How to handle financial risk – a brief guide for directors

"Risk comes from not knowing what you're doing."
– Warren Buffet

This short guide is a starting point for directors and management to understand financial risk. You can modify the list to suit your organisation's size, industry and complexity. See the *Directors Guide to Treasury Risk Management* in the CPA Australia Library.

First, work out what financial risks you want to take.

- What is your board's risk appetite?
- Does it match your shareholders' view of the company's right level of risk?
- Are management and shareholders aware of the board's attitude to risk (the organisation's risk ethos) and how much risk you will bear?
- Does your board understand the impact of remaining unhedged, partly hedged, fully hedged, or even, perhaps, to deliberately incur financial risks to increase profits?

Second, identify all existing and potential financial risks.

- Has a thorough effort been made to identify all current and potential financial risks?
- What about risks embedded in contract prices?
- Do you know your current financial exposures; how they are hedged; and their market values?
- Are all loan repayments and capital commitments included?
- Are any new or renewed borrowing facilities committed or uncommitted?
- Is the company able to pay its creditors and debts as they fall due?
- Does the company have sufficient cash to pay any proposed dividends, taking into account other cash commitments?

Third, encourage the right culture; get the right people managing the risks; and the right policies and processes to support them.

- Can management assure your board that the internal culture is conducive to intelligent risk-taking? (reference: PRMIA)
- Is the management structure clear and are there appropriate levels of delegated authority for different types of transactions?
- Are staff adequately experienced and trained for the complexity of the transactions they undertake?
- Have policies been documented and communicated to management, and is it clear that they are understood by management and treasury staff?
- If speculative financial risk transactions are prohibited, what procedures have management established to ensure that none has been undertaken?
- Is the board kept informed of all policy breaches, including technical breaches?
- Has management ensured and certified to the board that relevant operations have complied with the company's treasury policies and procedures?

Fourth, expect regular reporting from management and independent advisers.

- Are the results of transactions reported on a timely basis?
- Are transactions subject to independent assessment and review, for example, by internal audit and external audit?
- Have detailed cash flow forecasts for the current year and the following financial year been prepared and reviewed by senior management before presentation to the board?
- Have exposures been valued with appropriate frequency?
- Have external rates been used and is the valuation sufficiently independent of dealing staff?
- Has it been confirmed that all liabilities are included in the financial statements?
- Are there any unrealised losses at year-end that have not been recorded in the accounts?
- Do the systems and processes enable production of all required accounts and disclosures?

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