Help Our Scheme – Operational Risk Guide

What is Operational risk?

This risk arises largely from a failure of controls and procedures or a breakdown in processes, procedures, service delivery or equipment or as a result of people performance failure.

Operational risk management starts with a review of all the operational processes in the Community Scheme and their associated risks. This also needs to cover a review of all suppliers and service providers to the Community Scheme. The Community Scheme then needs to factor in continuity and contingency plans in the event of disruptions or disasters.

Effective operational risk management will ensure that the Community Scheme is in a position to consistently deliver quality sustainable service and facilities as required.

Risk management involves identifying, controlling, and minimising the threats that could negatively impact residents and the operations and objectives of the Community Scheme. The term 'risk' can be best described as the probability of an event and its adverse consequences.

An operational failure invariably results in a financial loss. This can be immediate or take time to manifest itself. Operational risks can also arise from many other risk areas, e.g. regulatory, governance/oversight, financial, crime, labour/HR, IT/technology failure, health and safety issues, socio-economic, environmental and physical threats.

Due to the number of risks out there that have an operational impact, it is not possible for a Community Scheme not to be impacted somehow. In extreme cases, disruptions can be so extensive that an organisation might have to seek legal protection to protect itself.

The key areas requiring focus to reduce the impact of operational risk are process, materials/equipment and people. All three elements need to be managed to ensure that the desired outputs and outcomes are achieved.

Decisions and actions by Trustees/Directors or Estate Management in the deployment of the resources of the Community Scheme, need to be well thought through and considered. Decision making becomes critical where limited financial resources are at hand. Operational decisions which could have negative financial implications need to be carefully assessed. These can extend from projects, capital expenditure, new facilities, selection of contractors or service providers, entering into binding contracts with service providers, hiring of key personnel to the taking of costly legal action. The use of professional external resources or consultants should be used to support operational decision making so as to lower the risk of poor or bad decisions.

Employees need to be productive, effective, kept safe and trained. Materials for maintenance or products and stock for the provision of services need to be on hand and in the required quantity and quality. Equipment and movable assets need to be well always maintained and fully functional.

Operational impacts can come from a vast spectrum of underlying events. At the heart of many of these is people's failure to perform as expected, when required or anticipated.

Process

Between the Trustees/Directors/Developer/Estate Management and where relevant, the Managing Agents, there needs to be clear accountability for the operations of the Community Scheme. Responsibilities for all the areas of the Community Scheme need to be clearly allocated, understood, defined, documented and agreed.

All operational work processes should be robust, repeatable and standardised. Robust policies and procedures are essential for the effective running of the Community Scheme. Without formalised processes, it is impossible to put effective controls in place. Processes and procedures also need to be documented, entrenched and enforced.

Having these in place will ensure consistent application and act as the internal checks and balances for individual employees as part of their job descriptions or in the case of outsourced third parties, as part of their contracts. Risk and losses are reduced as a result of less crisis management and individual employees or third parties just "doing their own thing", which inevitably results in errors, financial losses or a failure to perform effectively and efficiently.

It is extremely important that the responsibility for the key areas do not fall through the cracks and that there is clear accountability for the respective areas of operation. Where estate management is in place, it is important that there has been a clear and formalised delegation of authority to the Estate Manager/Office bearers for critical areas of the Community Scheme's operations. The Community Scheme needs to have an on-going maintenance programme/plan in place that is strictly adhered to.

- It is important to have robust controls and procedures in place in all the key operational areas of your Community Scheme, e.g. maintenance, HR, IT/technology, security, finance and administration.
- All processes and procedures should be adequately documented in an "Operations Manual". This should be comprehensive and detailed to ensure consistency, enable monitoring/management and the maintenance of control. Documented procedures and processes need to be easy to follow and are largely to ensure that continuity is easily facilitated where employees/Trustees/Directors or Estate Management change. All routine, ad-hoc and emergency processes and procedures should be documented e.g. regular maintenance routines, access controls and procedures, handling of crime incidents, procurement of materials and services, security monitoring routines, payment approvals, revenue/levy collection and recovery, insurance claims, emergency service call outs, imposition and enforcement of conduct/house rules, evacuation/fire emergency procedures, employee engagement/disciplinary processes. regulatory compliance, administration/secretarial, provision of management accounts, budgeting process, insurance claims, facilities (plumbing/electrical/pool) and gardens management, contracting/procurement, use of private information.
- Key operational deliverables and measurables must be set out in Service Level Agreements (SLA's) with service providers/suppliers/external contractors, job descriptions and performance contracts.

- The complexity of your Community Scheme's operations i.e. how intricate and complicated the process of delivering or rendering services to owners, residents, lessees, customers/ visitors/customers is, will have a major bearing on the likelihood of the risk for potential loss. The more complex an operating environment and the number of inter-dependencies, e.g. size and nature of the Community Scheme, reliance on outsourced or contracted service providers, the more difficult it is to manage and the greater the need for controls, measurables, checks and balances.

Maintenance Plan

A maintenance plan is a document that defines work to be done to proactively maintain assets and infrastructure in a Community Scheme. The contents of the plan will help facilitate the continued use of assets and facilities optimally. A Community Scheme can avoid significant breakdowns or unforeseen renewal, damage or repairs if it adheres to the guidelines provided in a plan. Effective maintenance planning is essential to the overall maintenance environment. The maintenance plan's contents, which include: the actual work, instructions/deliverables, schedule, maintenance workers involved, materials/spares/consumables/parts and the contractors to be used, will guide all the maintenance work activities. The idea of having a maintenance plan is to make the most of preventative maintenance while reducing downtime.

Maintenance planning will ensure that you can sustain the proper working condition of your equipment and fixed infrastructure. While a basic ordinary plan will get the job done, a Community Scheme requires an effective program in terms of not just the regulations i.e in terms of the Sectional Title Schemes Management Act (STSMA), a 10-year maintenance, repair and replacement plan (MR&R plan) for major capital assets must be presented at the annual general meeting for approval by the members of the body corporate. This is also to ensure that the assets and facilities are fully functional at all times and that essential repairs and routine maintenance are attended to and scheduled.

The 10 year MR&R plan needs to be carefully compiled, comprehensive with all likely costs validated against real cost estimates, current pricing and need to factor in inflationary and other likely increases over the timeframe. The MR&R plan must be realistic and executable. The Community Scheme needs to have the capacity and resources to implement and/or supervise. A pie in the sky unachievable/un-executable or un-fundable plan will achieve nothing.

One of the main objectives of planned maintenance is to better manage the Community Schemes financial position and reduce the need for special levies. Planned and scheduled maintenance will also ensure that the Community Scheme's infrastructure remains pristine and that investment values are retained. The Community Scheme's 10-year MR&R maintenance plan must be adjusted and updated regularly in accordance with needs, changing circumstances and actual income and expenditure.

Even where maintenance has been totally outsourced to third parties this area must be tightly managed and monitored, as the Community Scheme remains responsible for the 10 year MR&R plan. In addition to paying the contracted service provider fees, it will be billed for materials, consumables and certain equipment used.

A maintenance plan has to be aligned to funding, budgeting and timeframes. Without this, a maintenance plan in isolation is worthless. A maintenance plan allows for both time and finances to be managed more effectively. Carrying out maintenance regularly becomes less onerous and, by spreading out costs more evenly over time, preventative maintenance is more cost-effective. In many cases timeous preventative expenditure will save considerable amounts in the long term than last-minute crisis repairs.

In terms of the STSMA, the following is prescribed for the establishment of the reserve fund:

Less than 25%: If the body corporate reserve fund at the end of the financial year is less than 25% of the levy income generated during that year, the body corporate must provide for a reserve amount equal to 15% of the budgeted levy income for the new financial year.
Equal to or more: If the body corporate reserve fund at the end of the financial year is equal to or more than the levy income generated during that year, the body corporate is not obliged to make provision for a reserve amount in the new budget.

More than 25%: If the body corporate reserve fund at the end of the financial year is more than 25% but less than 100% of the levy income in that year, the body corporate must make provision for a reserve amount equal to the specific repairs and maintenance items provided for in the new budget.

The minimum annual reserve fund contribution is determined by the ratio between the previous financial year's reserve fund balance and total admin fund contribution.

The purpose behind the reserve fund is to set aside financial resources for the planned maintenance, repair and replacement of major capital assets. The reserve fund should be replenished with monthly levy contributions and interest earned on the reserve bank account.

An effective plan needs to cover all the areas of the Community Scheme's maintenance policy. The program should contain a detailed inventory of assets and areas that you need to maintain.
If expenditure adds value to capital assets, extends their useful life or prevents their deterioration, such an expenditure will typically be allocated to the reserve fund.

The following areas can be considered as part of reserve fund expenditure: electrical re-wiring, replacement of guttering and drainage, replacement of water and sewerage piping, parking area renovations, security/access control infrastructure, exterior painting, revamping of clubhouse facilities/gym/swimming pool, repairs of walls/fencing, waste area upgrades, revamping of gardens, repairs and maintenance of roadways etc.

The budgets for operational/general basic maintenance, specific and emergency repairs and known or likely scheduled basic maintenance needs, should be guided by past repair experience and historic expenditure. The administrative fund of the Community Scheme is used to pay for operational expenses and routine maintenance activities that keep assets in good working order.

Routine maintenance, required on a frequent or on-going basis, includes the following examples:

- running repairs to booms, gates and gate motors
- replacing of light bulbs
- repairs to/maintenance of electric fences/CCTV cameras/beams/energisers/batteries/solar panels/inverters/generators/pumps
- fixing of leaking pipes and taps
- cleaning and maintenance of the swimming pool
- basic gardening services
- general service call outs for lifts, hoists, gym equipment

Budgeting for the maintenance areas of the administration fund is an essential step towards maintaining control of a Community Scheme's expenses. By combining the 10-year cashflow forecasts of both the reserve fund and the administration fund, a Community Scheme will have more control over its finances.

Capacity and Resources to Undertake Maintenance

Trustees/Directors/Estate Management also need to identify the specific maintenance tasks or projects the Community Scheme intends performing. Where possible, these tasks need to be aligned to individual major assets or areas e.g. painting of complex, re-doing of gardens, replacing garage doors. A reasonable maintenance schedule should also suffice in guiding the whole maintenance program.

The costs of any outsourced general maintenance to contractors need to always be weighed up against those of employing your own team, the capacity of the Community Scheme to oversee the work performed, the quality of work and responsiveness of contractors to problems. Hiring of specialised equipment is always an option open to a Community Scheme to undertake certain work itself.

If the funds of the Community Scheme are insufficient or inadequate for the required maintenance, they will need to be supplemented by either raising a special levy or obtaining funding/a loan. If the people resources are limited, the hiring of additional appropriately skilled people will be required. Detailed cash flow forecasts and accurate budgeting will go a long way in guiding this process and affordability, and in avoiding the need for a special levy or debt funding or the recruitment of additional human resources.

For the efficient maintenance of your assets and infrastructure, the Community Scheme needs to demonstrate the skills-set required for each maintenance task. You don't want to use or hire inadequately skilled individuals to handle specialist maintenance. The different levels of maintenance required, from routine to specialist will help a Community Scheme prepare this section of the plan.

In some instances, it might be worthwhile for a Community Scheme to get a professional maintenance report which identifies the key areas needing focus/attention to guide the 10 year maintenance process (MR&R plan).

How does the Community Scheme build its Plan?

- **The Work Required**

As the Community Scheme creates a maintenance plan, you have to be clear on what exactly the Community Scheme needs to do. Decide the priority areas as well as the sequence of activities once the maintenance work begins.

- **Instructions**

Proper instructions and deliverables limit the dependency on specific maintenance workers. The maintenance work also needs to meet particular quality standards. The Community Scheme will only be able to achieve such standards if explicit instructions are included in the plan. All work should be overseen by objective parties with an interest in the outcome e.g. Trustees/Directors/Estate Management or contracted specialists.

- **Schedule**

The purpose of the schedule is to do the work as often as needed – not over-maintaining by doing the work too often – not under-maintaining so that you experience downtime and breakdowns. While weekend maintenance might be possible and cause limited disruption, there is a chance that you may fail to find suppliers or service providers to perform over these periods.

It is always wise to set aside the maintenance window/s when you begin your year. This will need to factor in specifics such as the rainy season, windy seasons, holiday periods etc. As the years progress, the necessary changes to the plan can be made to increase its efficiency.

- **Maintenance Workers**

The plan has to indicate the appropriate skill set for each maintenance task. This information will inform your choice of the best contractors for the work. Depending on the inherent skills and capacity in the Community Scheme/Estate Management, you can assign members of the maintenance team to specific areas.

Tasks that the Community Scheme will not undertake themselves should be identified and reserved for outside contractors. The Community Scheme needs to ensure that the plan also limits access to areas that pose high risks to the Community Scheme's residents, visitors and employees. A short list of appropriate contractors and service providers should be maintained at all times. This should be based on references, credibility, track record, reputation, capacity/capability and price.

- **Spare Parts, Raw Materials and Consumables**

In this phase, you can predict your spare part, raw/building materials and consumables consumption. Once you indicate the parts that you'll need, the maintenance team/workers know exactly what needs to be purchased and what can be picked from the store – before the actual maintenance work is commenced. With this section of the plan, the

Trustees/Directors/Estate Management gets insight into parts/spares/consumables/raw materials used in the previous period as well as future consumption. This makes the future preparation of budgets much easier.

- **Contractors/Outsourced Service Providers**

Some maintenance tasks may require outside contractors or service providers. They include external specialists who come on-site to do specialist work. Most of them bring special equipment like scaffolding, generators, welding equipment, compressors, high pressure hoses, long ladders and metering equipment tools to service assets and infrastructure.

The effective maintenance plan specifies the work that the Community Scheme will request contractors to do. More than one contractor/service provider can be assigned or be short listed for the various maintenance tasks. You could use these specifications to request quotes and tenders from different contractors to do a particular type of work.

1. Detail the work in basics terms that will be required on each asset/area/facility.
2. Schedule the work – use a dating frequency, running hours (machinery/pumps/generators/geysers/aircon units), or other measures that will provide insight into the condition/wear and tear of an asset. The schedule allows you to do predictive maintenance.
3. Add maintenance workers or contractors – including the estimated working hours/timeframes of projects.
4. Add spare parts, raw materials and/or consumables required. You can add quantities or items up front or later, as the work is commenced and the Community Scheme gets an insight into just how many parts/items and quantities are needed for the respective projects, jobs or tasks.

Due Diligence, Counterparty, Supply Chain and Procurement Risk

Counterparty risk can arise in many ways in the ordinary course of Community Scheme operations. This can arise from the extension of credit to debtors, relationships with trade suppliers, providers of funding/lenders, contracts entered into, supply agreements, contracts with service providers, outsource arrangements, franchise agreements, lease/rental arrangements and employee contracts etc.

Out of any engagement with a counterparty comes some risk. This can be insignificant in the case of a once-off low-value product sale or service engagement to very high in the case of a lengthy, complex building project.

Selection of the wrong or inappropriate counterparties can result in regulatory, reputational, and operational risk, mainly in operational interruption.

The way to deal with all counterparty risk is to establish everything you can about the party and their ability to perform as and when expected. This process is commonly known as “Know your customer or counterparty or (KYC)”. It is critically important that this is done before any contracts or arrangements are entered into, credit extended, supply agreements or outsource relationships are entered into or begun. Low cost, up-front work and due diligence can save lots of money in the long run.

Nothing should be taken at face value, given counterparties' ability to leverage off many elements e.g. social media, fake news, identity theft, fake web-sites, impersonation, use of untraceable numbers/temporary sim cards, manipulated records and financials, use of similar trading names, assumed domicile, fabrication of track records, “hiring” of temporary offices and warehouses, the imposition of middlemen, use of pressurising tactics, corruption, bribery and criminality.

You should undertake the majority of your KYC following strictly laid down processes. Whilst some data from credible third-party resources can be used, this needs to be independently verified. If you are unsure or concerned about anything or have reservations, insist on a performance guarantee, cash deposits for large bookings/reservations, only accept or undertake small orders or enter into limited contracts to minimise your risk until a track record and relationship has been established.

Counterparty risk management is an on-going process that only ceases when the relationship with, reliance on, or recourse to the counterparty ceases, expires or comes to an end. As such, the process of monitoring counterparties needs to be on-going.

Counterparty failure can be due to direct factors such as fraud, financial failure, change in ownership, change in support of group companies, inability to perform, physical risks experienced by parties (e.g. floods/fires), equipment breakdown, production challenges, labour unrest, raw material and supply chain problems. Indirect factors can be as a result of regulatory changes, legal action, lockdowns, strikes and transport delays.

- Many of the more significant operational risks arise from supply chain failures. These can be temporary in nature, to significant events with major permanent ramifications. The two most important questions around service providers, suppliers or contractors is whether they will perform or deliver as anticipated/expected/promised and whether you will want to do business with them going forward.
- All suppliers and service providers to a Community Scheme must be critically managed and reviewed continually. It is easy to get comfortable with a single supplier or contracted third party. Supplier diversification is a critical part of managing supplier risk.
- Many Community Schemes find themselves ignoring or deviating from laid down procurement policies i.e. three quotes, trade references, transparent tender processes, supplier selection guidelines and due diligence. These are essential processes to ensure that competitive pricing, alternate suppliers and service quality to the Community Scheme is maintained. It also acts as a control tool around collusive dealing, conflicts of interest and potential fraud and corruption.
- Knowing your supply chain starts with knowing where suppliers or service providers are located, what disruption risks are most likely to occur, and being ready to activate alternative suppliers or service providers at a moment’s notice.

Supplier or Service Provider KYC

Below is an example of the key elements that a prospective service provider or supplier should satisfy. These are basic vendor/service provider qualification criteria.

- Provide three years of Audited Financial Statements for their organisation/business
- Proof of financial solvency of the organisation/business
- Details of ownership of the organisation/business
- CV's/details of the owners/key shareholders/office bearers of the organisation/business
- Track record of successful business operations of the organisation, owner/s/shareholders
- An expression of interest outlining innovative offerings and value add that the supplier or service provider will bring
- Suppliers/service providers should have 5 - 10 years of related experience in their industry
- Positive peer, market and industry reviews, extensive references, industry recognitions or awards
- Industry affiliation and membership where relevant

Some specific aspects that you should consider around all your contracted counterparties:

- Does the counterparty have any assets?
- Has there been any change in the counterparty's ownership or controlling shareholder/ultimate ownership since you initially engaged them?
- What aspects could prevent the fulfilment of contractual conditions, e.g. supplier failure, regulatory, embargoes, loss of licence/cancellation of registration, loss of an agency/distribution agreement, labour issues, financial, failure of other customers, obtaining of required approvals?
- Are any guarantees going to be provided, and if so, by whom and do they have assets?
- What type of transaction/s is/are expected with the counterparty e.g. long term service provision?
- Are there other legal conditions present beyond standard contract terms?
- Details of any legal disputes or litigation they are involved in?
- What is your ability to grow your relationship with the counterparty – this can involve the colour coding of customers around their potential as a counterparty, i.e. supplier, service provider, contractor, alliance partner etc.?
- The level of debt in the counterparty organisation – will they be able to remain a going concern?
- The governance and ethical values in the counterparty?
- The level of concentration risk in the debtors/suppliers of the counterparty?
- The potential damage to your Community Scheme's reputation if you picked or aligned with the "wrong/dodgy" counterparty?
- The contractual capacity and authority of the parties you are dealing with/contracting to bind their respective organisations?

Disaster Recovery, Business Continuity and Emergencies

Risks can have varying impacts on a Community Scheme. These can be significant with an immediate impact or insignificant, with a delayed impact. Risk can be boundaryless or concentrated. Risks can be ad-hoc, recurring or intermittent. Disaster planning and business continuity need to factor in the potential impact of risk events and worst-case scenarios.

Even though your Community Scheme may not have experienced a major operational or criminal incident, it is imperative that you put in place business continuity, disaster recovery and emergency plans in the event of one.

These plans need to be comprehensive and cover most eventualities. The recent civil unrest and looting, coronavirus outbreak and extreme weather events in areas (floods, veld/wild-fires, high winds) indicate the reasons and need for a comprehensive disaster recovery plan. Water and extended power outages could well also require specific treatment and action.

Other examples of risks with big implications that a Community Scheme could face are immediate termination or failure of the Managing Agent, inability to collect levies due to debit order bank system failures, strike action by employees/service providers, major security breach or incident, water crisis, black-outs/extended power failures, technology systems outages or IT system failures, cyber-attack or major mechanical breakdowns.

Continuity plans should be put in place for major potential eventualities. These should cover back up power and water contingencies, back up IT/Technology for key systems, alternative security service providers and alternative suppliers for key services.

The sudden loss of key employees e.g. estate manager, along with the continuity of Trustees/Directors, should also be considered in disaster and succession planning. Key person insurance may also be considered in the case of Estate Management.

Evacuation plans need to be documented with assembly points clearly demarcated.

Insurance

Insurance is one of the main ways of mitigating operational risk, particularly where this involves the potential loss of or damage to assets, the impact of natural disasters, fraud, robbery and crime, business interruption losses and the overall resultant impact on the Community Scheme and its operations. All assets of the Community Scheme need protection.

In addition to the regulatory requirements around insurance of the Community Scheme's fixed assets, other potential areas of potential loss need to be considered. If deemed necessary and viable relative to potential loss, these risks need to be insured.

The Directors/Trustees and Estate Management of the Community Scheme need to ensure that they are also adequately protected in terms of directors' and officers' liability insurance. Cybercrime is now one of the most significant risks which all organisations will face in the digital age.

The Community Scheme needs to continually familiarise itself with the terms and conditions of their insurance cover and the excesses that apply. Where excesses are recovered from individual owners or other parties, their recovery needs to be closely monitored and tracked.

Affordability of insurance is a crucial consideration for a Community Scheme, as are the insurance policy excess levels that the Community Scheme believes it has the appetite for or can carry. The extent of possible loss and loss occurrence needs to be assessed against the insurance cost to mitigate these. Historical loss experience and crime incidents should also be considered in these decisions.

Key operational elements that can be insured are:

- Key staff /employees – key person insurance
- Loss of income or profits/business continuity
- Damage to property and assets
- Accidents, floods, fires, landslides and explosions
- Mechanical breakdowns
- Liability claims
- Robbery/theft/fraud/loss
- Goods in transit
- Debtors
- Sabotage, arson, willful misconduct, civil unrest, political and riots
- Cybercrime – impacts of hacking, data theft, ransomware
- Bilking, stock deterioration