Build a Dirt Path Before You Build a Superhighway

BY JAMES A. NORTZ

I recently attended the Ethics and Compliance Officer Association's Sponsoring Partner Forum in Washington, DC. Among the many speakers was David Landsittel, chair of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As you may know, COSO was organized in 1985 to sponsor the National Commission on Fraudulent Financial Reporting, an independent private-sector initiative that studied the causal factors that can lead to fraudulent financial reporting. It also developed recommendations regarding financial controls for public companies and their independent auditors, the SEC and other regulators, and educational institutions.

During his talk, Landsittel explained that today, COSO's goal is to provide thought leadership dealing with three interrelated subjects: enterprise risk management (ERM), internal control and fraud deterrence.

One of COSO's many influential documents relating to this subject matter (available at *www.coso.org*) is its 2004 "Enterprise Risk Management – Integrated Framework" (COSO ERM Framework). This document sets forth a comprehensive approach to managing enterprise risks, but, as Landsittel observed, it has not been as widely adopted as COSO had hoped. If you take a look at the COSO ERM Framework, it's not hard to understand why.

The COSO ERM Framework is a comprehensive and well-written, 125-page document detailing procedures companies might adopt to evaluate and manage enterprise risks in a coherent and systematic manner. The basic idea behind the methodology is summarized in the 3D matrix that shows the relationships between business objectives and enterprise risk management components.

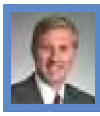
According to a 2010 survey COSO commissioned, however, 26.4 percent of respondents said they thought the cube is unnecessarily complicated and causes a negative reaction to the COSO ERM Framework. Still, only 28 percent of respondents described their current ERM implementation as "systematic, robust and repeatable" with regular reporting to the board. Almost 60 percent of respondents said their risk tracking is mostly informal and ad hoc, or only tracked within individual silos or categories, as opposed to enterprise-wide.

I don't believe that the poor state of ERM in companies can be blamed on the alleged complexity of the COSO ERM Framework. Instead, I think the principle reason we don't do ERM very well is that any serious attempt to systematically manage a company's enterprise risks is an inherently difficult and costly task.

If your company is among the 60 percent whose ERM is not what it should be, and you're inclined to do something about it, here are four things you might consider:

Don't panic

Even if you don't line up with COSO's ERM Framework, your company has likely invested heavily in many functional groups and structures designed to manage your most important enterprise risks. In most companies with a traditional structure, the biggest risks are managed by the law department, tax department, finance and accounting function, quality group, safety, health and environmental team, regulatory team, and other similar functions. If these functions are operating fairly well with reasonable oversight, you've got the luxury of time to sort out how you might improve their performance. If this isn't the case, go ahead and panic.



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Clearly define your objectives

Before you take the first step in persuading others to invest in ERM improvements, think carefully about what the underlying purpose of the exercise is. It's not to reorganize the whole company or make massive alterations to existing structures. Instead, the primary objective is to systematically examine the risks confronting your business, evaluate the effectiveness of your company's ERM, identify opportunities for improvement, and provide actionable intelligence to decision makers about resource allocation and business strategy.

Gather information

Before approaching management with a proposals to improve your company's ERM, you'll need evidence that it needs improvement. To find it, you can: 1) gather and look for trends in audit reports; 2) interview members of your company's functional groups who really know what's working and what isn't; 3) gather objective performance metrics, such as parts per million product defects, fines and penalties, law suits, enforcement actions and the like; and 4) gather data about how firms similar to your own suffered significant failures or setbacks that might have been avoided with a more robust ERM.

Regardless of how you do it, make the case that the business could materially benefit from a more sensibly designed ERM system, or, at the least, that incremental improvements are worth the investment you seek.

Start small

Unless you have an unlimited budget and a mandate from senior leaders to "build the best," avoid scaring your leadership with the COSO ERM cube. Even if your aim is to use the COSO ERM Framework as your guide, it's important to keep in mind that it is likely impractical to get there from where you are today in one jump. So, start small by building a dirt path first and getting people to actually use it before you seek funding for a superhighway.

During his remarks, Landsittel made a point of observing that the ERM field is still in its infancy. Given the continued failures we see on a daily basis in the news regarding firms that lacked sound ERM systems, even if all you do at first is construct a modest dirt path, it's likely a trail worth blazing.

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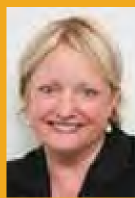

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