

A proper understanding of the risks facing a business can make the difference between continuity and failure as well as impacting on the cost of its insurance programme. However, despite this, the majority of businesses have no formalised risk management assessment and control procedures in place.

In order to help members to address this situation The Royal Institute of British Architects, (RIBA) in association with The RIBA Insurance Agency has produced this short guide. Whilst it's not intended to be exhaustive, it is designed to assist you in understanding and managing risk by outlining some suggested standard procedures for:

- Quantifying and managing risk
- Calculating risk tolerance
- Establishing a risk catalogue or register

## Overview

How risk is managed varies in each company. For example, in larger firms, risk management procedures and systems will be embedded in the culture and there is often a risk committee with responsibility for reviewing key risks, with different levels of authority for approving risk acceptance. Some firms even employ a dedicated Risk Manager. In smaller businesses the board of directors or partners may review the risk register on a regular basis and one of the directors or partners may be allocated the task of maintaining the register. However, whatever the arrangements in place, the risk management process itself tends to follow the same process which can be summarised as follows:

- Identification
- Quantification
- Probability
- Impact
- Mitigation

## Identification

Many businesses prefer to identify and record risks in what is termed a 'risk catalogue'. This provides a summary of the various exposures and offers a starting point for discussion at operational and management level.

## Quantification/Probability/Impact

One popular way of recording risk is to use a traffic light matrix system, where high probability exposures which are likely to have a high financial cost (quantum) and high impact on the organisation, are recorded as red (and attract the most scrutiny), whilst those with lower probability, quantum and impact are recorded as amber or green.

It is also possible to combine such an approach with a simple scoring system to assist in determining the category. For example, taking a simple scoring system where red = 3 points, amber = 2 points and green = 0 points; then a risk exposure carrying a high (red) degree of financial risk but with only a low (green) probability of occurrence and a medium (amber) level of impact on the business would produce an overall coding of amber ( $3 + 0 + 2 / 3 = 1.67$ ).

## Mitigation





Once the risks have been identified and coded it is possible (a) to see which need to be tackled with the greatest urgency and (b) to discuss and adopt strategies designed to mitigate them.

In simple terms the options are:

- **Accept:** The risk and the associated exposure is accepted as a business risk, and action is taken to monitor and manage it.
- **Transfer:** Risk transfer may be achieved contractually, by sub-contracting or mitigated by way of insurance. The degree to which this last strategy, which involves transferring exposure to an insurer for a known financial cost in the form of premium should be applied, depends on the risk bearing capacity of the organisation involved. We look at how this can be determined in the next section.
- **Reduce:** By modifying the way in which a process or procedure operates it might be possible to reduce the exposure by a greater or lesser degree.
- **Eliminate:** By ceasing an activity it might be possible to eliminate the exposure entirely.
- **Decline:** The risk is simply not taken. For example, you might choose not to enter into a particular contract or appointment.



Some examples of ways in which exposures might be mitigated include:

Risk	Mitigation	Category
Nature or location of project makes contract more susceptible to delay	Continual monitoring required	
A senior member of staff is the only individual in the firm to possess a key knowledge or skills set	Obtain the support of another sub-consultant or purchase insurance protection	
Possible currency fluctuations on an overseas project	Creation of a payment schedule to minimise risk	
Onerous contract conditions	Amend/renegeotiate contracts	

### Determining an organisation's risk bearing capacity

In business, acceptance of risk carries with it the possibility of reward but there is a balance which needs to be considered. There are many ways of calculating the risk bearing capacity of an organisation. However, the most popular method is to use, either a single measure, or what is termed a mean average combination of financial performance ratios or indicators measuring earnings, liquidity and financial strength.

Typical ratios/indicators together with recommended risk bearing levels include the following:

		Risk Averse	Risk Preferring
<b>Earnings</b>	Turnover	0.1%	0.5%
	Profit before tax	2.0%	5.0%
<b>Liquidity</b>	Working capital	1.0%	5.0%
	Available cash	5.0%	15.0%
<b>Financial strength</b>	Shareholders funds	1.0%	3.0%
	Current assets	0.5%	2.0%

Risk takes many forms. Common examples include:

- Financial
- Operational
- Legal and regulatory
- Strategic
- Reputational

Other considerations may include:

- Health & Safety
- Political risk/exposure
- Environmental risk
- Ethical policy

Risk can be reduced by knowing your limitations, having a full understanding of your obligations, ensuring each party is aware of its responsibilities and knowing your partners and clients.

You may decide to accept a risk because the cost of eliminating it is too high, a judgement which is made on the balance of probabilities involved. In arriving at this decision you need to consider the legal and financial consequences of risk acceptance and how this might affect the different areas of your business - compliance, human resources, legal, business interruption/continuity, asset protection etc.

Then, once you have evaluated the actions and procedures required to reduce risk, those procedures need to be put into place.

As noted earlier, one way of transferring risk is through the purchase of insurance. However, insurance should never be used as a driver for the acceptance of risk. Insurance is usually an annual contract and the continuance of cover is not guaranteed.

Equally, not all risks are insurable and, therefore, cannot be transferred or reduced accordingly. Insurance does not reduce your business risk but it can be used as a financial tool to protect against losses associated with some risks, providing some financial recompense and protection for claims brought against you.

To assist you in thinking about and formulating your risk management policy we next look at certain areas you should be considering when establishing the risks that arise from your business operations and any given contract/project.



It should be remembered that this is an ongoing process, not a one-off project, and that risks should be continually monitored and reviewed throughout the progress of a project. This produces valuable feedback and allows you to learn from experience and to apply that knowledge to improve your future risk management approach and strategy.

Typically the stages for a risk review will be as follows:

- Bid review
- Formal bid
- Contract
- Mid-contract review
- Contract closure
- Lessons learned/feedback

Risks to be considered could include:

- Does this appointment contract fit your business plan?
- Do you have the right experience for the contract?  
Have you undertaken similar work before or is this new territory for you?
- Does the delivery of the work potentially have any impact on your overall workflow?
- Is the reward worth the risk? Not just financially. For example, could the work or the client affect your reputation?
- Do you 'know your client'? Is your client and its sub-consultants financially sound? What is your client's business reputation?
- Have you checked the insurances of all sub-contractors/sub-consultants?
- Is the scope of work clear?

- Do all of the parties understand their statutory obligations?
- Is the timeframe adequate?
- Is the project budget adequate?
- Are your contractual terms acceptable?
- Is novation involved?
- Is there any joint and several liability?
- Are there any back-to-back contractual requirements?
- Are collateral warranties or third party rights required?

This is not intended to be an exhaustive list of questions but rather to illustrate some of the risks which need to be identified and considered.

As noted at the start of this guide in order to manage risk it is first necessary to have a process to identify and quantify it and to put in place mechanisms to consider the optimum methods of controlling those exposures. However, the alternative, of failing to plan could, ultimately threaten the continuity of the business concerned.

The RIBA & RIBA Insurance Agency welcome your feedback and would welcome your views on how this guidance might be improved and expanded.

The RIBA Insurance Agency provides advice on contractual matters and publishes articles on its website: [www.architectspi.com](http://www.architectspi.com)

This document is not intended to be an authoritative statement of law.  
It is issued for general guidance only.

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