

Serco's approach to: Risk Management

Serco operates in many different fields. We run world-class scientific establishments and railways, maintain offices and spacecraft, manage schools, prisons and motorway systems, test military assets and control air traffic. This presents us with an unusually diverse range of risks that need to be recognised, assessed and effectively managed. Over 40 years our experience in managing risks across such a diverse business base has convinced us that the process risk management should not be treated as an add on to the business – it needs to be an integral part of the way we function.

Our fundamental aims are to focus on customers' requirements, grow the business judiciously and respond effectively to changing requirements and markets. We need to do these things while ensuring that we protect the interests of customers, shareholders, investors, our people and the communities we work in. We have therefore needed to develop robust systems and processes, described within the Serco Management System, that work across a business that is technically diverse and geographically spread. A key element of these is risk management.

Taking and managing risk is a central part of our business, and balancing risks and opportunities is a key management responsibility. We have robust processes for identifying, analysing and managing risks and minimising the impact of undesired and unexpected events. We believe that effective management of the risks inherent in delivering services to customer organisations is essential to successful achievement of business objectives including technical, performance, timescale and budget targets. Serco is committed to the use of formal risk management techniques in all its businesses. All parts of the business have appropriate risk and crisis management plans that meet defined policy standards.

Identification and analysis of risk issues allows both Serco management and the customer to make informed decisions based on full information on the potential risks threatening the business. Risk assessment results in early warning of possible deviations from plan, allowing appropriate avoidance, mitigation or contingency measures to be implemented and maximising the probability of meeting business targets.

Risk management approach

We view risks as 'uncertain future events that might lead to the failure to meet one or more of the key business goals as measured in terms of stakeholder expectations'. These key business goals are to:

- Achieve high levels of customer satisfaction
- Operate safely and protect the reputation, value and assets of the company
- Create teams of highly motivated competent people who live Serco's culture and values
- Support the communities and environment within which we work
- Continually develop a sustainable business and our internal processes
- Deliver the business commitment.

The purpose of risk management is to provide a high degree of assurance that these business goals are delivered. Our approach is embedded throughout the organisation from every contract through to the Serco Group Board. At each level, the risk management processes are established

to reflect the nature of the activities being undertaken, the nature of the business and operational risks being faced and the level of control considered necessary to protect the interests of all stakeholders. Throughout the business we therefore:

- Identify business objectives that reflect the interests of all our stakeholders
- Identify the threats to the achievement of our business objectives
- Control and manage exposure to risk by appropriate risk reduction and mitigation actions
- Regularly review our exposure to all forms of risk and reduce it as far as reasonably practicable or achievable
- Apply robust risk management processes as part of a wider management system
- Educate and train our managers in risk management
- Regularly review the risks we face as a result of our business activities and of the business and economic climate in which we operate
- Identify cost effective risk treatment options
- Identify and regularly measure key risk indicators and take appropriate action to reduce our risk exposure
- Regularly review our key risk controls to ensure that they remain relevant, robust and effective.

The Serco Group Risk Management Policy Standard defines the framework by which business and operational risk is to be managed in the performance of Serco's activities to meet the requirements of effective business management and corporate governance set out in the Serco Management System Policy Statement. This ensures that it is integrated with other primary business management and compliance processes. The Quality Management and Audit functions, both internal and external, will audit the implementation of the risk management policy and procedures to provide assurance that the processes are being operated efficiently and effectively. The overall aim is to protect the interests of all stakeholders.

Risk management process

Risk management is a dynamic element of how we manage our everyday activities and is therefore integrated within our normal management processes. It is carried out in two ways:

- Explicit exercises to identify and assess risks and prepare plans to reduce or mitigate them
- Implicitly through normal management practices.

A risk management plan is developed for every contract/project and it sets out the results of the explicit risk management activities that have been undertaken. During the course of normal business activities, risk management becomes part of the ongoing cycle of risk identification, management and review built into normal management practices.

Risk management therefore forms an integral part of how we manage our business. The processes that we apply will vary during the life cycle of our business. At each stage of a contract's life cycle specific processes are applied. They start once an opportunity has been identified, even before invitation to tender, and flow through proposal development, contract award, lead-in, operations to contract completion. The risk management plan will describe in detail the specific procedures that will be applied at each stage. In summary the processes fall into four main areas. These are:

Identify risks	Risk assessment
Analyse risks	
Plan risk control	Risk management
Monitor and control risks	

Here's an overview of our approach to these four elements:

Risk identification

The risk identification process examines key areas of a contract/project in order to record all perceived risks. The process will specifically address the following types of risk:

- Risks intrinsic to the nature of the task to be undertaken, including those associated with the nature of the contractual relationship with the customer
- Risks associated with the management approach being proposed
- External risks that could affect the project, the company or the assumptions on which the proposal was made.

The risk identification is carried out from the company's perspective, identifying risks that have an impact on the company's objectives or its ability to meet the requirements of the project. A selection of techniques will be used to identify risks including brainstorming, structured interviewing, questionnaires and prompt lists, subject matter experts, previous project experience and specific operational experience from suppliers and subcontractors. This development process will consider risks from a variety of angles from those associated with external issues e.g. political climate, government policy etc.; relationships, both external and internal; management; performance; resources; compliance; and commercial/financial.

In identifying the risks the potential impact will also be defined from a contractual, operational capability or reputational perspective.

The output of the risk identification process is documented in the contract/project risk register, where risks and their impacts are described. Risks recorded in the risk register will be further analysed as part of the risk analysis process.

Risk analysis

A top-level qualitative analysis will be performed on the identified risks covering probability of occurrence and impact. As part of the risk assessment, a risk scoring system based on the Institution of Civil Engineers/Institute of Actuaries RAMP methodology is used to grade risks according to their probability and potential impact on the business case of the project.

Each risk is classified into one of five probability categories according to its probability of occurrence and is then classified into one of five impact categories according to the severity of the business consequences if the risk occurs. A numeric risk score for each risk is determined by multiplying the probability scale value by the impact scale value.

Based on the risk score, risks are assigned to one of five risk categories depending on the overall significance of the risk to the business as a whole. Once identified and assessed, the risks are consolidated within a contract/project specific risk register. The information this contains includes:

- Description of the risk and its cause
- Description of the impact of the risk
- Probability of occurrence before risk reduction
- Impacts on business goals before risk mitigation
- Risk reduction and risk mitigation measures
- Identification of the ownership of the risk.

In allocating ownership of individual risks, the objective is to allocate it to the party with genuine control over the risk while recognising operational and commercial considerations. This process enables us to allocate a risk to the party that either genuinely owns the risk or is best able to manage the risk in the most economic fashion. Analysis of the key risks identified in the risk

register will allow an assessment to be made of the probability of the contract/project achieving key milestones and highlight critical areas of the contract/project that require management attention. Financial information for risk budgeting and contingency provision will also be generated.

Risk planning

Having assessed the risks it is necessary to manage them. This requires focused management attention to develop a robust and effective risk plan. Risk planning involves addressing both risk reduction and risk mitigation actions.

Risk reduction involves reducing the probability of events occurring by taking early management action to remove or reduce identified risks before they can affect the contract/project. As part of the risk identification and analysis process, options to eliminate, reduce or control the risks to which the project is exposed will be identified. These measures may, in themselves, lead to secondary risks that will have to be analysed.

Risk mitigation, involving the identification of appropriate measures to reduce the severity of the impact of risks, is a key element of risk planning. These measures, or contingency plans, will aim to deal with the consequences of a risk occurring in ways that will reduce the overall impact of the risk. A particular case of risk mitigation is crisis management in response to foreseen or unforeseen risks where the scale of the actual or potential impact warrants a special management process.

The Serco Management System requires every contract to develop a risk management plan reflecting assessed risks and supported by appropriate measures and contingency plans to mitigate the impact of the risks.

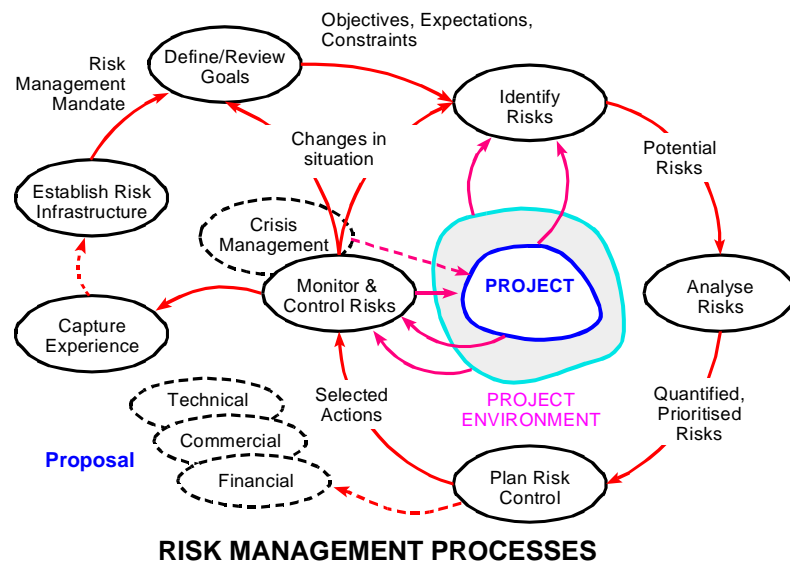
Risk monitoring and control

Risk does not remain static during the contracts/project's lifetime. Internal changes within the contract, changes in the external environment and the effect of management decisions will all affect the nature and extent of the risk to the achievement of business objectives.

Risk monitoring and control involves monitoring the contract/project and the external environment, reacting early to departures from plan and providing appropriate responses to reduce the impact of risks as and when they occur. In most cases, adequate financial resources and the time in which to apply them satisfactorily will be necessary. Early warning of events is critical to successful risk control and management, and the risk review and reporting process is a major factor in providing management with sufficient warning to allow timely action to be taken. The risk register will be reviewed at regular intervals throughout the life of the contract/project to identify new risks, to update risk mitigation actions or contingency plans where appropriate, to confirm the status of existing risks and to remove risks which are no longer of concern.

Process summary

This diagram summarises the processes described above and their relationship with each other. It also shows how the risk management process is initiated, how the process interacts with proposal development activities and how information is captured in order to learn from experience. A crisis management process is also included to identify its relationship with the normal risk management process.



Embedding the process

It is the responsibility of management to ensure that all contracts/projects have in place risk and crisis management plans that meet the defined policy standard. All staff are then responsible for the ownership and undertaking of their risk management functions and for the implementation of plans within the framework of the Serco Management System.

In developing our management structure for every contract, the risk infrastructure is considered to ensure that specific responsibilities are allocated and recognised within a contract's management team. This will provide a risk management mandate for the contract that is understood and supported by the whole management team.

To aid contract management teams in the identification, assessment and management of risks Serco has developed a software tool for risk management (STRIM) specifically for the Serco risk management process. STRIM provides facilities for recoding project goals and controls, risks and opportunities, assessing risks and opportunities in terms of probability and impacts, providing cross-references to the technical, commercial and financial proposals and printing a number of pre-formatted reports. The system supports risk reporting that forms an important element of contract management review both with the customer and internally. Risk reports form part of the overall contract assurance report for the contract board. Part of the contract board's agenda will be a formal review of the contract risk register. All contracts are required to undertake a formal review of their risk register at least twice per year. The information will also assist in informing management decisions with the objective of continually improving the services we provide to our customers.

The risk report prepared as part of the review of the risk register will summarise the current status of the contract and highlight current risk areas requiring management attention. It will also include the updates of the risk register giving the current status of each risk issue and identifying any new risk issues. Risk will be an essential agenda item for all progress meetings. Essential details from the risk report will be presented as part of management reporting.

Reports resulting from the review of the risk register will be provided to the customer as part of normal management reporting to give visibility of key risks. the suggested content of the risk report is listed below:

- Risk overview
 - Health & Safety
 - Environmental protection
 - Security
 - Business continuity
 - Finance and internal control
 - Corporate governance
- Risk review
 - Review of risk register
 - New risks
 - Re-assessed risks
 - Closed risks
- Action review
 - Review of risk reduction/mitigation plans
 - Review of agreed/planned actions
 - Future actions
- Crisis planning
 - Review of crisis and emergency plans.

An important element of the risk management process is the involvement of key subcontractors in both the identification and management of risk. As part of the regular management review procedure with subcontractors, risk management is included as an agenda item to include the review of existing risks, the identification of new risks and the review of continuing risk reduction and mitigation actions.

Benefits

Serco recognises its commitment to ensure that the risks facing the business are identified and appropriate mitigating processes/controls are planned and in place.

Our experience over the past 40 years in managing a diverse and complex business portfolio has enabled us to develop and refine robust systems and techniques for the effective management of risk including our own software tool (STRIM).

We have embedded throughout the organisation formal risk management techniques that deliver customer requirements while meeting our commitment to effective risk management as defined within our risk management policy standard.

Risk management is a dynamic element of the way we manage our everyday activities and is therefore integrated within our normal management processes. It forms part of management reviews and contract boards, ensuring that it is regularly updated to reflect changes that may have occurred and is supported by a reporting process that helps inform management decisions and provides our customers with assurance that the risks are being managed.