

CorporateGovernor

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Enterprise risk management: Avoid history repeating

By Bailey Jordan, Business Advisory Services partner

Amid a climate rife with corporate bailouts and collapses, it's easy to wonder, "Where is the risk management?" In some of these situations, risk was indeed recognized, but at some organizations, there was no forum or supportive culture for staff to voice their misgivings. Unheeded warnings and unquestioned momentum undermined existing risk mitigation efforts.



Companies with strong risk management programs not only are better equipped to weather an uncertain economy, they are better prepared to compete. Standard & Poor's has expanded ratings analysis of nonfinancial corporations to include an enterprise risk management (ERM) review. There is no time like the present to rethink your company's approach to enterprise risk management.

What is ERM and what can it do for you?

Risk is a reality of doing business and businesses must take risks to succeed. Risks arise from multiple angles — economic trends, political and regulatory factors, technological advances, demographic patterns, social or cultural changes and ecological concerns — but often, they are addressed unilaterally. One team may examine financial risk while a separate group manages IT risk, with neither one necessarily comparing notes.

With its holistic approach, ERM has been viewed as the gold standard of risk management methodologies, helping organizations identify, analyze, manage and monitor risk comprehensively. ERM focuses on the strategic analysis of risk throughout an organization, cutting across business units and departments, and considering end-to-end processes.

"By focusing on an enterprise-wide risk in a coordinated fashion, organizations are better equipped to prioritize the top risk drivers and are less likely to be distracted by lower-level risks that are less important to an organization's strategy," according to Mark Beasley, director of the ERM Initiative at North Carolina State University. This comprehensive approach to risk oversight enables an organization to align its risk appetite with its overall business strategy, deciding how much uncertainty is acceptable and how much could actually add value.

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How to start

During belt-tightening times, it's easy to dismiss any new process as unnecessary overhead. Yet measures undertaken to comply with regulations like the Sarbanes-Oxley Act largely overlap with ERM. In addition, incremental steps to expand your risk universe to include strategic, reputation and operations risk also can add value by providing better risk information for better decision-making and increase the likelihood of accomplishing objectives while laying the groundwork for ERM.

When building an ERM process, an organization should:

- Understand the company's strategic objectives, operations, control environment and inherent risk. What could keep the company from achieving its business objectives? What opportunities are out there to achieve its objectives? In what ways might the organization be too conservative about other risk areas?
- Define the risk universe and risk language, e.g., risk appetite, risk tolerance and risk response (accept, avoid, share, mitigate).
- Develop questions to gauge the current state of risk awareness (i.e., significance, likelihood and impact) through interviews, common risk attributes and industry knowledge. For example, an international not-for-profit organization recognized that the diversity of its services and rapid growth could equate to increased operation and reputation risks if it did not establish a risk inventory and risk-treatment strategies.
- Distribute and analyze a questionnaire to establish preliminary risk categories.
- Conduct facilitated sessions to define the risk appetite, finalize the risk categories and rank the top 15 risks.

- Assign risk owners and create an action plan.

Make ERM more effective

If your organization has already set ERM in motion but hasn't seen any benefits, there are numerous ways to make your system more effective. For ERM to work, it must be embraced by the board and senior management to establish a culture of risk awareness. A supportive ERM culture helps establish a "transparent" environment where people are willing to express their issues without fear of retribution. This is not possible without the CEO's active and visible support.

Steps to ERM improvement:

- Integrate strategic planning processes and risk assessment activities to take advantage of risk opportunities and consider risk variations across strategic goals. For example, how does the company manage procurement risk? Does the company utilize cross-functional, cross-geographical commodity teams to determine assurance of supply, calculate total cost of ownership and evaluate supplier performance and viability?
- Develop practical risk response action plans and regularly report progress to the board.
- Reward risk ownership and effective risk management action plans.

Risk is not static. Commit resources to periodically refresh the risk universe and risk priorities. Remember that ERM is an ongoing process; it is not a project with an end date. Don't overcommit and underdeliver — implement ERM in manageable increments. Also, establish an executive risk oversight group that regularly reports key risk management information to the board of directors. "The biggest ERM failure

in organizations is the fear of starting toward an enterprise-wide approach to risk oversight," says Beasley. "It's hard for business leaders to argue against being more risk aware; however, many are intimidated to begin. The key is to start and to keep it simple, allowing it to evolve over time."

The dos of ERM

- Follow a framework like COSO's *Enterprise Risk Management – Integrated Framework* to keep from getting lost in the details. Take advantage of ERM thought leadership already done for you.
- Name a risk champion who understands ERM's importance and can dedicate ample time to its implementation.
- Reflect on how other industries can affect your organization.
- Evaluate current, not just historic, data.

The don'ts of ERM

- Underestimate the impact of the organization's existing culture.
- Undersell ERM as business risk assessment.
- Employ ERM as a defensive measure.
- Implement ERM as a part-time job.
- Take on too much too soon.
- Overcomplicate the process.

Ultimately, the goal of ERM is not to eliminate risk but to help preserve and enhance value. ERM does this by arming organizations with comprehensive information; better risk information leads to better decision-making. In a global economy in which events in one sector can trigger a domino effect, organizations must take a proactive and comprehensive approach to managing risk. ERM provides an organization with the opportunity to be an example, not a cautionary tale. •

Universal language: IFRS and XBRL

By Trent Gazzaway, national managing partner of Corporate Governance

In a global economy, much can be lost in translation. Language and cultural barriers notwithstanding, applying different standards to financial information from various countries can make comparison difficult and transparency nearly impossible. International Financial Reporting Standards (IFRS) and eXtensible Business Reporting Language (XBRL) aim to remedy these obstacles and could become standard practices in the near future. Boards of governance need to understand the impact IFRS and XBRL will have on their organizations.

IFRS

IFRS is increasingly being viewed as the single set of high-quality accounting standards for global capital market participants. In 2007, the SEC adopted rules to accept filings from foreign private issuers without requiring reconciliation to U.S. GAAP, provided their financial statements were prepared in accordance with IFRS as issued by the International Accounting Standards Board.

In August 2007, the SEC issued a *Concept Release* on allowing U.S. issuers to prepare financial statements in accordance with IFRS, demonstrating the growing importance of the standards. Although the changing U.S. political and economic climate may affect the rate of change, many believe that within three to five years, U.S. capital markets will have made the changeover. Currently, more than 100 countries already have transitioned to IFRS (some have adopted country-specific versions). While it is still too early to tell when or

if non-profits, private companies and government entities will adopt IFRS, it is clear that these standards will play a vital role in the global business community.

With estimates that IFRS could become more pervasive or even required as early as 2011, boards need to know where their organizations stand. Is your organization planning to make the change to IFRS? If so, is your organization preparing by gaining an understanding of the IFRS differences, training financial reporting personnel and getting regular updates on IFRS deliberations? What changes might be necessary in your information and internal control systems to accommodate IFRS? Even if there are no immediate plans to transition, how will your business be impacted by those who have already transitioned?

Boards will need to be vigilant in their oversight during the transition process. The transition should become a regular board agenda item with candid feedback from management, internal auditors and independent public accountants.

As a principles-based regime, IFRS requires extensive use of judgment in the application of accounting policies, i.e., whether financial assets are held-to-maturity investments. Many of these judgments are subjective; the board will have to ensure management has a consistent process in place to reach and support such conclusions.

XBRL

Today, most business data are stored in proprietary systems and presented to users in fixed reports. Because these reports are static, users often are forced to re-enter the data they need, leading to errors, decreasing timeliness

and potentially reducing the amount of information available for making important decisions. Widely accepted worldwide, XBRL is an international, market-driven reporting format that “tags” data so a computer will be able to identify, read and use it in other programs and analyses.

The SEC strongly supports the use of XBRL, and the FDIC now requires all banks to submit call reports using this format. Companies can voluntarily file with XBRL to stay ahead of the curve.

XBRL can provide benefits for both public and private companies, including:

- access to original company data,
- reduction of data re-entry errors,
- reusable data,
- more timely information and
- reduction in cost, time and errors in financial statement preparation.

Boards need to ensure that proper IT controls are in place while transitioning to XBRL. As new developments like XBRL become more widely accepted and eventually required, boards and management must become fluent in these processes to ensure compliance and address new risks.

Boards and management should also recognize that XBRL will greatly enhance the ability of analysts, investors and even competitors to analyze financial information. It will be just as important to understand how XBRL data can and will be used as it will be to understand how to prepare it. •

COSO guidance update

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) will soon be publishing *Guidance on Monitoring Internal Control Systems*. Based on COSO's *Internal Control — Integrated Framework*, and developed by COSO and a diverse team led by Grant Thornton LLP, this guidance is designed to help organizations monitor the quality of their internal control systems. Learn more at www.grantthornton.com/coso.

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How should your board prepare for these global practices? **p. 3**

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Contact information

Trent Gazzaway
National Managing Partner
Corporate Governance
Trent.Gazzaway@gt.com

Editor: Emily Ford, editors@gt.com

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Grant Thornton
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www.GrantThornton.com

www.GrantThornton.com
Chicago, IL 60604
Grant Thornton LLP
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