RISK ADVISORY SERVICES

Enterprise Risk Management

Complacency is no longer an option, but a practical start is

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Experience shows why ERM is critical now

Business improvement imperatives

- Improve financial and operational performance
- Reduce losses
- Enhance competitive advantage

Regulatory requirements

Organisations are challenged by increasing regulatory requirements to have formalised risk processes in place. They must:

- Satisfy industry mandates, such as energy, banking, health and safety, and insurance regulations
- Satisfy corporate governance requirements (e.g., Sarbanes-Oxley section 404)
- Meet SEC requirement: 10-K description of "risk factors" in plain English
- Meet new ERM public company listing requirements emphasising board responsibilities and corporate governance
- Uphold a board's duty of care in managing a corporate entity

Key stakeholder demands

Rating agencies and analysts are increasingly monitoring business assessment of risk. Organisations must:

- Comply with rating agency guidance emphasising a company's ability to articulate and execute against a risk management strategy
- Address analysts' interest in evaluating governance efforts

Enterprise Risk Management: Complacency is no longer an option, but a practical start is

In an environment in which risks are proliferating, shareholders are demanding growth, and first-movers are expanding rapidly into new markets, many leaders recognise that implementing an enterprise risk management (ERM) program is becoming an urgent business priority.

Business imperatives, regulatory requirements, and rating agency monitoring are prompting a new focus on ERM (see box, *left*). In response to external pressures, many board members are expecting their management teams to implement an effective ERM program. Consequently, many leaders are seeking guidance in developing a practical approach to ERM — an approach that is tailored to their culture and structure, aligned with their business strategy, embedded in their business processes, and focused on their most critical risks.

Getting started with a clear and practical vision is critical, and a few key steps can enable leaders to build on existing risk assessments and get an ERM effort under way. Leaders who have successfully pioneered ERM tend to embrace several important practices, which may help others meet regulatory demands and add business value. Described below, these leading practices can provide the means of overcoming old barriers, achieving new buy-in, and ultimately realising ERM's potential for enabling organisations to add business value and achieve competitive advantage.

1. Gain buy-in from those running the business. Often in the past, ERM was a finance department "bolt-on" project, the champions of which likely had little broad support or leverage. As a result, ERM's potential value to the business was never fully realised.

A key step now is to establish a management risk committee (or risk council) that is charged with obtaining buy-in for the ERM programme across the organisation. With a lead/sponsor reporting to the CEO, the risk committee would include individuals who lead key areas within operations and support, such as legal, HR, compliance, finance, operations, strategy/corporate development, and IT.

The risk committee:

- Assists in educating employees and coordinating development of the risk profile (i.e., prioritised analysis of key risks)
- Confirms and approves the organisation's risk "language" and parameters (e.g., the point at which, for example, something would be considered a catastrophic risk, based on reduced cash flow, and loss of reputation)
- Sponsors and participates in reviewing the key risks and debating the risk profile, risk priorities, and important risk causes and consequences
- Evaluates emerging risks, discusses and reviews the risk reports, and reports frequently to the CEO and the board
- Facilitates the process of keeping risk profile current and relevant

Having obtained consensus, the risk committee is in a position to steer the ERM execution effort.

Understanding risk

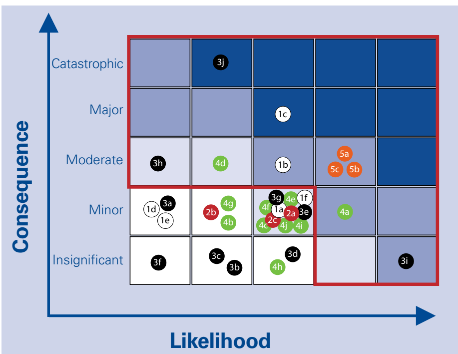
When a risk is categorised according to its likelihood and its potential consequence, leaders can determine how it may affect variables including profitability, market share, and reputation. They are then better able to understand and manage the risk, based on whether it is:

- Controllable. A risk occurrence management can reduce or prevent.
- Uncontrollable. A risk occurrence that management cannot prevent but that it can detect as well as manage the risk consequence.
- Discrete. One-time event that impacts business objectives within a discrete time frame and may recur.
- Ongoing. Iterative event that impacts business objectives over an indefinite time frame.

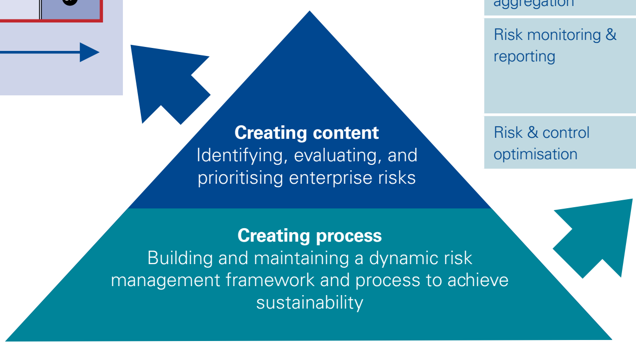
2. Identify and prioritise top risks — and explore how well you manage them. A successful ERM endeavor begins with a focus on two fundamentals: content and process (Figure 1). "Content" refers to key risks, and "process" indicates how the program for managing them is sustained across the business. The risk council's first goal is to facilitate the identification and prioritisation of an organisation's key risks — those that may prevent it from meeting its corporate strategic goals. This list can be based on the likelihood of the risks occurring and the potential consequences to the organisation should they occur (see box, *left*). Leaders would identify risks that they believe threaten the business model, the organisation's strategy, and the organisation's existence. Members of management within the risk council would vet these risks, develop an enterprise risk profile, and then identify priority risks (e.g., the top 10 to 20 risks). The risk council's second goal is to explore how well the business prevents and/or manages the key risks today and what changes may be necessary to improve that effort.

This process provides details about the effectiveness of the organisation's approach to managing risk and an assessment of vulnerabilities that could threaten the organisation's overall business strategy. This process can also assist leadership in critical decision-making. For example, if an organisation is planning to buy another company, the relevant risk information could help illuminate whether the potential acquisition could have a negative impact on the company's current top risks. So much business information is historical; risk information needs to be current and supported by a sustainable process to help enable a future focus.

Figure 1: ERM fundamentals



ERM framework	
Framework element	**Description**
Risk governance	Establishing an approach for developing, supporting, and embedding the risk strategy and accountabilities
Risk assessment	Identifying, assessing, and categorising risk across the enterprise
Risk quantification & aggregation	Measuring, analysing, and consolidating enterprise risks
Risk monitoring & reporting	Reporting, monitoring, and conducting assurance activities to provide insights into risk management strengths and weaknesses
Risk & control optimisation	Using risk and control information to improve performance



Implementing ERM successfully calls for doing two things well: creating content and creating process.

Source: KPMG LLP (U.S.) 2006

3. Assign accountability: Turning the corner from risk assessment to risk management. Identifying key risks can help the organisation understand accountability — who owns the risks, how effectively they are currently being managed, and whether the risks are being monitored. Internal audit or compliance departments may be in charge of monitoring certain risks, but often, because organisations are organised by function or geography and not risk, the highest risks may not have designated risk owners or risk monitors. Indeed, some risks may not be formally identified (for example, strategic risk is often not identified, and thus can be the source of some unwelcomed surprises). Assigning formal accountability for identified risks to the right people helps create a greater level of assurance for the board and the audit committee and a greater level of confidence in the organisation's governance framework.

4. Begin working toward a single view of risk. Many organisations have already invested in a variety of risk processes and functions, but these mechanisms often lack a unifying vision and clear objectives. Consequently, the potential benefits are unrealised. The effective implementation of ERM is the much needed "glue" that delivers a performance-based focus on risk management and, thus, a reward for the risk management investment. Implementing a single ERM approach allows leaders to replace the siloed approach to risk management with a single view of risk that is articulated across the organisation.

5. Consider your current position within an ERM framework. The risk committee can then build consensus on where the organisation wants to go next, based on its risk profile. With a single view of risk identified and an ERM framework (i.e., a construct of common language and approach/methodology for risk management) in place, an organisation can begin the critical work of articulating its own vision for ERM and ERM's role in the organisation. That vision can help determine the organisation's ERM approach and may likely be a call to more immediate action as leaders gain an appreciation of the gaps in their current efforts and can see a way forward.

Leaders take varying approaches to ERM, depending on the needs of the organisation and its risks. As outlined in Figure 2, ERM approaches can be plotted along a "maturity continuum." An organisation's approach, and the choices it reflects, affects the extent to which it makes ERM part of its governance and business operations

Figure 2: A risk continuum

Level	Basic	Mature	Advanced
Approach to ERM	Remain in compliance	Deploy as a management process	Embed as a strategic tool
Goals	The organisation has identified its top risks and has prioritised and addressed its compliance risks.	The organisation has a process for managing risk and a governance framework that supports the process. It manages compliance risk against strategic goals.	The organisation has embedded an ERM process; senior leaders use risk information as the basis for decision making; ERM is linked to performance measurement.

Source: KPMG LLP (U.S.) 2006

The way forward

ERM has evolved from a largely theoretical construct to a highly practical performance tool. Now, many leaders are beginning to recognise ERM's value and practical applicability as a means of responding to business or governance changes and stakeholder demands, improving the management of identified risks, and ultimately creating a sustainable process for gaining competitive advantage. Organisations that embrace ERM and build it into the core of their enterprises can anticipate the benefits that are possible when:

- Risks (the "content") are assessed, evaluated, and correlated across the enterprise
- A common risk framework (the "process") is in place, with accountability established for measuring, managing, and monitoring risk
- Risk quantification and aggregation is enabled throughout the organisation via common methodologies and tools
- Risk reporting to management and the board is effective (that is, it captures risk trends and emerging risks)
- The ERM program supports strategic decision making and brand protection and has predictive value
- Corporate governance processes are strengthened

Implementing an ERM approach is certainly not easy, and it cannot happen overnight. But as ERM's practical applications evolve, leaders have learned that an ERM approach can help organisations with two critical challenges: (1) How to derive tangible value from regulatory compliance efforts and (2) how to link risk and strategy to drive business performance and enhance the organisation's brand. Now that complacency is no longer an option, taking the practical first steps to build internal consensus can help enable leaders to meet rising external demands and, over time, to use ERM as the foundation for building competitive advantage.

ERM helps enhance performance and value

Using ERM, organisations can:

- Reduce cash flow volatility using derivatives, insurance, or improved controls
- Allocate and evaluate capital based on risk-based performance
- Integrate risk and business planning, investment, and M&A
- Reduce costs through risk consolidation and cross-functional efficiencies
- Reduce losses through coordinated enterprise risk monitoring and reporting

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