EFFECTIVE RISK MANAGEMENT FOR DIRECTORS

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In the current global financial crisis the March 2009 edition of *Company Director* devoted to *Making a Difference* is timely and in my opinion the enhancement of risk management skills is the critical area for directors who wish to make a difference. When appropriately applied risk management offers many cost effective benefits for directors by underpinning sound governance: effective decision-making; effective and efficient resource allocation; improved compliance; enhanced performance; organisational resilience; and competitive advantage. In summary, corporate governance is an organisation's strategic response to risk.

Risk management as a concept is profoundly misunderstood and misapplied not only in Australia but also internationally. Evidence for this comes from my professional consulting and research experience and the public commentary from many sources on the current global financial crisis. This misunderstanding arises from the failure to realise that the aim of risk management is not the management of risk *per* se but the achievement of objectives, *i.e.* risk is part of each objective. In contrast current enterprise risk management (ERM) practices focus on the risks with only tenuous linkages if any to objectives.

The management of risk is an uncomplicated process and is used in everyday life to achieve objectives. Examples include getting to work on time and safely, meeting appointments and deadlines, driving, crossing the road and so on. The processes of setting the objective, identifying and assessing the level of risk and developing strategies (risk treatments) to achieve the objective are intuitive and occur unconsciously as part of normal activities. The focus is on the objectives and the strategies to achieve them, not the risks. In contrast, organisations using ERM develop a separate, resource-hungry risk management framework focused on the risks with tenuous linkages if any to objectives and strategies. This ERM process unnecessarily duplicates the intuitive risk management activities in the standard business practices of planning and performance monitoring.

The linkage of risk management with objectives is reflected in the definition of risk as – *the effect of uncertainty on objectives* (International Standard on risk management ISO 31000 due for release in the second half of 2009).

A number of significant outcomes arise from this definition: the risk management process is integrated throughout the organisation with objectives; responsibility and resources for the management of risk can be clearly assigned thereby facilitating the assurance processes for accountability; capability and commitment for the management of risks are enhanced throughout the organisation; risk registers arranged by objectives transform risk information into knowledge; and resources used in duplicating the process as a separate compliance exercise can be redirected to more effective uses.

There are three additional concepts that enhance the value of risk management. The first is that by applying the risk management process to objectives risk treatments are at the same time controls providing reasonable assurance that the objectives will be reached, and strategies for achieving the objectives. It follows that the compilation and review of risk registers become part of the planning process and performance reviews against key performance indicators provide a real-time review of the effectiveness of the risk management system. The significant outcome from this linkage to objectives is that the risk management process is truly integrated into normal business practice.

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The second is that the concept of internal financial control ceased to be the overarching view of control more than a decade ago. The concept of control now covers all activities after the strategic direction has been set and it includes external as well as internal factors. My advice to directors is to seek advice that embraces this broader view of control and has clear linkages to objectives through the risk management process.

The third is the importance of internal audit in providing directors with independent, objective assurance over their company's control environment and therefore its risk management system. It is in a director's personal interest and in the interest of their company to ensure that its internal audit service has the skills to cover all of the company's activities not just internal and financial, is adequately resourced and that its program focuses on the areas of key business risk for the company. Oversight of the internal audit function is a critical audit committee responsibility.

A more detailed discussion of these concepts can be found in Standards Australia's HB254-2005 entitled *Governance, risk management and control assurance* and are available as downloads in my 2008 papers on the Publications page of www.Plumcon.com.au.

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