Preview

CGPM consulting llp

Summer 2013

Corporate Governance and Performance Management

Some charities and other regulated bodies such as social landlords and further education colleges continue to manage risk sporadically or feel that it is to be avoided at all costs. Yet, it is one of the cornerstones of what is widely regarded as good governance. Why?

Risk management

The word risk is believed to have its origins in the Arabic word **risq** and in the Latin word **riscum**. Both concern fortuitous events, favourable and unfavourable respectively. The 12th Century Greek derivation **risq** relates to chance outcomes which are neither positive nor negative. Generally today, risk connotes negative outcomes but in our view it should not.

ISO31000, the international standard on Risk Management, defines risk as being "...the effect of uncertainty on outcomes". A more practical phrasing, originating with HM Treasury, is the "...uncertainty of outcome, whether positive opportunity or negative threat, of actions and events. Organisationally, we tend to classify our thinking into different types of outcomes *viz*: contextual, strategic, operational and project.

Case study

Positive risk

A charity created a unique service providing a mutual support service for the carers of those experiencing a particular mental health issue.

Demand outstripped supply; local authorities and grant-funders gave material financial recognition in exchange for increased service levels. All occurred significantly earlier in the growth plan than designed and the charity was at risk of being a victim of its own success.

Developing this thinking further, risk management is about how we manage the uncertainties around how we achieve our desired outcomes at strategic, operational and project level in the context in which we operate. It is therefore, fundamental to the successful achievement of our goals at every level of the organisation.

Though fundamental to success, that does not mean it need be complex or [at the forefront]. Whole books are given over to risk management systems and processes. For certain sectors, such as banking and insurance, it is a core element of their pricing/ financial management policy and sophisticated techniques have been developed on a sector-wide basis. However, for the majority of organisations by number, risk management, though it need not be complex, it should be structured, timely and embedded in decision-making.

Risk management is a modification of your general organisational processes; it should not become a separate process. Where separation occurs we generally find that risk management does not become embedded, staff abrogate accountability for risk and cottage industries evolve to manage the organisation's risk.

Case study

Embedding in business process

A regulator had been managing all organisational risk to the lowest level achievable. As we redesigned their process they bought into two unique design-features. First, the old scoring process was numeric and counter-intuitive to word-based managers. Second, part of their business was about creating case law; therefore, they had to take a higher degree of risk in certain areas in order to test the legislation around their areas of focus. Both features were adopted and the "organisational" risk process was embedded into their case management process.

The level of risk which is acceptable to an organisation is called one of two alternatives dependant on how aggressive or defensive the culture of the entity is; the "risk appetite" or "risk tolerance". Either way, it is a difficult thing to articulate and few organisations successfully do so the first time around. There is no generally accepted method, though the most practical is to take the classes of risk the organisation faces and give an example of an acceptable and an unacceptable risk for that class.

The starting point in identifying risk should be always as a part of the planning and objective-setting process; recall the definition of risk – uncertainty of out-

CGPM consulting llp is a boutique firm of Chartered Accountants specialising in governance, risk management and the provision of specialist assurance services.

We would be delighted to meet with you to discuss how we may help. A summary of our competencies is overleaf.

Telephone: 0131-258 6925
Email: mail@cgpm-consulting.co.uk
Web: www.cgpm-consulting.co.uk

come. Thereafter, as planned outcomes evolve so too do the risks; some evolve, new ones appear, old ones recede.

Managing risk to the level identified as being the appetite or tolerance for risk brings an economic benefit. Managing risk to the lowest level possible usually has a price tag. Not all organisations test the value obtained against the price paid for minimising risk. The law of diminishing returns applies as much to risk management as it does in any other area of economics. Thus it makes sense to act only to reduce the level of risk to be within your appetite or tolerance level.

Case study

Risk appetite

A higher education institution created a framework which classified the nature of risk it faced into eight broad groups; for example, reputational, financial, regulatory, student outcome, etc..

The organisation then created four parameters by which it aimed to "measure" the impact. For example,

To be completed

The International Standards Organisation considers that for risk management to be effective at all levels it should comply with eleven principles. Some of these have been discussed above, but it is also worth pointing out one other. Risk management is not an exact science; it should be based on the best available information at the point in time when it is being considered. Critical to this, is understanding any underlying assumptions made and the limitations of any information or data being used.

A feature of good risk management is understanding how a particular risk changed from being a risk to becoming an issue; how it "crystallised". Crystallisation of risks does occasionally happen; this in itself is not the problem. It is a matter of self-improvement; did your process, procedures or communications work in the way they were meant to; if not what steps need to be taken to improve their operation. This is about giving the organisation the best possible chance to achieve its outcomes, not avoiding all risk at all costs.

Sadly, too many organisations conduct risk management as a one-off or sporadic event in their business calendar. Greatest benefit can be obtained where risk-based thinking (i.e. reducing the uncertainties around achieving your outcomes) becomes more embedded in the direction-setting, management and operation of your organisation.

Risk is not bad; it just needs to be well managed.

Next issue

In the next issue we shall be exploring whistle-blowing and Board effectiveness. Tom Mitchell shall also be reflecting on his experience as a charity trustee and some of the challenges he has faced.

Board evaluation

The UK Code of Governance states:

> "The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors."

Whilst most organisations who read this have no obligation to follow the UK Code, it is recognised good practice to review both the performance of the Board and of trustees individually on a periodic basis. Why?

Most will have, or will be evolving, Board recruitment practices which aim to fulfil their obligation under a legislative requirement to

procure appropriately qualified individuals to fulfil the role of a Board member (one of those charged with the governance of the organisation). For some time now, the general principle of accepting anyone who volunteers has no longer been defensible practice. For charities who are in receipt of Gift Aid, the introduction of the Management Test by Schedule 6 Finance Act 2010 means reasonable due diligence, appointment and development records need to be maintained. Organisations in receipt of public money must increasingly demonstrate that they are taking steps to protect and apply these funds wisely.

It would be appropriate to evaluate Board and Board member performance against predetermined criteria. As well as reflecting the "governance factors", these criteria should be driven by the purpose, aims and objectives of the organisation and the role that both Board and Board member are expected to play in achieving these.

The purpose of evaluation should not be to police, nor should it be adversarial in nature. It must seek to underpin a culture of continuous improvement in the organisation and enabling both Board and Board Member to engage in their leadership role in moving the organisation towards its objectives, as well as understanding and fulfilling their legal and regulatory obligations.

Many evaluations we encounter are designed as self-evaluations. This is a good starting point. Others are designed to be independently facilitated annually. Annual independent evaluation can prove time-consuming and expensive and a hybrid model is probably more proportionate for many organisations.

Please give us a call and take advantage of a free one hour consultation considering your board evaluation process.