Objective Centric vs Risk Centric ERM: Which one is best?

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About the presenter

Tim J. Leech, FCPA CIA CRMA CCSA CFE is Managing Director at Risk Oversight Solutions Inc. based in Oakville, Ontario and Sarasota, Florida. He has over 30 years of experience in the risk governance, internal audit, IT, and forensic accounting/litigation support fields. His experience base includes setting up a new business unit, a “first of its kind”, for Coopers & Lybrand, “Control & Risk Management Services” in 1987; founding in 1991, building, and successfully selling CARD®decisions, a global risk and assurance consulting and software firm, to Paisley/Thomson Reuters in 2004; serving as Paisley’s Chief Methodology Officer from 2004-2007; and 25+ years of global experience helping clients around the world with internal audit transformation initiatives and the design, implementation, and maintenance of integrated and more powerful ERM/IA methodology and technology frameworks.

He developed and successfully released CARD®map, the world’s first integrated risk and assurance software, in 1997. The web-enabled “cloud” version of CARD®map was released in 2000. Tim was the first in 2009 to develop and deliver training on IIA IPPF Standard 2120 training to equip internal auditors to assess and report on the effectiveness of risk management processes. He is the author of the Conference Board Director Notes December 2012 publication “Board Oversight of Management’s Risk Appetite and Tolerance” and co-author of the highly acclaimed January 2014 “Risk Oversight: Evolving Expectations for Boards”. Leech was a pioneer in the global control and risk self-assessment (“CRSA/CSA”) movement from 1996 to 2004. His latest groundbreaking article, “Reinventing Internal Audit”, is scheduled for release April 1, 2015 in the IIA’s Internal Auditor magazine.

In 2013 he launched a second generation of disruptive innovation with a breakthrough approach to risk and assurance management – “Board & C-Suite Driven/Objective-Centric” (BCD/OC) risk governance. The goal – respond to the rapid escalation in board risk oversight expectations and deliver substantially more “bang for the buck” from formal assurance spending. Leech is currently working with Resolver in Toronto, Canada to build RiskStatusNet™ software to support full integration of what is sometimes referenced as the five lines of defence. Beta testing is currently underway.

Leech was the recipient of IIA Canada’s first Outstanding Contributions to the Profession award at the first IIA Canada national conference in Quebec City in 2009 and is currently working with IIA Global in Florida to roll-out training on Board & C-Suite Driven/Objective Centric ERM and internal audit to IIA National Institutes and in-house IIA training clients around the world.
Agenda

• The catalyst for this presentation
• Risk Centric ERM: What is it?
• Core Elements of the Board/C-Suite Driven Objective Centric (BCD/OC) Approach
• Key Benefits of the Board/C-Suite Driven & Objective Centric (BCD/OC) Approach
• Implementation Barriers
• Where to get help
Objective Centric vs Risk Centric ERM: Which one is best?

The catalyst for this presentation

Ten reasons to be weary of risk registers

Robert Jeges
CEO at ProjectWare.au
Top Contributor

ISO 31000 does not recommend the use of risk registers. Of course this is not the same as disallowing them, and they are very popular together with heat maps, but users should be aware of their many pitfalls.

1. There is no interconnection between risks. Risks have interdependencies and correlations that are not captured in tabular risk registers.

2. Risks are dynamic events with outcomes, and the effect of these outcomes usually precipitates other events. The register is a static model that fails to explore further levels of exposure.

3. It assumes cause and effect. Risk can be non-deterministic due to stochastic processes so causes are not always determinable.

4. It uses a crude estimation of consequence and probability. Usually ordinal scales or indices are used that frame the risk into unwrorkable classifications.

5. No relation to objectives. The risk criteria should be determined with respect to the objective, and compared with the level of risk.

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Objective Centric vs Risk Centric ERM: Which one is best?

The catalyst for this presentation

ISO 31000 Risk Management Standard

Discussions Promotions Jobs Members Search

G31000

Top Contributors in this Group

Tim Leech
Managing Director Risk Oversight Solutions Inc.
Top Contributor

Your group contribution level

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Objective Centric vs Risk Centric ERM: Which one is best?

The catalyst for this presentation

The Institute of Internal Auditors (Official Global Group)

Objective Centric versus Risk Centric ERM: Which one is best?

Tim Leech
Managing Director Risk Oversight Solutions Inc.

A couple of years ago I authored a paper titled the HIGH COST OF ERM HERD MENTALITY.


That paper describes the "handicaps" created by many traditional "risk-centric" ERM frameworks, particularly those that use risk registers as a foundation. That paper, and others I have authored since then, propose a new approach to ERM that uses an OBJECTIVE REGISTER as a foundation instead of the more traditional RISK REGISTER. The HIGH COST OF ERM HERD MENTALITY paper suggests that serious defects in the current 2009 ISO 31000 standard, COSO ERM 2004, and risk-centric/risk register approaches to ERM are part of the problem, not the solution to weak risk cultures and governance. A survey report issued by NCSU and AICPA in the U.S. titled 2015 Report on the State of Enterprise Risk Oversight confirms that the handicaps described in my HIGH COST OF ERM HERD MENTALITY paper are seriously negatively impacting progress convincing senior executives and boards that risk management should be, first and foremost, a tool to help organizations make better resource allocation decisions. That NCSU/AICPA survey can be found at:
Risk Centric ERM: What is it?

Some Common Elements of Risk Centric ERM:

• A “risk register” is used as the foundation
• Use of risk “heat maps” is common
• Risks are gathered by asking “what do you see as the big risks facing the unit, the company, the process, the project, etc.?” If a risk assessment starts with a specific objective it is “objective centric”
• Linkage to end result objectives, if it happens at all, often happens after risks are gathered, assessed and prioritized
• The process is often not fully integrated with strategic planning
• Often the top rated risks in risk registers are not the top risks to the company’s top value creation objectives
• Boards are provided with “risk lists”, not a picture of the composite uncertainty of achieving key strategic and foundation objectives
KEY POINT:

Objective Centric ERM is recommended in order that ERM and Internal Audit become Board & C-Suite Driven ("BCD/OC").

This should be a key imperative.
Core Elements of the Board/C-Suite Driven Objective Centric Approach

Use an “OBJECTIVES REGISTER” with top value creation/strategic objectives and top potential value erosion objectives as the foundation for all ERM and internal audit work, not a “risk register” or “audit universe”

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**Sample Summary Report for Senior Exec and The Board:**

<table>
<thead>
<tr>
<th>Corporate</th>
<th>Description</th>
<th>End Result Objective Owner / Sponsor(s)</th>
<th>Composite Residual Risk Rating (CRRR)</th>
<th>CRRR Update Date</th>
<th>Potential to increase Entity Value</th>
<th>Potential to Erode Entity Value</th>
<th>Current Risk Assessment Rigor (RAR)</th>
<th>Independent Assurance Level (IAL)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Ensure that financial statements are reliable and in compliance with GAAP.</td>
<td>Tim Leech</td>
<td>6 - Major</td>
<td>6/12/2014</td>
<td>Medium</td>
<td>Low</td>
<td>Medium (M)</td>
<td>LOW</td>
</tr>
<tr>
<td>2</td>
<td>Safeguard and enhance ABC’s reputation</td>
<td>Tim Leech</td>
<td>4 - Advanced</td>
<td>6/10/2014</td>
<td>High</td>
<td>High</td>
<td>Very Low (VL)</td>
<td>MEDIUM</td>
</tr>
</tbody>
</table>
“Top potential value erosion objectives” are also called “foundation objectives” and include compliance with laws, reliable external disclosures, safety and other social responsibility objectives.
Core Elements of the Board/C-Suite Driven Objective Centric Approach

Engage senior management and the board in the process used to decide which objectives to include in the “OBJECTIVES REGISTER”
Assign primary responsibility to report upwards on the residual risk status linked to each objective to a “OWNER/SPONSOR”
Consider the full range of “Risk Treatments” when completing the Risk Treatment Strategy section.

Core Elements of the Board/C-Suite Driven Objective Centric Approach
Focus on the acceptability of “Residual Risk Status”, specifically whether it is, or is not, within the entity’s risk appetite and tolerance.
After the decision on acceptability of residual risk status has been made assess if the Risk Treatment Strategy is optimized.
Provide consolidated reports on residual risk status to the board

### Draft objective statement

<table>
<thead>
<tr>
<th>Draft objective statement</th>
<th>Owner/Sponsor Candidate</th>
<th>Target Risk Assessment Rigour</th>
<th>Target Independent Assurance Level</th>
<th>Composite Residual Risk Rating</th>
<th>CRRR Update Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ensure risks related to the ABC's business model of outsourcing management and advisory services have been identified, assessed and reported on to key shareholders</td>
<td>ABC Board</td>
<td>Medium</td>
<td>Medium</td>
<td>TBD</td>
<td>19/01/2015</td>
</tr>
<tr>
<td>Provide a liquid, balanced, single-point liquid access to private equity and private equity related assets</td>
<td>ABC Board</td>
<td>Medium</td>
<td>Medium</td>
<td>TBD</td>
<td>19/01/2015</td>
</tr>
<tr>
<td>Ensure the company maintains sufficient critical mass size of operations to maintain share liquidity capital market visibility whilst maximising short and long-term value for shareholders and aiming to optimise the shareholder base and deliver returns of 8% p.a. net outperformance over public markets over a 10 year period</td>
<td>Joan Smith</td>
<td>Medium</td>
<td>Medium</td>
<td>TBD</td>
<td>19/01/2015</td>
</tr>
<tr>
<td>Ensure senior management and the board meet or exceed in-force governance requirements for Toronto listed public</td>
<td>Joan Smith</td>
<td>Medium</td>
<td>Medium</td>
<td>TBD</td>
<td>20/01/2015</td>
</tr>
<tr>
<td>Safeguard ABC against fraud</td>
<td>John Miller</td>
<td>Low (target medium)</td>
<td>TBD</td>
<td>TBD</td>
<td>09/02/2015</td>
</tr>
<tr>
<td>Ensure that all risk/reward trade-offs relating to appropriate contractual provisions and insurance are understood and optimising the cost of capital and balancing risk and reward</td>
<td>John Miller</td>
<td>Low (target medium)</td>
<td>TBD</td>
<td>0</td>
<td>31/10/2014</td>
</tr>
<tr>
<td>Ensure all financial obligations and covenants are met whilst optimising the cost of capital and balancing risk and reward</td>
<td>John Miller</td>
<td>Medium</td>
<td>Medium</td>
<td>TBD</td>
<td>04/02/2015</td>
</tr>
<tr>
<td>Optimize investment portfolio to produce target returns whilst complying with investment guidelines</td>
<td>M Frederick</td>
<td>Medium</td>
<td>Medium</td>
<td>TBD</td>
<td>04/02/2015</td>
</tr>
<tr>
<td>Ensure that investment funds comply with the partnership agreement and disclose all actual and potential conflicts of interest</td>
<td>John Miller</td>
<td>Low (target medium)</td>
<td>TBD</td>
<td>TBD</td>
<td>07/08/2014</td>
</tr>
<tr>
<td>Ensure the company complies with all applicable laws and regulations</td>
<td>John Miller</td>
<td>Low (target medium)</td>
<td>TBD</td>
<td>TBD</td>
<td>06/08/2014</td>
</tr>
<tr>
<td>Protect the company's interests regarding existing and potential judicial, administrative and regulatory legal proceedings</td>
<td>John Miller</td>
<td>Low (target medium)</td>
<td>TBD</td>
<td>TBD</td>
<td>31/07/2014</td>
</tr>
<tr>
<td>Maintain the ability to operate in the event of a termination of the outsourced IT services provider</td>
<td>Chuck Clark</td>
<td>Low (target medium)</td>
<td>TBD</td>
<td>TBD</td>
<td>16/09/2014</td>
</tr>
<tr>
<td>Ensure financial statements are reliable and in accordance with IAS and Canadian rules and that investments are included at fair value and published in the balance sheet</td>
<td>John Miller</td>
<td>Low (target medium)</td>
<td>TBD</td>
<td>TBD</td>
<td>15/07/2014</td>
</tr>
<tr>
<td>Safeguard and enhance the company's reputation</td>
<td>Ann Peabody</td>
<td>Low (target medium)</td>
<td>TBD</td>
<td>TBD</td>
<td>28/01/2014</td>
</tr>
</tbody>
</table>
Internal audit provides regular independent reports on the reliability of the ERM process and reliability of the consolidated report on residual risk status provided to the board by the CEO/CRO.
Communicates the Value of ERM

BCD/OC better communicates (relative to risk centric/risk register approaches) that the two core reasons for spending time and resources on ERM should be:

1. Increase certainty that important value creation and potential value erosion objectives will be achieved while operating within a level of residual risk acceptable to senior management and the board.

2. Provide reliable information to help boards and senior management make better resource allocation decisions.
Active Engagement of Senior Management

Very, very important benefit - More active and visible engagement of senior management and the board relative to risk centric ERM processes and traditional internal audit defining what is to be included in the Objectives Register, the level of risk assessment rigor, and level of independent assurance each objective will receive.

Because of this feature, BCD/OC better meets the emerging stakeholder and regulatory expectation that the board be/is responsible for visibly overseeing an organization’s “risk appetite framework” and “risk culture”, and overseeing the reliability and completeness of the information they receive to fulfill that responsibility. (See UK Corporate Governance Code Sept 2014)
Clear Risk Status Reporting Aligned to Key Objectives

BCD/OC produces a composite picture of Residual Risk Status for top value creation and potential value erosion objectives that provides senior management and the board with the information necessary to decide if the current residual risk status is, or is not, within their collective risk appetite and tolerance.

Boards can see very quickly what management’s risk appetite and tolerance is across the full range of business objectives necessary for long term success and, most importantly, decide if management’s risk appetite is, or is not, consistent with their values and risk appetite.
Alignment to Strategy

BCD/OC better integrates with strategic planning and senior management remuneration processes relative to risk-centric/risk register frameworks. This increases senior management’s motivation to actively participate in formal risk assessment processes.

Many risk centric/risk register ERM initiatives are seen as annual/semi-annual compliance exercises with only token participation of senior management. Research surveys indicate many risk-centric ERM programs don’t integrate to any significant degree with top strategic/value creation objectives.
Consensus on Extent of Risk Assessment & Assurance Level Warranted

Risk Assessment Rigor (“RAR”) ratings define the type and extent of formal risk assessment senior management and the board are getting/want. (i.e. current and target RAR).

Independent Assurance Level (“IAL”) defines how much assurance senior management and the board are getting/want that the risk information they are receiving is reliable. (i.e. current and target IAL).

THESE ARE IMPORTANT RISK ACCEPTANCE DECISIONS IN THEIR OWN RIGHT
Roadmap for ERM & Internal Audit

The Objectives Register provides a clear work roadmap for the ERM support team and internal audit. BCD/OC raises the stature of ERM support teams and internal audit functions.

By requiring that the Objectives Register contain the top value creation/strategic objectives and top potential value erosion objectives it increases the importance, relevance and value provided by ERM support teams and internal audit.

The board looks to internal audit for opinions on the effectiveness of the entity’s risk management processes and the reliability of the consolidated report they receive on residual risk status.
Resource Assignment & Scope of Work

The amount of resources required for the ERM initiative and internal audit are defined by senior management and the board via how many objectives are included in the Objectives Register, the level of Risk Assessment Rigor (RAR), and Independent Assurance Level (IAL) assigned by them to each objective.

If the board only wants formal assurance on a narrow range of objectives mandated by regulators at a low to medium level of risk assessment rigor and independent assurance this defines the scope of the work done by ERM and IA teams.
Implementation Barriers

Not all CEOs want their board to be aware of areas of high risk acceptance. Not all boards want to know the whole truth and nothing but the truth.
Implementation Barriers

"Risk cultures" that are not supportive of identifying and disclosing the true state of residual/retained risk
Implementation Barriers

Reluctance to acknowledge that traditional risk centric/risk register approaches to ERM in use around the world are not working very well.
Implementation Barriers

Reluctance to acknowledge that traditional spot-in-time internal audit methods that focus on providing subjective opinions on the “effectiveness” of internal control need to change.

Figure 4. Satisfaction with internal audit value and performance

- Percent of stakeholders reporting internal audit provides “significant value”:
  - Board Members: 79% (2013), 68% (2014)
  - Senior Management: 44% (2013), 45% (2014)

- Percent of 2014 respondents reporting that internal audit “performs well”:
  - Board Members: 64% (2013), 65% (2014)
  - Senior Management: 49% (2013), 45% (2014)
  - CAEs: 65% (2013)

Implementation Barriers

For non-financial public companies, an absence of serious regulatory pressure to change except in the UK (UK Corporate Governance Code September 2014)

No tangible action since 2009 proxy disclosure rules

No tangible action since 2010 audit report on governance disclosures
Implementation Barriers

Truly effective ERM discloses information that may increase litigation risk
Implementation Barriers

In the absence of real and serious pressure to change, human beings often resist rapid radical change

Calls for Improved Enterprise-Wide Risk Oversight

68% indicate that the board of directors is asking “somewhat” to “extensively” for increased senior executive involvement in risk oversight. That is even higher for large companies (86%) and public companies (88%).

- 65% of organizations experience “somewhat” to “extensive” pressure from external parties to provide more information about risks.
- Financial services organizations are especially experiencing these external pressures with 79% experiencing them “somewhat” to “extensively.” These demands are most notably coming from regulators.

Risk Oversight Leadership

32% have designated an individual to serve as the chief risk officer or equivalent.

- Financial services organizations are most likely to designate an individual as CRO or equivalent, with such appointments occurring in 56% of the firms surveyed.

45% have a management-level risk committee

- For most organizations with a risk management committee, the committee meets at least quarterly.

Source:
Where to get help

Advisory and training services and training materials from Risk Oversight Solutions. We hope to have more authorized RiskStatusOversight™ distributors in place globally by end of 2015
Where to get help

IIA Training Seminars on Board & C-Suite Driven/Objective Centric ERM and Internal Audit offered globally

Reinventing Internal Audit: Audit Transformation Strategies to Meet New Expectation

Course Description

Surveys conducted by The IIA, PwC, KPMG, Protiviti, and others in the first six months of 2014 indicate growing customer dissatisfaction with traditional internal audit methods and service. The July 2014 Global IIA update “The Pulse of the Profession: Enhancing Value through Collaboration: A Call to Action” calls on the profession to make radical and rapid changes to the way internal audit services and assurance is delivered.

At the July International Conference in London and through articles, blogs and
Resolver offers software that supports BCD/OC. We hope to license more BCD/OC software providers in 2015.
Where to get help

IIA 2015 International Conference Pre-conference workshop for CAEs in Vancouver British Columbia

Sunday, July 5, 2015
9:00 a.m. - 5:00 p.m.  
Registration

1:00 - 5:00 p.m.  
Pre-Conference Sessions

CAE: Forum - By Invitation Only: Audit Transformation Strategies to Meet Escalating Stakeholder Expectations

Tim Leech, CCSA, CIA, CRMA  
Managing Director Global Services  
Risk Oversight Incorporated, Canada

New board risk oversight expectations are increasingly being codified by regulators, credit agencies, institutional investors and others globally. It’s now critical to utilize specific and practical skills, methods and tools so that internal audit and ERM better respond to these expectations.

In this forum participants will:

- Analyze what’s driving growing internal audit customer dissatisfaction.
- Understand what’s behind the rapid and unprecedented rise in internal audit customer dissatisfaction.
- Obtain an overview of global trends in order to codify board and senior management risk management and oversight expectations.
- Gain an understanding why credit agencies and institutional investors increasingly consider the quality and effectiveness of risk management and board risk oversight when assigning ratings and evaluating equities.
- Gain practical and specific strategies to address growing concerns of boards of directors, senior management and regulators.

Tim Leech helps companies effectively manage risk and assurance to meet escalating due diligence expectations. He has more than 25 years of experience in the risk and assurance fields, including global experience helping clients with ERM and internal audit transformation initiatives and litigation support work on officer/director due diligence actions.
Do you know where your Risk is? It’s time for a better approach to Risk...

New risk oversight expectations are emerging for Boards, CEOs and CFOs—-with escalating...
Where to get help

Questions?

Want more information?

Contact
timleech@riskoversightsolutions.com