grey paper

pilko

Governance & Assurance for Operational Risks:
"The Next Headline Should Not Be About Your Company"
By Greta Raymond

The energy and chemical industries have experienced an ongoing series of high-profile incidents in recent years. These incidents have had a severe impact on the lives of workers, the environment, earnings, share prices, and corporate reputation. Several of these incidents have occurred at large, well-respected companies with excellent track records. In the case of BP, the CEO was forced out in the aftermath of its oil spill, and assets are being sold to pay for the costs related to the spill.

Post-incident reviews bear out that the philosophy of "All accidents are preventable" is still valid. Given that hindsight is always "20-20," the real question for Corporate Officers and Board Members is how do you ensure that your organization is minimizing the probability of a major incident? Are there blind spots in information, culture, competency, or process that could lead to unexpected consequences?

We are sharing our perspective on the challenges facing industry, some of the common symptoms of poor Operational Risk governance and what the leading companies are doing about it. Our perspective is based on having conducted Independent Governance Assurance projects for 30+ major energy and chemical clients, in many cases advising them through the implementation steps as well. In addition, we facilitate a quarterly EHS Governance Forum attended by Outside Directors and Senior Executives from leading energy and chemical companies. Through this forum we are in touch with best practices in EHS and Operational Risk Governance.

The Challenges

The energy and chemical industries are facing four fundamental challenges which make safe and reliable operations increasingly more difficult. In no particular order:

- Energy and chemical assets are aging. Many facilities were placed into service decades ago, a high percentage have been operating for 40+ years. Some of these assets are well maintained; others are not.

- Most organizations are under pressure to "Do More with Less." These cost pressures are most acute in segments of the industry which have experienced extended periods of low profitability.

- An ongoing change of ownership as assets and companies are bought and sold adds another degree of asset impairment and complexity. Management of change is sometimes haphazard with predictably poor results.

- While growing numbers of "Boomers," who are well-versed and experienced in the operations of facilities are retiring, hiring and training new operators has not kept up due to cost pressures.

Add to this… the increased public, political, and investor expectation of Board Directors and Executives to better understand and control major operational risks. A question often asked in the aftermath of a major incident is "Where were the Executives and Directors?"

The Symptoms

When we conduct Independent Assessments of companies or individual businesses, we have observed the following warning signs which increase the probability of a major incident:

The Dozen Dangerous Symptoms

1. **Conflicting messages from the top about priorities. Saying safety is a top priority but behaving otherwise.**
2. **Unclear roles and responsibilities.**
3. **Lack of operational discipline and consistent processes and procedures for key activities.**
4. **Inadequate competency for personnel at any level and an overreliance on training as a "fix."**
5. **Out-of-date or irregularly tested emergency preparedness and response efforts.**
6. **Absence of outside Directors with recent knowledge of industry operational issues.**
7. **Excessive cuts or delays for maintenance capital expenditures.**
8. **A failure to learn from near-misses and events; weak investigation and follow-up.**
9. **Leaving line managers in place who cannot lead.**
10. **Failure to manage change effectively when the ownership, organization structure or people shift.**
11. **Complacent mentality: "We have always done it this way and haven't had a problem."**
12. **Absence of periodic "Cold Eyes Review" for governance of operational risks at both the Board and Management levels.**

What Leading Companies Are Doing

The companies who have the most robust Governance for Operational Risks have the philosophy "NEVER" and, if an incident or near-miss does occur, they will do whatever is required to learn from the experience, make the necessary adjustments and, most importantly, apply the "NEVER AGAIN" philosophy.

Those leading energy and chemical companies focus on robust governance processes and actions. Your company can follow their lead:

At the Board Level

- Ensure Directors have the experience, training and knowledge to make a meaningful assessment of operational risks and controls.
- Make operational risk review an element of a select Board committee and empower it to thoroughly understand and evaluate risk, ask the tough questions, and hold management accountable for progress.
- Review and approve significant capital investments with a full understanding of prioritized risks.
- Periodically conduct external reviews of your entire operational risk process with outside expertise. Review audit results with the Board.

At the Executive Management Level

- Drive consistency across, up and down the organization.
- Measure risk consistently using one matrix for all operational risk decisions and for global prioritization of capital investments.

- Set corporate minimum operational standards and apply them to all operations, everywhere.
- Audit operational practices against standards, track specific progress and hold all levels of management accountable for progress and report results to the Board.
- Show visible leadership to the workforce and listen to the challenges workers face.
- Create a culture where a questioning attitude toward risk is expected and rewarded.
- Make partners of your insurance underwriters to integrate enterprise risk reduction activity and provide "cold eyes" to monitor your progress.

When viewed objectively, these activities appear to be logical and straightforward. In fact, the leading companies are known for the lack of complexity in how they attack Operational Risks. Other companies often have dozens of overlapping initiatives underway simultaneously with predictable results. Unfortunately, "Common Sense is Uncommon Practice" within the energy and chemical industries with respect to managing Operational Risks. Make common sense a standard practice within your organization.

About Us

For the last 20+ years, Pilko & Associates has developed a fundamentally different model for advising on EHS, operational risk issues and governance practices. Our people are our differentiators. Pilko consultants have an average of 34+ years of operating, EHS and consulting experience. Many are either Outside Directors themselves or have been the primary Executive contact to the Board on EHS matters. The breadth and depth of our experience allow us to conduct governance assurance projects; provide frank feedback; and advise Corporate Officers and Boards on a customized roadmap for improvement. Standardized templates that work for one company do not take into account the culture and needs of each organization. Our customized assurance reviews focus on how and if practices actually work, not on how they are designed to work. We assess not only technical risk but also related organizational risks such as leadership and culture which often play a major role in unforeseen incidents and/or events.

If you would like additional information regarding this grey paper or Pilko's Governance & Assurance advisory services, please contact me at 713.357.1000 or greta@pilko.com.