management) view of the risks an organization faces and the internal controls and risk mitigation strategies in place to address them;

- the viewing of the process of internal control and risk management as being important in itself, recognizing that the risks an organization may face will change over time; and

- the importance of a strong and independent internal audit function, free to report directly to senior management.

5 Whilst the Organization's present risk management approach clearly addresses the internal audit function, the others are areas where improvements might be introduced. These are addressed in the following sections.

Risk management process and next steps

6 In line with the themes identified above, it is clear that the Organization's approach to the management of risk should become part of a formalized process, not as a one-off event. A risk management process, which may be thought of as being cyclical, would typically consist of:

- **Identifying risks** – i.e. documenting those risks within the risk framework which represent a material risk to the Organization's ongoing operation;

- **Assessing the level of risks** – i.e. gathering information on each risk and establishing its likelihood of occurrence;

- **Identifying mitigating strategies** – i.e. the controls and mitigating factors in place or required to determine and limit the exposure of the Organization;

- **Prioritizing risks and response** – i.e. evaluating the risks identified to determine the impact they would have on the Organization, allowing an overall prioritization to occur;

- **Developing work programme to address key risks** – based on the prioritization, develop a plan to address and manage each risk over the remainder of the cycle, for example the contingency planning recently undertaken for the Headquarters building;

- **Monitoring and reviewing progress** – i.e. developing and considering reports on action taken and any changes in the nature of the risk over time. This will in turn feed back into the risk identification and analysis for the next cycle.

7 This process should be considered cyclical, with, preferably, annual updates and a full iteration every 4-5 years. All stages will require input from senior management, with the high level outputs from the reviews and responses being considered by both management and the Organization's governing bodies.

Managing the Organization's risk

8 The Organization has developed an approach to risk management and control over a number of years. The key elements of this approach are:

- an independent Internal Oversight Section (IOS). The IOS reports directly to the Secretary-General and is consequently fully independent of the Organization's line management. This follows widely accepted good governance standards;

- an annual internal audit plan developed by IOS, which is risk-based and designed to focus on the operation and enhancement of internal management controls;

- an annual external independent audit of the Organization's financial procedures, accounting system, internal financial controls and its administration and management;

- the active involvement and close scrutiny by the Council in its review of all major undertakings of the Organization, including its audited financial statements; and

- clear assignment of management responsibility for controlling assets and managing liabilities.

9 Recent developments, including devolution of budgetary responsibility through the Change Management Programme, have had an impact on this framework with more authority now being delegated to those closely involved in service delivery. Nevertheless, there remains a clear line of accountability from the budget holders to the Secretary-General, who is ultimately responsible, through the Council, to the Assembly for the management of the funds of the Organization.

10 Such changes in responsibility with the present climate of increased focus on risk management make it imperative to review this framework to determine whether improvements might be made. In particular, whilst risk management is implicitly a significant factor in every decision currently taken by the Secretary-General and the Secretariat and financial expenditure is closely controlled, there has, to date, been no explicit risk identification undertaken to assess the broader risk environment in which the Organization operates and to ensure that responses to the risks identified are appropriate across the board.

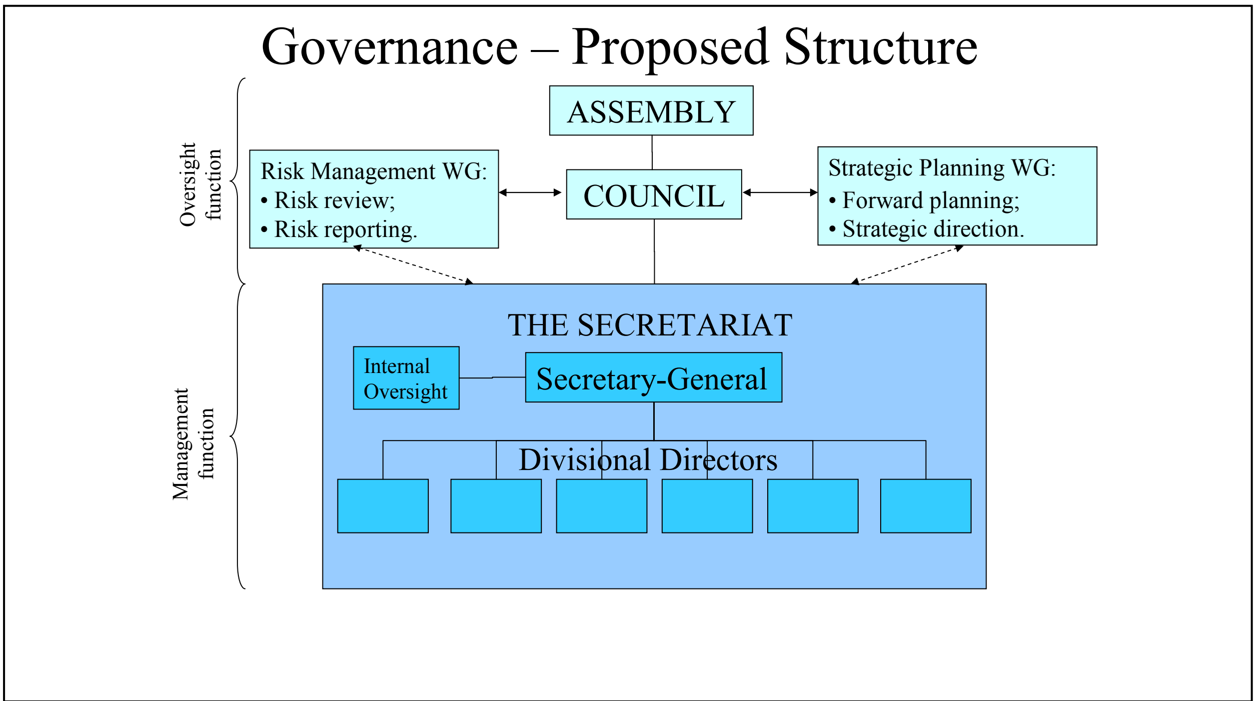
A comprehensive risk framework for the Organization

11 The Organization's explicit internal controls are primarily concerned with the financial risks to the Organization. These are clearly a key part of any risk framework but, as noted earlier, it is important to take a broad view of what constitutes "risk" in order to ensure that all identified risks are properly addressed. With this in mind, it is important that the Organization develops a formal, comprehensive, risk framework for all categories of risk. The process of identifying risks can then be the starting point for ensuring that such risks are being properly mitigated and controlled.

12 As a starting point for a formal risk framework for the Organization, it is standard practice to evaluate risks to an organization under broad categories. A key area is, of course, financial risk. In common with other UN organizations, IMO is being asked to 'do more, with less', which is a clear risk to our work; the depleting funds for technical co-operation are an example of this trend. Additionally, pressures on the UN system itself have led to demands for enhanced governance and oversight, ranging from ethics, through internal and external audit, to risk management and financial review. Financial risk is, therefore, only a part of the overall risk management framework. A draft risk management framework is set out in annex 1 and provides the high-level risk categories which can be used when determining the full range of risks which the Organization faces and which its membership and Secretariat have to address.

Enhancing the governance structure of the Organization

13 The importance of an independent, non-management body to review work on risk and mitigation is well-established globally in guidance and legislation as a fundamental part of a robust risk management approach. Within the Organization's existing structure, the Council itself performs this function *de facto*, with responsibility for the scrutiny of financial and other information and performance of an oversight role, with a responsibility to report on the financial accounts and budget to the Assembly, as established by Article 21(a) and Article 24 of the Organization's Convention. This arrangement has worked effectively in the past and has provided a robust structure for the Organization when controlling its risks. There is, therefore, no compelling need to change this arrangement and the Council's role in reviewing and reporting to the Assembly on the Organization's budget and expenditure reports should continue to remain paramount. However, the changing risk management environment mentioned earlier, the role of the Council, in particular, in adopting a more strategic view of the work of the Organization, and the broadening of the concept of a risk framework set out above, will inevitably increase the input required from any independent, non-management body established. This being so, it seems that the key point which should be addressed initially is a development of the Organization's governance and risk management structure to perhaps include the operation of a Risk Review, Management and Reporting Working Group. This might fit within the existing corporate governance structure as shown below.



14 Such a group would be complimentary to the Strategic Planning Working Group, with a remit to provide an independent, high-level input to the Organization's developing risk management framework and risk management procedures. In the context of financial risks, such a group might also scrutinize financial information with a view to assisting the Council in its oversight role. Proposed terms of reference for such a group are attached at annex 2. The question of the size and membership of such a Working Group may be considered by the Council, taking into account the benefits to be gained by ensuring that such a body includes representation with particular skills and experience.

15 As the decision to establish such a Risk Review, Management and Reporting Working Group will be a strategic one with both policy and resource implications, it might, as a first step, be appropriate for the *ad hoc* Council Working Group on the Strategic Plan to be requested to provide input to the identified risk reviews and prioritizations, and, in due course, advise the Council accordingly, taking full account of the need to avoid duplication or overlap of responsibilities between the two groups.

Action requested of the Council

16 The Council is invited to take note of the information contained in this document and to comment and decide as appropriate.

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ANNEX 1

HIGH-LEVEL RISK FRAMEWORK FOR THE ORGANIZATION

1 Based on an initial high-level review of the Organization, and on frameworks offered by standard Risk Management theory, the following risk framework could provide the basis for consideration of a framework suitable for the Organization. A detailed review will be the first stage in the formal risk management process and should provide an inventory to comprehensively cover the risks falling under each category, and the risk mitigations in place, or lacking, in each case.

- ***Strategic risks***
  - Damage to the Organization's reputation amongst a group or groups of stakeholders through, for example, failure to meet expectation or 'capture' by a narrow group of interests.
  - Over-regulation.
  - Regionalization or unilateralism in the regulation of shipping.
  - Changing stakeholder needs (rate of change and scope).
  - Public perception.
  - Demographic and social/cultural trends.
  - Failure to keep pace with technological innovation.
  - Capital availability for major programmes.
  - External regulatory and political trends, including wider UN developments.
  - Non-adoption or non-compliance with the Organization's standards.
- ***Financial risks***
  - Price (asset values, interest rates, foreign exchange).
  - Liquidity (cash flow, non-payment of assessments, inability to meet obligations as they fall due).
  - Inflation, and associated impact on purchasing power.
  - Unfunded or inadequately funded commitments.
  - Budget management and control.
  - Treasury management.

- ***Operational risks***

    - Business operations (human resources, capacity, meetings delivery, efficiency, service failure, ITCP delivery, meeting new requirements (Audit Scheme, etc.)).
    - Empowerment (leadership, change readiness).
    - Information technology (relevance, availability, stability).
    - Information/business reporting (budgeting and planning, accounting information, pension funds, After Service Health Insurance (ASHI) liability, investment evaluation).

- ***Hazard risks***

    - Fire and property damage.
    - Theft, fraud and other crime.
    - Personal injury.
    - Business interruption.
    - Disease and disability.
    - Liability claims.

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ANNEX 2

PROPOSED TERMS OF REFERENCE FOR THE RISK REVIEW, MANAGEMENT AND REPORTING WORKING GROUP

1 The Risk Review, Management and Reporting Working Group is a key part of the Organization's risk management and control framework, with a remit to provide an independent report to the Council on all matters related to risk and governance. It plays a companion role to the Strategic Planning Working Group, but with a different focus. Specifically, its remit is to receive reports from the Secretariat, review, input and recommend/report to the Council on:

- the definition of a formal risk management framework for the Organization;
- an initial review of risks and their mitigating strategies;
- development of a formal process for reviewing risks cyclically, based on a risk assessment considering likelihood and impact;
- specific areas of significant risk identified through the risk review process; and
- financial performance.

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