Enterprise Risk Assessment

Introducing the Concepts, Identifying the Benefits & Developing a Roadmap to Excellence.

Jonathan S Gorman, CPA, ABV, CFF, CGMA, CFE
Florida Accounting & Litigation Services (USA)

PRESENTATION GOALS:

- Discuss the Importance of Managing Risk and an Enterprise Risk Management System
- Introduce COSO's "*Enterprise Risk Management – Aligning Risk with Strategy & Performance*" the *proposed update to the Integrated Framework made available for Public Exposure on June 15, 2016.*
- Discuss why Enterprise Risk Management should be integrated into an Entities Corporate Governance Policies and Procedures.
- Review AON's Risk Maturity Index – an online assessment tool and associated reports available for ERM Benchmarking.

The Importance of Managing Risk

- Every choice we make in life is based on a trade-off of risk and reward;
- Individuals long for binary choices – and studies have shown that introducing more "bad" choices to an existing set can make the choice seem even more complicated ;
- Organization stakeholders (shareholders, lenders, employees, customers, critics…) have more access to information and have become more critical in analyzing management's 'after-the-fact' decisions;

The Importance of Managing Risk

- There is no politician or technology that can slow the pace of global volatility, complexity and ambiguity – Organizations must be more adaptive to change.
- Regulatory Agencies and Lenders have seen the benefits of effective ERM policies and certain aspects of ERM are finding their way into regulations and debt covenants.

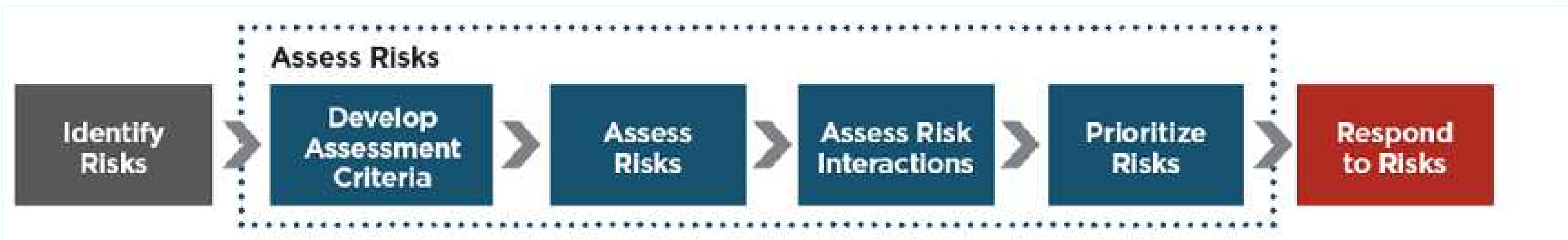
The Brief History of Enterprise Risk Management

- Committee of Sponsoring Organizations (COSO) was founded in 1985 by five United-States based financial & accounting organizations, and originally chaired by James C. Treadway (former Commissioner of the SEC).

- COSO's goal is to provide though leadership with three interrelated subjects:
  - Enterprise Risk Management;
  - Internal Controls;
  - Fraud Deterrence.

The Original Enterprise Risk Management Framework

- In 2004, COSO issued the seminal document on ERM - "*Enterprise Risk Management – Integrated Framework*"
  - The framework is internationally recognized as a proven roadmap to manage uncertainty and increase shareholder value;
  - Documented a set of comprehensive best practices for process development and Strategic Integration for Risk Management



  - Since publication, risk complexity has evolved, and the original framework has been enhanced and improved by academics, consultants and leading corporations.
  - While the overwhelming majority of the ERM Framework continues to be relevant to-date, *in 2014, COSO announced a project to review and update the Integrated Framework*

The NEW Enterprise Risk Management Framework

- On *June 15, 2016* COSO and PwC announced the publication for public exposure of "*Enterprise Risk Management – Aligning Risk with Strategy & Performance*
    - *Provides greater insight into the role of enterprise risk management when setting and executing strategy.*
    - Enhances alignment between performance and enterprise risk management.
    - Accommodates expectations for governance and oversight.
    - Recognizes the globalization of markets and operations and the need to apply a common, albeit tailored, approach across geographies.

The NEW Enterprise Risk Management Framework

- On ***June 15, 2016*** COSO and PwC announced the publication for public exposure of "*Enterprise Risk Management – Aligning Risk with Strategy & Performance*

  - Presents new ways to view risk to setting and achieving objectives in the context of greater business complexity.
  - Expands reporting to address expectations for greater stakeholder transparency.
  - Accommodates evolving technologies and the growth of data analytics in supporting decision-making.

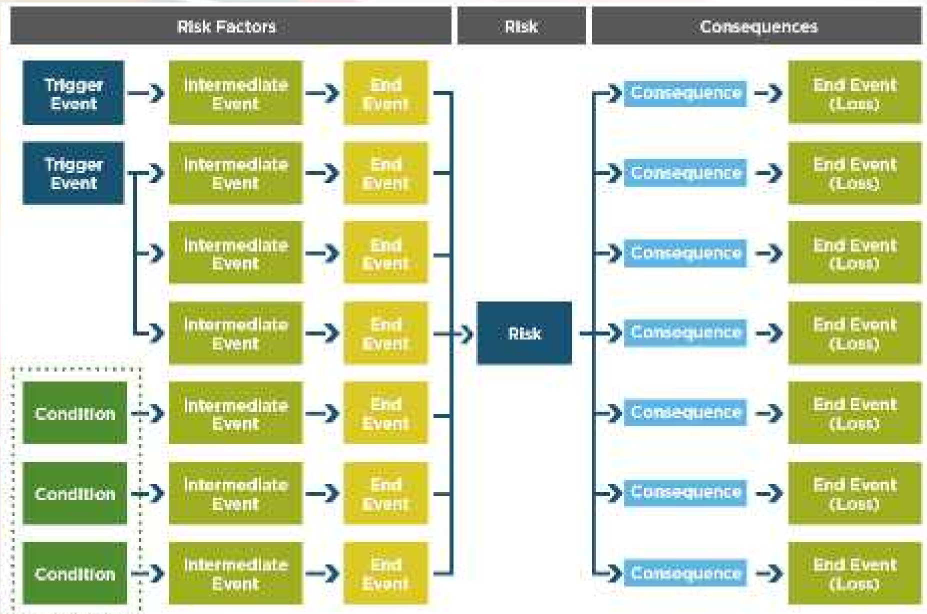
Key Changes from the Original Framework

- Adopts a components and principles structure
- Simplifies the definition of enterprise risk management
- Emphasizes the relationship between risk and value
- Renews the focus on the integration of enterprise risk management
- Examines the role of culture
- Elevates the discussion of strategy
- Enhances the alignment between performance and enterprise risk management
- Links enterprise risk management and internal controls
- Delineates between enterprise risk management and internal controls
- Refines risk appetite and acceptable variation in performance (risk tolerance).

Key Remnants from the Original Framework

- ***Application Techniques***, including many of the examples & illustrations of enterprise risk management components

Risk	Supply Chain Disruption	Customer Preference Shift	Copper Price Increase >25%	Work Stoppage >1 Week	Economic Downturn	Supplier Consolidation	Local Competitor Enters Market	New Substitutes Available	Cost of Capital Increase >5%	Tighter Emission Standards	FCPA Violation	Exchange Rate Fluctuations
Supply Chain Disruption			×	×	×	×	×					
Customer Preference Shift					×		×	×		×		×
Copper Price Increase >25%	×				×	×						×
Work Stoppage >1 Week	×				×	×					×	
Economic Downturn	×	×	×	×		×	×	×	×		×	×
Supplier Consolidation	×		×	×	×				×			
Local Competitor Enters Market	×	×			×							×
New Substitutes Available		×			×					×		
Cost of Capital Increase >5%					×	×						×
Tighter Emission Standards		×						×				
FCPA Violation				×	×							
Exchange Rate Fluctuations		×	×		×		×		×			



- The 2013 COSO document, "***Internal Control – Integrated Framework***" is neither replaced or superseded.
  - The revised framework focuses on the importance of delineating internal control and enterprise risk management initiatives (i.e. not putting ERM solely in the hands of the auditors).

The New Framework Summarized

The Five Components of Risk Management

1. Risk Governance and Culture

   Risk Governance is part of the organization's operating structure, performance reviews, compensation plans and strategy sessions.

2. Risk, Strategy and Objective Setting

   Leadership determines risk tolerances and align with strategy. Business objectives are in coherence with risk assessment.

3. Risk in Execution

   Risks to execution must be prioritized and assessed.   Risks are prioritized by severity and risk responses are selected.

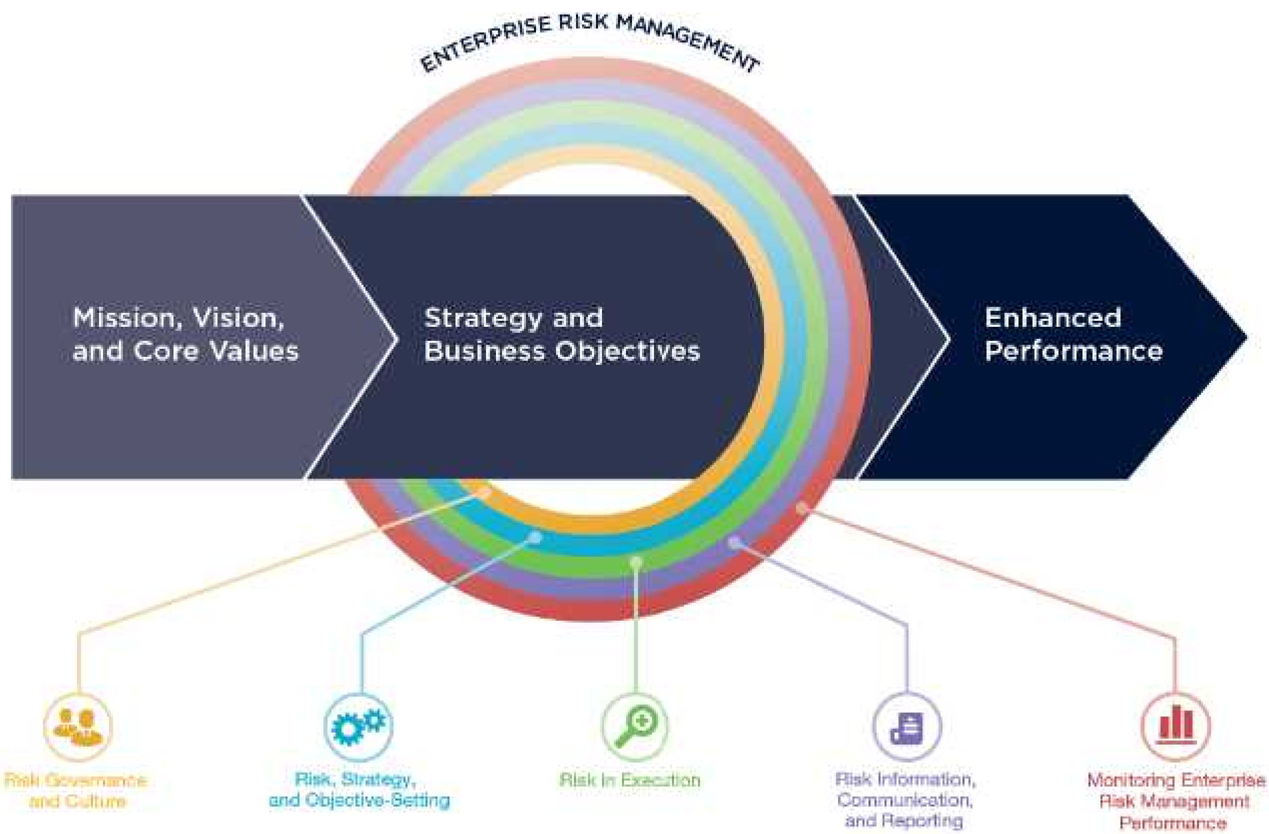
4. Risk Information, Communication and Reporting

   Transparent communication flowing in all directions, from internal and external sources with sufficient accountability

5. Monitoring Enterprise Risk Management Performance

   Measuring the effectiveness of risk management components and Key Risk Indicators (KRIs).

The 23 Detailed Segments of the Framework



1. Exercises Board Risk Oversight
2. Establishes Governance and Operating Model
3. Defines Desired Organizational Behaviors
4. Demonstrates Commitment to Integrity and Ethics
5. Enforces Accountability
6. Attracts, Develops, and Retains Talented Individuals

7. Considers Risk and Business Context
8. Defines Risk Appetite
9. Evaluates Alternative Strategies
10. Considers Risk while Establishing Business Objectives
11. Defines Acceptable Variation in Performance

12. Identifies Risk in Execution
13. Assesses Severity of Risk
14. Prioritizes Risks
15. Identifies and Selects Risk Responses
16. Assesses Risk in Execution
17. Develops Portfolio View

18. Uses Relevant Information
19. Leverages Information Systems
20. Communicates Risk Information
21. Reports on Risk, Culture, and Performance

22. Monitors Substantial Change
23. Monitors Enterprise Risk Management

The Importance of Aligning Strategy

Enterprise Risk Management starts at the top of the enterprise with an assessment of the Mission, Vision and Core Values of the enterprise.

Mission: To improve the health of the people we serve by providing high-quality care, a comprehensive range of services, and convenient and timely access with exceptional patient service and compassion.

Vision: Our hospital will be the healthcare provider of choice for physicians and patients, and be known for providing unparalleled quality, delivering celebrated service, and being a terrific place to practice medicine.

Core Values: Our values serve as the foundation for everything we think, say, and do. We will treat our physicians, patients, and our colleagues with respect, honesty, compassion, and accountability.

The Enterprise Risk Assessment Process

Based on the Mission, Vision and Core Values, leadership can start to develop a coherent strategy document.

Our Strategy:

- Maximize value for our patients by improving quality across a diverse spectrum of services
- Curtail trends in increasing costs.
- Integrate operating efficiency and cost-management initiatives.
- Align physicians and clinical integration.
- Leverage clinical program innovation.
- Grow strategic partnerships.
- Manage patient service delivery, and reduce wait times where practical.

Enterprise risk management does not create the entity's strategy, it informs the organization on risks associated with alternative strategies considered and, ultimately, with the adopted strategy.

The organization needs to evaluate how the chosen strategy could affect the entity's risk profile, specifically the types and amount of risk the organization is potentially faces

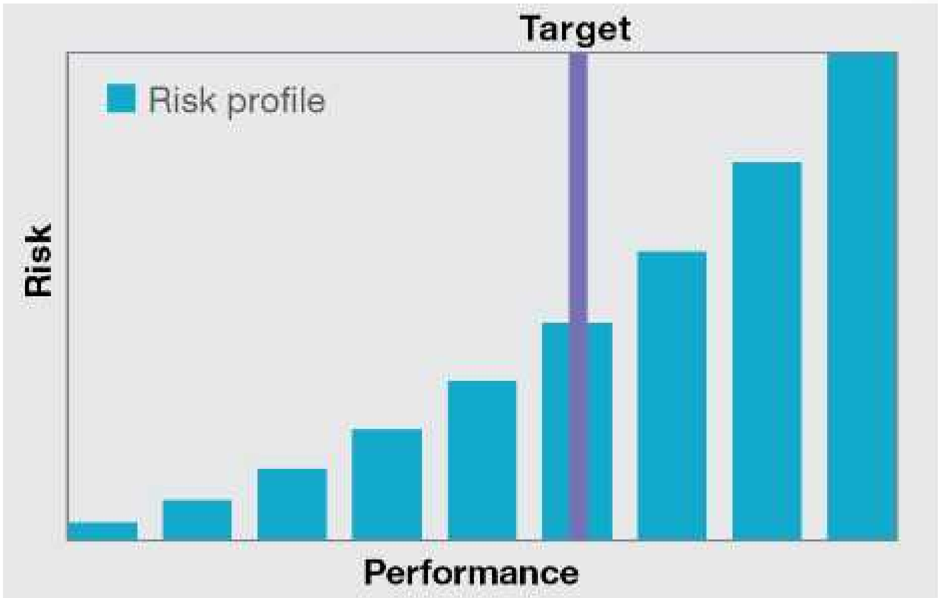
Understanding the Risk Profile

An entity's risk profile provides a composite view of the risk at a particular level of the entity or aspect of the business model.

This composite view allows management to consider the type, severity, and interdependencies of risks, and how they may affect performance relative to strategy and business objectives.

In the graph to the right, each bar represents the risk profile for a specific point of performance.

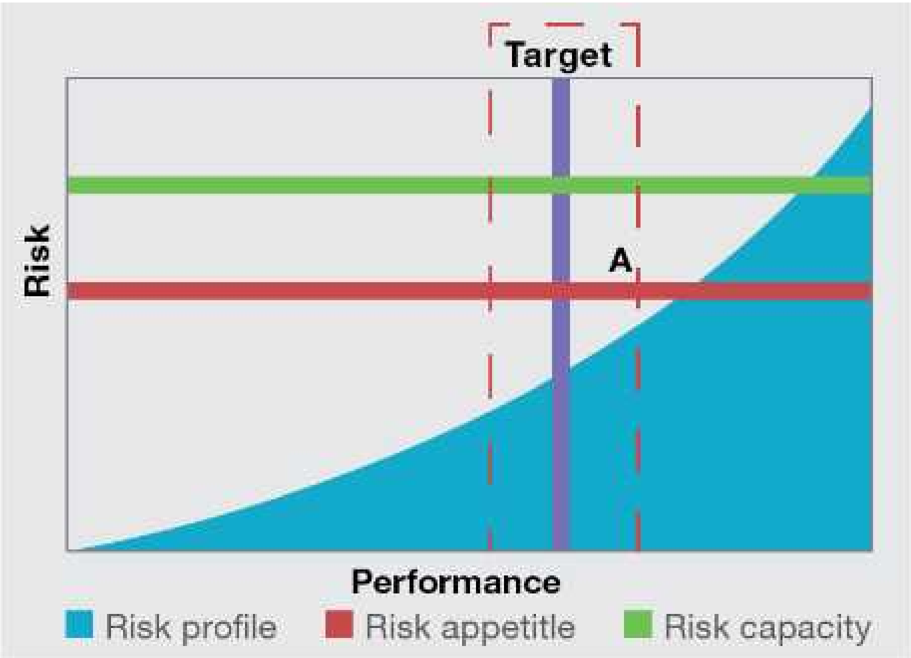
The vertical target line depicts the level of performance chosen by the organization as part of strategy-setting, which is communicated through a business objective and target.



Integrating Risk 'Appetite' and Capacity

Risk Appetite and Risk Capacity are discussed in great detail in the Framework – but simplistically Risk Capacity is the management's highest risk tolerance and risk appetite is management's level of relative comfort.

Having an understanding of acceptable variation in performance and risk enables management to enhance value to the entity. .



The right boundary of acceptable variation should generally not exceed the point where the risk profile intersects risk appetite.

Where the right boundary is below risk appetite, management may be able to shift its targets and still be within its overall risk appetite.

The optimal point is where the right boundary of acceptable variation in performance intersects with risk appetite

ERM and Corporate Governance

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders.

Corporate governance also provides the structure through which the objectives of the company are set, the means of attaining those objectives and the methods for monitoring performance…" ;

Effective ERM should be integrated into Corporate Governance as part of the organizations structure, means and a method to monitor performance.

Corporate Governance is *a set of relationships*

an integrated Enterprise Risk Management system

the means of attaining those objectives

the methods for monitoring performance

the structure through which the objectives of the company are set

Great Companies have Great Governance!

Aon Risk Maturity Index

Insight Report, November 2015

Risk. Reinsurance. Human Resources.

Empower Results®

The Aon Risk Maturity Index is a metric that can be calculated online - based on a questionnaire on risk management processes, corporate governance and risk understanding.

Access to the questionnaire as well as recent reports can be found at: www.aon.com/rmi/

Questions align with the Aon's 10 characteristics of risk maturity:

1. Board Understanding & Commitment to Risk Management
2. Executive Level Risk Management Stewardship
3. Risk Communication
4. Risk Culture: Engagement & Accountability
5. Risk Identification
6. Stakeholder Participation in Risk Management
7. Risk Information & Decision Making Processes
8. Integrating Risk Management & Human Capital Processes
9. Risk Analysis & Quantification to Understand Risk & Demonstrate Value
10. Risk Management Focus on Value Creation

The Relationship between Risk Management and Stock Price Performance and Volatility

For two out of the past three years our research found significant correlations between risk maturity and superior stock price performance for publically traded organizations. In the most recent prior research period, June 2013 – June 2014, for the first time our researchers noticed an absence of the stock price correlation. At the time we hypothesized that the optimistic sentiment of a bull equity market during this particular period could have more of an equalizing effect on stock prices.

Graph One: Share Price Performance 2015

During the period June 2014 – June 2015, our researchers once again found significant correlations between risk maturity and stock price performance. Why are we seeing this correlation again in 2015? It is most likely a result of the general transition away from the bull equity market environment of 2014 and the heightened market volatility, those organizations with advanced risk management practices are better able to demonstrate advanced risk management capabilities and have them reflected in the market's perception of those organizations.

* The Risk Maturity Index is scored on a scale of 1 – 5, with a rating of 1 defined as Initial and a rating of 5 defined as Advanced.

Top 'Risks' Identified by C-Suite & Risk Managers

PRESENTATION REVIEW

- Managing Risk and an Enterprise Risk Management System
- Download "*Enterprise Risk Management – Aligning Risk with Strategy & Performance*" at

  http://erm.coso.org/Pages/viewexposuredraft.aspx

- Integrating Enterprise Risk Management into Corporate Governance Policies and Procedures.
- AON's Risk Maturity Index online assessment tool and associated reports for ERM Benchmarking at

  http://www.aon.com/rmi/