



TRENDS

I N F I N A N C I A L M A N A G E M E N T

ALAN LEVINSOHN, EDITOR

How to Manage Risk—Enterprise-Wide

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Organizations of the Treadway Commission (COSO) completed its new enterprise risk management framework in September 2004, and it's now available.

Titled *Enterprise Risk Management—Integrated Framework*, the 89-page guidebook can help companies evaluate and improve their enterprise risk management (ERM). A 96-page “Applications Techniques” comes with the framework, and it provides examples of how companies can apply ERM. You can buy a copy of the framework and applications at www.imanet.org or www.coso.org. (See Perspectives on p. 6 for more information.)

In contrast to risk management by department or function, enterprise risk management encompasses all business risks and opportunities. It's a continuous process that senior-level management and boards of directors oversee but everyone in an organiza-

tion is responsible for.

COSO's new framework builds upon but goes far beyond its 1992 *Internal Control—Integrated Framework*. Written by PricewaterhouseCoopers (PwC) on behalf of COSO, *Enterprise Risk Management—Integrated Framework* can help an organization determine the right amount of risk for the value it's trying to create and how best to protect and enhance that value. The framework outlines key concepts and components of ERM such as a philosophy, risk appetite, and a portfolio view of risk. It's flexible enough so that each organization can adjust it to fit their particular business model.

The Executive Summary outlines eight components of ERM:

- ◆ **Internal Environment.** The internal environment gives people in an organization a basis for viewing and addressing risk.
- ◆ **Objective Setting.** ERM ensures that management has a process to set objectives and to

make sure these objectives align with the organization's mission and are consistent with its risk appetite.

- ◆ **Event Identification.** Internal and external events must be identified and distinguished from risks and opportunities.

- ◆ **Risk Assessment.** Risks are analyzed to help determine how they should be managed.

- ◆ **Risk Response.** Management decides how to respond to different risks based on the organization's risk tolerances and risk appetite.

- ◆ **Control Activities.** Policies and procedures are established and implemented to help ensure risk responses are carried out effectively.

- ◆ **Information and Communication.** Relevant information is identified, captured, and communicated throughout the organization to help people carry out their responsibilities.

- ◆ **Monitoring.** Every aspect of

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Kathy Williams, Editor-in-Chief

ERM is monitored, and modifications are made as necessary.

There is a direct relationship between these eight components and the four categories of objectives, which are strategic, operations, reporting, and compliance.

You can obtain a free copy of the Executive Summary at www.imanet.org or www.coso.org.

Three years in the making, COSO's ERM framework is the most exhaustive of its kind, the only one that has been developed through extensive primary and secondary research and a rigorous public review process, according to Tony Maki, chair of the COSO ERM Advisory Council.

COSO—a consortium of five associations, including IMA—seeks to improve financial reporting. In 1999 they decided ERM was important for accurate financial reporting and commissioned a study to see if a formal framework existed. It didn't.

COSO then set up an advisory council composed of professors and professionals involved in risk management. They issued an RFP to the then Big 5 accounting and consulting firms and in September 2001 chose PwC to carry out the project. To get a thorough understanding of ERM, PwC interviewed COSO member organizations, middle-market companies, large companies, not-for-profit organizations, risk management professionals, and regulators. Next, the firm drafted the framework, and, in July 2003, COSO issued an exposure draft for public comment—on which people from more than 70 organizations commented. Finally, COSO introduced the framework three months ago. ■