

Good Risk Management is Good Governance

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Events of the past decade—including the collapses of high-profile companies, economic volatility, and growing regulations and guidelines—have placed boards under greater scrutiny from regulators, shareholders, the media, and analysts. Such scrutiny has led to rising expectations for improved governance and risk management. In the current business environment where increased competition and globalisation are creating ever increasing pressures on costs, margins and transparency, any organisation which manages to strike an effective balance in its strategic planning process would have a competitive advantage.

Risk governance is a fundamental business practice that organizations must get right. It sets the framework to navigate uncertainty in the environment in which they operate. Stakeholders value organizations that demonstrate a strong commitment to establishing and disclosing robust risk governance practices that proactively manage risks before they occur and respond effectively to risks after they occur.

Risk Management is a term used to describe the processes which aims to assist organizations understand, evaluate and take action on their risks with a view to increasing the probability of their success and reducing the likelihood of failure. Risk management requires a detailed knowledge and understanding of the organization and the processes involved in the business.

Risk = Degree of Uncertainty as to the potential for Gain as well as exposure to loss.

Risk includes all events that impact performance either positively or negatively. Risk is inherent in every organization. Risk must be continuously managed to achieve organizational objectives.

Good corporate governance requires that the board of directors maintain a sound system of internal control to safeguard shareholders' investment and the company's assets. In meeting this requirement, principal risks faced by the organisation need to be identified and thereafter,

mitigated through an appropriate system of internal control

Corporate governance is all about running a business efficiently where risks and rewards are adequately balanced so that shareholders get an adequate return from their investments reflective of the underlying risks. It is also about directors' stewardship and their accountability to shareholders in terms of maintaining and enhancing shareholders' value. Effective risk management is an essential component of this equation

A good process of governance requires more than just focus on compliance with laws and regulations. Good governance requires:

- Establishing a culture based on sound business practices and ethics
- Strong emphasis on performance management
- Ensuring that management has adequate knowledge of risks the business is exposed to
- Implementing an adequate process to manage and monitor risks
- Ensuring timely information to the Board when things go wrong

Risk Management Compliance requirements under the Companies Act and Listing Agreement:

Section 134: The board of director's report must include a statement indicating development and implementation of a risk management policy for the company including identification of elements of risk, if any, which in the opinion of the board may threaten the existence of the company

Section 177: The audit committee shall act in accordance with the terms of reference specified in writing by the board, which shall, inter alia, include evaluation of risk management systems

Schedule IV: Independent directors should satisfy themselves that systems of risk management are robust and defensible

Clause 49 of the Listing Agreement: The Company through its Board of Directors shall constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

Stages of Risk Management

Risk Assessment: When developing corporate strategy it is important that the Board or senior executives know and understand the main risk factors, are able to analyze risk, and understand the threats and opportunities involved. The first step in risk management is listing out all of the risks that a firm is potentially exposed to and categorizing these risks into groups; this list is called risk library.

Risk Grouping: A risk profile lists every risk that a firm is exposed to but not all risks are equal in terms of likely occurrence and impact and It makes sense to break risks down into different groups viz. Operations, Market, Process, Legal & Compliance, Strategic, Financial, assets, information & knowledge

Risk Prioritization: The various risks may be further risk rated and prioritized on the basis of inherent risk being Critical, High, Moderate, and Low

Risk Mitigation Plan Effectiveness (MPE): A matrix of risk prioritization and mitigation plan effectiveness in terms of Ineffective, Effective, Highly Effective helps in assessing and short listing the risks needing considered and regular management attention

Risk Management Strategy: A strategy is developed to manage each critically prioritized risk through analysis of root causes and the decided mitigation plan with identification of primary process owner and the timelines for implementation

Risk Management Disclosure: The Annual Report should include information on risk management procedures,

which will enhance corporate credibility for shareholders, creditors and other stakeholders.

Board Risk Oversight

“Risk oversight” describes the role of the board of directors in the risk management process. The risk oversight process is the means by which the board determines that the company has in place a robust process for identifying, prioritizing, sourcing, managing and monitoring its critical risks and that that process is improved continuously as the business environment changes.

Components of the board’s risk oversight role:

- Ensure that a Risk governance structure is in place
- Oversight and monitoring of risk management processes
- Collaboration with the CEO and executive team to understand and oversee critical risks

What questions should Directors be asking?

For directors to effectively discharge their responsibilities in relation to risk management and internal controls they should begin by understanding and challenging what is currently in place. The following important questions focus on getting basic risk governance right:

- What are the significant risks facing the organization? How often do we review/discuss these risks at Board level?
- What is the risk management and internal control system in place to manage the key risks? Has this been independently reviewed?
- What is the risk culture of the company? Does it allow risks and control deficiencies to be raised freely?
- What are the assurance mechanisms in place to check that the risk management and internal control system is adequate and effective?
- Does the internal audit plan link to the risk profile? Is the scope/coverage sufficient for the nature, size and complexity of the company?
- Is there a clearly defined process for aggregating/

escalating risks and control deficiencies within the organization?

- Is there enough information/evidence to support the Board's comments in the annual report regarding adequacy and effectiveness of risk management and internal control?

Research indicates six distinct actions that can help boards in their risk governance efforts and enable a Risk Intelligent governance approach:

1. Define the board's risk oversight role
2. Foster a Risk Intelligent culture
3. Understand and approve an appropriate risk appetite
4. Help management incorporate strategic risk thinking into strategy
5. Assess the "maturity" of the risk governance process
6. Make sure the organization discloses the risk story to stakeholders

What can boards do to help cultivate a Risk Intelligent culture?

- Build an environment in which employees are comfortable challenging others, including authority figures, and the people who are being challenged respond positively
- Establish "safe/free" zones for those reporting potential issues, problems, or concerns
- Provide the right "tone at the top" to promote ownership, accountability, transparency, and collaboration, and reinforce expectations for performance with integrity in all of its dealings with management
- Encourage management to create repeatable processes to assess and continuously improve the risk culture of the organization
- Reward people who focus on managing and mitigating risk by aligning incentive, reward, and performance systems with a focus on risk, compliance, and controls
- Support management in its commitment to enhance the risk culture through appropriate allocations in

resources and funding, focused risk management training programs, and distribution of risk culture surveys

The trends and forces that impact business—along with the attendant risks—can change in a heartbeat. That's why the role of the Risk Intelligent board is so important.

According to a survey by Centre for Business Studies and Training, response to "How does your organization's board discharge its risk oversight responsibilities?" was as follows:

- 21% Full Board
- 32% Audit Committee
- 25% Risk Committee
- 7% Other Committee
- 15% No Formal Oversight

Good risk management is more than getting sued and having adequate insurance policy in place. Effective risk management prepares an organization to weather literal and figurative storm and sets the course for accomplishing the organization's strategic plan. Best Practice is to have broad based ownership of risk management from top to bottom and throughout the organization. The focus should be on establishing roles and responsibilities so that every one considers risk in the day to day activities.

The future is here

Risk management is at its core a governance discipline, not an end but a means to the end, with the end being the accomplishment of the organization's mission. It must be embedded in the DNA of the organization. Effective risk management prepares an institution to weather business storms and sets the course for enhancing and sustaining stakeholder's value. Boards are most effective if they operate with a clear set of priorities and concentrate on strategic oversight. Risk management should be on every board's to-do list for oversight. Dynamic risk management is today a crucial factor in an organization's effective corporate governance strategy.

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