# The Institute of Certified Public Accountants of Kenya (ICPAK)

**ENTERPRISE RISK MANAGEMENT SEMINAR**

**Theme: OVERCOMING EMERGING BUSINESS COMPLEXITIES**

***Topic:*** ***RISK GOVERNANCE***

***By***

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# Introduction

Governance is about how systems are ran and managed, the totality of actions, processes and traditions through which authority is exercised, decisions made and implemented.

Risk is the uncertain consequence of an event that adversely affects something of value to human beings. The effects of uncertainty on objectives with opportunities and benefits.

Risk governance is the identification, framing, assessment, management and communication of risks, the totality of actors, rules, conventions, processes and mechanisms through which relevant risk information is disseminated and how management decisions are taken.

# Risk Governance

It applies the principles of good governance.

It deals with how risk is managed within the purview of competing interest and needs .

Involves analysing and reviewing the opportunity costs attendant to every resource utilization. What sacrifices are to be made for what returns?

*"Success is 99 per cent failure"* Soichiro Honda

# Risk Governance

Includes risk profiling of each venture and strategic option taken on board, so that costs are weighted against benefits over a spectrum of choices, time and other variables;

Measures the cost-return (risk-benefit) differentials in risky ventures to obtain the optimal differential; *"Anticipate the difficult by managing the easy"* Lao Tzu

Reviews risk management measures put in place for compatibility, acceptability and approval;

Addresses the environmental factors that undermine effective risk management measures and systems; *"To be alive at all involves some risk."* Harold Macmillan

# Risk Governance Soft Issues

- Are all stakeholders’ interests taken into account?
- Is there violation of human rights in the measures?
- Are the risk management measures within the labour laws?
- Do the measures condone corrupt practices?
- Do they corrupt systems, procedures or processes?
- Do confidentiality clauses in contracts and companies limit exchange of information or outflow of information?
- Is the best option to mitigate reputational, legal or regulatory risks?

# Risk Governance

Risk governance advocates for adequate disclosure of relevant information for informed decision making;

It measures responsible and responsive reporting, communication and actions.

Supports Responsible & Responsive information sharing - providing adequate information on a need to know basis timely, accurately and correctly – without misrepresented facts or misconception or misinterpretation of information.

Misrepresentation of facts is bad risk governance in itself.

# Evidence-based Risk Governance

Risk governance mitigates potential danger accurately, correctly, timely and at minimal costs; stating facts objectively and responsibly based on available evidence on:-

- What is the role of science and technology in risk-related policymaking?
- Do organisations and people at risk understand the hazard and its consequences?
- Do they have the capacity to manage the risk and the resilience to deal with unavoidable consequences?
- What are the secondary impacts of a risk and how are they managed?

# Evidence-based Risk Governance

- What societal, environmental and economic values affect one's willingness to accept the risk?
- To what extent should a precautionary approach be used to address uncertainty and ambiguity?
- How best should one balance an inclusive approach to decision-making with the need to reach a decision?

(Source: IRGC, 2005)

# Benefits of a Risk Governance Framework

i) Efficiency in resource allocation,

ii) Improved information sharing,

iii) Coordinated strategy in risk management

iv) Better accountability to all stakeholders,

v) Sustainable competitive advantage,

vi) Solidified organizational integrity and reputation,

vii) Effective response when a significant event occurs,

viii) Avoids financial surprises,

ix) Effective management of resources

(Source: The Accountant, June-July 2010/2013)

# Factors that Influence Risk Governance

Many risks are accompanied by potential benefits and opportunities and influenced by the complexity, uncertainty and ambiguity on the technical aspects of risks.

**Complexity** - the difficulties in identifying and quantifying cause-effects links between a multitude of potential cause agents and specific observed effects.

**Uncertainty** – the lack of clarity or quality of the scientific or technical data, e.g. uncertainty inherent in natural disasters, acts of terrorism and sabotage.

**Ambiguity** - results from divergent or contested perspectives on the justification, severity or wider meanings associated with a given threat.

# Factors Influencing Risk Governance Procedures

Risk governance procedures are influenced by;-

- Top management support  and commitment,
- Effective communication,
- Positive culture,
- User friendly information technology (IT),
- Clear organization structure,
- Appropriate training,
- Public confidence & trust,

(Source: Ranong, P & Phuenngam, W, 2009).

# Challenges of Risk Governance

According to the International Risk Governance Council (IRGC, 2008) "*The **challenge** of better risk governance lies in **enabling** societies to **benefit from change** while minimising the negative consequences of associated risks*".

Risks arise from change and carry with them potential opportunities, benefits and challenges.

Challenges arise from i) ever increasing interconnectedness, ii) social networking, iii) an increasing volume of data and iv) fast-paced technological change, not matched with the slow evolution in risk governance mechanisms.

# Risk Governance Deficits

A risk governance deficit is a failure in the identification, framing, assessment, management and communication of a risk issue or  how it is being addressed. It is a risk governance challenge.

Risk governance deficits are common and are found throughout the risk handling process and operate at each stage of the risk governance process. Deficits limit the effectiveness of a risk governance framework, being actual and potential shortcomings.

To deal effectively with risk governance deficits, a good understanding of how they arise and how they are addressed is critical.

# Risk Governance Deficits

A study by IRGC (2008) analysing, “what went wrong?” “What goes wrong today?” and “What might go wrong in future? helps understand the causes of failures in the risk governance processes. ***Risks may not originate from failures in the risk governance processes but governance failure may cause risks***.

Risk governance deficits arise from the:-

i) assessment and understanding of risks - due to deficiencies either in scientific knowledge or knowledge about values, interests and perceptions of individuals and organizations;

ii) management of risks - relate to the roles of organizations and people in managing risks.

# Deficits From Assessment and Understanding of Risks

- Detecting early warnings of risks;
- Factual knowledge about risks;
- Perceptions of risk - determinants and consequences;
- Stakeholder involvement;
- Evaluating the acceptability of risks;
- Misrepresenting information about risks;
- Understanding complex systems;
- Recognising fundamental or rapid changes in systems;
- Assessing potential surprises;

# Deficits arising from Managing Risks

- Responding to early warnings;
- Designing effective risk management strategies;
- Considering a reasonable range of risk management options;
- Designing efficient and equitable risk management policies;
- Implementing and enforcing risk management policies;
- Anticipating side effects of risk management;

# Deficits arising from Managing Risks Contd.

- Reconciling time horizons;
- Balancing transparency and confidentiality;
- Organizational capacity;
- Dealing with dispersed responsibilities;
- Dealing with common problems and externalities;
- Managing conflicts of interests and ideologies;
- Acting in the face of the unexpected;

# Consequences of Risk Governance Deficits

Potential consequences of Risk deficits include:

- Lost opportunities and benefits;
- Costs incurred due to inefficient regulations;
- Loss of public trust;
- Inequitable distribution of risks and benefits between players
- Excessive focus on high profile risks, to the neglect of higher probability but lower profile risks;
- Failure to move from ‘business as usual’ and trigger corrective action;

# Sound Risk Governance

Addresses the consequences of risk deficits to minimise;-

- Inequitable distribution of risks and benefits;
- Effects of different approaches of assessing and managing the risk;
- Excessive focus on high profile risk versus high probability low profile risk;
- Inadequate considerations of risk trade-offs;
- Failure to understand secondary effects and linkages between issues
- Costs of inefficient regulations & loss of public trust;
- Decisions that discount public perceptions;

# Best Practices in Strategic Risk Governance

- Ascertain risk appetite;
- Define risk broadly by risk type;
- Recognize the downsides and the opportunities of risk;
- Develop a culture of evaluating and identifying different risks;
- Examine the total cost of risk financially and non-financially;
- Develop a disciplined process of discussing risk in strategic forums;
- Designate a risk identification champion;
- Have top decision makers prioritize risk;

# Best Practices in Strategic Risk Governance contd.

- Identify and monitor risk that interferes with strategic goals;
- Institute annual reports for high priority risks;
- Reassess high priority risks routinely under changing circumstances;
- Review and keep track of risks that are omitted or ignored;
- Institute risk identification mechanism across the organization;
- Benchmark risk practices with other institutions;
- Treat risk assessment practices as a continuing process;

(Source: The Accountant, June-July 2010)

# Risk Classification

***Degree of uniqueness***: is the risk emerging, re-emerging, increasing in importance, current (topical) or institutionalised?

***Scope****:* is the risk local, dispersed, trans-boundary or global?

***Range****:* does the risk impact on human health and safety, the environment, capital assets, trade?

***Time horizon***: what is the time frame available for analysing a risk?

***Type of hazard***: is it pervasive, persistent and or irreversible?

***Delay***: Is there a long time span between the trigger and effects of risk?

***Risks in science & technology***: is the change incremental?

# Risk Governance Framework

It is a comprehensive approach to foster better understanding, analysis and management of high priority risks to devise strategic options of dealing with them. The framework must:

- be informed by existing legal and regulatory provisions;
- bear the interests of all stakeholders;
- be objective, clear and free from ambiguities;
- be flexible to provide for environmental dynamics;
- be fair and seen to be fair;
- be facilitative and user friendly;

# Effective Risk Governance Framework

An effective framework distinguishes between analysing and understanding a risk (risk appraisal) and deciding what to do about a risk (risk management).

- It is able to easily identify weaknesses and vulnerabilities in systems, processes and procedures;
- It is capable of analysing risks and pricing them properly;
- It provides appropriate incentives and or penalties to induce prudent and right behaviour by stakeholders';
- It encourages innovations and focuses largely on the effects and impact of risk governance deficits;

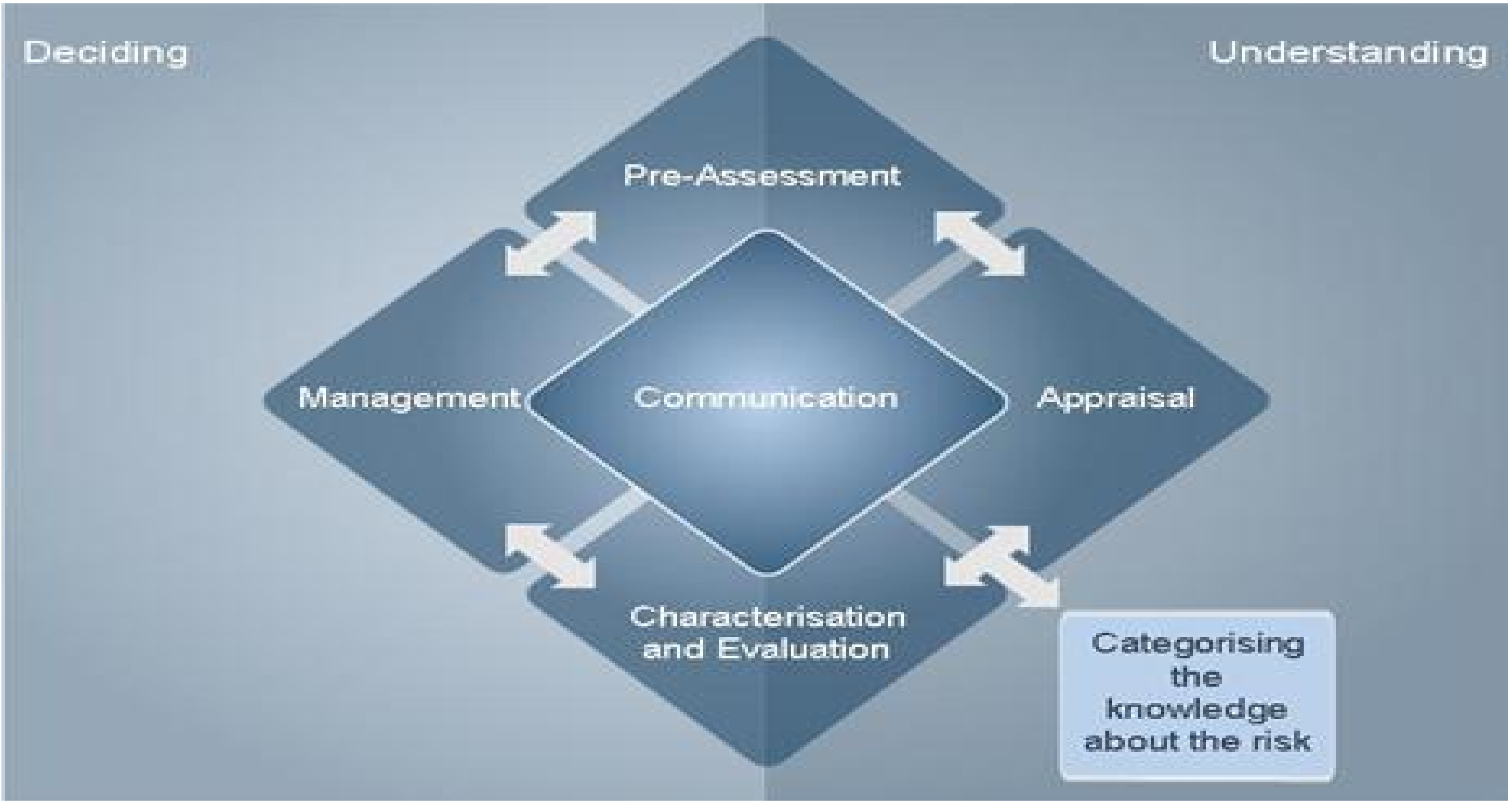
# Risk Governance Framework Development

There are five interlinked phases in developing an effective risk governance framework. The stages are;-

- Risk Pre-assessment Stage
- Risk Appraisal stage
- Characterisation and evaluation stage
- Risk Management stage
- Risk Communication stage

Source: IRGC's White Paper , 2005

# Risk Governance Framework




Source: IRGC's White Paper , 2005

# Risk Pre-assessment Stage

Do “early warning and framing” of the risk to provide a structured definition of the problem, how it is framed by different stakeholders, and how it is best handled. Pre-assessment clarifies the various perspectives on a risk, defines the issue to be looked at and forms the baseline for how the risk is assessed and managed. Crucially, it captures:

- the variety of issues that stakeholders and society may associate with a certain risk (and the related opportunities);
- existing indicators, routines and conventions on what is to be addressed as the risk, and the manner in which it should be addressed.

# Risk Pre-assessment Issues

- What are the risks and opportunities we are addressing?
- How do we define the limits for our evaluations?
- Do we have indications that there is already a problem? Is there a need to act?
- Who are the stakeholders? How do their views affect the definition and framing of the problem?
- What are the established scientific or analytical tools and methods that can be used to assess the risks?
- What are the current legal & regulatory systems and how do they potentially affect the problem?

# Risk Pre-assessment Issues & Deficits

- What is the organisational capability of the relevant governments, international organisations, businesses and people involved?
- What are the various dimensions of the risk?

***Deficits in Pre-Assessment Stage***

***Warning:*** signals of a known risk have not been detected or recognised;

***Scope:*** a risk which is perceived as having only local consequences may in fact be much broader and vice-versa;

***Framing:*** different stakeholders may have conflicting views;

***"Black swans":*** no awareness of a hazard or possible risk;

# Risk Appraisal Stage

Risk Appraisal combines a scientific risk assessment (of the hazard and its probability) with a systematic concern assessment (public concerns and perceptions) to provide the knowledge base for subsequent decisions.

Concern assessment is a special innovation, to ensure that decision makers account for how the risk is viewed when values and emotions come into play.

# Risk Assessment Issues

- What are the potential damages or adverse effects?
- What is the probability of occurrence?
- How pervasive could the damage be? How persistent? Can it be reversed?
- How clearly can cause-effect relationships be established?
- What scientific, technical and analytical approaches, knowledge and expertise should be used to better assess these impacts?
- What are the primary and secondary benefits, opportunities and potential challenges?

# Concern Assessment Issues

- What are the public’s concerns and perceptions?
- What is the social response to the risk?
- Is there the possibility of political mobilisation or potential conflict?
- What role are existing institutions, governance structures and the media playing in defining public concerns?
- Are risk managers likely to face controversial responses from differences in stakeholder objectives and values, or from inequities in the distribution of benefits and risks?

# Deficits in Appraisal Stage

***Information***: scarcity of scientific data about the risk and or about people's concerns, or, if there is sufficient information, there is a failure to accept it;

***Confidence***: a low confidence level in the data, the model or the interpretation of it;

***Lack of attention*** to interdependencies and interactions between actors and between actors and the risk target;

***Inadequate attention*** is given to the concerns of stakeholders;

# Characterisation and Evaluation Stage

Risk is evaluated as acceptable, tolerable (requiring mitigation), or intolerable (unacceptable) using the scientific data and having a thorough understanding of societal values affected by the risk. Pertinent risk evaluation issues include:-

- What are the societal, economic and environmental benefits and risks?
- Are there impacts on quality of life?
- Are there ethical issues to consider?
- Is there a possibility of substitution? If so, how do the risks compare?

# Characterisation and Evaluation Issues

- Does a choice of a particular technology impact on the risk? How?
- What are the possible options for risk compensation, or reduction?
- What are the societal values and norms for making judgements about tolerability and acceptability?
- Do any stakeholders – government, business or others– have commitments or other reasons for wanting a particular outcome of the risk governance process?

# Deficits in Characterisation and Evaluation Stage

***Exclusion:*** when some stakeholders and their views or significant benefits are accidentally or deliberately excluded from the evaluation process;

***Indecision:*** when there is indecision or lack of responsiveness, voluntarily or involuntarily;

***Transparency:*** when trade-offs are not made explicit and hidden agendas seem to determine the outcome of the evaluation process;

***Overlooking values*** – failing to fully consider social needs, environmental impacts, cost-benefit analyses and risk-benefit balances;

***Timing:*** when the timing issues are not properly addressed;

# Risk Management Stage

Risk management is about fairest costs and optimal returns, to ensure all tolerable risks have appropriate and adequate measures, i.e. actions and remedies necessary to avoid, reduce, transfer or retain the risks. It includes the generation, assessment, valuation and selection of appropriate risk reduction options and implementing the selected measures, monitoring their effectiveness and reviewing decisions taken. It addresses;-

- Who is, or should be, responsible for decisions within the context of the risk and its management?
- Have they accepted this responsibility?
- What management options could be chosen (technological, regulatory, institutional, educational, compensation)?

# Risk Management Issues

- How are these options evaluated and prioritised?
- Is there an appropriate level of international cooperation and harmonisation for global or trans-boundary risks?
- What are the secondary impacts of particular risk reduction options?
- What potential trade-offs between risks, benefits and risk reduction measures may arise?
- What measures are needed to ensure effectiveness in the long term compliance, enforcement, monitoring, and adaptive management plans?

# Deficits in Risk Management Stage

- ***No entity*** is responsible for managing the risk, or several are and things “fall between the cracks”;
- ***Inadequate or ignored information***: may lead to inappropriate decision;
- ***Regulation***: no appropriate regulatory structure or process;
- ***Sustainability:*** short-term decisions lead to further, secondary problems;
- ***Short-term expediency***: authority makes a decision on a knee-jerk basis to give the impression of management;

# Deficits in Risk Management Stage contd.

- ***Inflexibility***: failure to revisit a risk decision in the light of new knowledge;
- ***Indecision & lack of timeliness***: delays or inaction making matters worse;
- ***Inequity:*** decisions allot the risk and benefits unfairly;
- ***Accountability***: decision makers are isolated from the impact of their decision;
- ***Implementation***: decisions are ignored or poorly implemented;

# Risk Communication

Risk Communication determines how stakeholders and civil society understand risk itself. It allows them to recognise their role and participate in the risk governance process. It means sharing risk governance concerns with employees, shareholders, competitors, lenders, investors and regulators freely. Effective communication is the key to creating trust in risk management. Pertinent concerns in communication;-

- What are the demands, needs and purposes for information and communication?
- How is information interpreted by those who receive it?
- What has been and can be the role of the media?

# Risk Communication Issues

- What is known about the risk and the hazard, by whom, and how can it be conveyed to the interested stakeholders and public?
- How can communication be organised so that two-way information is effective, enlightening and timely?
- Are the concerns of stakeholders and the public being clearly articulated? Are decision makers listening?
- How can communication be facilitated between and among regulators, risk assessors and other experts, risk managers and interest groups?
- What is the degree of confidence in the risk managers responsible for information sharing and for organising a dialogue?

# Deficits in Risk Communication Stage

***One-way information*** instead of two-way flow preventing the building of a dialogue;

The ***communication is not adapted*** to the category of risk (simple, complex, uncertain, ambiguous);

***Communication does not account*** for how different stakeholders receive and accept information;

***Alienation:*** people's or organisations' concerns are treated as irrelevant or irrational;

***Low level of confidence or trust* in the decision-making process**: the information given or the communication channel weakens the whole process;

# Stakeholder Involvement

The concept of risk assessment now encompasses concern assessment – the consideration of individual, organisational and societal perceptions and concerns about the consequences of risk. Concern assessment provides guidance on how best to implement the idea of inclusive governance.

**Inclusive governance** assumes that all stakeholders have something to contribute to the process of risk governance and that their inclusion improves the final decisions.

Stakeholders involvement ensures that the risk handling process is inclusive and responsive to those affected by it, maximises the effectiveness and acceptability of the decisions that are made. It is an important part of the risk governance process.

# Deficits in Stakeholder Involvement

***Exclusion:*** accidental or deliberate exclusion of stakeholders and or their views;

***"Authority knows best":*** a deliberate refusal to seek or accept knowledge or to communicate with other interested parties. Influential stakeholders make all the decisions, irrespective of the need for consultation and dialogue;

***"Paralysis by analysis":*** selection of an overly inclusive process leading to inertia or indecision;

# Widening the Horizon

Beyond risk assessment, management and communication, risk governance framework stresses the social, institutional, political and economic contexts relevant in risk-related decision-making.

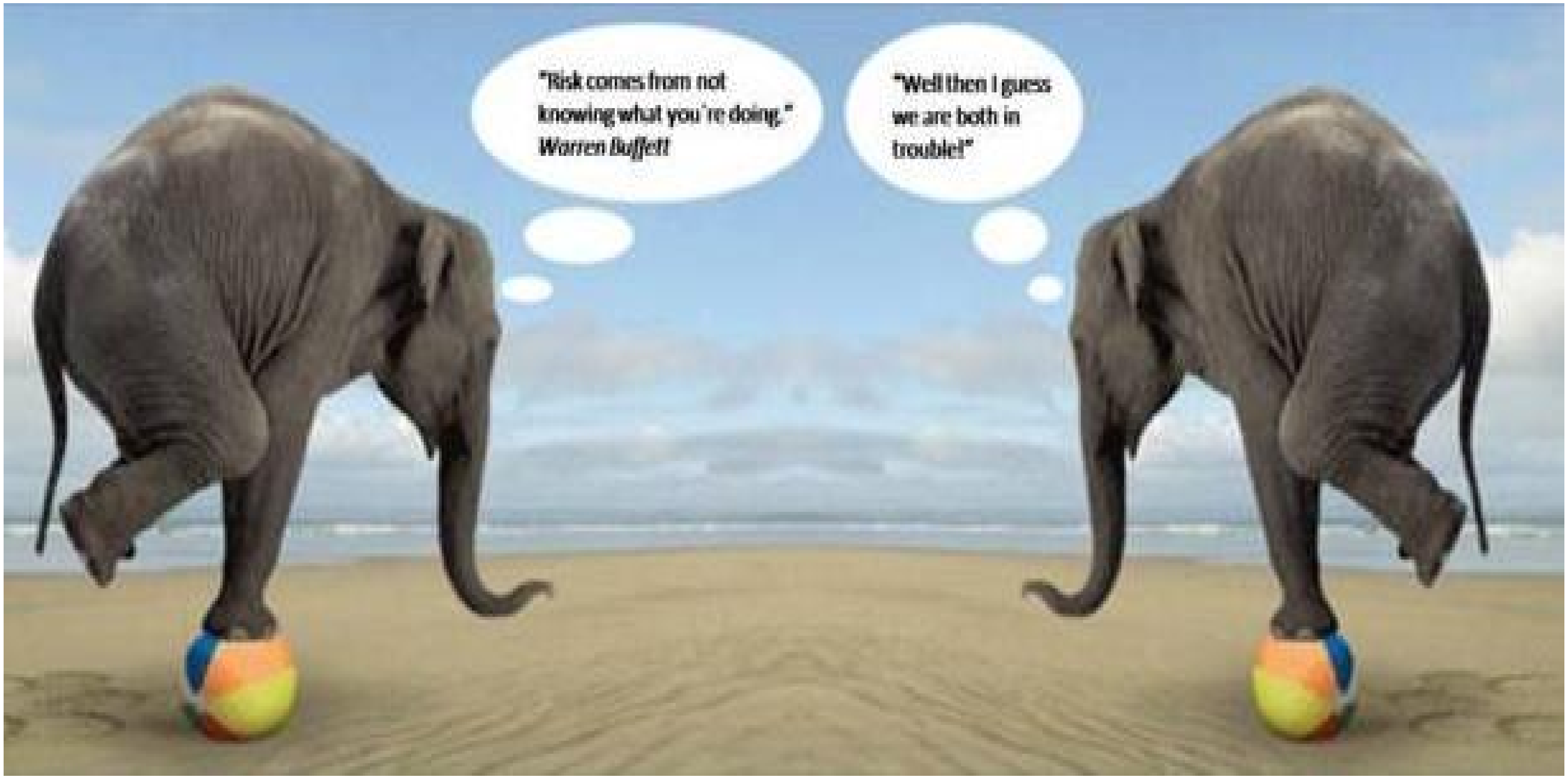
The ***organisational capacity*** - the capability of key actors in the risk governance process to fulfil their roles;

The ***political cultures*** - the governmental and regulatory 'styles' that define particular institutions or countries;

The ***risk culture –*** how it impacts on the level of risk tolerance or risk aversion;

The degree of ***trust*** in the institutions responsible for risk governance;

# Conclusion




Source: Kseniya (Kate) Strachnyi

# QUESTIONS & ANSWERS

THANK YOU