

Assessing Enterprise Risk Management

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Introduction

- ▶ What is risk?
- ▶ Why manage risk?
- ▶ Essential elements in risk management assurance
- ▶ Conclusion

What is risk

- ▶ Risk is the likelihood of loss or the probability of gain.
- ▶ Basic principles:
 - ▶ Identify loss exposure
 - ▶ Measure loss exposure
 - ▶ Evaluate methods for handling risk; assume, transfer and reduce.
 - ▶ Select appropriate measure
 - ▶ Monitor the results

Why manage risk

- ▶ Diversifiable risk argument is that all investors hold a portfolio of risky assets that duplicate assets in a market portfolio, thus they will not pay a premium to reduce unsystematic risk
- ▶ Manage risk
 - ▶ Adds value to the firm or organization in that it facilitates optimal investment
 - ▶ It is management's job
 - ▶ It reduces performance variations
 - ▶ Promotes job and financial security

Benefits of Enterprise Risk Management

- ▶ Align risk appetite and strategy
- ▶ Link growth, risk and return
- ▶ Enhance risk response decisions
- ▶ Minimize operational surprises and losses
- ▶ Identify and manage cross-enterprise risks
- ▶ Provide integrated responses to multiple risks
- ▶ Seize opportunity
- ▶ Rationalize capital

Best Practices for Enterprise Risk Management

- ▶ Best practice organizations are clear on their primary goals:
 - ▶ Create value by ensuring effective execution of strategy.
 - ▶ Ensure sound planning by focusing senior management on major risks.
 - ▶ Ensure that acceptable risks are properly assessed, monitored and mitigated.
- ▶ ERM leaders at best practice organizations aim to influence cultures and people. Vision at FRB KC is Trust and Confidence.
- ▶ Risk assessment and mitigation are tightly integrated with strategic planning
- ▶ Risk assessment and continuous improvement are top priorities

Lessons learned from risk management failures

- ▶ Know your business
- ▶ Establish checks and balances
- ▶ Set limits and boundaries
- ▶ Keep your eye on the cash
- ▶ Use the right yardstick
- ▶ Pay for the performance you want
- ▶ Tone at the top is key

How does this apply to government

- ▶ The concept of accountability for use of public resources and government authority is key to our nation's governing processes. Management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public effectively, efficiently, economically, ethically and equitably within the context of the statutory boundaries of the specific government program.
- ▶ As reflected in applicable laws, regulations, agreements, and standards, management and officials of government programs are responsible for providing reliable, useful, and timely information for transparency and accountability of these programs and their operations

Key risks in governmental organizations

- ▶ COSO key risk categories:
 - ▶ Strategic
 - ▶ Operations including performance and profitability goals
 - ▶ Reporting
 - ▶ Compliance
- ▶ What may be different in a governmental organization?
 - ▶ Reputational Risk is key, less emphasis on financial risk.

Seven essential elements in risk management assurance

- ▶ Assess the Risk Appetite
- ▶ Evaluate the Understanding of the Business Strategies
- ▶ Evaluate Process Risk
 - ▶ Documentation errors
 - ▶ Exceeding limits
 - ▶ Transaction errors
- ▶ Evaluate People Risk
 - ▶ Conflicts of interest
 - ▶ Failure to follow policies
 - ▶ Follow the money – people will do what they are paid to do

Seven essential elements in risk management assurance – cont'd

- ▶ Evaluate Corporate Culture
 - ▶ Tone at the top
 - ▶ Code of conduct
 - ▶ Senior executives spending – back to follow the money
 - ▶ Pay for performance
- ▶ Evaluate Information Security and Integrity
 - ▶ Alignment of information with strategy
- ▶ Evaluate Communication Channels

Conclusion

- ▶ What questions do you have?