Chapter 10. Risk Management

#### Overview

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| In this Chapter | This chapter contains the following topics.

|  |  |  |
| --- | --- | --- |
| Topic | Topic name  | See Page |
|  | General Information | 10-2 |
|  | Objective  | 10-3 |
|  | Definition of Key Terms | 10-4 |
|  | Risk Management Process | 10-5 |

  |

# 1. General Information

|  |  |
| --- | --- |
| Change Date | January 25, 2016, Change 1* This entire section has been updated.
 |

|  |  |
| --- | --- |
|  a. Overview | Per [OMB Circular A-123](http://www.whitehouse.gov/omb/circulars_a123_rev), Agencies and Federal Managers are responsible for improving the accountability and effectiveness of its program and operations by establishing, assessing, correcting, and reporting on internal controls on an annual basis. In order to determine if Loan Guaranty’s (LGY) mission in assisting Veterans is met in obtaining, retaining, and adapting homes, Quality Assurance (QA) reviews risks across all LGY program operations, including, but not limited to, Loan Production, Construction and Valuation, Specially Adapted Housing, Loan Administration, and Loan and Property Management. |

# 2. Objective

|  |  |
| --- | --- |
| Change Date | January 25, 2016, Change 1* This entire section has been updated.
 |

|  |  |
| --- | --- |
|  a. Overview | The objectives of QA’s risk management functions are generally expected to have the following characteristics:* Identify potential risks to LGY’s objectives.
* Ensure policies and procedures of LGY are working properly and as intended.
* Propose development and implementation of new policies and procedures to mitigate risk, when identified.
* Ensure program and resources are protected from waste, fraud, and mismanagement.
* Report outcomes and make recommendations.
 |

**3. Definition of Key Terms**

|  |  |
| --- | --- |
| Change Date | January 25, 2016, Change 1* This entire section has been updated.
 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  a. Risk Management Key Terms | The definition of key terms in the risk management program are:

|  |  |
| --- | --- |
| **Term** | **Definition** |
| Corrective Action Plan | A plan to correct and monitor deficiencies. |
| Internal Control | A means of managing the risk associated with programs and processes, and an integral component of an organization’s management that provides reasonable assurance that objectives are being achieved. |
| Key Controls  | Key controls, provide reasonable assurance about the entire internal control system’s ability to achieve the underlying objectives. |
| Reasonable Assurance | Assurance that program objectives will be met. Specifically, internal controls provide reasonable, not absolute, assurance of meeting a program objective. |
| Risk | The possibility of an event occurring that may have an adverse impact on the program’s strategic objectives. |
| Risk Assessment  | A phase of the risk management process is to document key controls, the actions required to meet the key control objectives, and impact to LGY’s strategic objectives if key control objectives are not achieved. |
| Risk Management | A process to identify, assess, manage, and mitigate potential events or situations, and to provide reasonable assurance, regarding the achievement of the programs objectives. |
| Risk Matrix | QA will review the major processes that fall on the risk significance matrix where the likelihood of occurrence is shown to be moderately likely, highly likely, and nearly certain. |
| Risk Register | QA will maintain a risk register. Identifying risks is accomplished through the process known as an environmental scan. As risks are identified, they will be documented in the risk register. |
| Findings | After analysis is complete, QA will present each Assistant Director (AD) and section Chiefs of the policy departments with the Notice of Findings Report (NFR), and recommendations. |

 |

**4. Risk Management Process**

|  |  |
| --- | --- |
| Change Date | January 25, 2016, Change 1* This entire section has been updated.
 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  a. Risk Management Process | There are ten major steps in the risk management process outlined in these steps below:

|  |  |
| --- | --- |
| **Step** | **Description** |
| 1. b.
 | Risk Management Board |
| 1. b.
 | Planning |
| 1. c.
 | Risk Assessment |
| 1. d.
 | Risk Identification |
| 1. e.
 | Identifying Key Controls |
| 1. f.
 | Identifying Control Information |
| 1. g.
 | What controls are designed to accomplish |
| 1. h.
 | Testing of Controls |
| 1. i.
 | Analysis |
| 1. j.
 | Findings |
| 1. k.
 | Corrective Action Plan |
| 1. l.
 | Ongoing Monitoring |
| 1. m.
 | Reporting |

 |

|  |  |
| --- | --- |
| b. Risk Management Board | The purpose of the Risk Management Board (RMB) is to assess identified risks that may prevent Loan Guaranty (LGY) from achieving its objectives and to ensure risks are appropriately addressed.The RMB functions through a charter developed in accordance with The Institute of Internal Auditors (IIA) International Professional Practiced Framework (IPPF) attribute standard 1000, Purpose, Authority, and Responsibility.The internal audit charter is a formal document that defines the internal audit activity’s purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity’s position within the organization, including the nature of the audit team’s functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board. |

*Continued on the next page*

**4. Risk Management Process**

 \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

|  |  |
| --- | --- |
| c. Planning | At the beginning of each fiscal year (FY), QA reviews LGY functional areas and processes to identify potential risk as follows:* Prior FY risk management report.
* U.S. Government Accountability Office (GAO) reports.
* Department of Veterans Affairs Office of Inspector General (OIG) reports.
* Prior site visit reports.
* Prior years’ congressional inquiries presented to Loan Guaranty Central Office (LGYCO).
* Formal request from the Regional Loan Centers (RLCs).
* Review of current events.
* Input from LGYCO policy sections.
* Other external reports documenting economic, social, and political trends that may potentially impact LGY business lines.
 |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| d. Risk Assessment | Risk assessment is conducted on an ongoing basis by interviewing the LGYCO Assistant Directors and each policy section Chief. This interview includes discussion of current, potential, external, and internal risks. Each key concern or potential deficiency, noted during the risk assessment phase, will be thoroughly examined and prioritized. Risk is measured in terms of impact and likelihood of occurrence. There are four categories of risk responses or risk strategies:

|  |  |
| --- | --- |
| **Response** | **Definition** |
| Accept | Form of risk response, an informed decision to tolerate or take on a particular risk |
| Avoid | Form of risk response, an informed decision not to be involved in, or to withdraw from, an activity, in order not to be exposed to a particular risk |
| Reduce (mitigate) | Form of risk response involving actions designed to reduce a risk or its consequences |
| Share (transfer) | Form of risk response, involving contractual risk transfer to other parties, including insurance |

Once potential risks have been developed, they are presented to the Risk Management Board (RMB), which will determine the risks to be further evaluated. |

*Continued on the next page*

**4. Risk Management Process**

 \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

|  |  |
| --- | --- |
| e. Risk Identification | Risk identification takes a systematic look at the nature of risks and opportunities facing the organization. Risks and opportunities are often grouped as strategic, project management/program/process, or operations. QA will maintain a risk register. Identifying risks is accomplished through the process known as an environmental scan. Risks can be identified through a variety of resources to include site visits, media, legislature, personal observation, recommendations from internal and external resources, as well as hearsay. |

|  |  |
| --- | --- |
| f. Controls | Internal control helps an organization mitigate risk and ensure that management strategies and objectives are carried out. However, organizations should not have unrealistic expectations about internal control. Internal control has both distinct benefits and limitations.Internal control can help:* Achieve organization performance targets
* Prevent loss of resources
* Support reliable reporting
* Support compliance with laws and regulations, avoid damage to reputation and other consequences

Internal control cannot:* Ensure organization success
* Ensure the reliability of reporting
* Ensure absolute compliance with laws and regulations
 |

|  |  |
| --- | --- |
| **g. Identifying**Control Information | Key controls analysis can be facilitated by considering factors that may increase the risk that the internal control system will fail to properly control or correct. In order to assess control risk factors, QA will analyze the following: * Complexity of controls,
* Determine controls that require a high degree of judgment,
* Determine whether controls are manual or automated (as manual controls are more susceptible to human error than automated controls),
* Identify known control failures,
* Determine controls that could be overridden by management, and
* Determine likelihood of control failure detection.
 |

*Continued on the next page*

**4. Risk Management Process,** continued

|  |  |
| --- | --- |
| **h. What Controls are Designed to Accomplish** | Controls help management accomplish business objectives, usually by reducing a risk to an acceptable level. There are a tremendous variety of controls available to management. Which control or combination of controls is best depends entirely on the objective and environment.Evaluating the design of controls requires a high degree of professional judgment. There are, however, a number of control concepts that help evaluate the design or controls in a given situation.The most commonly used terms to describe types of controls are based on their function.* **Preventative**: these are proactive controls that deter undesirable events from occurring.
* **Detective**: Detective controls are reactive and detect undesirable events that have occurred.
* **Directive**: Directive controls are proactive controls that cause or encourage a desirable event to occur. Guidelines, training programs, and incentive plans are examples of directive controls.
* **Mitigating**: Mitigating controls reduce the potential impact should an event occur. Insurance is a prime example of a mitigating control.
* **Compensating**: These are controls that compensate for the lack of an expected control. For example, close supervisory review may compensate for a lack of segregation of duties where a small staff size makes proper segregation impractical.

Controls may also be categorized as active or passive.* Active control implies a task that prevents or detects a deviation from the approved procedure. We can think of it as a control that works by some type of conscious intervention. An active control is sometimes referred to as a “manual control.” An example is a manger’s review of transactions.
* Passive control operates without human intervention. An example may be controls built into the computer system or a relationship of process that possesses control implications. We can think of it as a control that works by just being there. A passive control is sometimes referred to as an “automated control.” An example is a thermostat you set to maintain the temperature of a room.
 |

*Continued on the next page*

**4. Risk Management Process,** continued

|  |  |
| --- | --- |
| **i. Testing of** Controls | QA will test the key controls throughout the FY. QA and management of each LGYCO section will determine which controls will be tested and the proper methodology. QA will provide reasonable assurance that LGY’s risks have been managed effectively and that the goals and objectives will be achieved efficiently and economically. |

|  |  |
| --- | --- |
| j. Analysis | Following controls testing, QA will analyze the test results, compile findings, and formulate recommendations for each section.  |

|  |  |
| --- | --- |
| k. Findings | Following controls testing, QA will analyze the test results, compile the findings, and formulate recommendations. After analysis is complete, QA will present each Assistant Director (AD) and section Chiefs with the Notice of Findings Report (NFR), and recommendations. The ADs and Chiefs will then provide feedback to QA so that corrective action plans (CAPs) are developed to address and track deficiencies identified. |

|  |  |
| --- | --- |
| **l. Corrective**Action Plan (CAP) | In order to track and follow up on deficiencies, each LGY section will develop a corrective action plan (CAP). Corrective action plans should be developed for all material weaknesses identified, and progress against plans should be periodically assessed and reported to QA and LGYCO senior management. This plan will serve as a roadmap to correct and monitor deficiencies. The CAP will also be used for ongoing status reports to LGYCO senior management. |

*Continued on the next page*

**4. Risk Management Process,** continued

|  |  |
| --- | --- |
| **m. Ongoing** Monitoring | Monitoring is a continuous process to assess the quality of internal control performance over time. Two sets of activities constitute monitoring: * Integrated activities that provide ongoing assurance of controls, and
* Stand-alone assessment activities that provide management with separate and distinct evaluations of control operations.

QA employees will continuously monitor activities to identify and report to management:* New risks associated with policy/legislative changes,
* Risks associated with contract modifications, and
* Relevant external risks.

QA will provide a periodic CAPs report to LGY senior management detailing completed work and the status of any work in progress. The CAPs report will be a tool used throughout the year to ensure continuous progress and improvement. |

|  |  |
| --- | --- |
| **n. Reporting** | Quality Assurance, at the direction of the Risk Management Board (RMB), will provide periodic reports and a final Risk Management report the month following the end of the fiscal year, or at any other time as directed by the Board. |