April 2014

Risk Governance

Welcome to the second edition of our Across the Board email governance newsletter and thank you for your positive response to the first edition that we emailed at the end of last year.

In this edition we examine risk governance and the role of the school board or council.

Monitoring risk management is one of the board’s primary roles, together with establishing the vision and strategic direction of the school, ensuring compliance with legal obligations and appointing the principal.

While implementation of the school’s risk management plan is one of the duties of the principal, the board has a significant oversight responsibility. This paper describes how board members can take a lead in embedding risk management that adds value to school governance and management.

We have summarised the detailed discussion with a checklist of dot points.

Michelle Green
Chief Executive

Next Edition

In our next edition, we will be discussing the characteristics of an effective board. It is not a case of simply complying with legal and legislative requirements or developing governance policies. Good governance on paper does not necessarily translate into good governance in practice.

Many organisations have developed principles they consider underpin good governance, which we will explore and show how they can guide boards towards effective and efficient governing of your schools.

I welcome your comments about this edition and to hearing what you would like us to research and write for you in future editions. Please email Brian Peck with your suggestions.
Introduction

Risk is defined as indicating the possibility that something will go wrong. A more all-encompassing definition is:

*The effect of uncertainty on an organisation's objectives. It includes potential threats to achieving objectives (negative risks) and potential opportunities (positive risk).*

Risk is part of living in society. Improvement and advancement cannot be achieved without taking risk. Part of the mission of most schools is to provide high quality educational programs and to challenge students, which will involve taking risks.

The challenge for boards is to treat risks appropriately and in a cost effective manner to protect the school and its stakeholders without creating bureaucratic rules and procedures that limit the commitment and inspiration of volunteers or employees.

Risk is a possibility in all school activities and programs. Threats and opportunities come and go as a school’s relationship with its internal and external communities evolve. Risk is possible because of the regulatory environment and scrutiny from governments, parents, the public and the media.

Risk management is the process of limiting an organisation’s potential exposure to liabilities, preventing them, or providing the resources to meet them. Risk management anticipates risk to prevent or minimise the impact of negative risks and capitalise on opportunities. It is integral to strategic planning, decision making and resource allocation.

A risk management system is made up of:
- a policy development process
- a management framework
- tools and processes.

As part of good governance and good business practice, risk management should be embedded in schools’ operational, administration and change processes. It can be applied at three levels — strategic, tactical and operational.

A risk management plan can be used by schools to demonstrate to their financial institutions that they are committed to solid management practices and are a good lending risk.


3. Ibid. P101

### Role of School Boards

Instilling a strong risk management culture throughout the school requires board direction and management focus. Boards can help to build a risk intelligent culture by supporting the executive in its commitment to risk management, which involves creating a work environment that encourages employees to report potential issues, and allocating adequate resources to professional development of staff.

Risk oversight is a critical responsibility of the board that must ensure management has a process to identify and minimise negative risk within the school’s defined risk tolerance. The process is how the board determines that the school has robust procedures for identifying, prioritising, managing and monitoring critical risks, and that it is continuously improving them as the school’s situation changes.

Risk oversight enables the board to understand the risks inherent in the corporate strategy, the risk appetite of management in implementing the strategy and to ensure that it is alerted to any dysfunctional behaviour that could lead to excessive risk taking. A board committee can be appointed to be responsible for risk oversight but ultimately the entire board is accountable. Monthly, quarterly or annual reporting to the board is needed on risk in all areas of the organisation.

Crisis management oversight has become a significant component of a risk management plan, particularly with today’s instant communications and social media. The school board needs to be satisfied that there are policies and processes to address these matters.

When necessary the board can become involved as a participant in risk management. Finding the right balance can be difficult and it is important that board members and executive management agree on how involved the board will be. The question for board
members is: ‘How do we execute our fiduciary responsibilities while continuing to support management’s strategies to move the organisation forward?’

The board also assists senior management to incorporate strategic risks into the overall risk management plan so that there is a risk analysis for new and emerging opportunities. Principal succession planning is a board responsibility.

A school board:

- develops a risk profile with the school leadership
- oversees significant strategic and enterprise-wide risks
- identifies, with senior management, strategic risks, decides on risk treatment options and monitors risk improvement strategies
- ensures the risk appetite of the school has been determined and is known at all management levels
- ensures policies are in place that describe the responsibilities of the board, audit and risk committee and management
- ensures that there are systems to manage and monitor risk
- ensures that governance policies are in place and are reviewed regularly
- reviews and approves the risk management framework, controls and policies
- identifies and analyses risks threatening strategic objectives
- ensures there are adequate resources dedicated to risk management initiatives
- ensures the school is adequately insured at a competitive price and the insurance meets the school’s needs
- is satisfied that staff are trained to understand risk management policies and procedures
- is satisfied there are complaint handling processes that provide a prompt, emphatic response to preserve the goodwill and reputation of the school
- ensures the effectiveness of risk management is audited
- insists on clear, periodic reports on risk related activities.

The board should ensure that governance functions are included in the risk management plan such as strategic planning, financial planning, selection and evaluation of the principal, and behaviour of individual board members, for example their declaration of conflict of interest.

In consultation with management, the board should define and document its policy for managing risk, including the objectives for, and its commitment to risk management.

The policy should include:

- objectives and rationale for managing risk
- links between the policy and managing threats and opportunities
- processes to be used in managing risks
- accountabilities for managing particular risks
- details of the support and expertise available to assist those managing risks
- a statement on how risk management performance will be measured and reported
- a commitment to the periodic review of the risk management system
- a statement of commitment to the policy by the board and senior management.

Although risk management processes can be established and owned by management, the board oversees them and plays a key role in identifying leading practice and ensuring that the school's assets are protected and create value and opportunity.
Implementation of the risk management plan is the responsibility of the principal who is directly accountable to the board. He/she is responsible for pursuing a risk management culture among staff so that risks are proactively assessed and reported and effective risk treatment strategies are implemented. The principal is also responsible for monitoring risk appetite and the risk profile of the school.

There is significant information on risk management that can be found on the Independent Schools Victoria website (www.independentschools.vic.edu.au) by using the search facility. Two papers, Risk Management Process and Risk Management Framework for Schools are in the password protected members’ area.

The ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations include Principle 7: Recognise and manage risk. This is a useful resource for outlining a board’s role in establishing a system of risk management.

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Board Committee Structure

Many boards combine the risk and audit functions into one committee in their oversight of risk management. However these are two significant areas that require rigorous monitoring and some boards establish a separate risk and compliance committee. Other committees such as Occupational Health, Safety and Welfare also have a risk management role.

In addition to its financial responsibilities, a board audit and risk committee is responsible for coordinating the board’s approach to risk oversight and ensuring management’s assumptions, assertions and regular reporting are sufficiently challenged and verified.

This includes:

- engaging management on the extent and format of risk information to be provided to the audit and risk committee and therefore the board
- ensuring that the committee is able verify management’s risk assumptions
- overseeing the process for identifying significant risks and implementing adequate control and reporting mechanisms
- reviewing and overseeing systems of risk management, internal control and legal compliance.

5 Risk Management Policy and Framework (Draft), Presented at an Association of Independent Schools of South Australia (AISSA) governance workshop.

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Risk Appetite, Tolerance, Target

*Risk appetite* is the amount and type of risk an organisation is willing to accept. A risk appetite statement establishes an understanding between the board and senior management regarding the desirable risks underlying the school’s strategic objectives and activities.

*Risk tolerance* is the boundaries within which the board and senior management are willing to allow the day-to-day risk profile to fluctuate.

*Risk target* is the optimal level of risk that an organisation wants to take in pursuit of a specific goal.

Risk Management Processes

*The Australian/New Zealand ISO 3100:2009* is an international standard that provides principles and guidelines for effective risk management in any organisation. However the design and implementation of a risk management plan needs to meet the school’s varying needs, its strategic objectives, context, structure, operations, processes and functions, and its programs, services and assets and specific practices.

Elements of a risk management process include:

- communicate and consult with internal and external stakeholders
- establish the external, internal and risk management context
- identify where, when, why and how events could prevent, degrade, delay or enhance the achievement of objectives
- determine the consequences and likelihood and the level of risk
- identify and evaluate existing controls
- evaluate the risks by comparing estimated levels of risk against the pre-established criteria and consider the balance between potential benefits and adverse outcomes
- treat the risks by developing and implementing cost-effective strategies and plans for increasing potential benefits and reducing the potential costs
- monitor and review all steps of the risk management process and ensure changing circumstances do not alter priorities.
Treating Risk

Options for treating risk include:

- accept the level of risk and do nothing
- retain the risk but establish policies to minimise possible adverse consequences
- transfer responsibility by shifting the activity to an external party (e.g. outsourcing delivery of a service)
- avoiding risk by not proceeding with the activity.

Key School Contexts

Areas that should be considered in developing a risk management framework include:

- risk associated with the safety and welfare of students, staff, contractors and volunteers
- financial risk
- legal risk
- legislative and regulatory risk
- physical risk
- reputational risk
- community engagement risk.

More operational risks include:
A Risk Register

A risk register records details of risks identified, their likelihood of occurring and seriousness, and mitigation strategies, responsibilities and significant costs. It should cover organisation-wide and functional area risks. It can be used by the board and senior management to change behaviour and direct funding for the benefit and long-term sustainability of the school and for the wellbeing of students, staff and school community. The register should be brief and updated regularly.

A risk matrix is based on consequences and likelihood of each risk. Diagram Two uses five levels of likelihood, five levels of consequences and contains four levels of risk. Using the risk matrix, it is possible to assign each risk with a score and assess the level of the consequence likelihood for each risk.

Diagram Two: Risk Register Matrix

A more complex Risk Management Assessment Tool is available in the Appendix.
Risk Oversight: Board Checklist

Recommendations

- Take a lead in embedding risk management that adds value to school governance and management.
- Don’t become bogged down in micro detail and see risk everywhere.
- Don’t be overwhelmed by the planning, implementation and review processes.
- Stay focused on potential critical strategic risks.
- Select a workable number of areas that are of significant concern in the first instance.
- Use templates to simplify the development of the risk management processes.
- Establish small teams responsible for particular areas of risk.
- List risk areas for each round of board reports of risk management.

Questions to Consider

- Do board members play a key role in identifying and managing the school’s strategic risks?
- Does the board ensure consultation at each step of the risk management process?
- Are there mechanisms to ensure escalation of information about significant risks?
- Has the board considered levels of acceptable risk and effective risk treatment options?
- Has the board considered risks in relation to leadership; strategy and planning; client and market focus; financial management; people and innovation, and quality improvement?
- How frequently is the board informed on risk management issues?
- How robust are the reports on key risk issues?
- Does the board oversee a risk assessment method in line with the Australian and New Zealand Risk Management Standard ISO 3100:2009?
- Does the board oversee structured and ongoing monitoring and review of the risk management plan?
- Does the board have a policy to monitor the activities of volunteers, suppliers, tradespeople and others who are not directly involved with the school?
- Does the board include members with specific expertise in risk management and/or does the board have access to external risk expertise?
- Does the board’s self-evaluation include risk governance and management?
- Is there a professional development plan for board members to enhance the competency of the board?

References

In addition to footnotes, other references that were used in the preparation of this article include:

- ASX Corporate Governance Council – Corporate Governance Principles and Recommendations, 2010 Amendments, 2nd edition
- Deloittee – Risk Intelligent Governance Lessons from State of the Art Board Practices
Appendix

Risk Management Assessment

Risk Management is not about eliminating risk. It is about being aware of risk and managing it. Effective risk management needs to involve all areas within the School, including students, staff, the Principal and Council. Awareness and regular review by the Principal and staff, with a detailed annual/bi-annual summary (of assessment discussed) to be considered by Council is desirable.

Each School’s risk profile will differ. There will, however, be some common areas of risk which most Schools will face.

The tables below set out an approach Schools may wish to adopt in assessing risk.
Likelihood of Occurrence | Consequence Impact if Occurred | Likelihood X Consequence
---|---|---
1. Rare | 1. Insignificant | (e.g. Unlikely
2. Unlikely | 2. Minor | 2 x Moderate
3. Possible | 3. Moderate | 3 = 6
4. Likely | 4. Major | the Risk Level
5. Almost certain | 5. Critical |

<table>
<thead>
<tr>
<th>Area of Risk</th>
<th>Score</th>
<th>Score</th>
<th>Risk Level</th>
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</thead>
<tbody>
<tr>
<td><strong>REPUTATION</strong></td>
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<td></td>
</tr>
<tr>
<td>1. Loss of credibility with Parents</td>
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<tr>
<td>2. Loss of credibility with the community</td>
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<tr>
<td>3. Loss of credibility with Funding body</td>
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<tr>
<td><strong>FINANCE</strong></td>
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<tr>
<td>4. Financial loss from School operations or Trust Funds</td>
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<tr>
<td>5. Defalcation/mis-management of finances:</td>
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<tr>
<td>‧ Trust</td>
<td></td>
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<tr>
<td>‧ Administration</td>
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<tr>
<td><strong>LEGAL / COMPLIANCE</strong></td>
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<tr>
<td>(ASIC if applicable)</td>
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<tr>
<td>6. Non adherence to ATO/state tax guidelines</td>
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<tr>
<td>7. Failure to meet ASIC reporting requirements</td>
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<tr>
<td>8. Failure to meet funding body KPI’s or reporting responsibilities</td>
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<tr>
<td><strong>GOVERNANCE</strong></td>
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<tr>
<td>9. Appropriate number and mix of skilled Council Members</td>
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<tr>
<td>Succession planning for key positions and Council Members</td>
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<tr>
<td>10. Establishment and maintenance of governance structures (e.g. committee structure)</td>
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<tr>
<td>11. Review processes for Council</td>
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<tr>
<td><strong>HUMAN RESOURCES</strong></td>
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<tr>
<td>12. Occupational Health &amp; Safety</td>
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<tr>
<td>13. Superannuation Act</td>
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<tr>
<td>14. ATO Requirements</td>
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<tr>
<td>15. EEO and employment obligations</td>
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<tr>
<td><strong>DISASTER</strong></td>
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<tr>
<td>16. Fire</td>
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<tr>
<td>17. Theft</td>
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<td></td>
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<tr>
<td>18. Loss of information</td>
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<td></td>
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<tr>
<td>‧ School business data</td>
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<tr>
<td>‧ Student records</td>
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</tbody>
</table>
### Action

1. The above table be expanded and each risk is allocated a weighting in each column. The product represents the risk level. Schools may wish to obtain some specialist assistance in initially formulating risk profile and strategies to address risk.

2. The following table is used to rate each risk.

<table>
<thead>
<tr>
<th>Likelihood</th>
<th>Insignificant (1)</th>
<th>Minor (2)</th>
<th>Moderate (3)</th>
<th>Major (4)</th>
<th>Critical (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Almost Certain (5)</td>
<td>L5</td>
<td>M10</td>
<td>H15</td>
<td>E20</td>
<td>E25</td>
</tr>
<tr>
<td>Likely (4)</td>
<td>L4</td>
<td>M8</td>
<td>H12</td>
<td>H16</td>
<td>E20</td>
</tr>
<tr>
<td>Possible (3)</td>
<td>L3</td>
<td>M6</td>
<td>M9</td>
<td>H12</td>
<td>H15</td>
</tr>
<tr>
<td>Unlikely (2)</td>
<td>L2</td>
<td>L4</td>
<td>M6</td>
<td>M8</td>
<td>M10</td>
</tr>
<tr>
<td>Rare (1)</td>
<td>L1</td>
<td>L2</td>
<td>L3</td>
<td>L4</td>
<td>L5</td>
</tr>
</tbody>
</table>

Multiplying each vertical axis by each horizontal across, produces a figure in each box, which represents the overall risk.

- **Extreme risk** (20 – 25)
- **High risk** (12 – 19)
- **Medium risk** (6 – 11)
- **Low risk** (1 – 5)

3. The level of overall risk identifies areas for focus. The Principal can then present the final report to the Board, including narration and Action Plan.