

topical tips

Risk Management Guide

Risk Management Guide

Risk management should not be seen as an isolated activity for any charity. It links in closely with other key aspects of the trustee board's involvement in longer term strategic planning, in setting of shorter term objectives and in determining policies for reserves and investments.

Since the introduction of SORP 2000, charity trustees have been familiar with the need to refer to the charity's risk management process within the trustees' annual report. SORP 2005 reinforces the requirement that *'a statement should be provided confirming that the major risks to which the charity is exposed, as identified by the trustees, have been reviewed, and systems or procedures have been established to manage these risks'*. The only exemption from this disclosure

applies to charities that are not subject to audit because their gross income falls below the audit threshold. The Charities (Accounts and Reports) Regulations 2005 also contain a similar requirement for auditable charities to include within the Trustee Report *'a statement as to whether the charity trustees have given consideration as to the major risks to which the charity is exposed and the systems designed to mitigate these risks'*.

The increasingly prescriptive emphasis on the content and disclosure within the trustee report under SORP 2005 was intended to ensure that charities would clearly demonstrate their ability to govern effectively and to emphasise their public accountability. Charity trustees and their senior management team should focus on

strategic management and performance review as an integral part of best governance practice. Risk management plays a vital part in this strategic management process. It provides an opportunity to identify operational weaknesses and to minimise the chance of this affecting future development. However it's not just about preventing disaster, it should be seen as a positive tool in identifying and responding to opportunities which fall within acceptable boundaries for risk, as laid down in the charity's risk policy.

Assessing your risk

Whilst many charities may feel that they have evolved a reasonable method for risk assessment over the last few years, in practice this often results in the production of a huge list of every risk possible, however unlikely this is to occur in reality. The longer the list, the less chance there is of a timely response in dealing with the risks faced. Having produced the list, duty is seen to have been done, and it remains little used thereafter. Charities need to regularly review the means by which they get best value from the risk assessment and monitoring process. The following guidance should help them to achieve this aim.

What is risk?

Risk can be seen as the uncertainty surrounding the outcome of an event or action that provides opportunity for either a positive benefit or a threat to success. Risk can be affected by factors which are externally imposed or are internal to the organisation and this will in turn have an impact on the extent to which the risk can be mitigated.

Each charity is different and the nature of its activities and the environment in which it operates will impact on the type of risks faced.

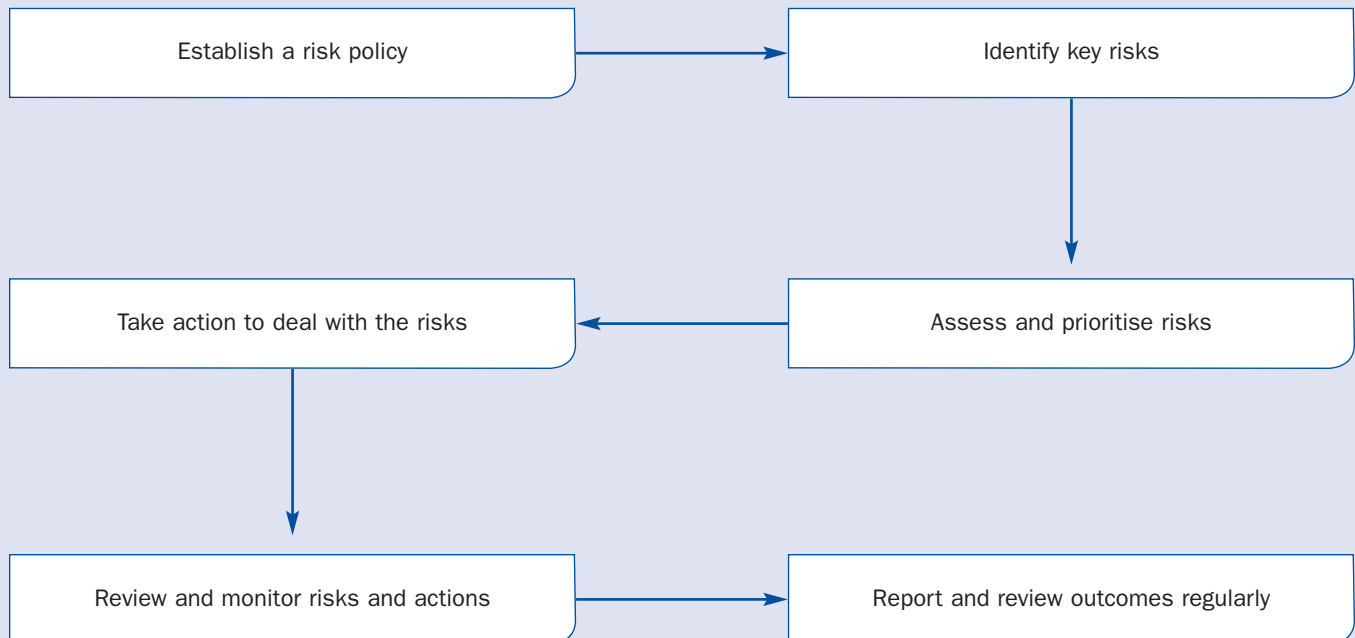
For example an 'aid' charity operating in remote parts of the world, reliant on local staff

on the ground to report back on activity, will have high operational risk associated with managing staffing overseas, financial reporting and utilisation of funds abroad. A charity providing care services will have high potential risks associated with loss of reputation and ability to attract future funding in the event of poor service delivery or bad publicity.

The impact of a particular risk can also be affected as much by the charity's lack of adequate response to a particular risk as by its ability to respond appropriately.

Key steps to effective risk management

The risk management process requires the following steps:



Establishing a risk policy

This is one of the key areas for input by trustees in the risk management process and requires them to have a full understanding of the sector, their charity's place within it, and the external factors which impact on the charity's service delivery.

The trustees must decide upon the level of risk they are prepared to accept in order to meet strategic objectives and to carry out planned activity. Trustees will also take account of the charity's ability to absorb or withstand risks in setting an initial risk policy. For example a large grant giving charity with high reserves and a solid income generating asset base may be

prepared to fund project proposals that have uncertainty, and therefore a risk of non delivery of outcomes, because the projects have huge potential to improve community life.

Throughout the risk management process the trustees will need to take account of any issues arising from the detailed assessment and evaluation of risks which will impact or change their attitude to risk and hence the risk policy. The risk policy should be revisited regularly to take account of changing needs and operating environment.

Identify key risks

In identifying key risks the charity should focus on those risks that impact on its ability to operate effectively.

Risks can be divided into two broad headings - those that are strategic and those that are operational. Further subcategories can be identified where relevant to each particular organisation. Examples are set out below of the areas that should be considered:

Strategic risk

Risks affecting the strategic objectives of the organisation such as:

- Loss of reputation
- Inability to deliver a stated aim as expected and to time
- Changes in legislation impacting on service delivery
- Lack of strategic planning
- Poor trustee management

Operational risk

Risks affecting day to day operations such as:

- Poor quality services
- Non compliance with regulation
- Poor/ uncompetitive contract negotiation
- Inadequate use of assets/capacity

Financial risks

- Loss of key funder
- Inappropriate reserves policy
- Poor investment policy
- Fraud
- Poor control over fundraising
- Mismanaged funds at branches/ overseas

Compliance risk

Failure to comply with regulation such as:

- Charity law
- Companies Act
- Trustees Act
- Health & safety
- Employment law

HR risks

- Inability to recruit or retain staff
- Employee disputes
- Poor staff morale
- Inadequate skills on trustee board

Asset risks

- Inadequate insurance
- Poor equipment maintenance
- Loss through fire/disaster
- Poor IT support/backup

Factors to be considered when identifying risk would include:

- What are your key objectives and what risks would prevent you from meeting them?
- What external influences affect your business development and ability to deal with risk?
Examples include:
 - Service users
 - Funders and donors
 - Economic and political influences
 - Technological advances
 - Demographic patterns
 - Social attitudes
- What internal controls are in place to support current activity and processes?
- How well does the flow of information between departments, staff, management and the trustee board support effective decision making?
- How does your operating structure impact on risk? (do you work on joint projects with third parties; do you have branches or subsidiaries?)
- What have you learned from problems encountered in the past and how were they dealt with?

Assess and prioritise risks

Whilst the trustees have overall responsibility for development of the risk profile and for risk management they should not need to carry out all of the detailed risk assessment themselves. For example higher level review of strategic risk could involve a subcommittee of trustees in brainstorming with the senior management team, however a review of health and safety and employee risks may be best carried out by staff with specialist skills in these areas.

Involving relevant staff in the review process also helps to encourage ownership and support in the subsequent management and monitoring of identified risks.

Try to use as many sources as possible to identify potential risks, such as:

- Long and short term business plans and impact of chosen strategies
- Annual budget process, underlying assumptions and potential contingencies
- Complaints procedures and client/service user feedback
- Staff appraisals and performance measurement
- Donor and funder feedback
- Inspections by external regulators or internal audit

Once the risks have been identified they need to be properly evaluated. **Risk mapping** is an effective means of analysing and comparing risks.

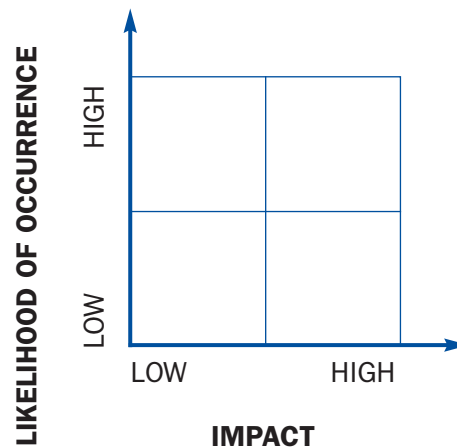
Risks are ranked according to likelihood of occurrence and severity of impact.

The risk of both occurrence and impact are given a ranking such as low, medium or high, with a scoring of 1 for least severity of impact or least likelihood of occurrence and a scoring of 5 indicating the highest severity of impact or likelihood of occurrence. For each given risk the allocated scores for occurrence and impact can be multiplied together to give a value for ranking of the risks.

A risk map provides an effective visual representation of the relative ranking of individual risks.

Whilst risks ranked highest for both impact and occurrence (top right hand quartile of the risk map) are likely to have the highest priority for action, it is important not to ignore low impact/high occurrence risks that may be a constant drain on finances or resources in the longer term. Plans also need to be made in advance to respond to high impact/low occurrence risks which would severely damage the charity if they came to fruition.

An example of a template for a risk map:



Take action to deal with the risks

For each risk identified the trustees must adopt an appropriate method to lessen impact and/or likelihood of the risk occurring. Steps can be taken to:

- Avoid the risk e.g. by ceasing to carry out a particular activity or operate in a particular area
- Transfer the risk e.g. by passing responsibility to a third party for insurance, outsourcing
- Limit or reduce exposure to the risk e.g. by improving internal controls, back up for IT, contingency planning for a 'what if' scenario
- Accept the risk - but monitor it regularly where it could have a significant impact

An example layout for a pro forma risk register would be:

Risk identified	Likelihood of occurrence (a)	Severity of impact (b)	Overall risk (c) = (a) * (b)	Existing controls	Proposed improvements	Responsibility for action	Residual risk (Note 1)	Timetable for action	Follow up review
Governance Trustee body lacks relevant skills	1	4 Ineffective decisions; failure to meet purpose; staff resentment	4	Skills audit carried out annually; induction programme; Given job description	Formal appraisal of board members annually; ongoing training	Chair Board members	2	Set procedures for next board meeting	Annual
Operational Improper advice given by casework staff	2	4 Loss of reputation; negative publicity; litigation	8	Training and supervision of staff; insurance; Casework meetings	Increase frequency of casework reviews; monitor minimum training hrs	Casework manager and CEO	3	Immediate	Quarterly

Note 1 Residual risk is a subjective appraisal of the remaining risk that cannot be fully eliminated by actions to mitigate risk

Review and monitor risks and actions

The method used to document the assessment and ranking of risk and the actions taken to mitigate the risks will depend on the size and complexity of the charity's operating structure and the level of risks identified. Smaller charities may find that they can identify key risks on a document that runs to no more than a couple of pages.

For larger charities it is important to follow a structured recording process which identifies:

- Key risks
- Impact of the risks
- Existing controls and any control gap
- Procedures to tighten controls and persons responsible for implementing and monitoring the controls
- Remaining 'residual' risk after mitigation
- Timetable for action and follow up reviews

An example layout is shown above.

Report and review outcomes regularly

As the sector struggles to meet the demands of increased regulation and the changing funding environment charities must resist the temptation to react by fire-fighting and look to benefit from an integrated approach to risk management which becomes part of the whole planning and performance management process of the organisation.

It is not sufficient to rely on historic information and documented processes. Charities need to look for potential risks, and in particular those risks associated with new areas of planned activity or growth. They should consider both the down side and upside of potential risks and plan for desired outcomes; regularly monitor risk and areas of uncertainty and consider a change of activity or approach where outcomes are not being achieved.

Bear in mind that actions taken to mitigate particular risks can impact on other risks or outcomes. Complimentary mitigating actions

will work together to reduce overall risk. However this may not always be the case. For example an action taken to limit the risks of a particular aspect of service delivery may result in an unacceptable increase in related costs, which in turn impacts on the risk of falling reserves or a loss making activity.

Remember that risk management is not a one off activity or an annual exercise undertaken to satisfy the Charity Commission. It should be a positive tool for effective organisational management and planned development. It adds value because it promotes understanding of the factors that affect an organisation's ability to grow and develop successfully. It protects the assets and image of the charity and it develops the organisation's knowledge base.

It is important to make sure that information from the risk review is filtered through the organisation appropriately.

Trustees should:

- develop a clear risk policy identifying the charity's attitude to risk and organisational responsibility for the management process
- know about the key risks facing the charity and how this will be communicated and managed throughout the organisation

Departments or units should:

- be aware of those risks for which they are responsible
- know how to monitor and manage those risks on a day to day basis

Individuals should:

- be aware of their accountability for specific risks
- know how to report to senior management on failures in existing controls over risk or new risks they have identified

Wording on risk management for inclusion in the trustees' report

The Charity Commission states that *'the form and content of reporting is likely to reflect the size and complexity of an individual charity's activities and structure'*. In other words, each charity can tailor the content to their circumstances provided they comply with the reporting requirements of SORP 2005.

For incorporated charities however, note the requirement set out in Statutory Instrument 2005/1011 – The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, section 234ZZB

'the directors' report for a financial year must contain a description of the principal risks and uncertainties facing the charitable company'

The only exception to this requirement for incorporated companies applies to those which fall under the definition of a small company for the purposes of the Companies Act.

We recommend that for best practice the narrative for all charity accounts should therefore address the following:

- an acknowledgement of trustees' responsibility for risk management
- an overview of the risk identification process, frequency of reviews and how the process is managed
- an indication of use of external review bodies or internal audit departments in the process
- an indication that major risks have been identified and assessed
- a description of key risks
- an explanation of strategies for dealing with risks



Kingston Smith LLP deliver an integrated range of professional services and independent advice to the charities and not for profit sector including audit and accountancy, governance and fundraising, IT strategy and consultancy, human resources, administration outsourcing, tax and VAT services.

© Kingston Smith LLP 2007. Registered to carry on audit work and regulated for a range of investment business activities by the institute of Chartered Accountants in England & Wales.

Every effort is made to ensure the accuracy of the publication, but no liability will be accepted for reliance placed upon it.

Contact

Nicholas Brooks
nbrooks@kingston-smith.co.uk

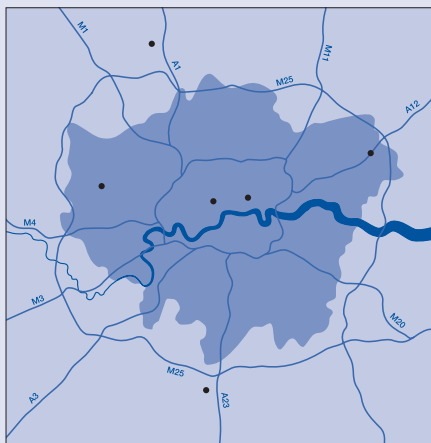
Neil Finlayson
nfinlayson@kingston-smith.co.uk

Sandra De Lord
sdelord@kingston-smith.co.uk

Telephone 020 7566 4000

www.kingston-smith.co.uk

How to find us



City Devonshire House, 60 Goswell Road, London EC1M 7AD Telephone 020 7566 4000

Hayes Middlesex House, 800 Uxbridge Road, Hayes, Middlesex UB4 0RS Telephone 020 8848 5500

Redhill Surrey House, 36-44 High Street, Redhill, Surrey RH1 1RH Telephone 01737 779000

Romford Orbital House, 20 Eastern Road, Romford, Essex RM1 3PJ Telephone 01708 759759

St. Albans 105 St. Peter's Street, St. Albans, Herts AL1 3EJ Telephone 01727 896000

West End 141 Wardour St, London W1F 0UT Telephone 020 7304 4646