# How Enterprise Risk Management Increases Value for Your Organization

*By Lawrence Burke, CPA*

"No one thought risk management was important," BlackRock CEO Laurence Fink told *BusinessWeek* magazine in late January. "(Throughout) the history of BlackRock, we've said risk management was important." Shares of BlackRock, a $1.4-trillion money manager, were up 36 percent since the start of 2007, compared with a nearly flat showing for Goldman Sachs and a 25-percent loss for the average financial company in the Standard and Poor's (S&P) 500 stock index.

As the convergence of strategy and managing risk and compliance across the enterprise are being viewed as competitive differentiators, risk management and internal controls are becoming more important to all types of organizations. In BlackRock's case, the ability to identify and effectively manage risks through better strategy and strong internal controls resulted in far greater profitability than that of its competitors. Conversely, both Merrill Lynch and Citigroup were less successful in managing these same industry risks, incurring billions of dollars in losses as well as the replacement of senior-level executives, including the CEO.

Although BlackRock, Citigroup and Merrill Lynch are large, high-profile, global companies, all organizations continue to grapple with the business complexities and related risks of an increasingly regulated and globally integrated operating environment. As a result of this struggle, organizations increasingly are emphasizing the need for a strong internal control environment, which is able to effectively identify and manage risks across the enterprise.

Understanding and identifying risks are typically the first steps organizations take in developing a risk management strategy. Although the term "risk" can have many different meanings, it generally can be defined as any event that unfavorably affects an organization's ability to meet its objectives. Conversely, an "opportunity" is a risk that an event will positively affect the achievement of objectives.

Keep in mind that managing risk has been an evolutionary process. It has been viewed as the boundary between modern times and the past, with the notion that the future is more than a whim of the gods and that men and women are not passive before nature. In fact, the ability to define what may happen in the future and to choose among alternatives lies at the heart of contemporary societies. Risk management guides us over a vast range of decision-making, from allocating wealth to safeguarding public health.

Concurrently, and perhaps as a result of the evolution of understanding and managing risk, modern business also has become much more complex and integrated into the global economy. For example, in 1848, John Jacob Astor was America's richest man, leaving a fortune equivalent to $110 billion in today's dollars, earned mainly from real estate and fur trading. Even with all that wealth, Astor's business was mostly a one-man show where he employed only a handful of workers, most of them clerks. This was typical of that time when the small partnership and independent merchant ruled the economy.

In today's digital age, mega-billionaires like Bill Gates and Warren Buffet oversee organizations with a global reach and that operate on almost every continent and employ thousands. In addition, company valuations are significantly affected by the increase in globalization and the rise of innovation and intangible assets. Perhaps the most recognizable example is Google, which has a book value of less than $23 billion but an enterprise value, depending on the day, of approximately $140 billion. Globalization, increasingly complex and rigorous legal and compliance requirements, greater reliance on third parties, increasingly complex business transactions and growing discrepancies between companies' book value and market value all contribute to management's desire for organizations to have stronger risk management practices and internal controls.

In addition, those charged with corporate governance as well as executive management for publicly traded organizations face increased expectations to ensure that risks are being identified and managed. For example, the New York Stock Exchange Listing Standards include a requirement, as part of the audit committee's duties and responsibilities, to discuss policies with respect to risk assessment and risk management with management on a periodic basis. The Securities and Exchange Commission also requires filers to list all relevant risk factors in certain of their regulatory filings. Even the ratings agencies are more focused on enterprise risk management (ERM) practices, with Standard & Poor's recently issuing a document seeking public comment, which discussed the use of ERM in the credit ratings analysis process for nonfinancial companies.

The good news is that many organizations already actively manage risk. However, it is often done in a silo. For example, finance risks are managed by the finance department and operational risks are managed by the operations department, but there is a lack of integration across the organization. Although siloed risk management practices are commonplace, there is a cost to this approach, as departments are overburdened with responding to multitudes of risk, compliance and control requirements. Process owners can suffer from assessment fatigue, overlapping efforts, gaps and inconsistent prioritization in risk activities, and uncoordinated responses to risks, resulting in losses to the organization.

For example, in 2002, Ford Motor Company reported a significant loss due to uncoordinated risk mitigation strategies. It seems that one part of the auto giant had attempted to corner the market on a key element needed to produce their vehicles by buying a large quantity of palladium. The price was roughly $1,500 per ounce. At the very same time, Ford's research labs did a magnificent job of reducing its dependence on palladium. Soon after, the price of palladium dropped to $400 per ounce, and Ford incurred a billion-dollar loss as a result of its inventory revaluation.

By formalizing the risk management process across the entire enterprise, those charged with governance can help ensure that both the organization's strategy and risk management practices are better aligned, increasing value to the organization's stakeholders. ERM should address all risks facing the organization and is designed to routinely identify these risks, assess the impact of the risks consistently across the organization and manage risk within the organization's risk appetite.

In 2004, the Committee of Sponsoring Organizations (COSO) (www.coso.org) of the Treadway Commission published "Enterprise Risk Management – Integrated Framework," which is designed to provide a robust framework for organizations to effectively identify, assess and manage risk across the organization. The COSO ERM framework provides key principles and concepts, a common language, clear direction and guidance. The framework can be leveraged to facilitate an ERM process for all types of organizations, be they profit, not-for-profit or governmental.

Most public companies are familiar with COSO and its "Internal Control – Integrated Framework," which is the most popular framework for assessing financial reporting risks under Sarbanes-Oxley (SOX). The ERM framework expands upon the "Internal Control – Integrated Framework" by providing a more robust and extensive focus on risks outside of financial reporting. For public companies that already comply with SOX and are familiar with the "Internal Control-Integrated Framework," adopting the ERM framework is often viewed as the next logical step after Section 404 compliance.

Emmett Lange, a principal with Sunera LLC, an international governance, risk and compliance firm, noted that although the ERM framework and definitions may be viewed as providing a lofty vision of how to manage risk in a perfect world, most organizations' risk management goals are much more practical. Initial goals for any organization adopting ERM should include:

- Aligning risk with overall strategy;
- Enhancing risk awareness;
- Minimizing surprises and chance for a catastrophic loss;
- Ensuring regulatory compliance and
- Assuring better discipline for capital allocation.

Ultimately, by achieving these goals and fully integrating ERM into its overall strategy, an organization will achieve its objective of providing increased value for its stakeholders.

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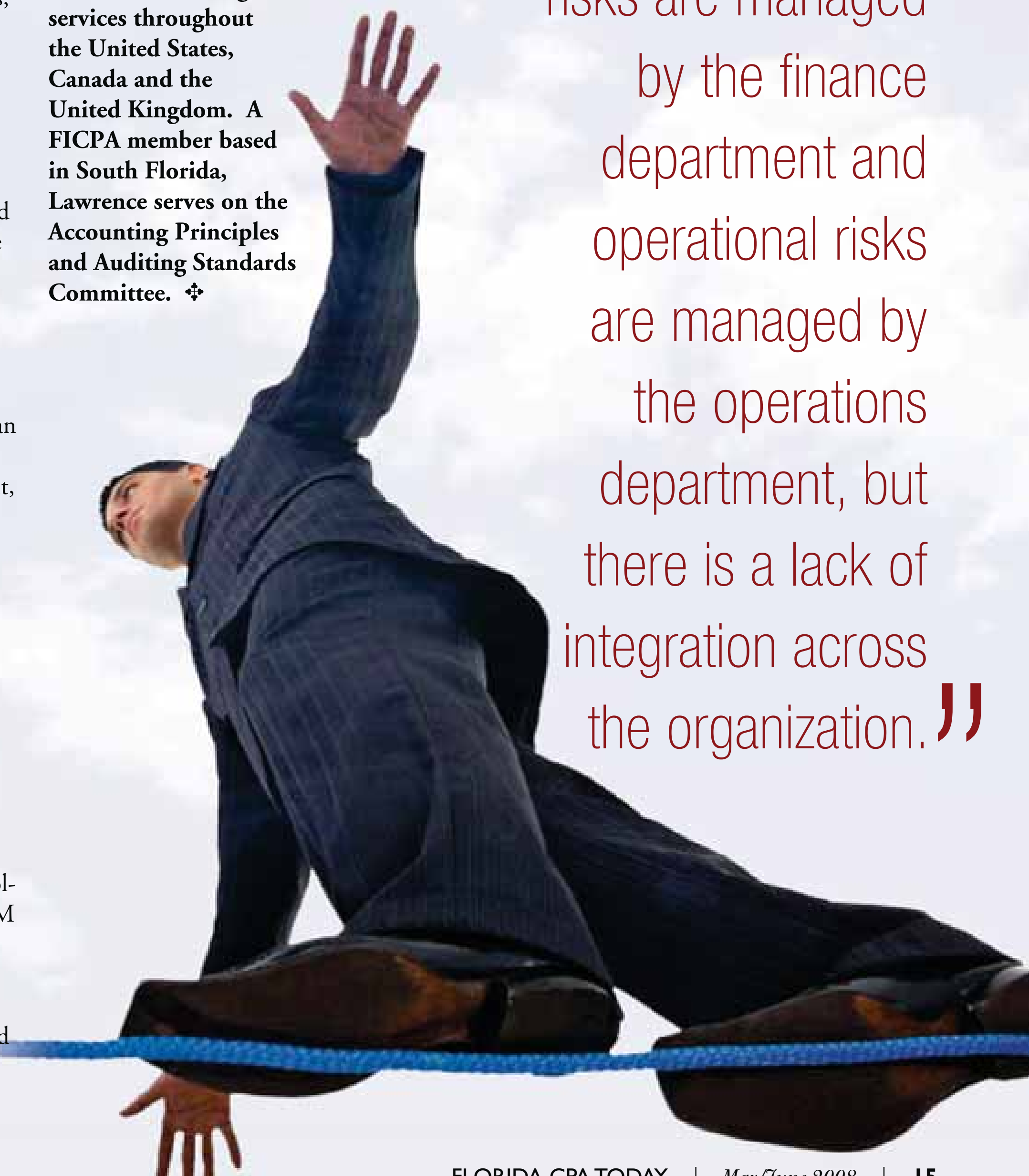

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