

2009 Compliance and Ethics Institute

Risk Management Culture:  
The Linkage Between Ethics & Compliance and ERM  
September 14, 2009



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#### Section 1 – Learning objectives

### Objectives

#### At the conclusion of this session, you will learn:

- How a strong risk culture supports a successful ethics, compliance and Enterprise Risk Management (ERM) program
- What is “Risk Culture” and how it is different from organizational culture and ethics culture
- What constitutes an effective risk management culture
- How risk management culture impacts your S&P credit rating and cost of capital
- How leading companies are measuring risk management culture

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Section 2 – Why measure risk culture

## What CEOs are saying about risk

92%

Agree that information about risk is either important or critical to their long-term success

CEOs recognize the importance of risk information to the success of their organizations...

...but lack actionable information to allow for effective risk decisions with clarity and confidence

23%

But only 23% of them believe they have comprehensive information about risk to their business.

## Why measure risk culture

### Manage change

- Increasingly difficult economic climate
- Increased pressure to reduce costs and “do more with less”

### Improve risk management

- Create a consistent culture of effective risk management
- Reduce risk management costs
- Avoid duplication of risk management effort
- Proactively manage S&P credit ratings

### Avoid fraud & misconduct

- Economic pressures can encourage fraud and misconduct

### Become more “Risk Resilient”

- Informed business decisions with confidence and clarity
- The ability to sustain growth regardless of business condition or economic climate by leveraging risk to avoid hazard, manage uncertainty and capitalize on opportunity

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## Defining enterprise risk management (ERM)

Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.<sup>1</sup>

<sup>1</sup>Enterprise Risk Management – Integrated Framework, Committee of Sponsoring Organizations of the Treadway Commission (COSO); ©2004

## ERM concepts

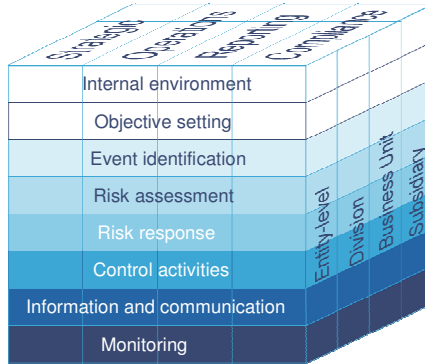
### Enterprise risk management is:

- A process, ongoing and flowing through an entity
- Effected by people at every level of an organization
- Applied in strategy setting
- Applied across the enterprise, at every level and unit, and includes taking an entity level portfolio view of risk
- Designed to identify potential events that, if they occur, will affect the entity and to manage risk within its risk appetite
- Able to provide reasonable assurance to an entity's management and board of directors
- Geared to achievement of objectives in one or more separate but overlapping categories.<sup>2</sup>

<sup>2</sup>Enterprise Risk Management – Integrated Framework, Committee of Sponsoring Organizations of the Treadway Commission (COSO); ©2004

## ERM supports the achievement of entity objectives

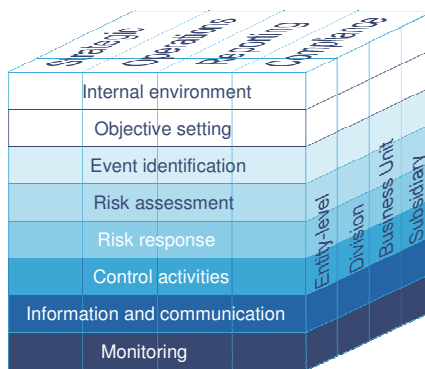
Strategic	High-level goals, aligned with and supporting the entity's mission
Operations	Effective and efficient use of entity resources
Reporting	Reliability of reporting
Compliance	Compliance with applicable laws and regulations



Enterprise Risk Management – Integrated Framework, Committee of Sponsoring Organizations of the Treadway Commission (COSO); ©2004

## Components of ERM

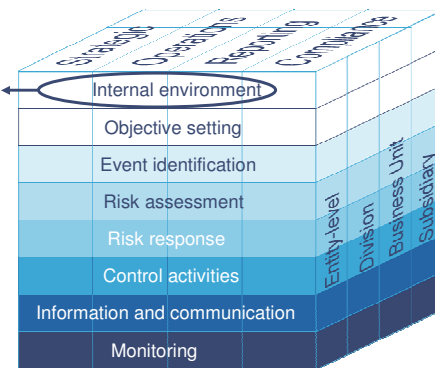
- Eight interrelated components
- Derived from the way management runs an enterprise
- Integrated into management processes



Enterprise Risk Management – Integrated Framework, Committee of Sponsoring Organizations of the Treadway Commission (COSO); ©2004

## Components of ERM – Internal environment

The internal environment encompasses the tone of an organization, and sets the basis for how risk is viewed and addressed by an entity's people, including risk management philosophy and risk appetite, integrity and ethical values, and the environment in which they operate.



Enterprise Risk Management – Integrated Framework, Committee of Sponsoring Organizations of the Treadway Commission (COSO); ©2004

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## It’s important to measure culture – But which one



Risk culture is related to, but distinctly different from, organizational culture and ethical culture.

## Organizational culture

Addresses a broad variety of employee attitudes on topics such as:

- Compensation
- Strategy
- People issues
- Processes
- Management
- Job satisfaction
- Job responsibilities



## Ethical culture

### Typically covers:

- Observed behaviors
- Knowledge and comfort
- Responsibilities
- Organization’s response

## Risk culture

Risk culture is the way all members of an organization feel and behave about risk, including employees' attitudes toward risk as it relates to their daily operating activities and management's view of risk in relation to decision-making processes.

Section 4 – Defining “Risk Culture”

## Risk culture

- Risk culture is related to, but distinctly different from, organizational and ethical culture.
- Addresses control and risk management principles more directly
- Encompasses a broader base of issues pertinent to governance, risk and compliance (GRC)

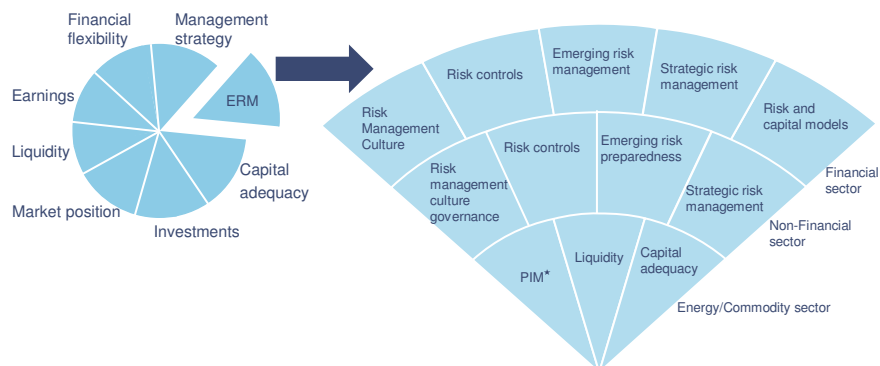
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## Benefits of measuring risk culture

- Can help to streamline GRC processes
- Reduces duplication of efforts
- A critical component in developing and enhancing an integrated approach to governance, risk and compliance
- The information gathered provides value to the broader risk and organizational culture
- Encourages collaboration between organizational units and functions

## ERM and S&P ratings

### S&P ratings criteria



Over the past two years, 10% of financial institutions analyzed had their rating either downgraded or upgraded due to their ERM score.

Section 5 – Measuring risk culture

## How are leading companies measuring their risk management culture

- Surveys
- Interviews
- Focus groups
- Other existing data which can provide indications of risk culture

Section 5 – Measuring risk culture

## Key attributes and sub-attributes of effective risk management

The Risk Culture Survey is designed to help an organization identify their key strengths and potential issues related to the risk and control environment, categorized along PwC's four key attributes for effective risk management:



## Key attributes, sub-attributes and key indicators of effective risk management

<b>Leadership &amp; strategy</b>	<b>Accountability &amp; reinforcement</b>
<ul style="list-style-type: none"> <li>• Integrity &amp; Ethical Values                             <ul style="list-style-type: none"> <li>- Tone at the Top</li> <li>- Personal ethical practices</li> </ul> </li> <li>• Communicate Mission &amp; Objectives                             <ul style="list-style-type: none"> <li>- Policies &amp; procedures</li> <li>- Top-down alignment of strategy</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Assignment of Authority &amp; Responsibility                             <ul style="list-style-type: none"> <li>- Assignment of ownership</li> <li>- Demonstrated accountability</li> </ul> </li> <li>• HR Policies &amp; Practices &amp; Performance Measurement                             <ul style="list-style-type: none"> <li>- Performance indicators</li> <li>- Incentives &amp; discipline</li> </ul> </li> </ul>
<b>People &amp; communication</b>	<b>Risk management &amp; infrastructure</b>
<ul style="list-style-type: none"> <li>• Commitment to Competence                             <ul style="list-style-type: none"> <li>- Employee competence</li> <li>- Training</li> </ul> </li> <li>• Information &amp; Communication                             <ul style="list-style-type: none"> <li>- Information quality</li> <li>- Top-down communication</li> <li>- Communication across processes</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Identify &amp; Assess Risk                             <ul style="list-style-type: none"> <li>- Risk assessment practices</li> <li>- Risk tools &amp; processes</li> </ul> </li> <li>• Establish Processes &amp; Controls                             <ul style="list-style-type: none"> <li>- Process reliability &amp; efficiency</li> <li>- Control effectiveness &amp; efficiency</li> <li>- System access &amp; security</li> </ul> </li> </ul>

## Risk culture survey questionnaire design

Key Attribute / Sub-Attribute	#	Statement	Key Indicator	1-Strongly Disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly Agree			
				Don't Know	1	2	3
<b>1. Leadership &amp; Strategy – Integrity &amp; Ethical Values</b>	1	The leaders of my unit set a positive example for ethical conduct.	Personal Ethical Practices	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	2	Individuals in my unit exhibit high ethical values at all times.	Personal Ethical Practices	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	3	I find our company's code of conduct to be useful in guiding my actions.	Personal Ethical Practices	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	4	I am expected to comply with all policies, laws and regulations to the letter.	Tone at the Top	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	5	The leaders of my unit emphasize risk management and control in their day-to-day interactions.	Tone at the Top	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	6	If I become aware of improprieties in our company, I feel comfortable communicating issues to senior management.	Tone at the Top	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Section 5 – Measuring risk culture

Risk culture survey questionnaire design

Key Attribute / Sub-Attribute	#	Statement	Key Indicator	1-Strongly Disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly Agree			
				Don't Know	1	2	3
3. Accountability & Reinforcement – Assignment of Authority & Responsibility	18	Management has communicated to me the importance of risk management and control.	Assignment of Ownership	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	19	I have sufficient authority to fulfil my responsibilities.	Assignment of Ownership	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	20	I clearly know who is accountable for each step in a process.	Demonstrated Accountability	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	21	Individuals in my unit adhere to company policies.	Demonstrated Accountability	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	22	Individuals in my unit are held accountable for their actions.	Demonstrated Accountability	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	23	Disciplinary action is taken against individuals who engage in professional misconduct.	Demonstrated Accountability	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

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Section 5 – Measuring risk culture

Risk culture survey questionnaire design

Key Attribute / Sub-Attribute	#	Statement	Key Indicator	1-Strongly Disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly Agree			
				Don't Know	1	2	3
4. Accountability & Reinforcement – Human Resource Policies and Practices & Performance Measurement	24	People in my unit are promoted and rewarded fairly.	Incentives & Discipline	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	25	In determining my compensation, appropriate weight is given to my performance in achieving longer-term objectives.	Incentives & Discipline	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	26	In determining my compensation, consideration is given to the adherence to established standards of business and ethical conduct, in addition to the achievement of business results.	Incentives & Discipline	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	27	I am responsible for achieving specific performance targets or standards.	Performance Indicators	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	28	My performance targets are relevant and reasonable.	Performance Indicators	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	29	My unit consistently tracks key performance measurements.	Performance Indicators	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

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Section 6 – Leveraging risk culture results

### Leveraging the output of the risk culture assessment

- Internal audit plan
- Broader ERM assessment
- Strategic planning
- S&P evaluation
- Component of SOX/Entity level controls
- HR employee engagement initiatives
- Ethics and compliance initiatives

## Measuring risk culture – Some keys to effectiveness

- Longitudinal view
- External comparability
- What's in a name?
- Slice and dice it
- Sell the benefits outside E&C

## Key themes

- Given this economic environment, it's more important than ever to have a strong risk management culture
- Risk management culture is an integral component to an effective and sustainable ERM program
- Get to know your risk management culture well
- Find out who else is interested in getting involved in assessing your risk management culture
- Be proactive rather than reactive
- Don't overcomplicate



## Next steps

- Know what vehicles are already in place to assess current risk culture
  - E.g. employee attitude survey, ERM related measures
- Take inventory of other risk management activities inside the organization, such as Internal Audit, ERM, strategic planning, regulatory, and compliance
- Leverage and collaborate with these resources to perform an assessment of your risk management culture
- Evaluate and communicate results to appropriate parties
- Develop action plan, accountability and ongoing monitoring to strengthen known problem areas

## Resources

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Thank You



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