# ERM: Anticipating Questions from the Board

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Boards of directors are under pressure to keep on top of a wide variety of risks that might endanger their organizations' success and sustainability. "What are we doing about enterprise risk management?" is a question being asked of directors and senior executives. How to respond? Rather than diving immediately into the details, Rick Julien, Todd Richards, and Jonathan Marks of Crowe Chizek and Company LLC advise finding answers from a practical, yet high-level, strategic perspective.

A simple question from a board member, such as "What are we doing about ERM?" can be intimidating. Enterprise risk management means different things to different people. Since it is an organizationwide process, its successful development is complex and takes time.

The best way to develop an appropriate answer is to start by understanding the context of the board member's question and why it's being asked now. What is the director's perception of ERM? How might it differ from your own view?

Consider at a high level what the value of ERM might be in your organization and how you could reach consensus to obtain optimal value from the sustained effort required. ERM is a multiyear journey, and drawing up a strategic road map is a more appropriate response to the question than hurriedly compiling a comprehensive and detailed inventory of risks.

It may be that your organization is doing a good deal of risk management yet the efforts aren't well-integrated, monitored, reported, or being communicated to the board. You can gain considerable momentum on the ERM journey by leveraging existing risk management activities. Plan to integrate these processes into a unified program that becomes increasingly sophisticated over time.

## Trends

Following an era in which some board members were perceived as hands-off and blamed for many of the business failures and corporate scandals, today boards are empowered and under considerable pressure to prevent the adverse events that crushed organizations like Enron, Adelphia Communications, Global Crossing, and WorldCom.

In general, there's a "Monday morning quarterback" attitude among the media and politicians when something goes awry at an organization.

Directors and senior executives are almost immediately put on the spot, and there is little patience when answers and documentation are not forthcoming. Because of the memories of recent business failures and corporate scandals, as well as widely reported C-suite salaries and controversies over stock-option backdating, there is reduced tolerance for business missteps and performance shortcomings.

The regulatory compliance burden has increased, and scrutiny from enforcement authorities and prosecutors has become intense. In addition, stock exchanges and rating agencies have updated guidelines that include risk management components.

The New York Stock Exchange requires the boards of listed companies to evaluate risks, although the guideline isn't prescriptive. In addition, Standard & Poor's and A.M. Best Co. are assessing risk management capabilities before they give out ratings.

Board members hear about ERM increasingly at conferences they attend, from discussions with their peers, from reading the business press, and from their business advisers. Knowing their personal reputations are on the line, as well as the financial health of the organizations they oversee, they are justifiably concerned about risk management.

Boards routinely receive financial performance and operational performance summaries, but a concise and strategically focused risk management summary and report has frequently been missing from board meetings. A holistic, high-level view of ERM can begin to reassure board members and build support for a sustainable program.

Some directors, of course, have audit committee or risk committee responsibilities and should take particular interest in ERM planning, development, and oversight.

## Challenges

One of the challenges of answering the question "What are we doing about ERM?" is understanding what is meant by the term ERM. Because it has been discussed in some circles for at least 15 years yet not widely implemented, there is confusion about what the concept is.

"ERM is still in the early stages of development in many organizations, although there are increasing signs of maturity," according to "Risky Business," a report from APQC.[1] ERM's relative infancy is shown by the fact that only 17 percent of the organizations participating in the APQC's recent study had established ERM more than five years ago.

To respond appropriately to the ERM question, it helps to understand why board members are asking the question, and why now. What is their concept of ERM? What are their principal concerns?

For example, is the question being asked out of a fear the organization is not complying with legal rules and regulations? Or from a more mature perspective that ERM is about managing risks from an integrated perspective, so that it can generate a competitive advantage?

Executive management may be frustrated by the question because managers believe they have risks under control. They may not want to allocate more resources for ERM, seeing it as another compliance effort, yet they feel pressure from the board to respond.

The challenge is to take the board's questions — or a mandate — and create an ERM plan that leverages what organizations are already doing and integrates it into a cohesive and strategically focused process.

Some managers may react quickly to the ERM question, but from a tactical rather than a strategic perspective. An internal audit director's understanding of ERM, for example, is likely to be much more detailed than a board member's concept.

Some internal audit directors make the mistake of diving deep immediately after being asked, "What are we doing about ERM?" In their zeal to respond, they strive for *Sarbanes-Oxley Act* thoroughness in cataloguing all risks in the organization, and then prioritizing and quantifying them.

Although this approach is understandable, it is not the kind of high-level answer a board member is seeking or appropriate, in most cases, given the lack of ERM knowledge and maturity in many organizations.

[1] "Risky Business: Employing Enterprise Risk Management to Sustain Growth, Mitigate Threats, and Maximize Shareholder Value," APQC, 2007, page 1.

# Solutions

If your organization is in the early phases of ERM, start with a strategy and visioning process. At this stage, knowing which questions to ask is more valuable than any other activity.

Here are some questions to guide your organization in getting started on the ERM journey.

***What is ERM going to look like in our organization?***

Having an open dialogue with board members is a good starting point. It helps to bridge gaps between different perceptions of ERM. Productive conversations can determine if the ERM concept is well-understood, along with the perceived value for your organization.

Although the following suggestion may sound overly basic, it cannot hurt to discuss key concepts, such as risk management and ERM. These terms are used frequently but interpretations vary.

Risk management to many people means insurance, but it is of course a much broader concept. Risks can be categorized as strategic, operational, compliance, and reporting. ERM enables organizations to identify and manage all significant risks in an integrated way. ERM can help avert surprises, reduce volatility, and aid an organization in achieving its business objectives.

Some organizations are committed to obtaining strategic advantage from ERM, whereas others will merely go through the motions to achieve the minimum expected. A dialogue will help assess the level of understanding and reach consensus on the value to be gained from ERM.

***How deep do we go on the first iteration?***

Rather than striving for perfection on the first round, it is important to simply get started. A practical approach reduces the chances of failure or spending too much on a "big bang" initiative with a long time horizon.

Communication with the board will help you reach consensus on how deep to go on the first iteration, and how to "rightsize" the effort in the earliest stage to help ERM take root successfully and grow into a more mature process.

A considerable amount of momentum can be gained by taking stock of what is being done and managing it under one umbrella. Many organizations are already doing a considerable amount of risk management, but there is a lack of integration and central coordination.

***Who is going to be on the team?***

ERM covers the entire organization, through all functions and all levels, and thus needs high-level sponsorship. It is essential to establish a hierarchy with multiple levels of coordination and feedback mechanisms to improve enterprisewide reporting of risks.

- **ERM Steering Committee:** This high-level oversight council has a clear idea of the strategic nature of ERM, which needs to be designed with the broad range of stakeholder concerns in mind. Strong support from the C-suite is essential, not only for the launch but through successive iterations. High-level executives who would be useful serving on this committee include the chief financial officer, general counsel, chief operating officer, chief risk officer, chief information officer, and internal audit director. (Titles vary, of course, by organization.) The steering committee keeps a sharp focus on obtaining value from the sustained effort.

- **ERM Core Team:** This group supports the ERM infrastructure and the ongoing ERM program. The core team, which drives the ongoing ERM process, needs knowledge of various business operations beyond finance, along with the skills to conduct objective risk assessments. Creating an ERM project charter will help establish objectives and guide the core team's efforts.
- **ERM Alliance:** This broad group includes representatives from the line, from business units, and from various risk management functions. Members of this alliance will "live and breathe" ERM, be closely involved in monitoring risks in their specific areas, and report back to the core team. Of the three groups, the alliance has the broadest representation.

Although ERM is an ongoing process, the core team should early on in the process identify some key risk process gaps with clear benefits. Holding a productive brainstorming session to determine the organization's top 10 risks, for example, can determine which of those risks are not being effectively managed. Making plans to bridge the gaps and obtain some quick wins on key risks in the first year will demonstrate progress and build momentum for successive ERM iterations.

***How can we embed risk management in existing processes?***

Building ERM from the ground up is an expensive proposition, and it makes sense to take processes that already work, strengthen them, and link them. Leverage the activities that already exist, identify the gaps, and allocate incremental funds to close these gaps.

Rather than creating all new processes, consider strengthening certain functions in your organization — in effect, injecting risk management processes into existing activities. Some areas to consider are strategic planning, product development, business planning, project management, and process redesign.

As companies re-engineer processes, for example, to do more with less, the initiative sponsors would be wise to consider possible adverse consequences. Staff reductions in process redesigns can damage customer service, possibly leading to reduced revenue.

Some organizations choose to pilot ERM in a particular business unit or a key process before broadening the implementation. A global apparel manufacturer, for example, decided to embed risk management thinking into its new procurement process.

Select a process or a business unit where the pilot is likely to succeed, and then you will undoubtedly produce more risk management champions who can educate others in the organization.

In addition to embedding risk management into key processes, organizations with a high number of separate compliance and risk functions have an opportunity to consolidate processes. As the regulatory climate has heated up in recent years, some organizations have a complex conglomeration of compliance activities.

Taking a fresh look at creating an enterprisewide compliance management system might yield ways to improve processes and reduce costs. The savings could be channeled to finance part of the ERM implementation costs in later iterations.

***How do we evolve ERM over time?***

Many senior executives and managers have an intuitive understanding of risk management. It is important, however, to create a formal, consistent process throughout the organization that helps people in the line and business units understand how to react and respond appropriately to risks.

Risk management needs to become part of virtually every existing process. The point is to make sure your employees have the tools and the training they need to monitor and manage risks, and know how to respond and report back. The ERM core team can provide and promote consistent processes and a methodology to guide people at varying levels of the organization.

Having consistent processes throughout the organization allows comparisons of risks. As risks are aggregated, the behaviors of pooled risks become more predictable.

The benefits of ERM start to emerge through better integration, which enables the board and senior executives to gain greater transparency into risk across the enterprise. In organizations where ERM is a mature process, the board and senior executives become more confident about managing risks and are able to take on additional opportunities in their overall portfolio of risks.

Directors want answers, but given that ERM is not accomplished overnight, board members are likely to appreciate high-level analysis and a road map for moving ahead.

You can discuss how and when the ERM journey will begin, and describe plans to identify key risks, process gaps, and methods to close gaps. You can also define ongoing monitoring and communication efforts, and how the risk assessment process will be updated since new risks emerge as the business environment changes.

Providing an overview enables directors to see what is currently being done in your organization, the gaps that need to be closed, and the oversight roles that the board can play to strengthen the ERM process and fulfill its corporate governance responsibilities.

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NA7014C1/PUB7361