Governance and Risk Management in the Public Sector

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Agenda

- Governance, why is it important?
- Compliance vis-à-vis Good Governance
- Why Enterprise Risk Management?
- Practical considerations in ERM implementation

Corporate Governance

Foundation and Dynamics of a Good Governance Process

- Honesty
- Competence
- Commitment
- Courage

Governance

- Good governance means to do what is correct. However, increase of citizens & stakeholders' satisfaction helps to justify its costs
- Good governance is a concept applicable to the public and corporate world alike
- Governance should be based on principles rather than on rules

Compliance vs. Governance

A good process of governance requires more than just focus on compliance with laws and regulations. A good governance that would resist the test of time, requires:

- Establish a culture based on adequate business practices and ethics
- Strong emphasis on results management
- Ensure that management and public servants have adequate knowledge of how to manage risks
- Implement an adequate process to manage and monitor risks

Interested Parties

- Public
- Stakeholders
- Employees
- Retirees
- Financiers

- Clients
- Suppliers
- Community
- Creditors

Why is it Important?

Comply with legal and fiduciary requirements
Accountability to the public and stakeholders

Other reasons:

- Attract and Retain Good People
- Fiscal Soundness & Public Trust
- Earn Community Support
- Competitive Advantages

Common Denominator of Lessons Resulting from the Ethical Collapses Experienced in the Last Few Years in the Corporate World:

1. Those employees who witnessed the events while they were taking place, did not find anyone to share their concerns with
2. Systemic failures
3. Undue emphasis on results without focusing on quality

What is Transparency?

Transparency means to provide all interested parties with as much relevant information as possible without compromising competitive advantages

What is Transparency of Information?

These are the qualitative attributes that define “transparency” in the financial information field:

Understandable: It is clear and concise and uses a language according to the target audience

Relevant: to the target audience for decision making purposes

Reliable:

- -Irrefutable
- -Substantive/Specific and not merely generic
- -Neutral, not biased/fair
- -Prudent and conservative
- -Complete

Comparable: between time periods and among similar entities

Steps for Establishing Good Governance

1 Understand Needs

Understand the minimum requirements for each element of Governance

2 Evaluate Status

Evaluate the status of the organization by comparing actual practices with minimum requirements

3 Gap Analysis

Identify the gap between the current state of affairs of the organization and the minimum or desired requirements

4 Develop Action Plan

Develop an action plan to take advantage of opportunities for improvement

Why Risk Management?

"The pessimist sees difficulty in every opportunity, the optimist sees the opportunity in every difficulty."

Sir Winston Churchill, (1874-1965, British Statesman and Prime Minister)

"We will not grow unless we take risks. Any successful corporation is full of risks."

James E. Burke, Chairman, Johnson & Johnson (interview, 1976)

"Everything in life is about risk management, not risk elimination."

Walter Wriston, anterior CEO and Chairman, Citicorp
(Risk and Other Four-Letter Words, p. 101)

Challenges

- Change and uncertainty are constants
- Increased public demand for greater transparency
- Better educated and discerning citizens
- Globalization and technological advances
- Operating efficiency

Risk Management Expectations

ü Citizen focus

ü Enhanced results management focus

ü Enhanced operational effectiveness

ü Responsible spending

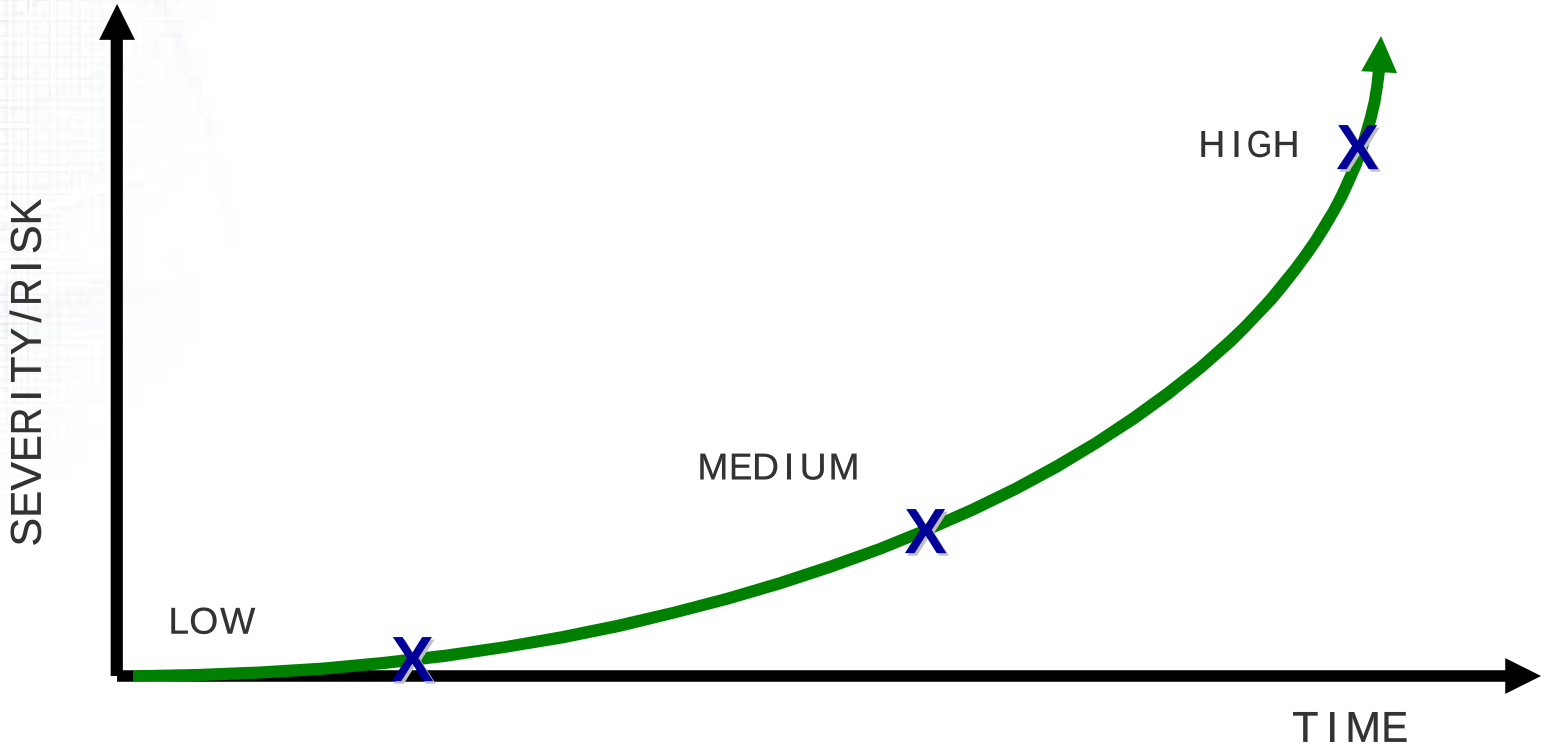
ü A more corporate and systematic approach to risk management

ü Contribute to building a risk-smart workforce

ü Increased delegation and decision making with enhanced accountability

What is Risk?

The chance of something happening that will have an impact on objectives



What is Risk?

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

ü Risk includes all events that impact performance either positively or negatively

ü Risk should be viewed as ***essential to the health of the organization***

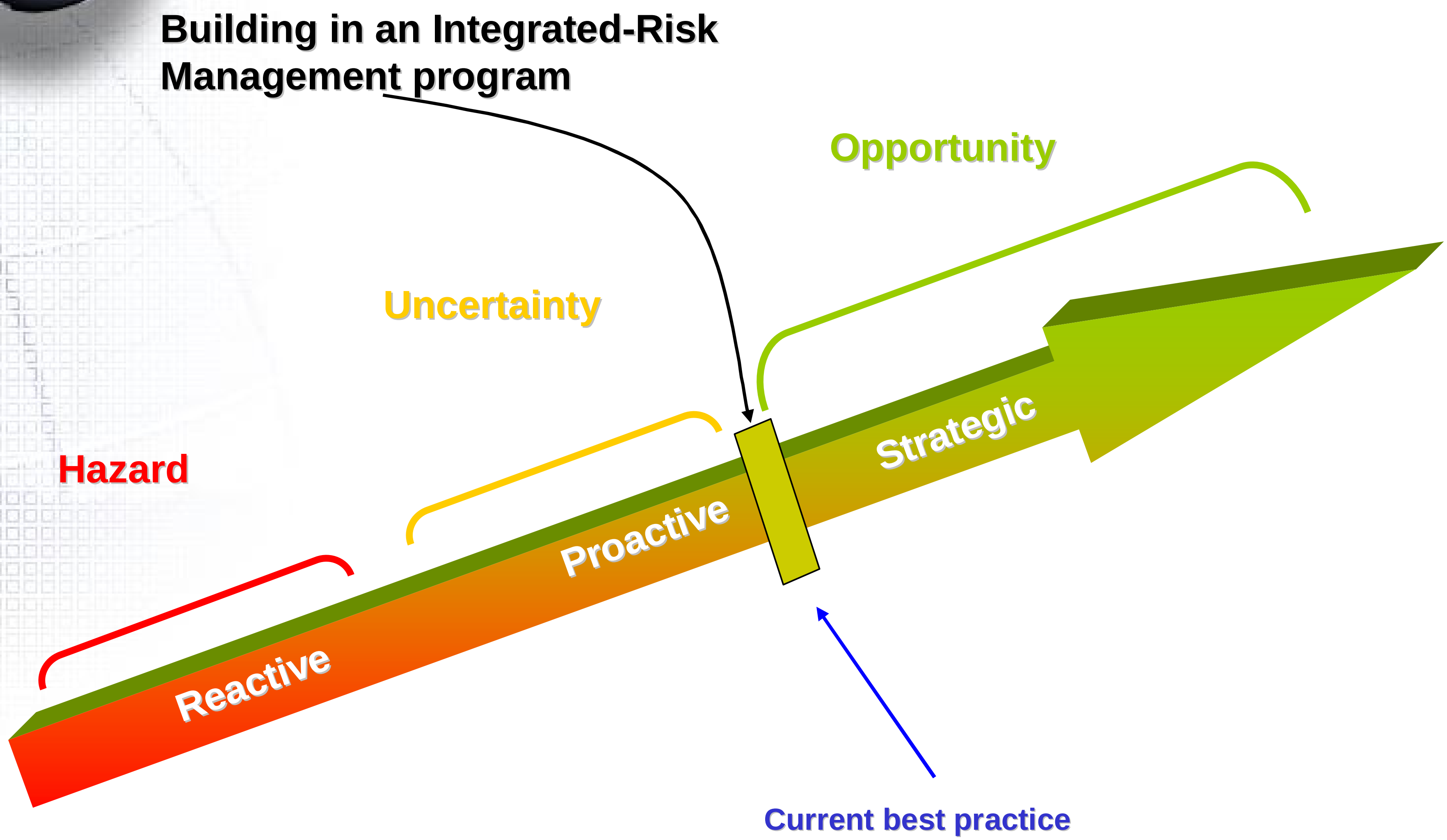
ü To eliminate or minimize all risks would result into ***weak or ineffective results***

ü Risk **MUST** be continuously managed to exploit opportunities and achieve objectives

NO RISK, NO REWARD

ERM Evolution

Risk Management Continuum



Address All of the Following Areas

Attitudes Toward Risk-Taking Culture

- Business strategies
- Performance expectations
- Risk strategy
- Leadership style
- Reward systems
- Straight talk, conflict management and reaction to failures
- Decision making process
- Personal risk taking

Established Organizational Capabilities

- Environmental scan
- Desired risk profile
- Risk KPI's
- Tolerance levels
- Policies, roles and responsibilities
- Organization structure
- Enabling frameworks
- Pooling/Aggregation
- Monitoring

Specific Risk Management Capabilities

- Assessment
- Risk strategies
- Capabilities
- Monitoring
- Continued improvement
- Information focus

Strategic ⟷ **Tactical**

Types of Risks

- **Hazard type risks: Insurable, extensive data available, SOP's used to manage, accident rate that is uncertain, treat by reducing likelihood/consequence or both – preventative**
- **Response: Workers comp., property, financial management, clinical**

- **Uncertainty-based risks: hard to quantify, catastrophic in nature, out of control, always negative outcomes, restorative planning**
- **Response: Business continuity, emergency response, disaster recovery**

- **Opportunity type risks: Often non insurable, assessment is qualitative, perrformance related, treat by avoidance, risk sharing, etc., integrated into business**
- **Response: Strategic, business and project planning (opportunity costs, relationship, reputations, efficiency & effectiveness)**

A Common Framework Will Accelerate Progress

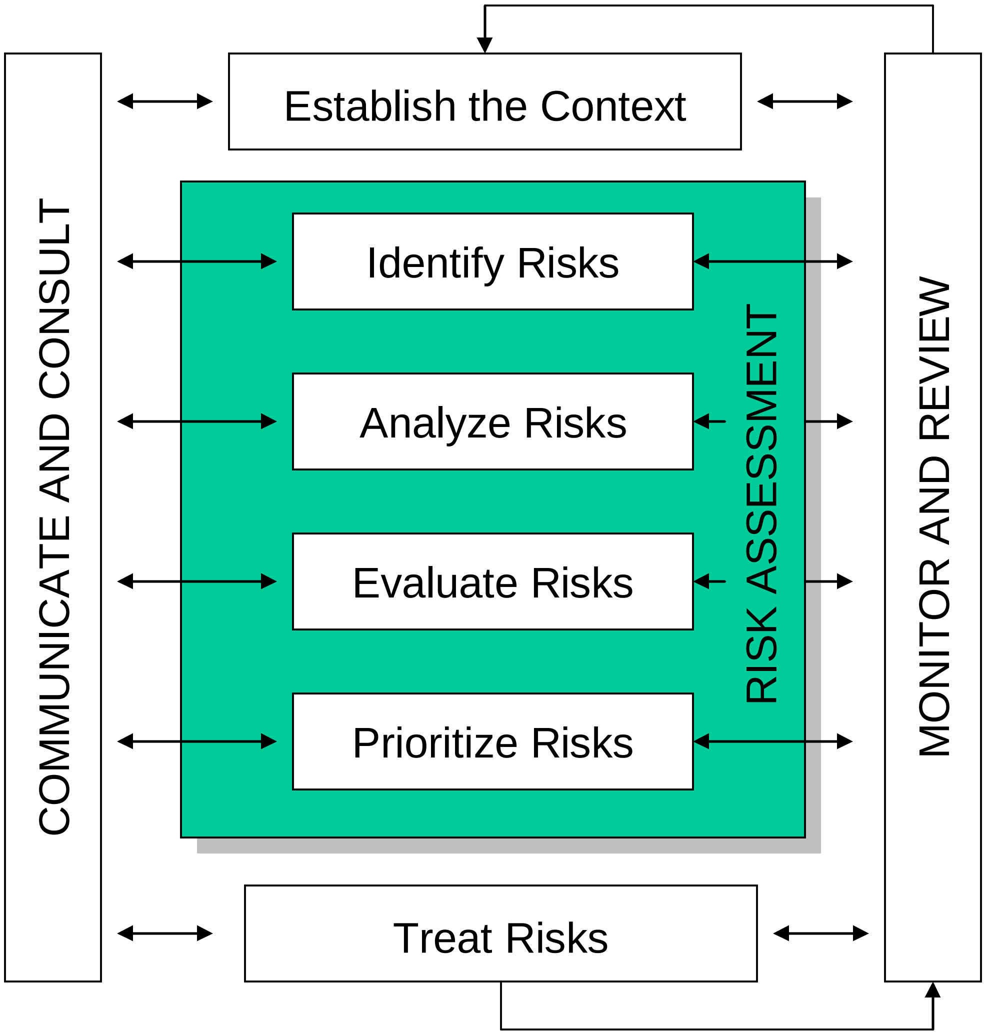
- Need a common language
- Need criteria against which to benchmark
- Familiarity of concepts is useful
- Application guidance is critical piece
- Issuance of framework is only the beginning

Risk Management Process

- Built-in continuous improvement cycle
- Risk Assessment

= Identify, Analyze, Evaluate & Prioritize Risks

- Define Context first
- Opportunities as well



Common Framework

Objectives:

- Ø Support governance responsibilities
- Ø Improve results
- Ø Strengthen accountability
- Ø Enhance stewardship

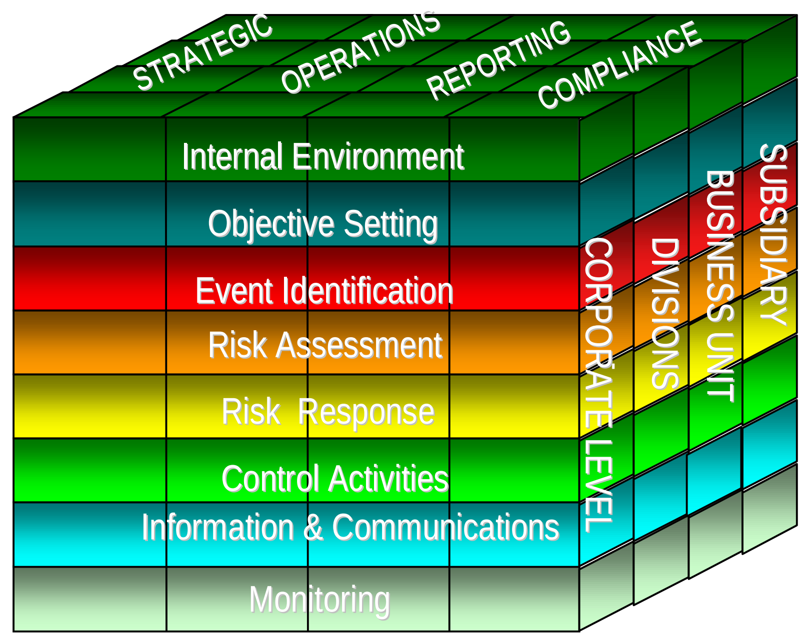
Elements:

- F *Develop a corporate risk profile*
- F *Establish an Integrated Risk Management Function*
- F *Practice ERM at all levels*
- F *Ensure Continuous Risk Management Learning*

The COSO Framework and the Components of ERM

Enterprise Risk Management:

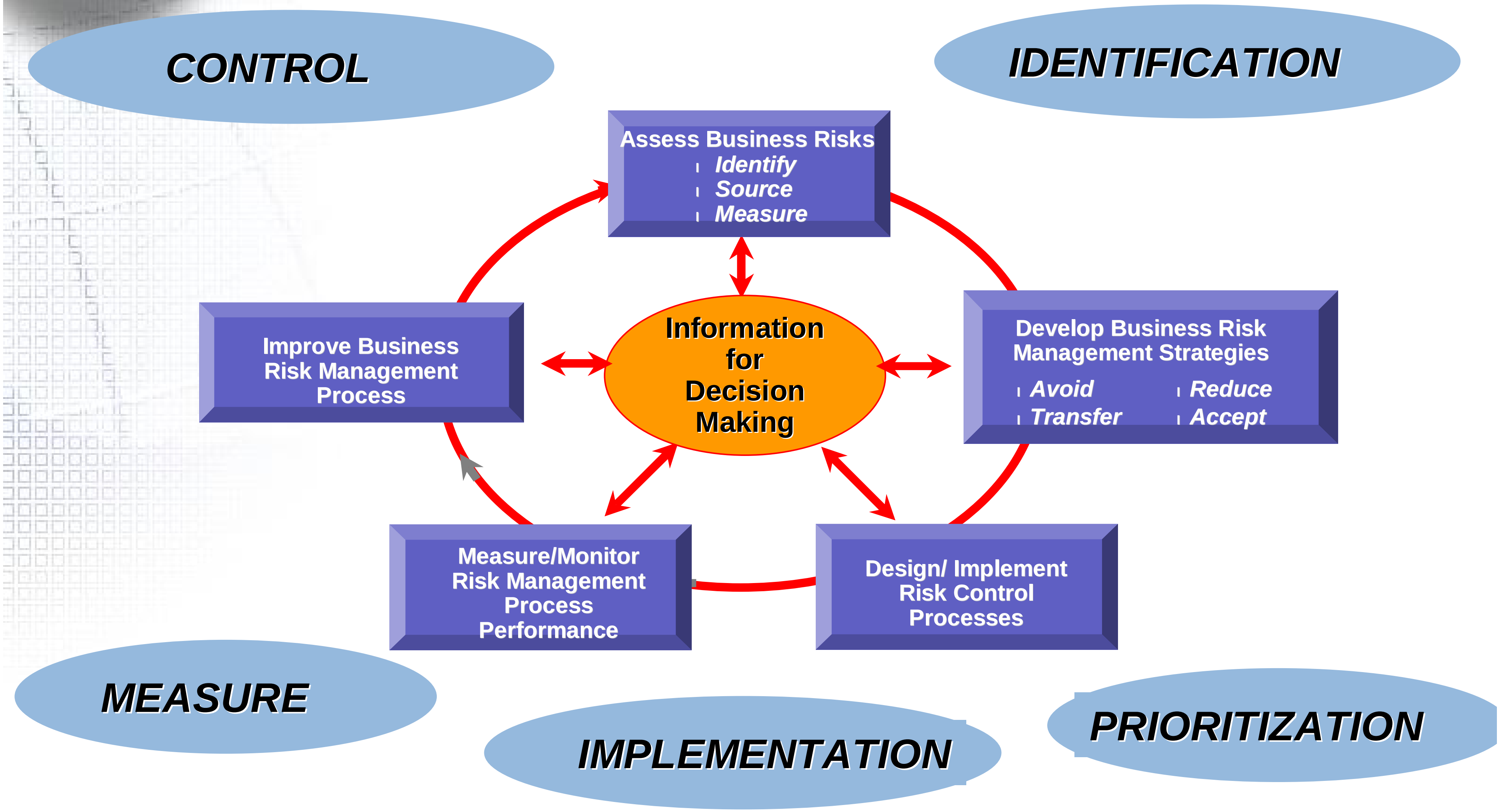
- Is a process
- Is effected by people
- Is applied in strategy setting
- Is applied across the entity
- Is designed to identify potential events
- Manages risks with risk appetite
- Provides reasonable assurance
- Supports achievement of objectives



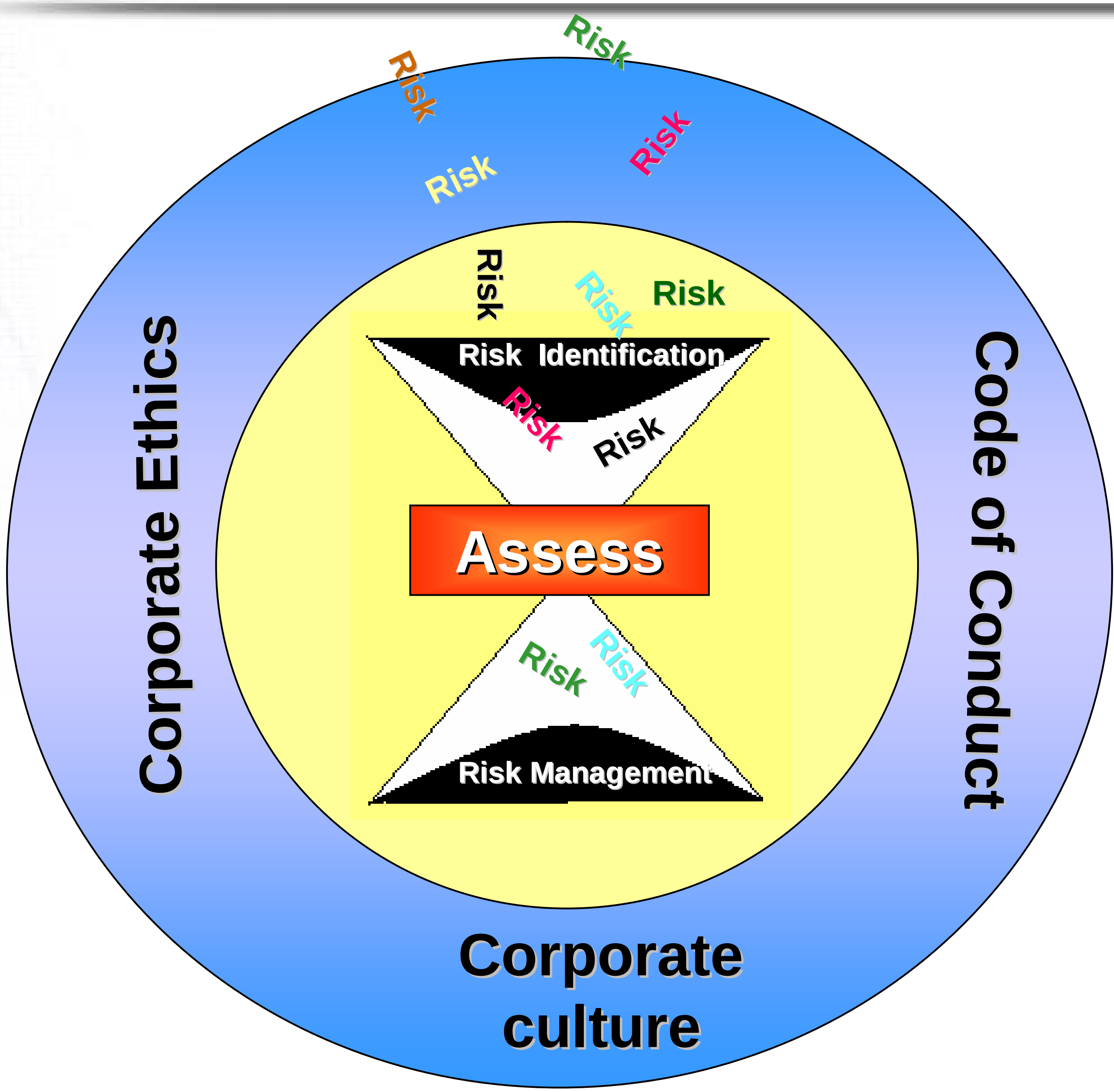
The COSO ERM Framework – What's the Message?

- There are a multitude of possible elements that make up an ERM solution – the COSO framework incorporates these elements.
- No two ERM solutions are alike.
  - Organizations have different objectives, strategies, structure, culture, risk appetite and financial wherewithal
  - The specific policies, processes, skillsets, reports, methodologies and systems comprising the elements defining the solution for one organization may differ from another company
  - The COSO Framework can be used as a benchmarking tool

A Common Framework Will Accelerate Progress



ERM is about Risk Assessment and Management



How to Identify Risk?

To identify and understand the inherent risk associated to a particular activity one has to have:

- *A deep knowledge of all relevant processes involved.*
- *An active imagination and tools to generate ideas about the potential effects of risks.*
- *A risk framework and a common language about risk and risk management.*

Common Questions when Assessing Risks

Are we improving at the proper pace?

That our risks are the same?

That we are meeting expected results and objectives?

Our strategies are the right ones?

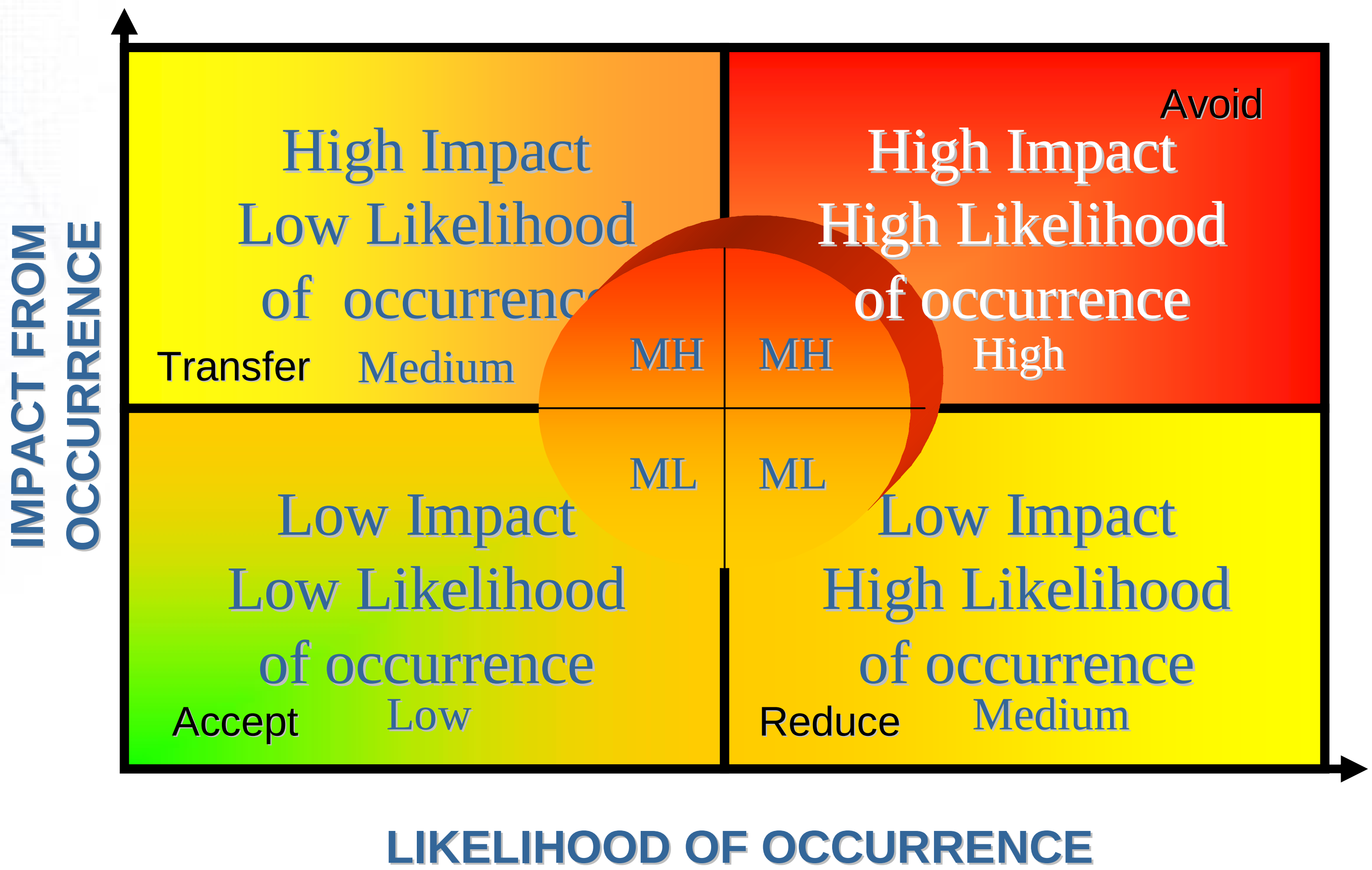
That we have the proper supervision process?

Our measurement process is the right one?

That we have the capacity to implement our strategies?

How to Measure Risk?

Risk Matrix



ML: Medium low
MH: Medium high

RISK PRIORITIZATION TOOL

Impact

Major

Significant

Moderate

Minor

Orange Events

High importance:

- Heightened action
- More resources
- Consider escalation
- Monitoring bi-monthly
- Consider controls

Red Events

Very high importance:

- Immediate action
- More resources
- Escalated immediately
- Monitoring once a month
- Additional controls

Green Events

Low importance:

- Business as usual?
- Release resources
- Release controls
- Monitoring half-yearly
- Opportunities worth pursuing?

Yellow Events

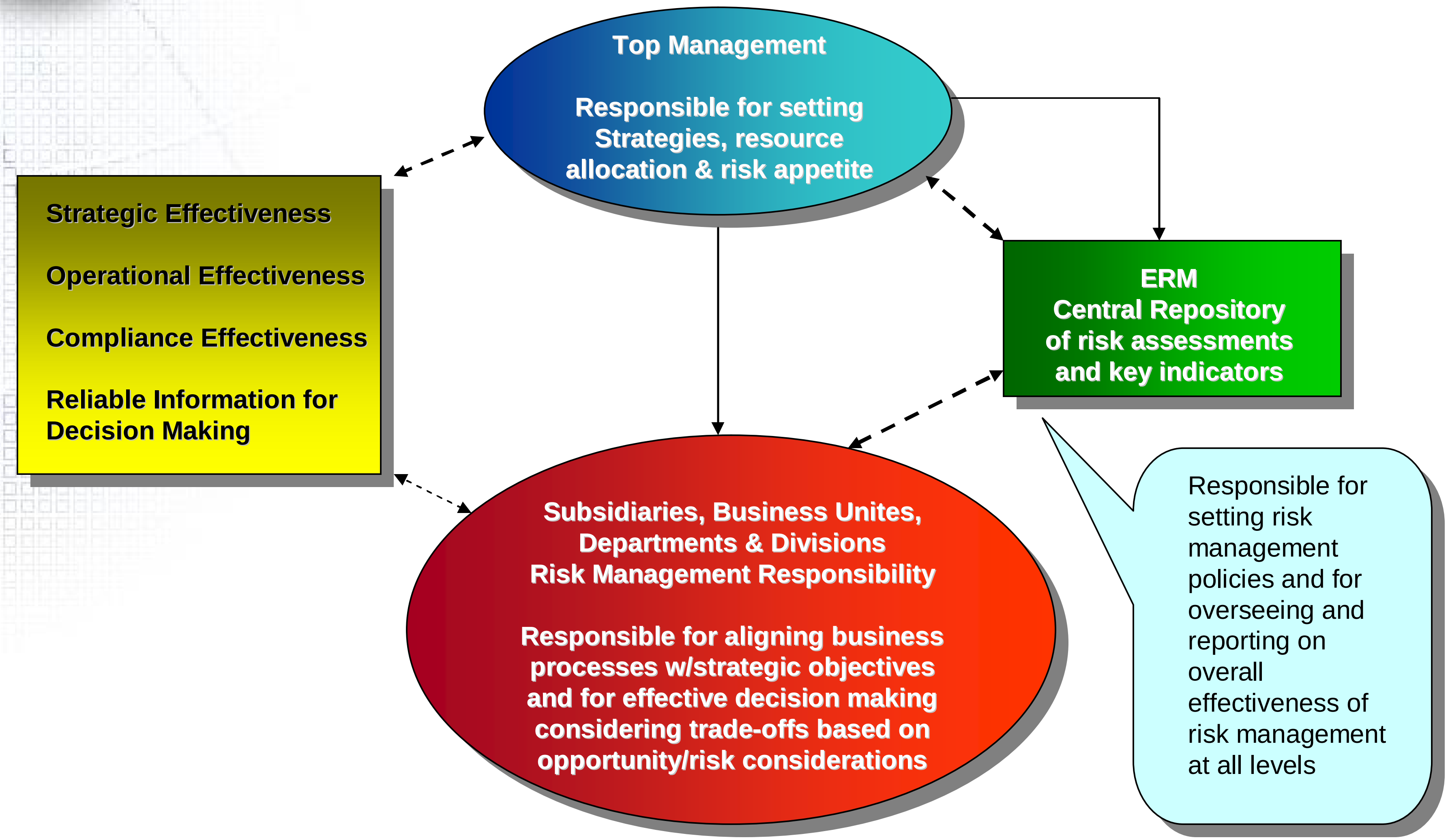
Moderate importance:

- Action
- Consider releasing resources and controls
- Consider escalation
- Monitoring and reporting quarterly

Remote Possible Probable Almost certain

Likelihood

ERM Structure



Corporate Risk Profile

- Threats and opportunities identifying through environmental scans, analysis and adjustment
- Status of risk management within the organization – challenges/opportunities, capacity, practices, and culture are recognized in planning risk management strategies
- Organization’s risk profile is identified – key risk areas, risk tolerance, and capacity to mitigate

ERM - Practical Considerations

- Every organization’s journey is different
- You must build off “your” current state in all areas of risk management
- Focus on good execution of processes
- Find champions to help advance the cause
- Set realistic goals:
  - Secure the foundation
  - Integrate into core management practices
  - Achieve transparency in the risks of the institution
  - Utilize continuous improvement mindset and practices
  - Everyone knows their role and are held accountable
  - Stay forward looking / anticipate events sooner

“Applied Across the Enterprise” is Vital

- For most organizations, ERM is a cultural change
- Uneven applications have plagued prior applications
- If implementation isn’t enterprise-wide, it isn’t ERM
- Reasons for uneven application:
  - Didn’t have support from the top or stakeholder ownership and buy-in
  - Didn’t link to priority business issues
  - Didn’t manage the process issues
  - Didn’t consider the cultural issues
  - Didn’t effectively balance entrepreneurial and control activities
  - Didn’t manage conflict of interests

ERM Benefits

Performance:

- **Improve business risk communications and knowledge sharing** through development and implementation of a common risk language.
- **Improve information for decision making and reduce uncertainty** through a more holistic and comprehensive view of risk and application of more robust risk management techniques.
- **Prevent unacceptable surprises** through a proactive, anticipatory risk assessment process.

Controls:

- **Improve risk oversight, monitoring, compliance, and reporting** by creating an organizational framework that formalizes risk management roles and responsibilities to foster a strong focus on managing by results, allowing for greater flexibility while strengthening accountability.
- **Achieve the highest confidence from the Board and Senior Management in risk management capabilities** by:
    a. Demonstrating that key risks have been identified and are being effectively managed.
    b. Applying a uniform risk assessment process to new risk taking activities.
    c. Aligning business and individual incentives with institutional objectives, performance goals, and risk tolerance.

ERM Benefits *(cont.)*

Process and methodology improvement:

- **Clarify risk management's role and purpose** through a well-defined vision statement and policy.
- **Improve organizational learning** through knowledge sharing and a uniform risk assessment process. The process enhances analysis and evaluation of alternative investment and growth opportunities as it maintains or builds the organization's intellectual capital in risk management.
- **Implement more efficient and effective approaches to improve risk management** through a uniform business risk management process customized to provide for organizational-wide aggregation and integration of key business risks.

Organization strategy:

- **Increase risk awareness and sensitivity** through alignment of organization objectives, strategy, and performance goals.
- **Perform more robust risk assessments** that increase understanding and improve management of risk.

Competency:

- **Improve risk management performance** through a systematic approach
- **Identify key risk "owners"** to collaborate on establishing uniform best practices to improve risk management capabilities.