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RISK ASSESSMENT: THE FOUNDATION FOR ERM

Buzz Words: Risk Assessment and ERM

Risk Assessment and Enterprise Risk Management (ERM) are becoming two of the biggest buzzwords in the Credit Union industry today. Although the underlying goals of Risk Assessment and ERM are similar: to identify and manage risk, the importance of using Risk Assessment to build the foundation for ERM programs is sometimes overlooked. The significance of effective Risk Management in the Credit Union industry is being highlighted by the recent financial crisis coupled with the failings and government takeovers of many large natural person and corporate Credit Unions. Risk Management is becoming more prevalent in the minds of Credit Union executives as they try to guide their organizations through the current economic downturn, and rethink how to be better prepared in the future. Credit Unions and regulators alike are trying to understand how the recent crisis occurred, and how to ensure something similar does not happen in the future. While attempting to understand the crisis, the lessons are clear – we need to improve the way we identify, understand, and manage risk.

Risk Management is also gaining traction as regulators in the public and private sectors grapple with how to impose better control. The Sarbanes-Oxley act of 2002 is the most well known legislation aimed at improving visibility into how publically traded companies manage the risks related to external financial reporting. More recently SAS 104-112 is aimed at imposing a similar, but slimmed down version of SOX on private companies as well as Credit Unions. In addition to SAS 104-112, Credit Unions are subject to compliance requirements from the NCUA on improving Risk Management practices (e.g., NCUA 748 A - SAR reporting and filing requirements, Risk Assessment requirements and compliance program requirements). The message is clear: Risk Management is no longer a voluntary exercise. This mounting pressure to implement Risk Management, however, has led some organizations to implement programs without performing proper planning or effectively utilizing a Risk Assessment approach to build the necessary foundation for a successful ERM program.

ERM Begins with Risk Assessments

Many organizations view Risk Assessment and ERM as similar and interchangeable terms. This belief is causing some organizations to perform a one-time Risk Assessment believing that they have implemented an ERM program or a slimmed down version of ERM. The two major problems with this belief are first, performing a Risk Assessment is not the same as performing true ERM and second, Risk Assessments performed on a one time/ad hoc basis are static and only capture risk for a certain moment in time.

In order to effectively implement a comprehensive ERM program, organizations must embrace the concept that effective Enterprise Risk Management is an ongoing and continuous process. Although implementing ERM often requires dedicated resources and introduces new processes, it is simply a framework to structure ongoing and continuous Risk Management. Risk Assessment, on the other hand, is an ERM component providing prioritization and scoping for the overall ERM program. Performing an initial risk assessment as part of the initial ERM planning phase allows organizations to identify the business areas with the highest potential risk. As organizations continue to grow, transform, and adapt, updating Risk Assessments periodically allows management to stay aware of the changing risk landscape. The ability to understand potential risk in a changing business environment is essential to an effective ERM program and requires consistent, efficient, and ongoing Risk assessments.

Conducting Risk Assessments

The goal of Risk Assessment is to provide management with an understanding of where potential risk exists in the organization. Risk Assessments are typically conducted by personnel with strong internal controls, Risk Management, or audit backgrounds, and require a deep understanding of the business. When conducting a Risk

About Vital Insight

Vital Insight, Inc. was founded in 2005 by former Big Four accounting firm executives and visionary software architects with a single goal in mind - to help companies manage and simplify Governance, Risk and Compliance.

With industry best practices built into the solution, our Governance Insight platform enables companies to automate, centralize, and streamline Enterprise Risk Management, audit, and global compliance programs. Our solutions help customers and partners to lower overall compliance and Risk Management costs, ensure greater regulatory compliance, and create effective corporate governance frameworks that can be leveraged across the enterprise.

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Assessment, management identifies and uses Key Risk Indicators (KRIs), associates those KRIs to business processes and/or business areas, and provides a score for each business process / KRI association. KRIs are not actual risks, but rather gauges to evaluate whether actual risks may exist and what impact a risk could have. Some KRI examples include: Fraud, Complexity, Prior Audit Findings, Access to Member Data, and Use of Accruals. Identifying the proper KRIs to use is specific to each individual Credit Union, and may require identifying as little as five and as many as thirty or more KRIs (i.e., not all Credit Unions will have the same number or types of KRIs).

Once the KRIs are assigned to business processes and scored for each business process or area, the resulting scores allow management to prioritize business processes based on the assigned potential risk. Management can then use the business process prioritization to determine where and how to focus the ERM program. Continuing to update the Risk Assessment on a periodic basis (e.g., annually), gives management the ability to refine and improve the ERM program focus, and also understand how the risk landscape changes over time.

Performing Risk Assessments requires tracking and managing a significant amount of data and supporting calculations. Many risk managers may become overwhelmed with the administrative requirements of the risk assessment, and data can often become outdated or error-prone. Rather than focusing on prioritizing and analyzing business processes, many organizations struggle with just operating the program. Therefore it is very important to have guidelines, procedures, and technology in place to automate and manage Risk Assessment performance, data, and reporting.

Benefits of Automation

When performing and managing the Risk Assessment process, Credit Unions and their risk managers need to focus on performing effective and efficient Risk Assessments. The burden of data management, change control, and other administrative activities can slow down the process and cause potential errors.

Whenever possible, organizations should look towards automation to manage Risk Assessment data, metrics, and reporting. Automating the Risk Assessment process, as well as other ERM program components, helps reduce the administrative overhead required to manage a significant amount of data. More importantly automation provides a method for managing, controlling access, and consistently reporting on Risk Management data.

Vital Insight's ERM solution (Governance Insight) provides full centralization and integration of Risk Assessment data, ensuring that current information is always being available and easy to update. Organizations that have conducted a risk assessment have completed the first – and most difficult part of an ERM program. Armed with the initial risk assessment, ERM efforts can be focused on the highest risk processes, products, and systems. Hundreds of risks may be identified and evaluated, with corresponding risk responses and mitigation activities documented and managed as well. Using Governance Insight to conduct the preliminary risk assessment provides a path for organizations to implement a comprehensive ERM program. Governance Insight allows management to determine appropriate risk responses, maintain and monitor control activities, and create and distribute meaningful status and deficiency reporting.

Vital Insight's solution streamlines the entire ERM process by managing documentation and workflow, tracking activities, providing a centralized repository for organizational policies and regulations. The software also provides executive dashboards and reports to track progress, manage issues, and ensure accountability. In addition, Vital Insight provides the Credit Union market with industry leading training, education, and consulting services from ERM experts and partners. This combination allows Credit Unions to institute stronger risk and control environments, which result in better operational practices, improved reputation, and increased member confidence.