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PERSPECTIVES

ENTERPRISE RISK MANAGEMENT – THE ULTIMATE RUBIK'S CUBE

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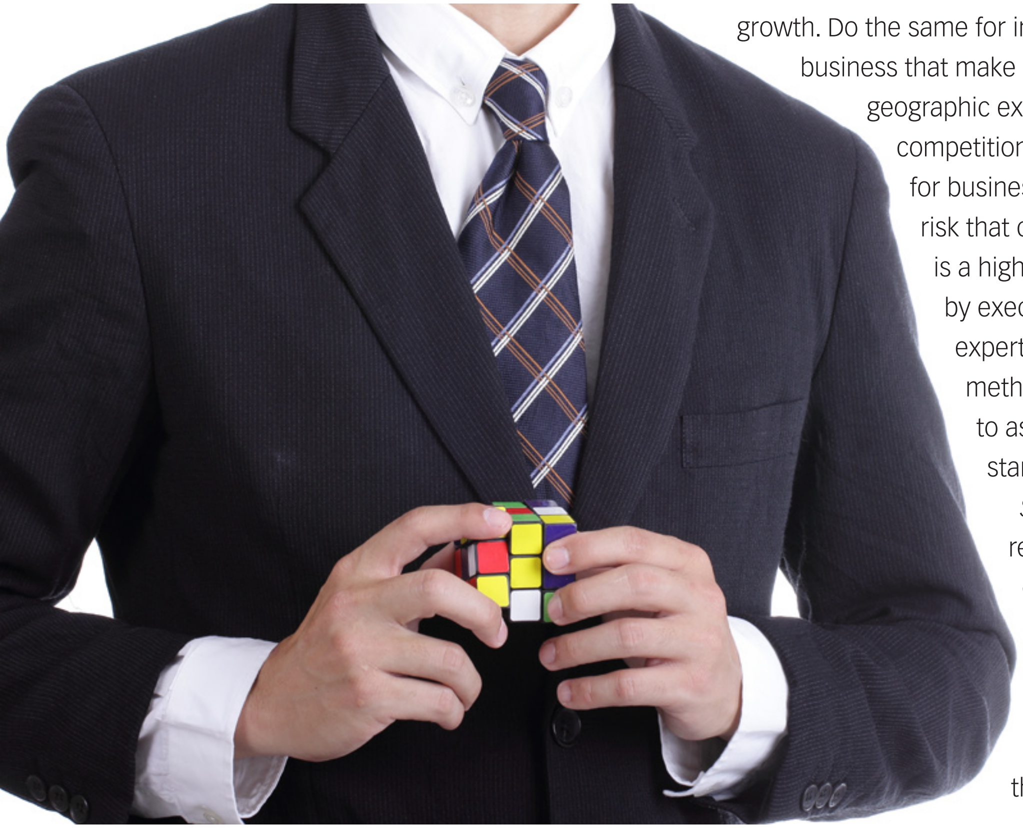
> WOMEN CORPORATE DIRECTORS

Enterprise Risk Management (ERM) is the ultimate solution. Once we get this right, we can sleep at night because we are completely prepared. Whether it is evaluating an acquisition, fund investment, new business, or the existing business, we have all the pieces necessary to navigate for continual success. After all, is not ERM the means to identify the sustainability and dependability of revenue and components that impact cash flow? OK, maybe not, because risk is for prevention, or then maybe to satisfy stakeholders, or the mantle needed to demonstrate compliance with prescribed rules and mandated policies. Of course, we can utilise COSO, ISO 31000, guidelines from the NYSE and SEC, etc.

As a trained risk practitioner and reader of thousands of ERM articles and numerous methodologies, an ultimate solution gets my mind spinning as there are so many footprints none can be seen. This brings us to the Cube – The Rubik's

Cube. Referencing Wikipedia permutation approach, suffice it to communicate there are 43 quintillion possibilities for the Rubik's Cube. This is fine for engineering or challenging your intellect, but we are in business. We want useful and effective ERM – so how to untangle?

The key to the puzzle is to utilise a methodology that is founded in common sense. We have all worked with professionals who 'get it'. They have a grasp of what is important and how to apply information. Thus, the business mind is the lead. Regulatory, legal, reporting and other mandated requirements need to be included. We refer to these as the 'prescribed requirements'. It is also important to recognise that many of these prescribed requirements contribute to sound business decisions and ERM.



So, below is the formula to solve the Rubik's Cube of ERM.

Step One. Determine the components of the business that sustain it and contribute to its growth. Do the same for intangible aspects of the business that make it attractive, such as geographic expansion, branding, reduce competition, etc. These are the core for business 'value'. Surface the key risk that can impair the value. This is a high level exercise to be led by executives and subject matter experts as it will guide the ERM methodology. This is referred to as the 'core business standards'.

Step Two. Prescribed requirements should be collected and organised by topic. Each topic is incrementally broken down to the lowest level, which is typically the way prescribed requirements are systematised by the governing body or professional association. Every incremental level should have a tag which identifies its origins, for example, SEC, insurance regulation, GAAP, etc. Of course, consistency of topic and labelling tag is critical. Creating a reference dictionary is advisable.

With this as a complete digest, the core business standards from Step One, which should carry the identifying tag of 'business', are integrated. Consolidate all and you will be amazed how the number of Rubik's Cube permutations is reduced as there is significant redundancy. Upon conclusion of Step One and Two, there are roadmaps for high level as well as granular elements.

Step Three. Create and build out the architecture for an ERM. ERM should be built upon the core business standards as the rest is to support the business or meet requirements established by others. Choosing the architecture for the build is also daunting as there are many methodologies reflecting the differences in business types and complexity. We have found that by adapting the FDIC model risk governance framework, all the key elements and considerations are identified. Its value is the methodology which is easy to follow and it provides the key considerations and questions. It is a systematic and pragmatic approach. There is an FDIC article in 'Supervisory Insights 2005' that provides a useful guide. Of course, it is easy to conclude this is outdated, which is why it is so useful. It is thoughtful and precedes the intricacies that new methodologies expound. The architecture is only as good as its usefulness and by focusing on what senior and executive management need is the most effective ERM architecture.

This architecture can be expanded and contracted allowing for the filtering of information to the appropriate level. For example, there is high level consolidated information for the C-Suite and board and detailed reports for various business functions; for example, producing compliance reports, analysing the profitability of a product, etc. Also, with a bit of tweaking, this can serve as the basis for due diligence.

This ERM approach is enhanced by reporting formats and predictors. It is essential to have uniform, consistent and application appropriate reports. The goal is to have meaningful and useful

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receipt and delivery of information focused on the purpose. This provides producers and recipients with knowledge, confidence and accountability. While each report will vary in depth, content and purpose, there are a number of elements that should be embedded in reports. Some basics are: purpose, list of recipients, list of contributors, name and signature of quality review officer, frequency of report, key influences, (such as data timeliness; theory biases) key observations approved by quality review officer, highlight any changes made to material underlying substance of the report. To have report consistency with information and presentation is essential.

Reports speak to history and it is important to identify emerging trends and risk predictors. Separate and distinct from all methodologies, a business should put together its ERM predictors. Some examples may be tacking sales against norms or a trained professional noticing something that may appear unusual. These early warning systems are both on a high level macro basis and granular level.

ERM is essentially connecting silos, so information flows meaningfully and selectively, providing decision makers at all levels with the tools needed to run the business. The RMA of New York has a tag 'Managing Risk for Enterprise Success', which should be the purpose of the risk function.

The Rubik's Cube is an assembly of alternatives. ERM is an assembly of alternatives. Random actions will not successfully solve 43 quintillion possibilities. The solution to solving the ERM puzzle is to determine and stick to a methodology founded in core business standards. R&C

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