Ineffective risk management and the difficulties experienced by Interserve [1]

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Risk management failings

As reported on 15 March 2019 both in the press and on its company website, the parent company of Interserve plc, the British multi-national company, has applied to enter administration[2]. At the time of the announcement Interserve plc was an international support services, construction and equipment services company headquartered in the UK and listed on the Financial Times Stock Exchange (FTSE) share index. They had been engaged by public and private sector clients in more than 40 countries, with a workforce of circa 68,000 people worldwide[3]. While not an exhaustive list, the company has been employed in the aviation, defence, education, energy, highways, marine, nuclear and pharmaceutical sectors. In summary, at the time of applying to enter administration, it had at least 50 active contracts worth £2.1bn with the public sector, predominantly with central government[4.] Prominent contracts included one to clean the London Underground and one to manage the Ministry of Defence's estate in the UK[5]. Interserve advised that if administrators were appointed, in all probability they would immediately sell Interserve's business and assets to a new company, to be controlled by Interserve's lenders. This article follows the previous PM World Journal article entitled "Ineffective Risk Management and the collapse of Carillion". Regrettably a number of parallels can be drawn between Interserve's current problems and the collapse of Carillion plc, a former competitor of Interserve. As with the demise of Carillion, the examination of failed companies provides valuable insights into failed corporate processes. These lessons are important not only for executives but also for lenders, shareholders, construction managers, project managers, risk managers and advisers. At the heart of Interserve's difficulties has been an acute lack of understanding and management of risk by both the UK government[6] and Interserve itself [7]. As Interserve Chairman Glyn Barker disclosed in the 2017 Annual Report for instance, while Interserve was impacted by external events, poor performance predominantly resulted from "self-inflicted mistakes of the past".

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[1] How to cite this article: Chapman, R. (2019). Ineffective risk management and the difficulties experienced by Interserve; *PM World Journal*, Vol. VIII, Issue III (April).

[2] Building (2019) "Interserve formally applies for administration", By Will Ing, 15 March 2019

[3] https://www.interserve.com/

[4] Sky news, UK, (2019) "Interserve faces administration but all jobs are to be saved in sale". James Sillars, Friday 15 March 2019

[5] Tussell.com (2018) "Interserve in crucial funding talks with banks" https://www.tussell.com/insights/interserve-in-crucial-funding-talks-with-banks.

[6] Parliament UK (2018) The Public Administration and Constitutional Affairs Committee report, "After Carillion: Public Sector Outsourcing and Contracting". https://publications.parliament.uk/pa/cm201719/cmselect/cmpubadm/748/748.pdf /09 July 2018. The report stated "Our report finds that government ineffectiveness has contributed to the problems that Carillion and other companies have faced. The Government has deliberately promoted an aggressive approach to risk transfer to the private sector - often even attempting to transfer risks that the government itself has completely failed to analyze or to understand".

[7] Glyn Barker, Interserve's Chairman, stated in the Interserve 2017 Annual Report "The circumstances that resulted in the challenges faced by the Group during 2017 were, in my view, due in part to weaknesses in the corporate governance framework of Interserve over several years".

Background

The UK Government had been Interserve's largest customer for many years, and at the time of writing, Interserve was one of its largest suppliers, retaining its pan European contract with the Foreign & Commonwealth Office which they have held for over ten years. In addition, Interserve had successfully secured new key accounts such as UK wide contracts for the Department for Works & Pensions, the Department for Transport and the Ministry of Justice. Public sector contracts had accounted for 70% of Interserve's turnover[8]. These new and retained accounts had supported the longevity of the company. The new face of Interface, its organisational structure and its financing have yet to be revealed.

Parallels between Carillion and Interserve

Interserve had struggled with a number of critical issues for over a year. These included: being over leveraged resulting in crippling debt; structured as a federalised organisation exacerbating decision making and accountability; poor corporate governance; inappropriate reporting of goodwill and goodwill impairment; engaging in contracts with very low margins; struggling with securing payment on Middle East contracts; poor performing 'energy from waste' projects; the burden of high board salaries; and inadequate risk management. All have all undermined bottom line performance. There are a series of striking parallels with Carillion plc before its demise, as set out in Table 1 below. As reported in the press, on 15 January 2018 Carillion plc, the British multi-national company declared insolvency and the Official Receiver started to liquidate its assets and contracts. The company predominantly operated in low-margin industries[9] within highly competitive markets with inherent risks[10]. A large element of Carillion's contracts were government construction and facilities management contracts.

Aspect	Carillion	Interserve
Over leveraged (which some commentators have described as "crippling debt").	✓	✓
Substantial finance costs arising from borrowings	✓	✓
Escalating borrowings year on year	✓	✓
Failing corporate governance	✓	✓
Overstated goodwill	✓	✓
Substantial fall in share price over time	✓	✓
Difficulties experienced in obtaining payment on Middle East contracts	✓	✓
Failing construction contracts (substantial overspend)	✓	✓
Entering large contracts with small margins	✓	✓
Large number of government contracts	✓	✓
Board directors paid high salaries and bonuses despite poor company performance	✓	✓
Acceptance of inappropriate risk transfer	✓	✓
Engaging in risky contracts in the Middle East (based on local norms and culture)	✓	✓
Inadequate internal controls and risk management	✓	✓

Table 1: Common aspects between Carillion plc and Interserve plc

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[8] Building (2019) "Interserve formally applies for administration", Will Ing, 15 March 2019.
[9] Financial Times (2018) "Unravelling a web of failures at UK outsourcer Carillion", https://www.ft.com/content/37f63372-58f3-11e8-b8b2-d6ceb45fa9d0, May 16 2018.
[10] UK Parliament (2018) House of Commons Hansard. *Carillion.* 12 July 2018. Volume 644. https://hansard.parliament.uk/commons/2018-07-12/debates/2D8B6F0E-B8C0-47C6-B9D0-D274EC5D72DD/Carillion

Interserve plc behaviours, practices and characteristics

Organisation: Interserve recognised the deficiencies in its working practices, decision making and accountability and as a consequence, following a strategic review carried out in 2018, completed a very radical streamlining of its divisional structure from more than 40 to 3 divisions. It replaced the fragmented and federalised entity that existed up until the end of 2017. Divisions were acting semi-autonomously without adequate control. This reorganisation Interserve considers is helping it to become: leaner; better aligned to its customers; an organisation with greater leadership accountability; and more competitive. In particular Interserve wished to build a common company culture with strong governance and accountability with appropriate internal controls and risk management. Risk management was clearly not at the heart of decision making.

Corporate Governance: Within the 2017 Annual Report, Glyn Barker, Interserve's Chairman stated that "good corporate governance requires a strong system of effective internal control to assess and manage risk and a culture of integrity, openness and a desire for continuous improvement". However, Baker makes specific reference to weaknesses in Interserve's corporate governance which he believes ultimately contributed to poor performance: "the circumstances that resulted in the challenges faced by the Group during 2017 were, in my view, due in part to weaknesses in the corporate governance framework of Interserve over several years". However, on inspection of the 2016 Annual Report for instance, these weaknesses were not highlighted-despite these shortcomings existing "over several years". Corporate governance encompasses the establishment, implementation and monitoring of internal controls of which risk management is one.

Acquisitions: Commentators have made the observation that Interserve's difficulties were exacerbated by "a string of ill-timed and ill-advised acquisitions"[11,12]. One commentator remarked: "between 2010 and 2014, the company spent about £430 million in cash acquiring other businesses, including £250 million (in cash and shares) for Initial Facilities, the facilities management business of Rentokil Initial PLC. Over the same period the company generated post-tax profits of about £210 million, or less than half the amount it spent on acquisitions"[13]. A rising debt burden should have been flagged as a prominent risk.

Goodwill: As discussed above, numerous parallels can be drawn with Carillion. As reported in the previous article describing the demise of Carillion plc[14], much of Carillion's growth was achieved through acquisition. When undertaking acquisitions Carillion paid questionable amounts for "goodwill", the accounting term used to describe the difference between the net assets and the amount paid. Goodwill represents the intangible assets (such as company brand, skills and experience of the workforce, patents, trademarks and copyrights), as opposed to physical assets like buildings and equipment. The appropriate value of goodwill is very hard to

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[11] Independent (2019) "Interserve: Major government contractor which employs 45,000 to go into administration", Tom Barnes. March 2019.
[12] Financial Times (2019) "Interserve's banks line up pre-pack administration", Gill Plimmer, March 9, 2019
[13] Masterinvestor (2018) "Who will be the next Carillion? John Kingham 15 February 2018. https://masterinvestor.co.uk/equities/who-will-be-the-next-carillion/
[14] Chapman, R. (2018). "Ineffective risk management and the collapse of Carillion"; *PM World Journal*, Vol. VII, Issue XII (December). https://pmworldlibrary.net/wp-content/uploads/2018/12/pmwj77-Dec2018-Chapman-ineffective-risk-management-and-collapse-of-carillion2.pdf

define. It is possible for an acquiring company to pay too much for goodwill. Within its 2018 full year results, Interserve reported that during 2018 "the carrying value of the Industrial Services business was impaired by £15.0 million and a further £7.1 million loss was incurred on its final disposal. As part of the Group's 31 December 2018 annual goodwill and intangible assets impairment review, further write-downs of the carrying values of its Support Services Private Sector cash generating unit (£26.9 million) principally related to the acquisition of Initial Facilities in 2014 and a further £6.2 million on its Learning and Education business". Unlike Carillion however, Interserve it would appear have been more transparent and not manipulated unrecoverable goodwill to prop up its balance sheet and allow the notional values of goodwill to sit on the balance sheet year after year, without any re-assessment.

Debt: As reported within Interserve's 2018 Full Year Results, as of November 2018 net debt increased from £502.6million (2017) to £631.2million (2018) an increase of 25%, primarily driven (it states) by: incremental cash costs from 'energy from waste' contracts; incremental exceptional costs on a number of construction projects; delays in collecting receipts from certain Middle Eastern customers; and an unwind in the UK Construction business's working capital as the construction division's revenue continued to decline[15]. However, within the same report Interserve advise since 31 December 2018 the Group's net debt position had increased. This was primarily due to the recognition of costs associated with the deleveraging transaction, a further deterioration in the Middle East relating to receivables for Support Services and RMD Kwikform (the concrete formwork business) and further working capital unwind in the construction business. This in aggregate represents a deterioration of approximately £107m above the expected increase in net debt due to what Interserve describe as "seasonality". Interserve declared the Group remained over-leveraged. Of significance is that the net finance charges increased from £21.4million to 40.9million in 2018. Of greater impact was that the Group net finance costs jumped from £19.6million in 2017 to £105.4million in 2018[16]. The constant increase in debt exposure presented a major risk.

Dividend payments: Dividends are a distribution of profits. Typically, there is pressure on companies to, at the very least, maintain dividend payments. Dividend payments can be seen as a barometer for indicating changes in financial position, positive or negative. It is possible to get an idea of the financial health, management, attitude and expansion plans simply from a company's dividend policy. Hence downward adjustments to dividend payments can significantly affect shareholders trust, the company's share price and its overall reputation. While declared profits can be based on expectations, dividends are paid out in liquid assets-money. Interserve has adopted a more responsible approach to the payment of dividends than Carillion plc did. As reported within the Interserve 2018 results "the dividend remains suspended with no interim or final dividend due to be paid. Under the terms of our existing financing facilities, no dividend is payable until historical net debt to EBITDA[17] is below 2.5 times". A board's trading statement as far back as October 2017 stated: "We now believe there is a realistic

[15] Interserve PLC Full Year Results Announcement 2018, dated 27 February 2019
[16] Interserve PLC presentation of 2018 Full Year results, dated February 2019
[17] EBITDA is the abbreviation for for Earnings Before Interest, Taxes, Depreciation, and Amortization and is a metric used to evaluate a company's operating performance. It is very easy to compute and it is a good proxy of the company's operating cash flow.

prospect that we will not meet the net debt to EBITDA test contained in our financial covenants for 31st December 2017. As previously announced, we are engaged in constructive and ongoing discussions with our lenders. We have engaged a financial advisor to assist us in these discussions, as well as looking at options to maximise the short-and-medium-term cash generation from the business" [18].

Winning bids: Revenues declined by 10.7% in 2018 to £2,904.0m (2017: £3,250.8m) due to a fall in UK construction and a more disciplined and commercially focused group-wide bidding process[19]. As highlighted by a Forbes article[20]: Interserve's "construction division says it is failing to win bids for new contracts because of 'financial uncertainty.' For a heavily leveraged outsourcing company whose solvency entirely depends on future cash flows, falling revenues and bid loss are potentially fatal". Critical risk considerations are not to win bids at any price or accept a risk exposure which is disproportionate to the potential income.

Construction: Overtime, based on its experience, Interserve has modified its risk appetite and more closely scrutinises the potential risk exposure of the contracts it contemplates bidding for.

- *Experience:* Within its 2016 Annual Report Interserve stated "Our UK Construction business delivered a disappointing performance. The continuation of a long period of challenging market conditions, coupled with pockets of underperformance in operational delivery in a number of contracts, offset strong performances in most of our regional businesses, resulting in a net loss result for the division". The 2018 report described the UK construction business as still being a challenge, with a fall in revenues. However, progress had been made in closing out some complex and legacy accounts and exiting the London Construction market. Costs associated with this exit and anticipated losses on the close out of contracts within this business sector amounted to £24.8 million. They anticipate that this exit and the associated cash outflows will conclude in 2019.

- *Response:* Within its 2016 Annual Report Interserve stated that the poor results described led to a series of senior management, procedural and other organisational changes across the division combined with investment in new management information systems to improve scrutiny of and risk assessment in its operations. The review of the approach to be adopted continues. The 2018 Report continues to advise that plans are in place to improve the organisational structure and capability to support future profitability and performance and they will be rolled out early 2019. The same report records that the construction business's focus is on forming long-term relationships and delivering repeat business through commercial structures such as framework agreements.

[18] The Construction Index (2017) "Interserve on verge of breaching financial covenants", 19 Oct 2017.
[19] Interserve PLC Full Year Results Announcement 2018. https://www.interserve.com/docs/default-source/investors/financial-reports/presentation-results/2018/final-rns-full-year-results-2018-final.pdf?sfvrsn=4
[20] Forbes (2109) "Interserve teeters on the Brink of Insolvency", Frances Coppola**.** Mar 11, 2019.

- *Risk Exposure:* The 2016 report stated "strategically, we have narrowed our focus for winning work to core sectors and activities and have refined the risk profile of work that we take on". Interserve became more selective focusing on low-risk projects with an average value of less than £10 million. Interserve reiterated this theme in their 2018 report stating "the focus will remain on quality contracts, targeting profits and not revenue. During the year we continued to focus on cost, pricing and bidding controls, a narrow strategic focus". Why it took so long to realise that the overriding goal should be to target profits not revenue is difficult to comprehend as narrow margins are notoriously difficult to manage.

Risk Management: While the Interserve annual reports describe laudable risk management practices, risk management had not been integrated into the company culture and particularly during key decision making.

Risk Framework: The Annual Reports record that the Board has documented a framework setting out its risk management objectives in terms of risk appetite, risk management policy, risk oversight structures and accountability, risk identification and assessment, escalation, monitoring and reporting, and guidance on the application of the framework, which is included within the Group's internal controls manual. It implies the company is following common good practice.

Effectiveness: Interserve's 2015, 2016 and 2017 Annual Reports carried exactly the same text: "The Board has carried out a robust assessment of the principal risks facing the Group, as required by the Code, together with a review of effectiveness of the Group's risk management and internal control systems, including operational and financial controls during the period covered by this report and has not identified nor been advised of any failings or weaknesses in the operational or financial controls which it determines to be significant". Given the turbulent times that the business had been through, which had only been attributed to external factors in part, this unchanging statement seems surprising, if not inaccurate.

Risk exposure: Included in the Table 2 below is what the Interserve Financial Report[21] describes as its "Principal Risks and Uncertainties" which the Group was addressing through its risk management measures. The table also includes the risks from the 2016 and 2017 annual reports. Within its 2016 Annual Report Interserve state the obvious in that given their large-volume (multi-contract) relationships with particular clients, a loss of one or more of those clients would put a hole in revenue and profits. Of greater significance is their recognition that the management of such contracts entails potential risks including: mis-pricing, inaccurate specification, poor mobilisation leading to missed objectives, failure to recognise risks accepted, poor control of costs or of service delivery, sub-contractor performance or insolvency and failure to recover, in part or in full, payments for work completed. However, the effectiveness of the risk management practices must be called into question given that in 2017 Interserve commissioned an independent review of approximately 125 of its largest contracts with the goal of minimising risk exposure and potential underperformance[22].

[21] Interserve PLC Full Year Results Announcement 2018, dated 27 February 2019
[22] Interserve plc 2017 Annual Report

Risk Status: The changing status of these risks (i.e. deteriorating, unchanged or improving) relative to the last bi-annual review undertaken by the Board in August 2018 are depicted in the column entitled "Risk Environment" which echoes the title used in the table included in the 2018 annual report. The arrow system adopted in the Interserve table has been interpreted to depict that in the main the risks/uncertainties were deteriorating in nature. The interpretation was necessary as no legend was provided.

Risk descriptions: The risks described by Interserve are broad brush risk titles as opposed to risk descriptions based on known causes. Broad titles make if particularly difficult to define specific tailored response actions.

Procedures: Interserve advises in the same report "the established risk-management and internal control procedures, which are regularly reviewed by the Group Risk Committee on behalf of the Board, are designed to manage their effects and thus contribute to the preservation and creation of value for the Group's shareholders as we pursue our business objectives".

Risk exposure described in the 2018 Financial Report	Risk Environment, 2018 report	2017 Annual Report	2016 Annual Report
Deleveraging Plan	Deteriorating	✗	✗
Business, economic and political environment	Deteriorating	✓	✓
IT Systems/Security	Deteriorating	✓	✓
Data Management	Deteriorating	✓	✗
Operating System	No Change	✓	✓
Financial risks	Deteriorating	✓	✓
Major contracts	Deteriorating	✓	✓
Damage to Reputation	Deteriorating	✓	✓
Key people	Deteriorating	✓	✓
Health and Safety Regime	No Change	✓	✓
			Environmental Change

Table 2: Principal Risks included within Interserve annual reports from 2016 to 2018

Assessment: The risks are not numbered, ranked or assessed in terms of their probability, impact or proximity. The question has to be asked what is the value of the risk reporting in the Annual Reports when shareholders and investors are not advised of the scale (value) of the uncertainties and risks.

Non-Executive Directors: The Interserve Board has four non-executive directors[23]. A House of Commons report stated in relation to Carillion plc, but also relevant to Interserve plc: "Non-executives are there to scrutinise executive management. They have a particularly vital role in challenging risk management and strategy and should act as a bulwark against reckless executives". While very experienced, it is not clear what role has been assigned to the Interserve NEDs, what challenge they have provided or to what degree they were listened to. Of interest is what influence the NEDs have had to-date in terms of say the level of borrowings, the acquisitions pursued, the level of goodwill accepted onto the accounts, the effectiveness of

[23] Ibid

internal controls, margins on contracts, the level of risk accepted on contracts and the information supplied to the Board on the status of contracts.

UK government behaviours

Government monopoly: A significant factor in Interserve's difficulties (as with Carillion plc in the past) is that the Government's position in some public sector markets has been and remains monopolistic. As a consequence, the government has very considerable power as the only buyer in these markets to stipulate the risk to be absorbed by bidders and to set challenging prices and standards of quality.

Government transfer of risk: The Government it is claimed has deliberately promoted an aggressive approach to risk transfer to the private sector - often even attempting to transfer risks that the government itself has completely failed to analyse or to understand[24]. The Chair of PACAC, Sir Bernard Jenkin MP, said: "It is staggering that the Government has attempted to push risks that it does not understand onto contractors, and has so misunderstood its costs[25]. Serco's chief executive Rupert Soames has been particularly vocal on what he has described as the government's excessive transfer of risk to the private sector. Soames told MPs on the Public Administration Committee (during their inquiry in 2017 into the way the civil service works) that at one-point Serco had been in "severe danger of collapse" as a consequence of the terms of their contract with the Home Office to provide accommodation for asylum seekers. Soames said the government was partly to blame for Serco's troubles because of the way it had sought to overload contracts with excessive risk. He said: "what has happened is two things: the government got into a place where it was advised to do massive transfer of state risk onto suppliers," he said. "And it became a badge of pride to go and transfer as much risk onto suppliers as you could. At the same time, suppliers, I think, through foolishness and incompetence, certainly on our part on a couple of things, were foolish enough to say 'yes'."[26]

Consensus on approach adopted by government: During the House of Commons inquiries into the collapse of Carillion and subsequent reporting by the Public Administration and Constitutional Affairs Committee, it transpired that there was a clear consensus among a number of commentators that successive governments have sought to transfer risk inappropriately and that they continue to do so. A key finding of the Committee was that the UK government's focus on cost and aggressive risk transfer during negotiations has led to difficulties during the operational phase of contracts. These comments are considered pertinent here.

- Rupert Soames, Chief Executive of Serco (which also provides outsourced services) said that in his view "Government has started transferring unmanageable amounts of risk into

[24] House of Commons. The Public Administration and Constitutional Affairs Committee publishes its latest report, "After Carillion: Public Sector Outsourcing and Contracting". 09 July 2018. https://publications.parliament.uk/pa/cm201719/cmselect/cmpubadm/748/748.pdf
[25] Web page www.parliament.uk. Commons Select Committee. "Carillion collapse exposes fundamental flaws in Government outsourcing". 09 July 2018.
[26] Civil Service World (2017) "Serco chief: government saw it as "badge of pride" to transfer "massive" risk to outsourcers". Matt Foster on 24 January 2017. (Based on The Public Administration and Constitutional Affairs Committee questioning of Rupert Soames, Chief Executive of Serco, on the structure and organisation of the Civil Service 23 January 2017).

the private sector". He recommended public agencies should refrain stipulating a requirement such as the requirement that contractors bear risk for regulatory and legal changes for 10 years.[27]

- Michael King, the Local Government Ombudsman remarked that "all too often" local authorities try to outsource responsibility for a contract as well as operational risk[28].
- Professor Sturgess wrote in 2017 that "the experience of recent years has been that [government] procurement teams are aggressively seeking to maximise risk transfer"[29].
- The NAO found that the Home Office had allocated risks to Raytheon, the IT contractor on the Eborders programme, which the company had "proved ill-placed to manage"[30].
- The think tank, The Institute for Government, reported that the Government is "transferring more financial risk onto providers"[31].
- A recent report by the CBI recorded that 37% of businesses who work with the Government felt that the "government's handling of risk had deteriorated since 2015, with almost half stating there had been no improvement during this period"[32].
- The NAO stated that when designing payment by results schemes, the Government needs "to understand potential providers' capacity to take on risk"[33].It is not clear that the Government have done this.
- Paul Davies, a partner of PWC's Infrastructure and Government team in the UK and Capital Projects and Infrastructure global network, commented the Government's approach of pursuing the lowest possible cost and the highest possible risk transfer has flowed from a very transactional approach to contracting.

Audits: As a consequence of the failure of Comet, BHS, Carillion and others, auditors and the financial regulator have come under severe criticism and as a consequence the UK government's spotlight. As articulated by Sir John Kingman, the quality, accuracy and reliability of corporate reporting, governance and audit are fundamental to the trust shareholders, investors and the wider public place in companies[34]. Given the recognised failure of the Financial Reporting Council (FRC), in April 2018, the Secretary of State for Business, Energy and Industrial Strategy, The Rt Hon Greg Clark, asked Sir John Kingman to undertake an independent review of the FRC (the auditor watchdog), and to report by the end of 2018. Kingman was requested to undertake "a root and branch review that would put forward proposals to make the regulator a beacon for the best in governance, transparency, and independence"[35]. The Kingman report, recording the recommendations of the review, was published on 18 December 2018. The report highlighted that two major government Select Committees had accused the FRC of "timidity, a lack of pace

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[27] Engineering News Record. (2018) "When Carillion's Leaders Missed the Biggest Risk of All". February 28, 2018. Richard Korman and Peter Reina. https://www.enr.com/articles/44058-when-carillions-leaders-missed-the-biggest-risk-of-all
[28] Sourcing public services: lessons learned from the collapse of Carillion inquiry. Report: After Carillion: Public sector outsourcing and contracting, Section 4
[29] G. Sturgess, (2017) "Just another paperclip: Rethinking the Market for Complex Public Services", Business Services Association, March 2017, pp. 10–11
[30] Comptroller and Auditor General Eborders and successor programmes (December 2015) p. 10, 34
[31] D. Crowe, T. Gash and H. Kippin, (2014) "Beyond Big Contracts", Institute for Government and Collaborate, January 2014, p 6
[32] CBI, Partnering for Prosperity: CBI/Browne Jacobson 2018 Public Procurement Survey, June 2018, p. 12
[33] National Audit Office The Work Programme (June 2014) p. 7
[34] DBE&IS (2018) Independent review of the Financial Reporting Council (FRC) 2018: Final report, Department for Business, Energy & Industrial Strategy
[35] Ibid

and excessive closeness to those it regulates". The report summaries the FRC as a ramshackle "house" cobbled together with all sorts of extensions over time, which leaks and creaks, (sometimes badly), which the inhabitants had sought to patch and mend. According to a press release issued by the Department for Business, Energy & Industrial Strategy on 11 March 2019, the FRC will be replaced with a new regulator called the Audit, Reporting and Governance Authority[36]. Secretary of State for Business, Energy and Industrial Strategy Greg Clark said: "This new body will build on our status as a great place to do business and will form an important part of strengthened public trust in businesses and the regulations that govern them".

Summary

Following hard on the heals of the collapse of Carillion plc, Interserve has now gone into administration. An attempt has been made to describe some of the parallels between the two companies in terms of their debilitating behaviours and characteristics. The problems encountered by Interserve have not arisen due to any sudden and dramatic changes in the business environment over which they have little or no control. They are due in the most part to the actions of the directors and their senior management. In addition, these adverse events have evolved over a number of years affording the directors time to take corrective action. Given that the backdrop to their own management challenges will have been the difficulties experienced by Carillion, Serco and others, the directors will have been armed with knowledge of the ramifications of specific growth strategies. While risk management practices have been described in the Interserve Annual Reports, they only provide a high-level overview. What is surprising is that successive Interserve annual reports have repeated verbatim the following statement: "The Board has carried out a robust assessment of the principal risks facing the Group, as required by the Code, together with a review of effectiveness of the Group's risk management and internal control systems, including operational and financial controls during the period covered by this report and has not identified nor been advised of any failings or weaknesses in the operational or financial controls which it determines to be significant". Clearly the principal risks have not been understood (or have been recognised but not acted upon) and the weaknesses in the risk management practices have not been identified and corrected. The directors have persistently underestimated the threats to the company. The annual report statement above implies risk management has been superficial and given the events of 2018 and 2019 poor risk management has been the root cause of poor performance with catastrophic consequences for shareholders.

[36] DBE&IS (2019)"Audit regime in the UK to be transformed with new regulator, Financial Reporting Council to be replaced with a new regulator following review by Sir John Kingman", Published 11 March 2019, from: Department for Business, Energy & Industrial Strategy and The Rt Hon Greg Clark MP. https://www.gov.uk/government/news/audit-regime-in-the-uk-to-be-transformed-with-new-regulator

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