

# Insights

## Risk Management



### The Legal Profession An Insight for November 24 2010

This feature will examine how SA's legal profession is structured, the scope of services provided, the impact of recent and pending legislation and how legal firms are adapting to the challenges of the internet information age.

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## Key cost factors

THE responsibility for growth, profitably and continuity within an organisation — each of which form a vital pillar of organisational success while creating shareholder value — lies squarely in the hands of senior management.

Steyn McDowall, Aon global risk consulting executive, says fundamentally there are two main cost components to enterprise risk management.

"First, there is the cost of risk controls. "These control measures are put in place before the event occurs. Whether they are preventative, detective, corrective or detective, each control's purpose is to ensure the consequence associated with the realisation of the risk is mitigated sufficiently."

McDowall says the second cost component refers to the cost of the response.

"Senior management can elect either to transfer the risk to an insurer at a negotiated premium; tolerate the risk and ensure that it remains within acceptable limits; terminate the activity associated with the risk; treat the consequence after the risk has materialised; or take the risk," says McDowall.

# Protect the bottom line

Companies must ensure they get paid and avoid bad debt, writes DAVID JACKSON

WHETHER the corporate crystal ball is predicting a U-shaped recovery or a double-dip recession, the question for companies should be: have they protected their bottom line?

"There should now be no sharper focus for companies than ensuring that they get paid, for it is liquidity and profitability that ultimately will be the separator between making a go of it or just becoming another statistical failure," says Roger Munitich, GM marketing and R&D at Credit Guarantee Insurance Corporation.

"Any risk-management model should be sounding loud alarm bells if there is any probability of incurring one or more bad debts. A bad debt loses a company a lot more than just the cost of the goods; it also interrupts cash flow and wipes out the profit margin — then start adding the costs of trying to recover the debt. It is actually

quite alarming when one considers the effect that one or more bad debts could have on a company. Risk management, as King 3 espouses, should take this aspect into consideration."

Mike Morgan, national manager: corporate business at Zurich South Africa, says that organisations both locally and internationally are considering their strategic options as they adapt to a challenging economic landscape and an increasingly regulated environment.

"Emerging slowly from the mire of the recent economic crisis, this is no time for complacency and organisations will need to ensure that their risk management philosophy is appropriate to identify, assess and mitigate not only industry-specific challenges, but also those of a more generic nature, such as, for example, epidemics. "Stakeholders continue to demand above-average returns and this places an even heavier burden on management to maintain competitive advantage in order to deliver improved top- and bottom-line performance."

"This calls for a closer alignment between the risk management philosophy and the strategic direction of the business. There is a compelling



Roger Munitich ... if one or more bad debts are being incurred alarm bells should sound.

need for risk managers to become more involved in all facets of the business and play an increasingly important role in driving strategy."

With the worst of the global financial crisis now apparently over, organisations are facing a variety of recurring new threats and challenges.

This has been highlighted in the third annual Ernst & Young global business risk report in which more than 70 leading industry executives and analysts

across 14 industrial sectors were asked to identify and rank the top business risks for each sector for the next 12 months, as well as risks currently below the radar that could rise into the top 10 in the years ahead.

Regulation and compliance regained the top spot across the majority of sectors, according to the report, driven principally by the general uncertainty surrounding regulation, which analysts believe is stalling business decision-making.

However, access to credit and the threat of continuing weak economic performance in parts of the world remained high on the list of potential concerns. Recruiting and managing talent was a significant climber up the risk table this year, as was dealing with emerging markets and social acceptance risk. Corporate social responsibility was new to this list this year, suggesting different strains on business as the economic recovery takes shape.

Norman Lonergan, global head of advisory at Ernst & Young, says: "Although there is some sense of normality with firms now refocusing on how to compete with available talent and looking at the risks and opportunities of investing in



Norman Lonergan ... access to credit is still the second-highest risk that business faces.

emerging markets, access to credit is still the second-highest risk that business faces and the risk of a double-dip recession the third. Now is definitely not the time for companies to take their eye off the ball.

"It is clear that across the sectors organisations need to continue to scan the environment to identify emerging risk issues. The ability to anticipate threats, respond and adapt is as a critical a part of the management process as it has ever been," says Lonergan.

## All the disciplines must be integrated

A COMMON trend in risk management has been the silo-based approach to managing risks, with a number of specialised risk management disciplines all having their own approaches, methodologies and even organisational structures.

Many of the risks covered within these areas are inter-dependent and one or more may even have a knock-on effect, resulting in additional risks occurring, says Caryn Davies, risk manager at The IQ Business Group, an independent management consulting firm.

"As such the specialised risk management disciplines need to be integrated throughout an organisation at all levels to ensure all types of risk are addressed, which will also lead organisations towards more mature risk management."

"In addition, it will assist in addressing internal and external factors that are contributors to risk and are highly interrelated and may trigger multiple risks," she says.

The Consumer Protection Act, the new Companies Act and King 3, among others, communication between the different specialised risk management disciplines is even more critical.

"This will improve the management of significant risks that have many interrelated contributing factors and other significant business issues, such as capital management and loss strategies that will in turn assist with the management of risks in the future," says Davies.

She says that South African banks are being criticised for only focusing on the regulatory requirements and quantification of the risks in a separate manner. A combination of these will lead to the management of risks at a strategic level, as well as at a more focused level, for example, credit or liquidity risk, Davies says.

"To harness this opportunity for national economic growth, every sector of the South African economy needs to ensure that risk is being managed in manner that integrates all specialised risk disciplines without the silo approach," says Davies.

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## Problems of risk prediction

RISK management features increasingly on most board agendas because of the emphasis placed on it in the King 3 report, which recognises risk management as inseparable from a company's strategic and business processes.

"At the heart of an effective risk management programme is the company's ability to identify and predict risks accurately," says Herman Schoeman, MD of Guardrisk. "This is not an easy task. Businesses today face an ever-growing spectrum of risks, many of which seemed inconceivable before they happened."

He cites the example of the ash from Iceland's Eyjafjallajökull volcano that wreaked havoc far beyond the airline industry. However, identifying risks and putting risk control measures in place is just one part of the equation, an effective risk financing programme that rewards prudent risk management is vital.

"Risk management is meaningless if there is not a solid

risk financing programme in place to back it up."

He says one of the fastest-growing sectors in the insurance industry is alternative risk transfer (ART), which gives companies the ability to manage their own risk appetite, effectively increasing the company's capacity to finance more of its own risks, which translates directly to reducing the cost of risk.

"In recent years the traditional and ART markets have converged to the extent that today corporations are most likely to find their risk financing programme combines elements of the traditional and ART markets, rather than depending specifically on one or the other."

In SA, ART facilities such as cell captives essentially give corporations the benefits of owning their own insurance company without the inherent cost and administrative burdens. Each cell is ring-fenced, so the corporate is affected only by its own losses.

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Herman Schoeman ... an ever-growing spectrum of risks.

### Advertising Feature

## Continuous auditing and monitoring can help reduce company risks

Andre Gouws

Risk management has been around since the start of mankind, and at its core it provides us with critical information and ways to lower and effectively manage our exposure to threats that arise from decisions we make. Today organisations are dealing with an unprecedented range of new challenges and risks that require many of them to revisit and take a new look at enterprise risk management. King III Report on Corporate Governance recommends that "The board should ensure that management monitors the risk management plan effectively and continually". Due to the complexity of most organisations and the ongoing focus on costs, there is an increased focus on adopting innovative ways to assess and manage risk while enhancing performance. Organisations are increasingly making use of improved business process understanding and knowledge of financial, operational and compliance risks to improve governance, manage risk and improve overall market and stakeholder trust. Many organisations have found it efficient and cost effective to implement automated controls within their IT systems in order to assist with the management of these risks. Advances in technology are making it possible to continuously monitor or audit the business architecture of organisations through robust data analysis procedures (data analytics).

Continuous monitoring is defined as an automated feedback mechanism used by management to help ensure that systems and controls operate as designed and transactions are processed as prescribed. Continuous auditing is the collection of audit evidence and indicators, by an internal or external auditor, on IT systems, processes, transactions and controls on a frequent or continuous basis throughout a period. Organisations that have moved to a continuous monitoring and auditing environment experienced early benefits in fraud risk management and procurement. For companies embarking on their continuous monitoring and auditing implementations, pilot projects can deliver rapid results and could, potentially, see continuous monitoring and auditing become self-funding whilst decreasing potential current costs. This can then lay the groundwork for wider implementation of continuous monitoring / auditing within the organisation. In addition to the financial benefits that can be achieved from implementing a continuous monitoring and auditing framework, organisations may experience the following benefits:

- Improved organisational ability to ensure compliance with regulations and employees' compliance with internal policies and procedures.
- Increased detection and prevention of fraud and misconduct and a reduction in the number of such incidents.

Reduced time required to conduct audits and investigations and the establishment of standardised audit results.

Tracking results can help organisations evaluate the improvement of the control environment over time. Continuous auditing and monitoring can operate at various levels of automation and business architecture - for example some organisations already have some form of automated forensic audits, configuration auditing and automated user provisioning. In the future, organisations can expect to see integration between these separate monitoring systems.

In many instances implementing continuous monitoring / auditing is seen as a technology-driven initiative. Although technology is a key driver, the success of continuous monitoring and auditing is highly dependent on the people and process aspects of the implementation. From a people and process perspective, the implementation usually brings about a cultural change in the organisation by enhancing the type, speed, and visibility of information on risk and performance which in turn has a significant impact on how business decisions are made and monitored. The successful implementation of continuous monitoring and auditing takes commitment, and organisations can expect a variety of challenges, possibly the biggest being an organisation's resistance to change and corporate culture to effective risk management.

It is critical that business stakeholders are involved in the decision to move to a continuous monitoring and auditing environment and performing a stakeholder analysis will help to identify and measure the qualitative and quantitative benefits that can be achieved by adopting a continuous monitoring and auditing framework. Organisations that have followed a holistic and business focussed approach to implementing continuous monitoring and auditing experience early benefits.

Continuous monitoring / auditing is thus a fantastic approach to assist organisations in managing risks given the increasingly complex legislative and compliance requirements facing business today. While appropriate technologies also need to be considered, it should also be borne in mind that certain cultural and process changes are required in order for a continuous approach to be fully effective. This will enable organisations to better appreciate the benefits a continuous monitoring / auditing approach offers.



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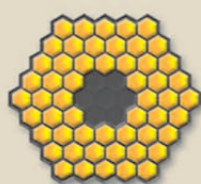
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