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UNIT 5 RISK MANAGEMENT



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Introduction

- In the course of managing institutional resources, many risks arise and education managers ought to know how to manage them.
- In this unit, we shall look at the concept of risk management where we shall examine the different types of risks faced by educational institutions.
- In addition, we shall learn how to manage those risks by looking at the risk management process.
- We shall also look at how to manage risks that arise from credit.
- We shall end the unit by looking at auditing in schools.



Expected learning outcomes

Upon completion of this unit, you will be able to:

a) Describe risk management

b) Discuss effective credit risk management

c) Explain the role of auditing in risk management

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Introduction to risk management

- Every organization has to live with risks.
- Managing risks well is therefore a vital element of good governance and management.

What is a risk?

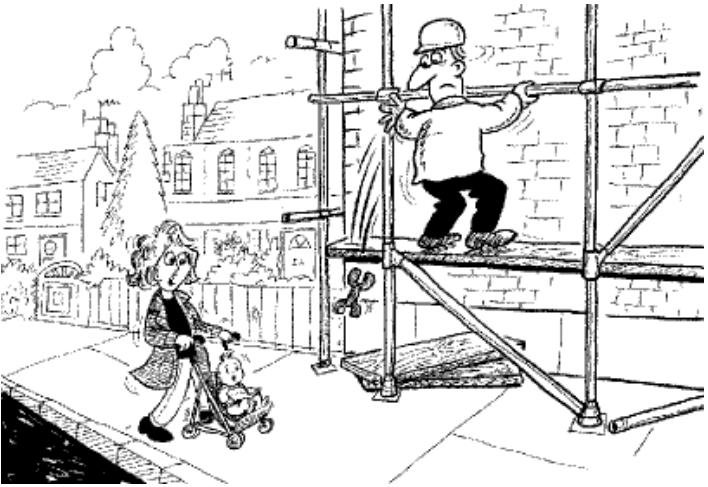
- This is a threat or possibility that an action or event will adversely or beneficially affect an organization‘s ability to achieve its objectives.
- Risk regarding the possibility of loss can be especially problematic.
- If a loss is certain to occur it may be planned for in advance and treated as a definite, known expense.
- When there is uncertainty about the occurrence of a loss, risk becomes an important problem.



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Risk landscape

- Risks are expressed in terms of causes and effects.
- If the organizational risks are poorly managed there will be consequences in terms of integrity, performance etc.
- The causes of risk must therefore be understood so that solutions to these issues can be identified.
- The effects of risk must also be understood so that the best possible contingency plan is developed.



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CAUSE

EFFECT



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Risk Management

- This is the systematic process of managing an organization‘s risk exposure to achieve objectives in a manner consistent with public interest, human safety, environmental factors, and the law.
- It is a proactive attempt to recognize and manage internal events and external threats that affect the likelihood of an institution‘s success.
- Risk management focuses on the following issues:
  - What can go wrong (risk event)
  - How to minimize the risk event‘s impact (consequences)
  - What can be done before an event occurs (anticipation)
  - What to do when an event occurs (contingency plans)



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Benefits of risk management

- Supporting strategic and business planning
- Supporting effective use of resources
- Promoting continuous improvement
- Fewer shocks and unwelcome surprises
- Quick grasp of new opportunities
- Enhancing communication between departments
- Reassuring stakeholders
- Reduced costs by limiting legal action
- Improved reliability leading to an enhanced reputation
- Helping focus internal audit program
- Robust contingency planning



Types of risks:

There are 3 types of risks

(i). Internal risks: These are risks linked to the internal environment, e.g. operational risks in running a project or activity. These risks will largely be within the sphere of influence of the organization, and need to be proactively managed.

(ii). External risks: These are risks linked to the external environment, e.g. political risks associated with the organization. These risks will largely be outside the sphere of influence of the organization and may require robust contingency planning; and

(iii). Internal and External risk interface: These are risks linked to the interface between one or more organizations (internal and external risks). Managing these risks requires close cooperation with stakeholders.



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Internal risks
Strategic, programmatic
Operational
Operations/business process
Management and information
Organizational/general administration
Human capital/people risks, integrity
Information technology
Financial

Internal and External risks interface
Relationships and partnerships

External risks
Political
Economic
Socio-cultural
Technological
Legal or regulatory
Environmental and
Security



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Stages of risk management

- There are four major stages in risk management.
- These include risk identification, risk analyses, risk response development, risk response control.

1. **Risk identification:-**Generate a list of possible risks through brainstorming, problem identification and risk profiling

2. Risk analyses:-Risk analysis includes analyzing the risk and measuring frequency, severity and impact.





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3. Risk response development: After analyzing the risk then decide how the risk will be controlled.

a. **Mitigating Risk:** Reducing the likelihood an adverse event will occur. Reducing impact of adverse event.

b. **Avoiding Risk:** Changing the project plan to eliminate the risk or condition.

c. **Transferring Risk:** Paying a premium to pass the risk to another party. Requiring Build-Own-Operate-Transfer (BOOT) provisions.

d. **Retaining Risk:** Making a conscious decision to accept the risk.

4. Risk response control: This involves risk control and establishing a change management system.

- **Risk control:** This involves execution of the risk response strategy, monitoring of triggering events, initiating contingency plans and watching for new risks.
- **Establishing a change management system:** This involves monitoring, tracking, and reporting risk, fostering an open organization environment, repeating risk identification/assessment exercises and assigning and documenting responsibility for managing risk.



Risk Assessment Plan

- A Risk Assessment Plan is a critical ingredient in risk management.
- The following are the steps that will guide you as you develop a Risk Assessment Plan for your institution.
  - Define a Risk Framework
  - Identify the risks
  - Identify probable risk owners
  - Evaluate the risks
  - Set acceptable levels of risk
  - Identify suitable responses to risk
  - Implement responses
  - Gain assurances about effectiveness
  - Embed and review





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i. **Define a risk framework**: When initiating a risk management program the first stage is to set a framework that takes into account: context, objectives, constraints, techniques to be used, policies and any legal or compliance requirements.

ii. **Identify the risks:** This is where the range of risks that may affect a particular new activity, existing operational activity or project is listed. A risk is any event that could prevent the project from progressing as planned, or from successful completion.

iii. **Identify probable risk owners and a risk coordinator**: The responsibility for managing risk is shared amongst all the stakeholders of the program. However, authority should be sought for implementing mitigation strategies that have cost implications.

iv. **Evaluate the risks**: Risk assessment is the act of determining the probability that a risk will occur and the impact that event would have, should it occur. This is basically a —cause and effect analysis.



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The probability that the risk will occur can be measured using the following template:

Activities in the institution	Frequent	Likely	Occasional	Seldom	Seldom
1.					
2.					
3.					
4.					
5.					
6.					



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The impact of risk can be measured using the following template:

Activities in the institution	Insignificant	Minor	Moderate	Moderate	Moderate
1.					
2.					
3.					
4.					



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Set acceptable levels of risks:

- The overall level of risk or 'exposure' that an organization or part of an organization is prepared to tolerate needs to be determined.
- This level may be different for different risks and the level may change depending on circumstances.
- Once determined, risk thresholds provide triggers for action, changes in monitoring regime and can help determine what information is escalated to senior management.
- The thresholds are determined in the same way as the risks, using the impact and likelihood scales.
- Although each risk should have a threshold a global threshold also assists in monitoring the risk severity. Where a risk score increases and passes the global threshold action is triggered.
- The global threshold currently applied is 15/25.
- Using the scales above these are the risks that are 'High' and 'Very High' and they should be closely monitored.



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Identify suitable responses to risk:

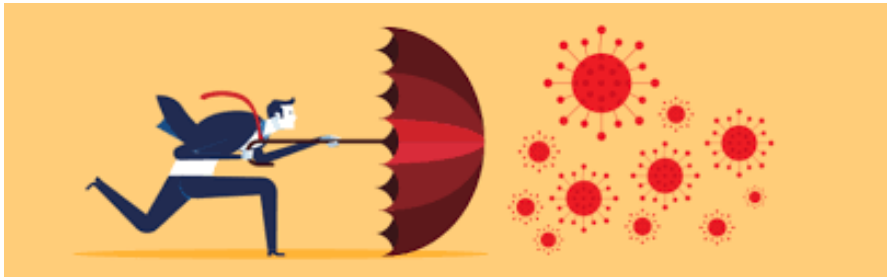
- During this stage a range of practical responses to each significant risk should be identified. There is likely to be a number of responses (controls) in each case.
- There is a range of responses (controls) to a risk:
- Reduce - taking action to reduce either the probability of the risk crystallizing further, or its impact.
- Accept - when the probability and impact are low and it would be too expensive to mitigate a risk.
- Transfer - transferring the risk to a third party, e.g. insurance.
- Terminate - identifying actions to eliminate the risk such as withdrawing from the activity.
- Contingency - having a plan of action to be implemented when a risk crystallizes further or passes through a risk threshold or goes beyond the global threshold.
- Prevent - identifying measures to prevent a risk having an impact on an organization.



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Implement responses:

- During this stage the most appropriate responses to each risk must be selected and implemented.
- The risks that have been prioritized and the most serious risks should be dealt with first.
- The responses to be implemented should be those that bring the most serious risks below the risk tolerance thresholds determined earlier (both individual and global thresholds).
- Once implemented the responses (controls) should be monitored to see if there are any knock-on effects on other activities and amended as necessary.



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Gain assurances about effectiveness:

- In this section the risks responses implemented above are assessed for effectiveness, that is, are the controls keeping the risk within the agreed tolerance levels?
- The risk owners should determine this through their own monitoring.
- A risk-based internal audit program can provide further assurance on effectiveness as can external auditing.
- If the total risk score has increased it would indicate further controls may be necessary or, if the risk is outside the school‘s control and deemed too risky, withdrawal from the activity altogether.
- If the total risk score has reduced, a relaxation of control may be required in order to prevent any loss of opportunity.

Embed and review:

- The risk management arrangements should be reviewed on an annual basis.
- The report should assess the risk management culture, its processes, its effectiveness and suggestions for improvement or development.





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Credit risk management

- Now that you have been introduced to the concept of risk management, you are ready to focus on credit risk management.
- Managing credit risk is a challenge in many institutions.
- Below are terms related to credit risk management:

Credit: Credit occurs when you provide services or goods to another person without them paying for them immediately.

Debt: Debt, on the other hand, occurs when you get services or good without paying for them.

Credit risk: The potential for loss due to failure of a debtor to meet his/her contractual obligation to repay a debt in accordance with the agreed terms. It is the potential loss due to the nonperformance of a financial contract, or financial aspects of nonperformance in any contract.



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- **Bankruptcy or insolvency**: In this case the legal entity is dissolved having been declared bankrupt or insolvent by a commercial court
- **Failure to pay:** The legal entity is not able or does not make the contractual payment
- **Government action:** Any action(s) by a government or an agency of government that results in outstanding claims becoming unenforceable
- **Moratorium on debts:** The legal entity declares a standstill on its existing debts and interest payments

- **Obligation acceleration:** A contractual obligation becomes payable before its due maturity due to default by the legal entity. This is similar to, but not identical to, cross default since it refers to a direct obligation with an affected party, whereas cross default refers to a third party.
- **Obligation default:** An event of default has occurred in the legal entity‘s obligations.
- **Repudiation:** The legal entity disaffirms or disclaims its debts.





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Assessing credit risk

- Assessing credit risk requires you to determine the probability of the other party defaulting fully or partially. Based on this assessment you can thereafter decide to either extend credit or refuse credit. You can use the following methods to evaluate credit risk:

i. **Judgmental methods:** Apply your experience and understanding of the case to the decision to extend or refuse credit

ii. **Expert systems:** Uses a panel approach to judge the case or formalizes judgmental decisions

iii. **Analytic models:** Use a set of analytic methods, usually on quantitative data, to derive a decision.

iv. **Statistical models** (e.g. credit scoring): Use statistical inference to derive appropriate relationships for decision making.

v. **Behavioral models:** Observe behavior over time to derive appropriate relationships for reaching a decision.

vi. **Market models:** Rely on informational content of financial market prices as indicators of financial solvency

Controlling credit risk

- A key issue for credit risk management is in controlling risk.
- The following are the various approaches that are used to control credit risk:
  - Loss Given Default
  - Covenants and monitoring
  - Diversification
  - Risk pricing
  - Loss provisioning





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i. Managing the Loss Given Default

- Managing the credit risk means managing the amount of loss if a default should take place, known as the loss given default (LGD).
- This can be done by ensuring that the party being given credit provides a security such as collateral against the default.
- The benefit of using from using collateral is that in the event of default, the lender is spared the expense of the default process and can sell the collateral to recover the debt.

ii. Covenants and monitoring

- A covenant is a restriction on, or requirement imposed on the other party, and agreed to under the terms of a contract. An example would be where the other party is requested to bring a guarantor to guarantee the party.
- Other examples include asking the other party to use liquid assets orworking capital as a guarantee for credit.



According to the Basic Education Act (2013) Section 18, the Board of Management (BOM) is allowed to take a loan and make proper provision for the payment of the loan, interest and other charges as per the terms and conditions of the loan or order of the Cabinet Secretary.

- Discuss the risks that education institutions face as they acquire loans and how these risks could be managed.



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iii. Diversification

- Diversification is an important element in financial risk management since it allows the credit grantor to spread its risk.
- For instance, a school that allows different parents dependent on the same source of income such asagriculture to access education on credit has undiversified risk.
- If these farmers experience hard times, it will affect their ability to pay the school fee arrears.

iv. Risk pricing

- Credit risk could be controlled by taking into account expected losses in transactions.
- For instance, education institutions that engage in income generating activities must ensure that the goods or services they offer are inclusive of administration fees, establishment costs, the institution‘s desired profit and other costs of being in business.

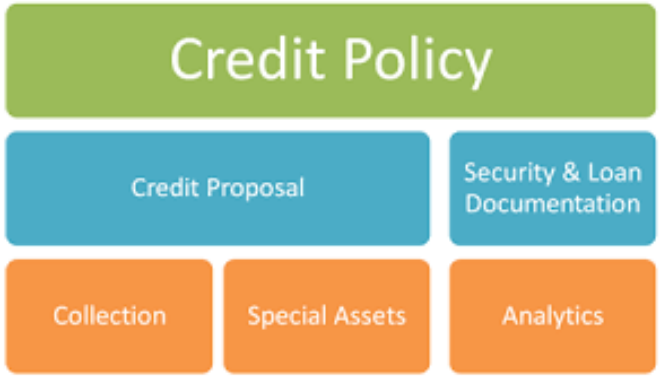


Loss provisioning:

- This method requires you to make a provision against expected losses.
- This provision is a mechanism used to recognize in a timely fashion impending losses on troubled credit.
- This means that the institution has acknowledged and accepted that a certain proportion of credits will default.
- This means that the institution would need to have a reserve for expected bad debts.
- When the institution finds that it is impossible to collect a debt that debt should be written off as a bad debt.
- A provision for bad and doubtful debts may be made if there will be problems in recovering a debt.



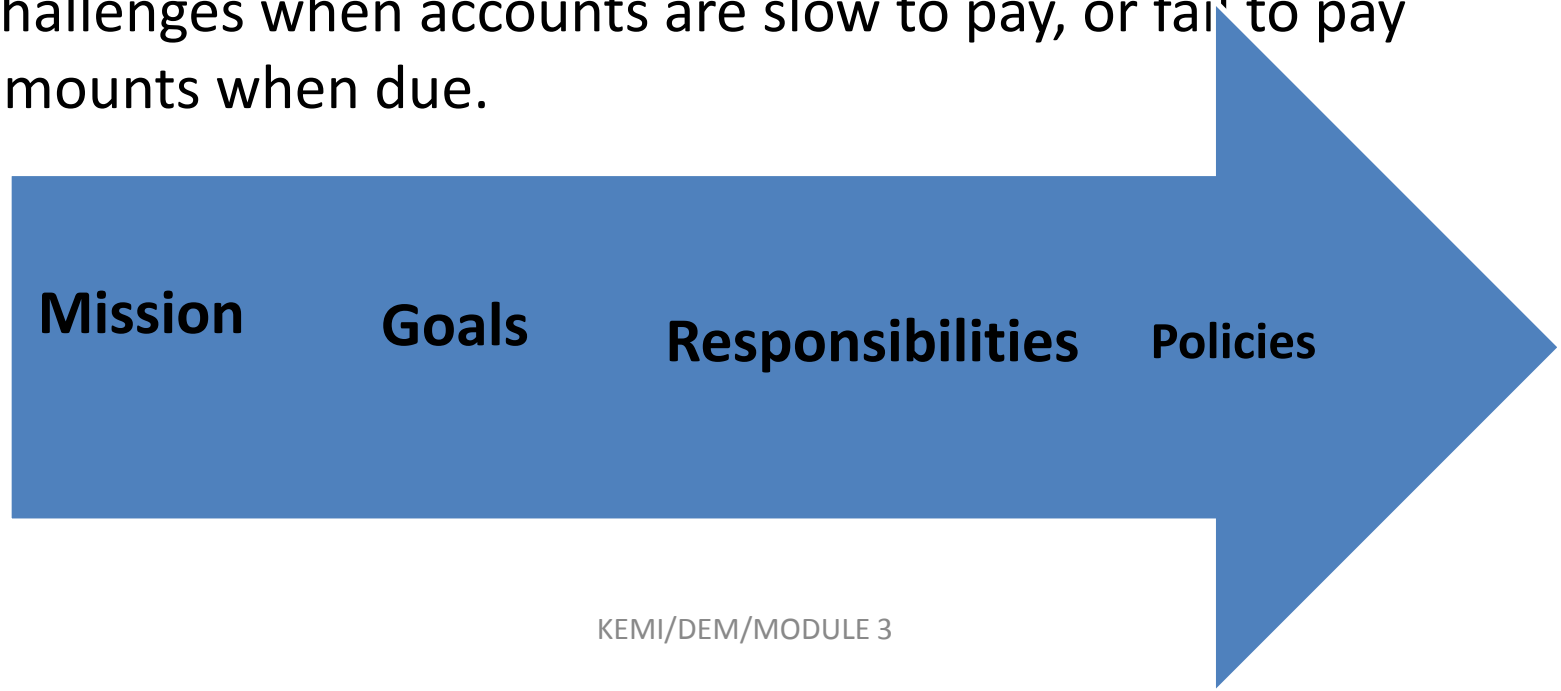
Age analysis of credit: It is important for us to note that as an aid to effective credit control, an age analysis of outstanding credit may be produced. This is simply a list of the persons who owe money, showing the total amount owed and the period of time for which the money has been owed. The age analysis of creditors can be used to help decide what action should be taken about debts that have been outstanding for longer than the specified credit period.



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Credit policy manual

- Every institution needs to have a credit policy manual to formalize its decision processes regarding the day-to-day management of credit decisions and the resultant collection challenges when accounts are slow to pay, or fail to pay amounts when due.





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i. **Mission:** The mission statement will provide a summary of the overall objectives of the credit risk management process detailed within the manual.

ii. **Goals:** These include the goals of the credit management process.

iii. **Responsibilities:** This includes the responsibilities and limitations of staff involved in credit risk management. There is a potential conflict of interest between those individuals who are rewarded by creating new business and those who act to control risks. Hence proper separation of lines of responsibility should be outlined.

iv. **Credit management policies:** This section includes all the policies and processes that govern the credit management process.

v. **Additional Policies:** Additional policies can be identified for issues such as compliance, regulation and the law regarding lending and credit.



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Government debt management system

- In this section we will look at the functions of the Public Debt Management Office and the role of the Cabinet Secretary/National Treasury in Public Debt Management Office.

Functions of the Public Debt Management Office:

The functions of the Public Debt Management Office shall include—

i. Carrying out the government's debt management policy of minimizing its financing cost over the long-term taking account of risk;

ii. Maintaining a reliable debt data base for all loans taken by the national government, county governments and their entities including other loans guaranteed by the national government;

iii. Prepare and update the annual medium-term debt management strategy including debt sustainability analysis;

v. Prepare and implement the national government borrowing plan international practices benchmarked to the debt management offices of including servicing of outstanding debts;

vi. Acting as the principal in the issuance of government debt securities on behalf of the national treasury;

vii. Monitor and evaluate all borrowing and debt-related transactions to ensure that they are within the guidelines and risk parameters of the debt management strategy;

viii. Process the issuance of loan guarantees including assessment and management of risks in national government guarantees;

ix. Transact in derivative financial instruments in accordance with best of other governments that are internationally respected for their practices.



Role of Cabinet Secretary in Public Debt Management Office:

The Cabinet Secretary/ National Treasury is required to:

i. Develop the policy and financial framework in accordance with Constitutional principles within which the Public Debt Management Office operates;

ii. Delegate to the Head of the Public Debt Management Office the operational decisions on borrowing and debt management and the day-to- day management of the Office;

iii. Ensure that the Public Debt Management Office has the resources and skills to manage the debt and borrowing according to international best practices for liability management; and

iv. Be accountable to Parliament for the work of the Public Debt Management Office.





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Auditing

auditing is an important risk management tool. We shall discuss about auditing and how its conducted. Let us define terms related to auditing:

Audit: This is an independent examination of financial records of a reporting entity by an auditor in pursuance to appointment and compliance to any relevant statutory obligation.

Audit Documents: It is the responsibility of an institution head to submit their books of accounts and financial statements and other financial documents to the Schools Audit Units by the 31st January of the ensuing year to enable the Audit Unit to carry out the Audit exercise

Internal auditors are employed by individual companies to investigate and appraise the effectiveness of company operations for management.

- **Independent auditors** are typically certified either by a professional organization or government agency.
- **Auditor qualification criteria:** An effective auditor should possess a combination of professional skills, people skills and personal attributes.
- **Evidential matter:** This is any information that corroborates or refutes an assertion





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Objectives of auditing

- All public institutions are required to be audited.
- Auditing serves the following functions:

i. **Good governance**: Reviewing the governance mechanisms of the entity and mechanisms for transparency and accountability with regard to the finances and assets of the entity;

ii. **Internal control**: Conducting risk-based, value-for-money and systems audits aimed at strengthening internal control mechanisms that could have an impact on achievement of the strategic objectives of the entity;

iii. **Asset management**: Verifying the existence of assets administered by the entity and ensuring that there are proper safeguards for their protection;

iv. **Good practices**: Providing assurance that appropriate institutional policies and procedures and good business practices are followed by the entity; and

v. **Decision making**: Evaluating the adequacy and reliability of information available to management for making decisions with regard to the entity and its operations.



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Types of auditing

There are two types of auditing.

(i). Internal auditing

Internal auditing is an internal management activity and service intended to ensure regular and frequent checking on an institutions financial transactions and records. It also serves to check whether all financial transactions have taken place according to budget, to set procedures, and following management policies. The objectives of internal auditing may differ from institution to institution, but the general aim is to promote efficiency in the institution's financial control and management.

(ii). External auditing

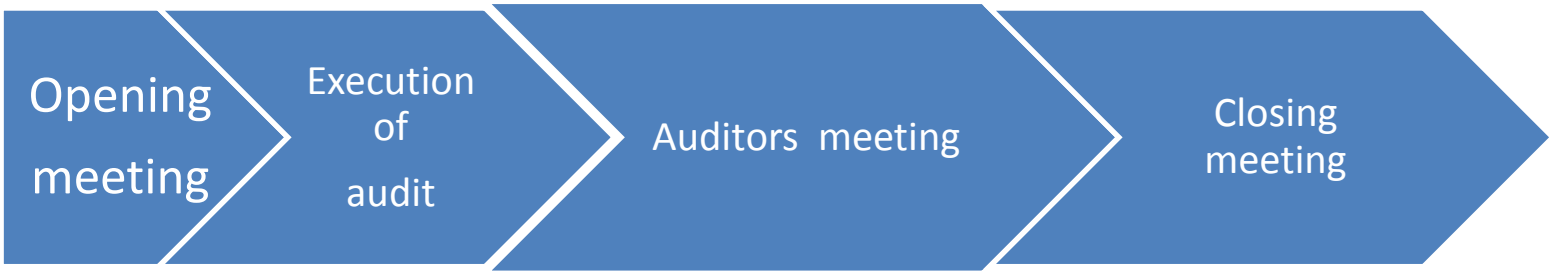
External auditing is conducted by an external auditor who gives an independent report on the financial performance of the institution. The focus of external auditing is on establishing the truth and fairness of the accounts. It gives added credibility to unaudited financial statements and records of the institution's financial transactions and confirms their compliance to the statutes.



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The auditing process

- There are 4 phases in the auditing process which include; the opening meeting, execution of audit, auditors‘ meeting and the closing meeting.
- These phases are described below:



Opening meeting:

The following activities take place during an opening meeting:

- Introduction of members and observers and recording of those present
- Confirm objectives, scope, basis, reasons and benefits of the audit
- Review audit plan
- Explanation of the audit method and documentation to be used
- Explain the tasks of the accompanying auditee‘s representatives
- Confirm method of communication
- Confirm availability of facilities
- Explain closing meeting/format
- Issue of confidentiality are discussed



Execution of audit

- Must be done according to timetable
- Only factual questions are asked
- Answers are verified through observation
- Audit trail is followed.



Auditors' meeting

- Compilation of findings/observations
- Recording of non-conformities
- Preparation of summary report
- Formation of opinion to be presented at closing meeting

Closing meeting

- Introductions and recording of attendance
- Principles of sampling followed during the audit are mentioned
- Audit observations are presented (positive, general observations and nonconformities)
- Corrective actions and corrective action dates discussed
- Agree on follow-up date
- Close meeting



Role of management in the auditing process

As an education manager you are expected to play a role in the following stages of the auditing process:

i. Pre-audit Stage:

- Liaise with auditors for management's concerns and expectations to
- be addressed by the audit



ii. On-site audit Stage:

- Meet audit team for entrance conference:
- Discuss action taken by since the previous audit
- Explain/reiterate purpose of audit
- Explain/reiterate audit procedures
- Avail all staff members for the audit inspection
- Instruct all officers to surrender books and properties under their care/control for inspection as and when required
- Instruct all officers to respond to audit observations
- Hold exit conference with audit team for findings
- Offer explanations for errors/offences
- Agree audit recommendations plan with audit team

iii. Post audit Stage:

- Request for draft report before release
- Respond to final report within statutory period (30 days)



Common audit queries

It is important for you to be aware of the common audit queries in public institutions.

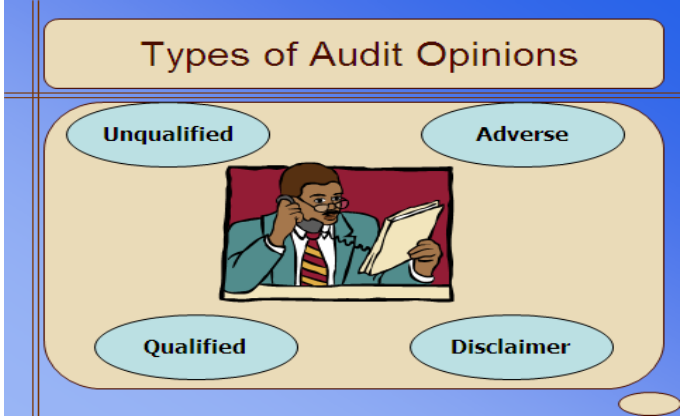
- Misappropriation of funds
- Embezzlement of funds
- Misapplication of funds
- Non-acquittal of payment vouchers
- Un-presented /missing payment vouchers
- Incomplete programs
- Unused funds
- Mis-procurement
- Deficiencies in store records
- Undue retention of withholding tax
- Personnel/payroll irregularities
- Refusal/failure to payback staff advances





Responding to audit queries

- You are required to respond to auditors queries within a required timeframe.
- Below are suggestions on how you can respond to audit queries effectively:
  - Set up a committee to study the report
  - Tease out relevant sections for concerned/technical staff to respond
  - Collate and comprehend responses from concerned/technical staff
  - Committee to review draft responses
  - Responses/explanations should be relevant Valid, complete and accurate
  - Responses/explanations should be supported by relevant source documents
  - Reply submitted to auditors within the specified timeframe
  - File copies of report



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Types of auditor's opinion

- You need to be familiar with an auditor‘s opinion.
- This is a statement recorded in an auditor's report by the external auditor.
- The auditor's opinion can be unqualified, qualified, adverse or disclaimer (denial) of opinion depending on the state of the books of accounts and any other evidence the auditor may have examined and evaluated.

i. **Unqualified opinion:** The auditor has no material reservations regarding the financial statements as a whole.

ii. **Qualified opinion:** The auditor is satisfied that the financial statements present a fair and accurate picture of the institution and comply with generally accepted accounting principles. A qualified opinion contains exceptions, which may include the scope of the audit.

iii. **Adverse opinion:** The auditor has accumulated enough evidence to indicate that the financial statements, as a whole, are not fairly presented.

iv. **Disclaimer (denial) of opinion:** The auditor is unable to form an opinion on the financial statements as a whole due to a scope limitation.



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- We have come to the end of the unit where we have looked at the concept of risk management.
- We have learnt about different types of risks and how to develop a risk management plan
- We have also learned about credit management in educational institutions. We hope you now know what needs to be done to ensure that the school does not accumulate large debts.
- In addition, we have looked at auditing as one way of managing risks and have learnt how audits are undertaken and how to respond to audit queries.
- It is out hope that you are now in a position to manage different types of risks in your institution.