Risk Oversight

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Webinar Objectives

- **Learn**
  - what the term "risk oversight" means, and
  - how risk oversight intersects with the board's legal and fiduciary responsibilities.
- **Jump in**
  - take a close-up look at several risk oversight frameworks, and
  - explore how to custom fit a risk oversight capability to your mission, circumstances and the maturity of your nonprofit

What is Governance?

- Means in which the leading authority, often the board of directors… guides and monitors the **values** and **goals** of its organization through policy and procedures.

  Source: **www.pfc.ca/cms_en/page1112.cfm**

- **Governance** is the act of governing. It relates to decisions that define expectations, grant power, or verify performance. It consists of either a separate process or part of decision-making or leadership processes.

  Source: ***Governance Journal***

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What is Risk Governance?

- **Risk governance** applies the principles of good governance to the identification, assessment, management and communication of risks.

Source: International Risk Governance Council

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What does "risk "oversight mean?

- Here's a corporate definition:
  - Directors are responsible for **risk oversight**, including **overseeing management's systems and processes for risk management** (identifying, evaluating, prioritizing, mitigating and monitoring risks).
  - Directors are also responsible for **approving the corporation's risk parameters** including risk tolerance and appetite. Such parameters are designed to prevent the destruction of asset and shareholder value and to reduce the likelihood of underperformance over the long term.
  - Directors should consider taking a heightened interest in **assessing risks associated with strategy and leadership** since management should not be expected to objectively assess its own performance, capabilities and strategy from a risk perspective.

SOURCE: *"Building High Performance Boards," CCGG*

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What does "risk oversight" mean in a nonprofit organization?

- The Board is responsible for overseeing management's efforts to identify, evaluate, prioritize, mitigate and monitor risks.
- The Board is also responsible for establishing risk policies that protect assets needed for the nonprofit's mission.
- The Board should pay special attention to the risks associated with strategy.

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What is Risk Oversight?

Means by which the board of directors guides and monitors:

- the organization's risk appetite,
- risks related to strategy, and
- the adequacy of risk management activity that is the responsibility of management.

Source: Herman and Del Bel Belluz

Boards and Management have Different Roles

- **Board Role:** Oversight and Governance
- **Legal Duties:** Duty of Care, Duty of Loyalty, Duty of Obedience
- **Roles Challenged by:**
  - Oversight pressures
  - Social dynamics of decision-making
  - Information gap

Management and the **Board share** responsibility for an evolving **Risk Culture**

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Another perspective on the Board's role

"The **board** should adopt a written mandate in which it explicitly acknowledges **responsibility for**...

b) adopting a strategic planning process and **approving**, on at least an annual basis, a **strategic plan** which takes into account, among other things, the **opportunities and risks** of the business;

c) the **identification of the principal risks** of the issuer's business, and **ensuring** the implementation of appropriate **systems to manage these risks** ..."

Source: ***Corporate Governance Guidelines, National Policy 58-201***, Canadian Securities Administrators (approved, June 2005)

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The New Expectations for Risk Management Oversight

- Boards are placing an increased emphasis on risk management in response to accusations that boards "missed" the risks that led to or exacerbated the financial crisis and corporate failures of 2008.
- While the execution of the risk management function remains the responsibility of management, boards must be vigilant in overseeing this function.

Source: What Boards Should Be Doing Right Now. Jeffrey Stein, King & Spalding LLP. The Harvard Law School Forum on Corporate Governance and Financial Regulation, December, 2009

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10

NACD Blue Ribbon Commission Report:

Risk Governance: Balancing Risk and Return

Every board should be certain that:

1. the risk appetite implicit in the business model, strategy, and execution is appropriate;
2. expected risks are commensurate with the expected rewards;
3. management has implemented a system to identify, prioritize, monitor and manage risk,
4. management keeps the board informed about major risks;
5. a culture of risk awareness exists throughout the organization; and
6. there is recognition that management of risk is essential to the successful execution of the key strategies.

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What does the Board know… and when does it know it?

Asymmetric information —
the gap between the information *known by management* and the information <u>presented to the board</u>.

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Asymmetric Information

The Advisory Council noted that:

- "The role of a director, by nature, is a part-time job. As such, directors are reliant upon the executive team to provide information necessary to evaluate risks and corporate performance. Obviously, management cannot—and should not—provide every piece of data to the board. Thus, in selecting the information to be presented to directors, gaps can arise in what the C-suite is aware of as opposed to the board."

SOURCE: 2012 NACD Advisory Council on Risk Oversight

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The Failure of Risk Oversight

"Much of what is commonly referred to as enterprise risk management (ERM) has been implemented using a "risk-centric" approach where the focus is on risks without equal or greater focus ensuring clear linkage to related business objectives."

"Generally this approach involves conducting annual workshops and/or asking management via interviews and/or online surveys what they view as the firm's top risks. This annual update generates lists of the top 10, 20, or 50 risks along with an action plan to address "red rated" risks, risks where the current mitigation efforts are considered inadequate."

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How are risks typically shared with a board?

- Lists of top risks are periodically presented to the board.
- Risk "heat maps" and risk "traffic lights" are used to communicate the urgency of risk issues.
- **What's missing?** Connection to overall objectives and goals… issues key to mission success.

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You Get What You Ask For

- "…arguably the biggest single handicap that boards of directors face today in [risk oversight] … **is self-inflicted**."
- "Many boards, for a variety of reasons, including the rationale that **"this is how we've always done it**" or **"it would be impolite to ask,"** have simply not asked senior management and other relevant parties for the type, quality, and quantity of information necessary to meet increased risk oversight and risk governance expectations.
- Directors must ask themselves, "**Are we as a board meaningfully influencing the** type and quantity of… risk …**information provided by management**, internal auditors, risk functions, chief legal counsel, external auditors, and other key players?"

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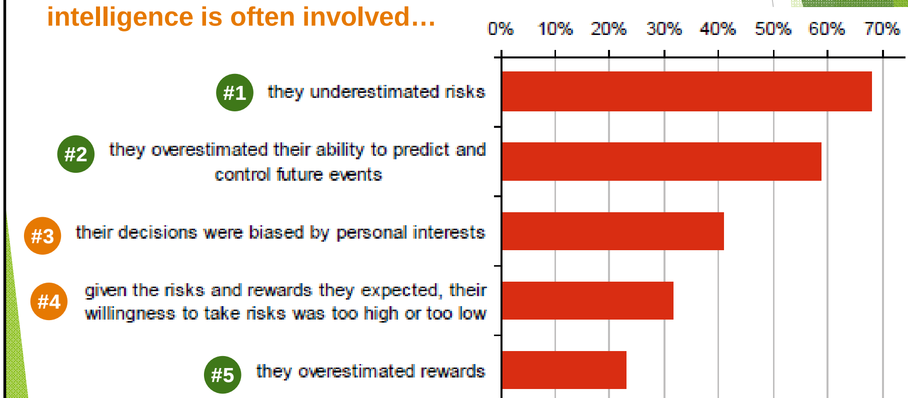
Risk intelligence depends on:

-The ***supply*** of high-quality risk information
- The ffectiveness of decision processes (***apply*** risk info)

When strategies fail, a lack of risk intelligence is often involved…



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Source: *The Association of Chartered Certified Accountants (London), 2012*
The Reality of Risk, Culture, Behaviour and Role of Accountants

Some key attributes of Qualified Risk Directors

Selected from the Risk Directors Governance Council, DCRO

- **Personal Attributes:**
  - Unafraid to ask basic and necessary questions
  - Assertive and able to manage conflict with strong personalities and to challenge "group think"
  - Healthy skepticism, able to probe and challenge without becoming antagonistic

How can the board cultivate these behaviors?

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Board-Driven / "Objective-Centric" Approach to Risk Oversight

- Help boards embrace their risk oversight role
- Provide role clarity
  - Board, board committees, CEO, management team, risk committee, functional teams
- Insist on a link between risk oversight and the mission and core objectives of the organization
- Provide board training, particularly on soft skills

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Examples of a Board's Goals for Risk Oversight

- Increasing the likelihood of achieving the organization's mission and objectives
- Enhancing the organization's success competing for contracts and other opportunities
- Increasing the ability to cope with uncertainty (e.g., funder/donor loyalty, client loyalty)
- Enabling the organization to better meet the expectations of consumers, customers, volunteers, members, donors, chapters, etc.
- Meeting risk management expectations from accrediting bodies and national organizations
- Enhancing stakeholder confidence

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SAMPLE
The Board's Role

The **Board of Directors** is responsible for:

- Determining the organization's risk appetite
- Assessing whether the expected risks in the organization's strategic plan are commensurate with the expected rewards
- Evaluating the adequacy and appropriateness of processes to manage, monitor, and mitigate risk given the organization's size, growth aspirations, business model, and key strategies
- Providing guidance to ensure that the risk management program delivers reliable information to the board on the major risks facing the organization, including significant risks to the organization's reputation

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Key Risk Oversight Questions

- Is our risk-taking calibrated to balance the demand for short-term performance/success with long-term sustainability?
- Do we acknowledge (or bury) failure and do we exercise discipline in learning from our mistakes?

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Risk Oversight

- **Does the board receive accurate, timely information about the risks facing the organization?**
  - "The potential indicators of an inadequate infrastructure can be the lack of adequate and timely information about risk, inconclusive discussions about risk, or feelings of being uninformed about risks."

SOURCE: Deloitte: *Risk Committee Resource Guide for Boards*

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Key Risk Oversight Questions

1. Do our decisions and actions strike an appropriate balance between risk and reward in strategic decisions? (i.e., align with risk appetite and balance the demand for short-term performance with long-term sustainability)
2. Do we understand how enterprise risks are identified and assessed and prioritized?
3. Are we satisfied that management & staff are taking appropriate steps to manage enterprise risks and build resilience?
4. Are we satisfied with the ongoing efforts to monitor the organization's risk exposures and its capacity to respond?
5. Do we exercise discipline in learning from our performance (successes/failures/mistakes)?

24

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Creating a Risk Oversight Framework

The key questions in a risk oversight framework are:

- WHO?
- WHAT?
- HOW?

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Let's start with WHO

- "In carrying out their role of risk oversight, some boards choose to assign responsibility to selected committees to assess the risks relative to their mandate. Some boards have established a separate risk committee. Many boards prefer to have risk oversight assessed by the entire board." SOURCE: *"Building High Performance Boards," CCGG*
- (1) existing committees; (2) new risk committee; (3) board as a whole
- How to decide?
- What will work best for your BOARD given your governing structure, size, and culture?

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WHAT

- Review the examples of goals, aspirations, and board roles for risk oversight
- See slides #19 and #20

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HOW

- Clearly assign board responsibility for risk oversight (e.g., in the bylaws, committee charters, etc.)
- Ensure breadth of capability on the board to understand and oversee critical risks; retain independent advisors as needed
- Ensure directors are engaged in a conversation about risk: what's changing? What more do we need to know to make the best possible decisions about strategy?
- Allocate sufficient time on the board's agenda to consider risk.
- Begin drafting a narrative about how the board oversees risk.
- Educate board members and prospective directors on the behavioural expectations for risk governance: (e.g., asking questions that emphasize evidence, objectivity, and open exploration of uncertainty)
- Provide board training on soft skills

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Join us for the two remaining sessions in Risk Governance series

- **Risk Aware Boards** (July 7th)
- **Teamwork is Job One** (November 3rd)

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Closing Thoughts

Contact us with questions!

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