SIMPLE TOOLS AND TECHNIQUES FOR ENTERPRISE RISK MANAGEMENT pdf

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Sources of Risk internal to a business and emanating from the environment Internal Processes Figure 1. Good board practices and corporate governance are crucial for effective ERM. There is more of a focus on formal approaches. Internal controls are a subset of corporate governance. Risk management is a subset of internal controls. Risk management is aimed at: The aim is to accomplish this through the identification and assessment of risks facing the business and responding to them to either remove or reduce them or where appropriate transfer them to a third party where it is economic to do so. Both are clearly acceptable approaches. Whichever route is selected, the parameters of any study have to be mapped, communicated and agreed so that the timeframe, resources, costs, inputs and deliverables are understood. It is proposed here that the risk management process is broken down into six processes called analysis, identification, assessment, evaluation, planning and management. While activities follow a largely sequential pattern, it may be a highly iterative process over time. For as new risks are identified, the earlier process of identification and assessment are revisited, and the sequential process is repeated through to the implementation of risk response actions. They are a development of the traditional PEST analysis an abbreviation for the external influences called political, economic, social and technological. This risk exposure exists from their inception. However, there would appear to be a swell of opinion that says risk is now more complex, diverse and dynamic. In particular, the source of risk is broader and the rate of change of the sources of risk has dramatically increased. The emergence of ERM has come about from 12 Simple Tools and Techniques for Enterprise Risk Management the desire and need to move away from managing risk in silos and identifying and managing risk interdependencies. This is not some startling new intellectual breakthrough but rather a practical solution to a practical problem. It is clear from surveys and the press that board members believe that ERM is important to business growth. Whatever strategy boards adopt they must decide what opportunities, present and future, they want to pursue and what risks they are willing to take in developing the opportunities selected. Hence whatever the approach businesses adopt for risk management, they must strike a judicious balance between risk and opportunity in the form of the contradictory pressures for greater entrepreneurialism on the one hand and the limitation of downside risks on the other. In the aftermath of a series of unexpected risk management failures leading to company collapses and other corporate scandals in the UK, boards are under greater scrutiny and expectations of corporate governance have significantly increased. Board members cannot distance themselves from risk management or believe that they will not be held to account. Risk management needs to be integrated with the primary activities of the board. There are a series of clearly recognised benefits of implementing risk management practice, when applied in a systematic and methodical way. A framework was described for examining ERM to understand the pressures for its development, its composition, implementation, the overall process and the sources of risk. The Crisis in our Boardrooms: This revised and updated edition was published by Profile Books Limited, London. This chapter looks at the drive behind improvements in ERM through examination of the incremental developments in corporate governance and their catalysts. The purpose of corporate governance is to ensure board oversight of business operations. For any business, governance means maintaining a sound system of internal control within its normal management and governance processes. Internal control is required to assist in: While the need for governance has always existed, corporate governance and particularly risk management has been seen to be inadequate in a number of high profile businesses that have collapsed. This chapter offers a definition of corporate governance to place internal controls and risk management in context. Chapter 3 examines the developments in corporate governance in the US and Canada. Similar initiatives were introduced overseas such as the Canadian Dey

Report, published in Dey Through a continuing process of revision and amendment, subsequent reports have broadened the focus of corporate governance. The collapse of Enron in the latter part of , followed by other major corporate crises in the US and elsewhere, called into question the effectiveness of many of the established concepts of corporate governance. As a result, the adequacy of governance arrangements in the US, the UK and internationally, have all come under closer scrutiny. In the UK, this process has involved a wide-ranging review, leading to the introduction of a revised Combined Code on Corporate Governance in Combined Code on Corporate Governance For ease of assimilation, the key reports, codes and guidance from Cadbury onwards are listed chronologically in Box 2. Separation between membership and management has many advantages: However, the separation between management and ownership within a UK listed company may create tensions between the interests of these parties. As a result, they are likely to pursue self-serving objectives, which will not necessarily be in the best interests of the shareholders. As Cooper describes, the problem of agency may manifest itself in board decisions that promote the interests of the directors but do not necessarily enhance the value of the company for the shareholders. Cooper cites examples of such decisions as being: In extreme cases this may result in shareholders and others being seriously misled. Two recent notorious examples concern the US energy corporation Enron and the Anglo-Dutch petrochemical company Shell. The level of reserves was restated four times. The restatements prompted investigations by both UK and US authorities. The Committee report has come to be recognised as a landmark in thinking on corporate governance and was thought to strike a chord in many countries. There was also concern over the composition of boards in relation to the balance of directors to non-executive directors. Some company boards had no non-executive directors NEDs at all and where NEDs were appointed, they were commonly outnumbered by executive directors. In addition, there was concern over the independence of NEDs as a result of their former role as executive directors of the same company, close connections with external advisers or major shareholders, or personal relationships with the chairman. Thousands of depositors lost heavily when BCCI was wound up in amid accusations of money laundering and fraud. The bank had lost money from its lending operations, its foreign currency dealings and its deposit accounts. It was reported that the bank was the bank of choice for money-launderers and terrorists, in that drug money from Colombia and Panama and funding for the Mujahideen in Pakistan and Abu Nidal in the Middle East, all flowed through the bank. Maxwell ran his companies and the pension funds as if they were one. He moved assets between them as best suited his interests. The key recommendations of the Cadbury Code were in four main areas: The board of directors: To ensure that the board functions as an authoritative decision-making body, rather than a formal rubber stamp for executive decisions, the Code recommended that the full board meet regularly. In addition it should establish a formal schedule of matters including material acquisitions and disposals, capital projects and treasury and risk management policies, specifically for its collective decision. It suggested that in addition to their share in the strategic responsibilities of the board, they have explicit control and monitoring functions, which are distinct from the day-to day managerial responsibilities of their executive colleagues. The Cadbury Code referred to the treatment of executive remuneration and drew attention to the potential for conflicts of interest between shareholders and directors on matters of pay, performance and job security. Accordingly it recommended that shareholder approval should be obtained for new service contracts in excess of three years and stated that executive pay should be subject to recommendations of a remuneration committee made up wholly or mainly of NEDs. This should include a coherent narrative explanation of its performance and prospects, with details of setbacks as well as successes. The principal objectives of the Greenbury Code were to: The version of the Combined Code consisted of 17 Principles of Good Governance, 14 of which were addressed to listed companies and the remainder to institutional investors. Hampel made the point that they wanted to encourage the use of the broad principles of corporate governance and their application with flexibility and common sense, adapted to the specific circumstances of a business. The guidance includes certain essential requirements that every audit committee should meet. These requirements are highlighted in bold in the text. Compliance with these is necessary for compliance with the Code. Listed companies that do not comply with these requirements are required to provide an explanation as to why they have not complied within the statement required by the Listing Rules. The audit committee is stated as having the role of acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control. The report provides guidance on: The review was led by Derek Higgs Higgs , a respected investment banker and in the eyes of the sponsor, a senior independent figure from the business world. The review was motivated by the belief that stronger and more effective corporate boards could improve corporate performance. Higgs summarised the terms of reference of the review as building and publishing an accurate picture of the status quo, to lead a debate on the issues and to make recommendations to clarify the role and increase the effectiveness of non-executive directors. The summary of recommendations consisting of six pages of the report is wide ranging, reflects the terms of reference and covers such issues as independence, recruitment, appointment, induction, tenure, remuneration, resignation, audit committees, liability and relationships with shareholders. These being data on the population of nonexecutive directors supplied by Hemscott Group Limited, data on the role of non-executive directors surveyed by MORI and data on the relationships and behaviours that enable effective non-executive director performance, supplied by three academics, McNulty of the University of Leeds and Roberts and Stiles of the University of Cambridge. The report was commissioned by the Department of Trade and Industry DTI , who were concerned to implement the recommendations included in the preceding Higgs Review on how companies might improve the quality and performance of their boards â€" through changes in the way they identify, select, recruit and train individuals to serve in NED positions. Dean Laura Tyson of the London Business School was invited to chair the task force selected to undertake the review. Tyson states that diversity in the backgrounds, skills and experience of NEDs enhances board effectiveness by bringing a wider range of perspectives and knowledge to bear on issues of company performance, strategy and risk. It is derived from a review of the role and effectiveness of Developments in Corporate Governance in the UK 19 non-executive directors by Derek Higgs and a review of audit committees by a group led by Sir Robert Smith. This new Code applies to reports issued by listed companies on or post-November The preamble to the Code explains that the Listing Rules would not be amended as far as listed companies being required to issuing disclosure statements in two parts in relation to the Code. While the European Union EU commission does not want to enact a European code of corporate governance, as it currently sees no need at present, this may change. In addition, as the commission considers that the existence of different codes may cause some frictional and fragmentary cost, it is encouraging a move towards greater convergence. Only time will tell if statutory compliance will be introduced. This current avoidance of prescriptive rules reflects the view that different governance approaches are required for different companies, depending on their size, business activity, operating environment and ownership structure. In other words, one solution does not suit all circumstances. In consequence, successive Codes have no statutory force, but have been appended to the Listing Rules, with a requirement on listed companies to disclose in their annual reports whether or not they have complied with Code recommendations and where they have not, providing reasons for the areas of non-compliance. A definition of corporate governance is important here to aid both comprehension and understanding, in terms of its purpose and its relationship with internal control. While appealing 20 Simple Tools and Techniques for Enterprise Risk Management in its simplicity, this definition is not particularly informative. The Organisation for Economic Cooperation and Development OECD expands the definition to cover issues of stakeholder management, objective setting and monitoring performance: Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. A detailed definition is offered here, adopting the themes of earlier publications and including the elements of direction, resources and management: While corporate governance and risk management are important to all businesses, whether they be sole traders, partnerships, private limited companies, cooperatives or franchises, corporate governance and enterprise risk management has greater significance for listed companies.

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Simple Tools and Techniques for Enterprise Risk Management, Second Edition shows you the way. About the Author Robert Chapman is the Director of Risk Management in the Middle East for AECOM, a publicly traded company on the New York Stock Exchange, and listed on the Fortune as one of America's largest companies.

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