Managing Enterprise Risk: CFOs Look to Protect Businesses and Shareholders
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Introduction

The Phoenix Business Journal held its second in a series of quarterly public roundtable discussions featuring our inaugural CFO Advisory Board. About 100 people were on hand at Desert Botanical Garden to learn how our panelists, representing a cross section of Valley businesses and industries, tackle enterprise risk management for their companies and organizations.

Enterprise risk management is an industry term for how leaders prepare for and manage all possible risk factors that could affect their business, from internal controls and finances to strategic planning and management. By identifying and proactively addressing risks and opportunities, businesses protect themselves and create value for their stakeholders, including owners, employees and customers.

ERM is evolving to address the needs of various stakeholders who want to understand the broad spectrum of risks facing organizations to ensure they are appropriately managed. Recently, regulators and debt rating agencies have increased scrutiny of the risk management processes of companies.

The following are their responses to questions posed in advance of the event.

Question #1: What were the drivers or triggers at your organization to embark on the enterprise risk management journey?

ADELA JIMENEZ (Director of finance and administration, Arizona Society of CPAs): The simple fact of being in business elicits the need to have an enterprise risk management function. ERM is ongoing; it is embedded in the processes, decisions and actions we take throughout our organization on a day-to-day basis. We look at risk from the perspective of the probability or impact of the event and then align possible solutions. Our vision, mission, values and guiding principles incorporate the level of risk our organization is willing to tolerate. Risks also can provide opportunities that can enhance the value proposition of an organization. Over the past year, we have embarked on a project to offer webinars to our members. We took clues from our external environment, including our competitors and the fact that we know CPAs are busy, live all over Arizona and have a need for education that can be provided in short time periods without causing them to travel. Although in years past we saw this as a threat to our in-class offerings, we gathered a team to review, develop and implement this new teaching modality to our members.

Before implementing, we were careful to look at our strategic goals to ensure that this project was within its objectives. We then moved to identify existing operational constraints and addressed those constraints. Therefore, as a result of our ongoing ERM review, we currently offer free and fee-based webinars to our members as part of our value proposition, ensuring that we are not excluded from this market.

GREG NELSON (Vice president and CFO, World at Work) : A few years ago, the audit and finance committee of our board of directors requested information about how we viewed our business risks and what we have done to mitigate those risks. We quickly understood that the type of assessment we needed was much broader than just our insurance programs and backup processes for our computer

database. It opened our eyes to reviewing the many significant threats to “business as usual” and forced us to think about how we would react to a serious business threat.
Prior to this wider assessment, we had narrowly viewed risks and addressed those risks by developing a pandemic plan, employee call trees, a centralized vendor contact list and performing nightly IT system backups. Our new approach was a proactive assessment that involved developing action plans to respond to various situations.

BILL JUDGE (CFO, Kitchell Corp.) : One of our primary operating units is Kitchell Contractors Inc., a general building contractor. This industry is characterized by relatively low profit margins in a very high-risk environment.

To manage the risks we face, we made the decision in the early ’80s to join a captive insurer. Today we own a portion of that insurance company, which pools our risk with 41 other similarly sized and safety-focused construction companies. At the same time, we’re afforded group purchasing power for certain insurance coverages and a forum for information sharing.

Separately, we made the decision six years ago to form an internal legal department based on our growth and the ever-evolving types of risk we face as an organization. The decision to make that investment has repaid itself many times over.

Question #2: What have been the benefits of your ERM program?

JIMENEZ: The benefits are great in that each person at every level of the organization has the information on how to proceed when an issue arises. When an organization does its due diligence and really looks at every facet of their business, including strategic and operational activities, the process then helps minimize costs or losses, ensures timely and accurate reporting and helps avoid damage to the entity’s reputation.

NELSON: We are more comfortable that we have a viable plan in place or under development for the most significant business risks we identified. It caused us to think about how we could recover from the most likely “disasters” and “situations,” and how much time, data, revenue, etc., would be lost under various scenarios.

The idea was to assess how quickly we could get the company and our employees back to a productive, profitable level with minimal disruption and transacting business with our customers. It also caused us to look more closely at the safeguards we now have in place and to seek alternatives that would be more cost-effective and robust. For instance, we discovered that for less than what we were paying, we could replace the two data security and recovery firms we used with an off-site, real-time data storage site at our Washington location.

Finally, it has been a learning opportunity for our employees who were involved in the discussions.
Describe the communication plan used in launching ERM at your organization and the ongoing communication to board members, senior management and third parties about ERM.

MARY JANE RYND: (Executive vice president and CFO, Virginia G. Piper Charitable Trust): ERM is something we look at continually, responding to the changes in the environment. On a yearly basis, our staff develops new measurements in support of our strategic goals. These measurements are shared with the board of directors and, once approved, they are incorporated into our day-to-day activities.

Even though we update procedures as changes occur, we have chosen the month of February to review each one of our functions and activities to identify any new changes in the environment that would necessitate new procedures. These changes are then updated in our procedure manuals and shared with those who may be impacted by the changes.

TIM PROPP (CFO, Thunderbird School of Global Management): We first had a discussion with all of senior management to review the initial process for identifying risks and then assessing the level of concern and potential impact, as well as the existing or planned mitigation efforts. The audit and risk management committee of the board reviewed the process and provided input along the way.

Once the identification effort was completed, a risk review process was incorporated into a bi-monthly review of each business unit. In addition, each board committee monitors the current risk report for the risks assigned to it.

It is the responsibility of each committee to provide feedback to management and report their observations and concerns to the audit and risk management committee, which oversees the board monitoring process. The internal process also has provided an improved foundation for discussing risk factors with the external auditors.

Question #3: Has an ERM program been a competitive advantage?

JIMENEZ: Yes, it has. It has served as a valuable tool to understand our market and forced our organization to remain current and viable.

JUDGE: In our industries, I suppose you could say that if you don’t manage risk acceptably, you won’t have to worry about being competitive — because you won’t be in business. Yes, managing risk effectively requires the ability to drive costs out of the system in the long term, which results in our ability to bring the best value to our customers. If you don’t manage risk effectively, you incur costs that have to be passed on for your business to remain viable. Over the long run, you won’t be able to sustain that model.

Another area where managing risk will result in competitive advantage is in access to capital financing. Bankers and other lenders are particularly good at assessing the risk that is inherent within an organization. If they perceive your organization to be well-run, the availability and pricing of capital will reflect that and lead to competitive advantage.

Question #4: Describe the process used in determining your risk universe, risk tolerance level, risk metrics and monitoring processes.

JIMENEZ: Our risk universe involves every risk that could affect our organization. To put in place controls that could affect all of these risks would be unrealistic and cost-prohibitive. Therefore, we try to anticipate those that are more likely and that would have an immediate and damaging impact on our organization. We use our values to determine our risk tolerance and the monitoring process.
The leadership team then creates a strategic measurement plan that is presented to the board. Once approved, that is used to develop the action plan against each measurement. Each time the board of directors meets, this plan is shared and status updates are provided. We have found that stating the measurements and updating them on a monthly basis keeps the organization focused.

NELSON: The overall objective was to identify potential risks, analyze and prioritize those risks, create compensating controls, plan and schedule control activities, deploy, test and document outcomes. To do this, we assembled a small group of key managers to discuss the biggest risks to our business. We started with the premise that we should not initially get "bogged down" in solutions, but focus solely on the risks. It was amazing how many potential risks we identified. After we had narrowed the list to the top three or four most probable and serious threats, we discussed those risks and the safeguards we had in place. Determining appropriate risks to focus on involved discussions of the cost - benefit solutions to mitigate risk.

Finally, the meeting on enterprise risks forced us to take a critical look at the success and failures of the annual disaster recovery test performed by our information technology organization.

Question #5: Do you have a risk committee? Who is on it, and what are their roles?

JIMENEZ: Our organization does not have a specific committee, but our board of directors and leadership team play the role of risk assessment managers.

PROPP: The CFO's organization serves as the coordination point for the ERM process. Both the CEO and CFO attend bi-monthly business reviews of each business unit, where the current risk report is reviewed with the business unit head and their team.

The audit and risk management committee of the board oversees the board risk monitoring process and each board committee oversees management's assessment of the risks assigned to their committee.

Question #6: What lessons would you share with other organizations or executives as they undertake the ERM process?

JIMENEZ: Experience has shown that taking the opportunity in advance to identify potential risks can lead to reducing surprises and costs or losses. If an organization is committed to the process, it can serve as a great tool for the yearly planning cycle.

PROPP: Always begin with the end in mind, and have a clear vision of what you are trying to accomplish. The ERM process should contribute to improved business performance over time. Also, the process should be dynamic and eventually become part of the organization's culture.

NELSON: Forming a cross-functional team helped us to develop a broader perspective for identifying key risks. Our team consisted of individuals from several departments who understood our business well enough to contribute to the process.

Team members were most effective in defining risk in their own functional areas: IT had a focus of data backup and recovery plans, operations discussed logistical issues, employees from the product and marketing areas brought another perspective, etc.

As we brainstormed the areas of risk, we tried to keep the word "key" in our discussion. In the final analysis, we concluded that although we could not foresee every possible risk, we had developed a valid and substantial listing of the key risks we needed to address.

JUDGE: It's not a destination, but rather a process whereby risks have to be identified and then continually reassessed, ranking likelihood and severity. Aggravating and mitigating factors for each identified risk, as well as interrelationships between risks, also must be considered. Beyond that, decisions must be made on how to manage each risk, including deciding whether a risk can be transferred via insurance or other mechanisms, and who internally is responsible for each risk.

The other thing that comes to mind is the current economic environment, which in itself leads to heightened risks. You can see that in the sheer number of new lawsuits being filed each week. While decisions made today regarding risk may seem like the right answers in this economy, always keep in mind that these decisions may have to be paid for in the future.