Information Paper

Internal Control from a Risk-Based Perspective

Published by the Professional Accountants in Business Committee

International Federation of Accountants

Professional Accountants in Business Committee
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

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This publication was prepared by IFAC's Professional Accountants in Business (PAIB) Committee. The PAIB Committee serves IFAC member bodies and the more than one million professional accountants worldwide who work in commerce, industry, the public sector, education, and the not-for-profit sector. Its aim is to enhance the role of professional accountants in business by encouraging and facilitating the global development and exchange of knowledge and best practices.

This publication may be downloaded free-of-charge from the IFAC website http://www.ifac.org. The approved text is published in the English language.

ISBN: 1-931949-84-0

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Introduction: Edward Chow

Internal Control is a topic that is truly at the heart of many professional accountants in business. Not only because internal control is an integral part of good management, but also because the lack of it has been cited by many as one of the key reasons for most corporate failures.

The flood of rules and requirements that resulted from these failures, and the often time consuming and costly compliance efforts, make us almost forget that the right kind of internal controls - focused on the real risks of an organization - actually can save time, money and ensure creation and maintenance of value.

For this reason, IFAC's Professional Accountants in Business (PAIB) Committee, commissioned Robert Bruce, a leading financial journalist, to conduct a series of interviews with ten leading professional accountants in business on their experiences and views on internal control. Although they are from different organizations all over the world, they have all struggled with similar issues and their solutions point in the same direction, which readers can benefit from. Therefore, we invite you to use these interviews as a useful approach to benchmark your own organization's internal control efforts and philosophy.

Most of all, the experience sharing of these fellow PAIBs are interesting and will provide you with inspiration that internal control can also drive performance and create value for your organization instead of only assuring conformance.

This interview-based information paper is part of a larger PAIB Committee project on internal control. In 2006, the PAIB Committee published the well-received overview paper entitled "**Internal Controls - A Review of Current Developments**", which reviewed current developments and some of the latest thinking in the area of internal control. Together with these interviews, it forms the groundwork for a principles-based, good-practice guidance paper on internal control, to be published in 2008.

Edward Chow
Chairman, IFAC PAIB Committee

Executive Summary: Robert Bruce

Overview

Internal Controls are the Key to a Risk-Based Perspective

The overall view of the many people interviewed in this survey is probably best summed up in the way that James Riley, CFO of the Jardine Matheson Group, described himself. He was, he said, "The keeper of internal control efficiency." His view was clear. "In essence a strong internal controls system is a key and integral part of running and managing a disciplined and controlled business." "Internal control helps management to design, implement and maintain controls and then internal audit ensures that management sticks to them," said Cees Klumper, vice-president, internal control with Dutch stores group, Ahold. "We are supporting management."

The other theme which came to the fore was accountability. "It is about accountability," said Philip Wessels and Rob Shuter of Nedbank in South Africa, "the setting of correct policies and procedures and ensuring you monitor it properly on an ongoing basis."

And the dangers of underestimating these two concepts were dramatized by John Boers, CFO with insurance group Nationale-Nederanden in the Netherlands. "Risk is everything," he said, "everything which could hinder us achieving our strategic objectives."

And William Henry Harmon, CEO of Triana Energy in the US, emphasized the wider objectives. "My role at the head of these enterprises is to orchestrate the activities of those people we employ to drive the business in such a way as to ensure that the company is not only successful but that the resulting enterprise is true to its intended design."

The Nature of Risk

For many of the interviewees, the underlying philosophy was clear. "We have to make management understand the exposure to the risks, both strategic and political, which they are facing," said KC Ong, group internal audit manager with Fraser & Neave Holdings in Malaysia. "What we are trying to do is, firstly, eliminate the easily foreseeable risk, then secondly, the other foreseeable risks, and if something happens, catch it quickly," said Oscar Lewis, Controller with Umbra Cuscinetti, the aerospace group. And risk connects all other concepts in this field. "Risk management and internal controls are two sides of the same coin," said Rob Whiteman, chief executive of the London Borough of Barking and Dagenham. The rationale was probably best expressed by Harmon. "Our success depends in great measure upon our ability to use a single template of controls that we apply uniformly across our enterprises," he said. "It is imperative that every officer in every aspect of our businesses is able to depend upon compliance with these uniform controls to assure that the control metrics are correct and timely. Without that base confidence in our systems, our ventures would be burdened with a much greater overhead cost for routine administration and our timelines for delivering products to market would be extended to a point that would eliminate the competitive advantage we've worked to build."

How it is Done?

Every organization is different. However, it becomes clear from the interviews that there are some essentials which transcend the differences in types and style of businesses. "We need to be kept aware of the issues that arise," stressed Riley of Jardine Matheson, "so there is a focus on reporting upwards."

For John Boers, success came from a different approach. "Basically why enterprise risk management was successful was that it really increased risk awareness with management," he said. "Going through the process, the workshops and the brain-storming sessions brought a huge understanding of risk to many managers." His conclusion was that: "Enterprise risk management was a very successful project." At Ahold, the approach was allowed to vary. "In the operating companies, the scope varies," said Klumper. "Some are very wide, from supporting enterprise risk management right down to a store audit function, for example, and others are more limited. It is the local choice of each operating company. Ahold chose not to dictate a standard scope."

He said the most significant issue was retaining the efficiency of the process while maintaining effectiveness. "There has to be a healthy tension between these two," he said. "You have to maintain communication between central and local and you have to ensure the adequacy of the processes."

"We have fine-tuned the ability to identify management controls that could mitigate the risks we identify," said KC Ong. "The whole of management is integrated into this, while internal audit gives assurance that it is all in place." He emphasised integration. "It must be supported by the Board, the audit committee and senior management," he said. "That is very important." And you need to provide assistance to ensure it happens. "You need a framework, which management can use to facilitate understanding and the adoption of enterprise risk management," he said.

John Fraser, Vice President, internal audit, and chief risk officer at Canadian electricity provider, Hydro One, would agree. "Enterprise risk forces the management team to articulate what their objectives are," he said. And Rob Whiteman suggested that it turned the business philosophy upside down. "We are shifting from a rather timid reliance on internal control for its own sake to a culture of "can do" with a fit for purpose risk management and internal control regime." For him, the advantages are impressive. "Proper risk assessment enables us to make informed decisions about the challenges and risks that we want to take on, and can help us to target our resources to achieve the best possible results," he said.

Facing up to the Issues

The issues for internal control vary from organization to organization.

"For internal controls, especially operational effectiveness, we have gone through dramatic improvements over the last several years," said John Fraser. "The most recent are a return to the core business, stability, improved accountability and commonsense."

Oscar Lewis found that systems had not been designed sensitively enough. "We were hindering peoples' ability to get their jobs done," he said. "We found multiple levels of approvals to get things posted in the system, and they were really keeping people from getting as much work done as they needed to get things done." A complete reappraisal of how the system worked was required. There were different issues in the complex world of financial services. "When you are dealing with product development, it is very important to introduce not only product-development people, but also risk management people," said John Boers. It had to be an integrated process otherwise risks would be created and go unnoticed. “People designing new products have to be alongside risk management people,” he said.

For Harmon, the same type of issues arose. But in his case, scientists were the problem. “The greatest challenge to the system always comes from the scientist group,” he said. “They are extremely talented individuals who are focused solely on the science involved and they really get fatigued quickly by administrative controls. When that fatigue sets in we know they will not hesitate to circumvent the control systems.” It becomes a cultural issue. “Scientists seem to have one perception of the culture,” he said. “So do the engineers. So do the finance people. It is very difficult trying to get people to appreciate the system for its own sake. But they have to see them as useful in their own context.”

Identifying the Successes

The most obvious success arising from these sorts of projects is essentially the embedding of the process, which allows for continuing success in the future. For Harmon, “The control system drove a change in culture that resulted in ‘continuous improvement’ becoming an expectation of employees throughout the company. You need significant buy-in from each of the businesses. You cannot simply be the central policeman. It has to be a question of monitoring your own standards,” said Riley of Jardine Matheson. “The successes we have had reflect our steadily built and international philosophy of the importance of internal controls from the grass-roots up,” he said. “It is the importance of maintaining and sustaining a very efficient internal controls system. It has to be an area of priority and focus.”

For Paul Whiteman of Barking, the success was the transformation of the possibilities the systems brought about. “Risk management and the internal control environment is an enabling concept, not a restrictive one,” he said. “It gives us the confidence to make the most of the opportunities we now have to build communities and transform lives.”

Learning from the Failures

“There have been limited failures since the new processes were put in,” said Wessels. “The original failures were due to a lack of proper accountability, so the theme for learning from them is a need for greater accountability.”

“Weaknesses occur when people take their eye off the ball,” said Riley. “Staff changes can harm you. You need to pick up the warning signs early. New people can take more time than you expect to get up to speed. And by then, significant control weaknesses can start coming in. The essential lesson is that you can’t allow things to drift.” This was the consensus. It was behavioral issues that brought about the failures. “I understand that controls systems are supposed to protect the company and its data from the human element,” said Harmon, “But my experience tells me that it is the human touch that ultimately determines the success of the control environment. If you spend time and money making sure to recruit the right human resources, the cost of your control systems will be reduced dramatically.”

The Lessons

The lessons suggested from the interviewees are many. "Stay close to management," advocated Cees Klumper. "For example, a lot of companies implementing enterprise risk management do it top down," he said. 'It becomes a one-off add-on, or an exercise, which doesn't become engrained in the company. It becomes their, the corporate center's system, rather than the company's," he said. "You need to embed the processes bottom up. You get much more benefit that way."

For Harmon, there were several interlinked lessons. "Never apologize for the imposition of control systems," he said. "An enterprise cannot survive and flourish if it's not built within a design and the discipline of controls is intended to assure success, and that's the overall goal." Next, he recommended linking the process with behaviors. "Invest in people and set high expectations for them," he said. "Good people respond when they understand what's expected of them and they often achieve things for the enterprise which are beyond what they think they are capable of achieving." Then he said, "Expect a return on your investment. Well-designed controls should create a positive work environment and that should soon drive an expectation of continuous improvement and that should contribute to the bottom line." And finally: "Never let yourself think you are finished building your control system," he said. "These things take constant care and nurturing. It should become second nature to the successful business enterprise."

John Fraser summed up the lessons in one phrase: "Have good people doing the right things," he said. For Wessels, the most important thing was "to change the mindset, the hearts and minds of our staff," he said. "You cannot do it if the staff are not all onside. You need constant and clear communication to staff, talking to them in an open and honest way." And he also said that the quality of staff was very important as well. "All our positive experiences have been where we have brought in very good people," he said. KC Ong made a similar point. "You will always need more education of your recruits," he said, "and in particular new senior management." His conclusion was equally clear. "Education is the most important part," he said. "It is a journey to continuous improvement. Focus on that." And management was crucial. "The most important element is to ensure the values of the organization with respect to risk management and internal controls are communicated from the top as the key values of the organization," James Riley said.

In addition, commercial imperatives should never be forgotten. "It is no good having a director who creates opportunities but who doesn't properly control his business," he said. And Oscar Lewis stressed the fundamentals. "It is better to do it slower and well than quickly and have to do it over and over again."

And One Final Lesson…

Cees Klumper of Ahold offered some more advice on what can be done within small groups of like-minded professionals working in the same field. "There are only about twenty SOX-compliant companies in the Netherlands," he said. "We set up a roundtable, a peer group. We excluded external advisers and we meet three to four times a year, just exchanging experiences: 'What tips do you have? 'What has worked for you?' that sort of thing." He recommends the process. "Someone needs to take the initiative and reach out," he said. "Do it yourself. But exclude advisers and consultants. You can pick up major ideas from peers which you otherwise would not have done. We email each other. It is a way of keeping the tips running from each other," he said. "It is very beneficial in picking up good practices."

John Boers

John Boers is Chief Financial Officer for Nationale-Nederlanden, the largest Dutch insurance company, a subsidiary of ING Group. He is responsible for finance and risk management.

"I am a member of the Board of Nationale-Nederlanden," he said. "So I am next to the Chief Executive Officer, reporting to him. I inform the CEO of every aspect of risk management, being pro-active in detecting issues and creative in coming up with tools to manage the risk." In a very large financial services company, this is key. "Risk is everything – everything that could hinder us in achieving our strategic objectives."

He said his organization started integrating enterprise risk management into the overall management system last year.

"We asked people in the business lines to do an inventory of all the risks we face," he said. "They made a list of measures to manage the risk. Then they analyzed their work.

"Risk is everything – everything that could hinder us in achieving our strategic objectives."

"Did we manage the risks to an acceptable level, or are there gaps?'" he asked. He said now that the system is up and running, the people in the business lines constantly check their risk management process to see how it is working. And, he emphasized the importance of independent monitoring.

"The internal controls department comes in here," he said. "They tell me whether the controls are effective over the year."

Financial services companies went through many changes in recent years as the tide of regulatory measures that they have to implement and comply with has risen inexorably. There are also increasingly complex rules and regulations for the financial instruments that financial services companies use. It is a major issue for both the industry and risk management.

"ING is listed on the New York Stock Exchange," he said. "We have to deal with Sarbanes-Oxley. There is also new legislation here in The Netherlands on customer care. And, we have a new supervisory body, the AFM, the Netherlands Authority for the Financial Markets. This is the Dutch equivalent of the US Securities and Exchange Commission." This growth in regulation has changed the landscape. "Managing risk is now a big issue," he said.

He credits the enterprise risk management process for raising management's awareness of risk in the organization. "Going through the process, the workshops and the brain-storming sessions brought a huge understanding of risk to many managers. When you brainstorm the risks people start thinking about what can happen. That brings a lot of risk awareness into the organisation," he said. "Enterprise risk management was a very successful project."

He suggests some good practices for other companies.

"Introduce a continuous enterprise risk management process in your organization," he said. "Make it part of your management decision-taking. Make it part of your product development process. Embed sufficient controls in the operational processes. And finally, think through internal controls as well."

He emphasizes the importance of this process when new products are being developed.

"When you are dealing with product development, it is very important to introduce not only product development people but also risk management people," he said. "Make it an integrated process."

He stressed the importance of having all types of people in the organization exchanging views and providing different perspectives. "People designing new products have to be alongside risk management people."

This is particularly true in financial services. "It should not only be actuaries but also operational risk managers and compliance officers," he said. "They should all be part of the product development process."

He is currently happy with how the risk management process is going. 'We have changed a lot in the last couple of years," he said. "My advice to others would be to keep risk management as close to the business as you can. And don't let it become too high-level a process. Make it local so that everyone is aware of what is going on."

He stressed this: By including many managers in the process, you keep more people informed and aware of risks that the organization faces. Risk management should not be seen only as something for specialists, he said. "The processes have to be close to ordinary managers."

Boers know that adapting to constant change is the key to success. "It is an ongoing process. A continuous learning process. It is about learning in a changing environment with changing customer needs. For example, you see more and more customers interested in sustainability and the environment. As a company, you run a risk if you are not moving in the same direction. You need to understand the needs of all stakeholders and that is a continuous process," he said. "Taking note of needs and tying them into the strategy."

That done you need to take stock, he said.

"You need to then think about what kind of potential risks you are running and what measures and controls are required," he said.

As for advice to other organizations, he thinks people should keep it simple and work as a team. "I hope other companies are really building a strong risk management function," he said. "The whole spectrum of risk should be covered. Don't build silos, or run it on a standalone basis. The important qualities are cooperation and mutual understanding."

He emphasized the importance of connections.

"There are a lot of specialist risk managers," he said. "But they have to understand the whole risk spectrum for it to be effective. That's the best advice I can give."

Key lessons:
• Introduce a continuous enterprise risk management process in your organization. Make it part of your management decision-taking and your product development process. Embed sufficient controls in the operational processes. And finally, think through internal controls as well. • Keep risk management as close to the business as you can. Don't let it become too high-level a process. Make it local so that everyone is aware of what is going on. • The whole spectrum of risk should be covered. Don't build silos, or run it on a standalone basis. The important qualities are cooperation and mutual understanding.

John Fraser

John Fraser is Vice-President, Internal Audit and Chief Risk Officer at Hydro One Inc., the largest electricity delivery company in Ontario, Canada.

"I perform two roles," he said. "I was hired as Head of Internal Audit, and after a year with the company, I was asked to be Chief Risk Officer, which is a methodology and facilitation role. All risk management and accountability remains with line management."

His role provides stability, in contrast with some of the company's history. Fraser helps steer a careful course.

"I run a very conventional internal audit group," he said. But, he also has chief risk officer responsibilities. This dates back to the period of upheavals at the company.

"When Hydro One was created with the break up of its predecessor, the vertically integrated power utility Ontario Hydro, a new independent board was appointed, and they wanted to bring in best practices and, in particular, enterprise risk management. Consultants came and went but nothing stuck."

How does he handle the conflict between acting as both chief risk officer and head of internal audit?

"I make it clear which role I am playing," he said. "For example, if my auditor staff wanted to see the results of a risk workshop they would need the signed approval of the Vice President involved. It keeps audit and enterprise risk separate."

The answer to how the risk management and internal control systems fit into the organization's overall management system is complex.

"We adopted enterprise risk management in late 1999, after several failed attempts, and it is holistic and enterprise-wide. Risk management and internal control in all forms continue to improve throughout the firm: financial, safety, environmental, regulatory and so on," he said. "Enterprise risk forces the management team to articulate what its objectives are. Management has set some very aggressive long-term targets. For example, we had a 40 percent to 50 percent customer satisfaction rate, which is now up near 90 percent and ahead of schedule. We have the 2010 corporate targets and objectives up on the wall next to me," he said. "We have very publicly stated long-term objectives."

Good practice and experience flows out of the issues faced and how people have dealt with them. Fraser has had his share of issues. “Take your pick,” he said. “After many years working on Bay Street, (Toronto’s financial district), I thought this might be boring and then all heck broke loose. Our company demerged from a much larger Crown corporation in 1999 with a headcount down from 25,000 to 5,000, with all the attendant baggage and bureaucracy. We moved to a centralized model, preparing for an Initial Public Offering (IPO). There was tremendous trauma. The plans for preparing for the IPO were troubled. For example, staff was offered early retirement,” he said. “The company expected 800 to accept, but 1400 did and they were mostly senior staff,” he said. ”They all went to play golf on the same day.”

The troubles did not end there. “Then there was a major stock market recession. The pension plan was in deficit.” In 2002, the IPO was cancelled. The board resigned under pressure from the Government and then, later in 2002, the current CEO, and an entirely new board and management team were installed.”

“I thought this might be boring and then all heck broke loose.”

“Since then life has become far more stable,” he said.

We now have a capable management team. In the days when I was reporting to the Chief Financial Officer in the old management team, we had only one person who knew how to spell electricity,” he said. “No one in executive management knew the business. Then the new CEO came in and surrounded himself with people who understood the business. He has a very direct style. The company now has clearly articulated long-term goals which are understood by all staff.”

Fraser is clear on the successes and credits internal control for some of them.

It is a different world. “For internal controls, especially operational effectiveness, we have gone through dramatic improvements over the last several years,” he said. The most recent are a return to the core business, stability, improved accountability and common-sense.”

When asked what good practices he would recommend because of his experiences, Fraser said simply, “Having good people who know what they are doing.”

Coming out of a period of crisis management reminds people how important the simple things are. “We have all the basics,” he said. “I report to the CEO and that allows me to report on all the risk and discuss major issues at the management team meetings. It cuts back on the bureaucracy. In too many companies, my position reports only to the CFO, thereby narrowing the focus. We have a strong internal audit group. With a very small group of only ten auditors, we audit all risks in the company including financial, safety, environmental, computers, regulatory and operational. We cannot fix things as auditors, but we can be the conscience for management.”

He is equally clear about the source of weaknesses or failures.

“Most of the failures were due to previous senior management who didn’t understand the business,” he said. He also blames constantly rearranged organizational models and business models the staff did not understand.

"The organizational structures changed every six months," he said. "I would go and do an audit of a department, and by the end of the audit, the organization would have changed again." He links the flux to the impending, but eventually cancelled IPO.

"We were trying to be sexy," he said. "We were trying to put some sizzle on the steak ahead of the IPO, but people started to do silly things as a result."

It is no wonder he has a very short answer to the question of what positives he learned from these experiences. He echoes a previous thought. "Have good people doing the right things," he said.

How satisfied is Fraser with the current system? And, how does he think the systems will adapt in an ever-changing environment? He is characteristically forthright in his answers. "We are embarking on a major series of computer initiatives to upgrade outdated systems," he said. "We have massive transmission construction requirements to implement. And, ongoing challenges due to demographics and regulatory challenges, among others," he said. "We are very focused now on the big risks and, like most businesses, life here is neither static nor submissive."

Any other advice he would offer?

"To me, internal control is just one way of getting enterprise risk management to work. Internal control is a subset of governance and enterprise risk management. I would recommend having good governance and implementing enterprise risk management. The key is good governance," he said. "You have to explain what risk you are addressing. Managers now know if they want to spend money, they must articulate what risks they are mitigating and how these have been assessed."

It comes down to keeping focused on the basics. "What I believe we do better than others is to actually execute what we plan and talk about, unlike other organizations I have worked in. Here we get a lot done with little friction or excuses."

Key lessons:

- The Chief Risk Officer has a methodology and facilitation role. All risk management and accountability remains with line management.
- Have good people who know what they are doing.
- Internal control is just one way of getting enterprise risk management to work. The key is good governance**.** You have to explain the risks you are addressing.

William Henry Harmon

William Henry Harmon is President and CEO of Triana Energy, an affiliated group of private companies in the oil and gas industry on the eastern seaboard of the United States.

Private firms face different risk management and internal control issues than public companies, mainly due to private equity investors in the business, Harmon said.

"They are never interested in the costs of implementing systems," he said. "They are interested in the comfort levels. Being able to carry our reputation forward is important, and it is just as important to carry it forward with our auditors as it is with private equity investors and our bankers. My role at the head of these enterprises is to orchestrate the activities of those people we employ to drive the business in such a way as to insure that the company is not only successful, but that the resulting enterprise is true to its intended design."

> *"Private equity investors are never interested in the costs of implementing systems."*

Running a variety of enterprises brings different challenges, he said. "In addition to our core businesses, we usually have a number of ancillary projects under way at any time, he said. "Our success depends in great measure upon our ability to use a single template of controls that we apply uniformly across our enterprises. It is imperative that every officer in every aspect of our businesses is able to depend upon compliance with these uniform controls to assure that the control metrics are correct and timely. Without that base confidence in our systems, our ventures would be burdened with a much greater overhead cost for routine administration and our timelines for delivering products to market would be extended to a point that would eliminate the competitive advantage we've worked to build."

"The control system defines how we do business. At a minimum, it sparks conversation in our management team," he said. "We are all investors here. The origins of the group date back to a company, which they had managed, and which was the subsidiary of a public company. It suffered a hostile takeover. They struck out on their own, formed their own company, and then eventually took their old company over."

This transforms attitudes. "Being an owner makes people step outside their disciplines and view it differently," he said. "They are no longer in a silo. People have a more vocal approach to controls and they are much more effective as a result."

The issues that the group has faced also stem from the nature of the business. "The greatest challenge to the system always comes from the scientist group. They are extremely talented individuals who are focussed solely on the science involved and they really get fatigued quickly by administrative controls. When that fatigue sets in we know they will not hesitate to circumvent the control systems. We guard against that by keeping administrative support involved in every phase of the projects so that there is always someone familiar with the circumstances and ready to guide the project within the control system," he said. "Scientists seem to have one perception of the culture. So do the engineers. So do the finance people. It is very difficult trying to get people to appreciate the system for its own sake. But they have to see the controls as useful in their own context."

And there are also information issues. "Our other biggest challenge in years past was documentation in the information management department," he said. "These are professionals who are responsible for building our computer applications and so they need to be on the frontline promoting the control systems. Unfortunately, in a start-up environment, there is frequently a tendency to take short-cuts in order to meet deadlines. One of the easiest short-cuts is to trim the amount of time spent on documenting the system. After all, once the system is up and running the backlog on projects demands that the analyst move on to more productive tasks," he said. "Of course, without proper documentation, management has no grounds for assurance of system integrity, the audit-ability of the system is compromised, and subsequent modifications of the system become more complicated. This was the first and maybe the most critical of all the issues we had to remedy when getting serious about our controls system."

He attributed several successes to good practice in internal control. "In one of our earlier ventures," he said, "we were successful in implementing an environmental controls system that earned us certification under ISO 14001. Since we were the first in our industry to achieve that designation in the US, we gained an elevated status among our peers and the perception of a competitive advantage. More importantly the control system drove a change in culture that resulted in 'continuous improvement' becoming an expectation of employees throughout the company."

He also referred to a recent success. "In our last major venture, we were able to turn around a company that was in trouble in just about every conceivable way, and our investors made an eight times multiple on the resale of the enterprise just two years later. You cannot argue with success like that, and once you have tasted it, you become a disciple of doing things right," he said.

Because of his experience, he recommends what he sees as good practices. "There is no denying that the process of building a control system from the ground-up is time-consuming and expensive, but trying to reform an existing system of controls in an established company is even worse," he said. "Sometimes the best approach is not to try to reform a control system, but to stop whatever exists and build it new from the ground-up."

He emphasised the human element. "When you take this radical approach what you realize is that building a control system and making it functional is totally dependent on the people involved," he said. "I understand that control systems are supposed to protect the company and its data from the human element, but my experience tells me that it is the human touch that will ultimately determine the success of the control environment. If you spend time and money making sure to recruit the right human resources, the cost of your control systems will be reduced dramatically."

It is about understanding the human element. "You can have the greatest system in the world on paper but if people don't respect it then it is not very useful," he said. He also suggested that the type of company could help this to work. In a small organization, where people have pulled together and been together for a long time, it becomes easier. "Longevity of service is a key factor. People respect each other. It's not something you see commonly in today's business world."

There have also been setbacks from which people can learn. "When we acquired a company of significant size in 2003, we put it on a course towards a public stock offering which meant we needed to test the corporate systems and prove compliance with Sarbanes-Oxley standards," he said.

"Our first reaction was to form a separate team of professionals who were charged with making the transformation happen and assuring that the compliance targets were reached on schedule. This turned out to be a huge mistake because it let the remainder of the officers and managers in the company side-step their responsibilities for the control systems. The project team got mired in the evolving language of the control environment and the team process became more important than the outcome. After we had spent far too much money and achieved far too little result, we understood that the only approach that was going to work was to have the effort fully integrated into the culture that we were trying to create and to have every officer and manager in the company accountable for making it happen."

Such setbacks also suck in management resource. "It drove me crazy," he said.

But there were several positives that he felt he learned from the experiences:

- First: "Never apologize for the imposition of control systems. An enterprise cannot survive and flourish if it's not built within a design and the discipline of controls is intended to assure success, and that's the overall goal."
- Second: "Invest in people and set high expectations for them. Good people respond when they understand what's expected of them and they often achieve things for the enterprise which are beyond what they think they are capable of achieving."
- Third: "Expect a return on your investment. Well-designed controls should create a positive work environment and that should soon drive an expectation of continuous improvement and that should contribute to the bottom-line."
- Fourth: "Never let yourself think you are finished building your control system. These things take constant care and nurturing. It should become second nature to the successful business enterprise."

He said if he had the chance of implementing the systems over again he wouldn't take a much different approach. "While it seems overwhelming to try and examine all your control systems at once, you cannot allow yourself to think of controls as being independent of one another," he said. "An effective business enterprise is one integrated system. Get everyone involved, get organized, and do it. The piecemeal approach doesn't work effectively."

He also felt the experience was very different in the environment of a private company.

"It is much easier in a private company," he said. "Everyone has a sense of ownership. You don't need to establish a position of power in the organization for personal gain or bonus. People don't need to jockey for power because everyone's voice is heard."

"I am comfortable with our attitude toward the control environment, and I am confident in the integrity of the systems," he said. "But, I always think that there must be a simpler way to do things. I think if a CEO ever becomes content with the way things are, then he has outlived his usefulness. The job of the CEO is to drive change."

He suggests one final lesson. "Look through the typical formalized process of establishing controls and first see if there are common-sense controls that fit within the natural flow of the business," he said. "Most of the time, effective controls are not expensive. In fact, they frequently pay for themselves in terms of lost time avoidance."

Key lessons:
• An effective business enterprise is one integrated system. Get everyone involved, get organized, and do it. The piecemeal approach doesn't work effectively. • First see if there are common-sense controls that fit within the natural flow of the business. Most of the time, effective controls are not expensive. In fact, they frequently pay for themselves in terms of lost time avoidance. • Without proper documentation, management has no grounds for assurance of system integrity, the audit-ability of the system is compromised, and subsequent modifications of the system become more complicated.

Cees Klumper

Cees Klumper is Vice-President, Internal Control, with international supermarket and foodservice operators, Ahold NV.

"We have an internal control function alongside our internal audit function," he said. "Internal Control helps management to design, implement and maintain controls, and then Internal Audit ensures that management sticks to them. We are supporting management."

The structure to achieve this is straightforward. "We have a small group of seven people at the corporate center and 90 people in the operating companies reporting to me and to the operating company CFO," he said.

"A company like Ahold, which had problems in the past, has invested significantly in internal control."

"Ahold has chosen to limit the scope of the internal control function at a central level to SOX 404 compliance," he said. "But in the operating companies the scope varies. Some are very wide, from supporting enterprise risk management right down to a store audit function, for example, and others are more limited. It is the local choice of each operating company. Ahold chose not to dictate a standard scope."

Like many other people in his position, his main challenge has been Sarbanes-Oxley. "My biggest exposure was to SOX 404 implementation," he said. "It has always been the mainstay. We faced all the main issues that all corporates faced. The most significant was being effective and efficient at the same time. There has to be a healthy tension between these two. You have to maintain communication between central and local and you have to ensure the adequacy of the processes."

He identified the implementation of SOX 404 procedures as his main success. "First, I think of our 2006 compliance in the first year of SOX 404. We didn't identify any major risks or anything we would have to disclose externally," he said. "I attribute that to overcoming all the basic difficulties. A company like Ahold, which had problems in the past, has invested significantly in internal control. And it was through this process that we realized the way we were adopting 404 was sub-optimal. So now we have a fundamentally different process which will take off fully in the coming year."

"It was simple," he said. "More than 90 percent of companies implemented SOX 404 by adding on process. We are now embedding controls. We have moved from adding on to embedding. This ensures that the controls are working effectively, but in a more efficient way. We are making sure the right controls are in place and ensuring they are working properly without having to do it all over again."

From his experiences at Ahold, he would advise others to put their own internal processes in the center when looking at risk management. "The fundamental difference is that companies need to be assured from within, rather than relying on ad hoc external assurance. This had already happened through such practices as total quality management. Or production or logistics processes. Now it is happening in the financial processes. You have to make sure you have controls in the processes, rather than relying on assurance from outside the process."

"To do this you need a simple basic checking system just to ensure that people stay honest. But you don't have to do more than ten percent," he said. "Just build the controls and embed them in the process. That is much more efficient. So you have cost savings. And you only control it by the people who know where the risks are. And therefore, it is also more effective. It is dangerous for the process owners to rely on external assurance."

What does he think Ahold could have done better?

"We failed to come up with an enabling tool, a streamlining software tool," he said, referring to SOX implementation software. "Nobody is happy with the existing software tools. This is true of many other companies."

He also thinks the organization tried to do more than was necessary to build an effective but also efficient risk management and internal controls system. And, managers and employees should have communicated better.

"You need good communication between all the different parties involved," he said. "It's not complicated. It is just that you have so many different parties involved. Different parties at different levels. All of them have to talk to each other. It is almost impossible to get that right. There are mishaps. They thought they intended 'this' and instead got 'that' because the message didn't get across."

Klumper urged those embarking on risk management to learn from their actions.

"There is always a lesson in every difficulty," he said. "It just reinforces what you are doing. Communication is important, for example. We all fall into the same traps. Don't be over-ambitious. Don't take on too much. Increase your capacity by 50%. Build in more buffers than you possibly think you will need'.

In hindsight, would Klumper do anything differently?

"It would definitely be different," he said. "We would not have followed our add-on implementation approach. With hindsight, I would have embedded the controls in the processes from day one. I would have done everything differently. It is a big tanker to turn around and it should have been smaller."

Does he plan to adapt the present systems?

"We are not completely satisfied with our control systems," he said. "But we are not looking to make major changes. We are fairly happy. It will not require a major overhaul. We just need to continuously adapt."

The advice he would pass on is, again, all about communication.

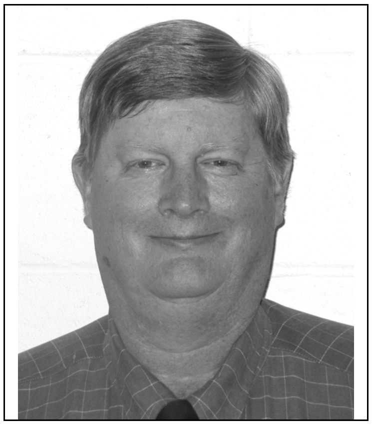
"Stay close to management," he said. "For example, a lot of companies implementing enterprise risk management do it top down. It becomes the corporate headquarters' system, rather than the company's. You need to embed the processes bottom up. You get much more benefit that way."

He also offered some more advice on what can be done within small groups of like-minded professionals working in the same field. "There are only about 20 SOX-compliant companies in the Netherlands," he said. "We set up a roundtable, a peer group. We excluded external advisers and we meet three to four times a year, just exchanging experiences, such as, 'What tips do you have?' What has worked for you?' That sort of thing."

You can pick up major ideas from peers, he said. "We email each other. It is very beneficial in picking up good practices."

Key lessons:

- You have to make sure you have controls in the processes, rather than relying on assurance from outside the process.
- Control it by the people who know where the risks are. It is dangerous for the process owners to rely on external assurance.
- Embed enterprise risk management bottom up. This way it becomes the company's system, rather than the corporate headquarters.
- You can pick up major ideas from peers. Set up a roundtable for exchanging experiences.



Oscar Lewis

Oscar Lewis is Controller with Umbra Cuscinetti Inc., an aerospace company that manufactures precision ball screws and other components, based in Washington State.

"Our company, while private, is a subsidiary of a large Italian aerospace company," he said. "But because of what we do and who we deal with in defense contracts or with Boeing or Airbus, there is a requirement for a level of internal control that we need to meet to give assurance to our customers."

Lewis is in command of the entire risk management system within the company. "The way the system fits into the company's overall management is very similar to the quality initiatives, like ISO 9000, those that are required of manufacturers," he said. "It is a question of: 'Say as you do' and 'Do what you say' – the same premise. Everyone has that understanding. So that is how it fits in."

'Say as you do' and 'do what you say'

"What we are trying to do is, firstly, eliminate the easily foreseeable risk, then secondly, the other foreseeable risks, and if something happens, catch it quickly," he said. It is a practical approach. "We go through our business processes, our paper and money flow, and then document ways to handle that. We do this to see if there are efficiencies to be gained and to see where there might be holes in the system which someone could exploit. And then we plug those holes as well as we can without slowing down or hindering the process."

"We are fortunate in that, financially, most of the things we have to deal with are either check or wire related. There are no cash transactions."

On the inventory side it is rather different, he said.

"We have high-value items in raw materials, like titanium, and with the prices of metals over the last 15 to 18 months, we have had to increase our security," he said. "We found people from outside our organization trying to find ways in. That's the biggest issue we've faced."

Yet, though challenging, he said he has seen some successes in handling inventory issues. "We were lax with inventory handling," he said. "We had things which were accessible to non-employees. If they knew where to look they could reach it," he said. "So, we built safe places. And, we have put in a system to count high value inventory on a weekly basis," he said.

"Internally we have also started doing a lot of basic things. We have opened more bank accounts to separate our payroll from our accounts payable to avoid the risk of fraud, for example," he said. “We have segregated duties.”

He would recommend some good practices as a result. “The very first good practice is to document what you do,” he said. “Unless you know how things work you can’t improve them. Then some fixes are readily apparent. Three or four things will jump out at you. Maybe you aren’t locking your checks up, for example.”

Materiality is also an issue. “You need to think about your risk and prioritize your risk by its size on your balance sheet,” he said. “If you have a lot of fixed assets, then that’s where you should concentrate.”

He also talked about his lessons learned.

“I would say the two biggest things we came across were: First, we were hindering peoples’ ability to get their jobs done. We found multiple levels of approvals to get things posted in the system, and they were really keeping people from getting as much work done as they needed to, he said. “We re-examined the entire approach, especially in areas like purchasing. We were able to keep things moving smoothly.”

“Second, we had to figure out how to segregate duties and find out what makes sense,” he said. “So we are mitigating all the risk it is possible to mitigate.”

“I think that the entire documentation process points to things which really didn’t need to be done,” he said. “Something is in there as a legacy from whenever and no one has ever really thought about it,” he said. “And the second is giving a level of comfort to the board of directors and outside auditors that we are doing everything that they reasonably expect of us to keep things moving ahead, assuring them that something bad is not going to happen.”

If he could start the risk management process over again, he would handle a few things differently.

“I would still start with the documentation phase. I can’t stress that enough,” he said. “What I might want to do differently is make sure everyone who is affected is involved. Try and get everyone involved. I would also widen the base of people to get it a little smoother. And I would also spread it and circulate it more so everyone understood,” he said. “Meetings on what we are doing and why it is important, for example. We could have spent a little more time on the education phase.”

There is still room for change, he said. “The system is a loop and you keep monitoring it and looking at how you are doing. You need to take the time to do that. We need to tighten up our fixed asset monitoring system, for example,” he said.

His advice to others is practical. “Besides emphasizing the documentation, I think it’s important for people, especially in smaller organizations, to realize they aren’t going to get everything done right away,” he said. “It is better to do it slower and well than quickly and have to do it over and over again.”

Key lessons:
• Document what you do. Unless you know how things work, you can’t improve them. • Make sure everyone who is affected is involved in the risk management process. • It is better to do it slower and well than quickly and have to do it over and over again.

Photo not available

K C Ong

K C Ong is the Group Internal Audit Manager with Fraser & Neave Holdings Bhd in Malaysia, a fast-moving consumer goods business. It produces and bottles Coca-Cola in Malaysia, for example, and has a portfolio of branded dairy products.

“My role is to review identified risk in the risk register and ensure group risk policies are implemented,” Ong said. “We report every quarter to the audit committee and the Board.” The system is straightforward. “We have a routine audit covering operational risk management,” he said. “Strategic risk would be identified in the risk register and recorded by the divisional management. On a half-yearly basis, I cover strategic risk as well and provide assurance to the audit committee.”

For Ong, the main issue is long-term risk, the strategic risks. “Management controls them in the short-term,” he said. “For example, we set up a plant in China, but with a small customer base. In order to grow we have a long-term perspective with short term annual plans to increase and diversify the customer base. We have to make management understand the exposure to the risks, both strategic and political.”

His efforts are working. “We have done strategic risk management for a third year now, and we have fine tuned the ability to identify management controls that could mitigate the risks we identify,” he said. “The whole of management is integrated into this, while internal audit gives assurance that it is all in place.”

He advises integrated support for the project. “It must be supported by the Board, the audit committee and senior management,” he said. “That is very important.” And you have to provide practical assistance for this to happen.

“You need a framework that management can use to facilitate understanding and the adoption of enterprise risk management,” he said.

“The actual period of implementation is a time of education,” he said. “In the beginning, management often cannot articulate the risks and management controls required.”

“As time goes on, people get educated, on a quarterly basis, as it were. People then get better and better all the time,” he said. “It’s a journey.”

The advantages of approaching risk in this way are clear. “You have a better picture of some of the down risks the group is facing,” he said. “You have a better perspective and a better focus. That is the biggest benefit for me.”

Looking back, he wouldn't change much about the system he helped to implement and fine tune.

"I might change it slightly," he said. "We have a standalone system for managing risk management. It would be ideal to have a web-based system where anyone could log in anywhere in the world and identify risk and the people who have to deal with it."

> *"It is a journey to continuous improvement"*

Such a system would provide more timely information and action. "A real-time system would be better than a quarterly one for managing risk management in an ever-changing business environment around the company," he said.

He advocates one more thing. "You will always need more education of your recruits," he said. "And, in particular, new senior management."

How would he advise others on risk management?

"You need a holistic approach," he said. "You need to do it with key stakeholders and run it as a learning experience and more towards enterprise risk management. You need to avoid the silo of just strategic risk management, for example. You need to integrate the two."

"Education is the most important part," he said. "It is a journey to continuous improvement. Focus on that."

Key lessons:

- You need a framework that management can use to facilitate understanding and the adoption of enterprise risk management.
- A real-time system would be better than a quarterly one for managing risk management in an ever-changing business environment around the company
- You need to do enterprise risk management with key stakeholders and run it as a learning experience.

Photo not available

James Riley

James Riley is Chief Financial Officer of the Jardine Matheson Group, one of the largest and oldest Asian-based trading conglomerates. Jardine Matheson runs a wide range of businesses ranging from property, supermarkets, motor retailing, insurance broking, engineering to construction, as well as the management of the Mandarin Oriental hotel group.

Riley is, as he put it, "The keeper of internal control efficiency." He is, of course, much more besides. But his is the role at the center of the way that risk is managed. "I have all risk management and internal auditing reporting to me," he said. "Internal controls are an integral part of how the whole business operates."

"Internal control is just one of the tools available to manage risk and it is a central part of how the organization manages risk," he said. "In essence a strong internal controls system is a key and integral part of running and managing a disciplined and controlled business."

But the interests of Jardine Matheson spread wide. Some businesses in the group are wholly owned. Others have different levels of ownership. Identifying and managing risk in such an enterprise is a potentially difficult task.

"We have a very wide diversity of businesses," he said. "So we have a comprehensive process running up from the individual businesses and to maintain control we have to have well-structured processes."

It is a straightforward system. "The use of audit committees and risk management committees ensures we have effective reporting of the oversight and controls," he said. And as a large group operating everywhere from sophisticated cities to areas where trading can be complex and sometimes challenging, Jardine Matheson needs to have a system which can provide swift alerts to dangers and even faster reactions. "We need to be kept aware of the issues that arise, so there is a focus on reporting upwards. The issues are the ones you would expect, for example frauds and insurance claims. An important part of the system is to ensure that they occur as infrequently as possible but that where they do occur we can make good the faults and learn from errors. Our aim is to keep costs to a minimum," he said.

He gave an example.

"There has been very serious flooding in Jakarta in Indonesia recently where we have a very substantial business. The head office was under water for nearly a week at a time when we were trying to finalize the figures," he said. "Large numbers of our operating outlets were affected as were the homes of many members of staff. We had comprehensive business continuity plans for each element of our business and were able to get most operations up and running as soon as the floods receded, the financial results out a matter of days late, whilst also helping with food and accommodation for the worst affected staff and their families." But the existence of such plans alone is not enough. "Having effective business continuity plans in place is very important. But having them properly tested, reviewed and knowing them to be effective is just as important," he said. The same system worked in crises caused by disease, in particular during the outbreaks of severe acute respiratory syndrome (SARs). "It was similar during the SARs scare in Hong Kong," he said. "We had separated key offices into two locations so that if one office got shut down by an infection the second office could still remain operational."

It is harder to ensure that controls work throughout many different businesses. "You need significant buy-in from each of the businesses. You cannot simply be a central policeman," he said. "It has to be a question of structuring themselves and monitoring their own standards."

Riley thinks that Jardine Matheson's success in this field develops from this point: There is a need for a centrally inspired but locally applied culture. "The successes we have had reflect our steadily built and international philosophy of the importance of internal controls from the grass-roots up," he said. "It is the importance of maintaining and sustaining a very efficient internal controls system. It has to be an area of priority and focus."

"You have to make sure that the idea of the team as a priority is a very important element in maintaining good practices. That idea has to be part of the culture. The whole emphasis and focus on business continuity plans is a good example," he said. "And so is our emphasis on control self-assessment questionnaires. Both are examples of locally held responsibilities."

"People do their own assessments and internal audit reviews them from time to time," he said. "It is self-policing. It puts the responsibility on the teams themselves. As a result the responsibilities lie with everyone and it is not just down to someone at the top. And it is up to them to keep improving." And there is one element that has to underpin such a system. "Having a strong internal audit element is very important. It has got to be supportive," he said.

"It is no good having a director who creates opportunities but who doesn't properly control his business."

Riley also feels that weaknesses tend not to stem from processes and systems but – as so much in business – from the human element, people. "Weaknesses or failures come about in part through people," he said. "No organization is error-free. Organizations can become complacent. But if the system is strong it will guard against problems if things start to slip. Weaknesses occur where people take their eye off the ball." And sometimes it happens with simple changes. "Staff changes can harm you. You need to pick up the warning signs early. New people can take more time than you expect to get up to speed. And by then, significant control weaknesses can start coming in. The essential lesson is that you can't allow things to drift," he said.

The positives that come out of this enable you build a culture that understands the balance of controls and freedoms within the organization.

"It is important to understand the degree to which, if you do focus on it, you can build a culture which understands the importance of controls," he said. "People can be reluctant to put controls in because they feel it is the dead hand of bureaucracy. There is a need to put in controls in a way in which people feel they are able to breathe and move. It should be possible to have appropriate controls and disciplines and still have entrepreneurial flair."

For Riley, the long-term lessons are clear. "Our systems have been put in place progressively over a long time," he said. "You need to guard against complacency. One should never feel that you have done it. You need to keep it fresh. If it becomes stale then people just see it as process."

But, overall, a clear understanding of the importance of internal controls, from top to bottom and back up again, offers the maximum advantage.

"The most important element is to ensure the values of the organization with respect to risk management and internal controls are communicated from the top as the key values of the organization," he said. "It needs to be part of a broader culture and code of conduct." And the crucial commercial importance needs to be emphasized. 'It is no good having a director who creates opportunities but who doesn't properly control his business," he said.

Key lessons:
• Having effective business continuity plans in place is very important. But having them properly tested, reviewed and knowing them to be effective is just as important. • People do their own assessments and internal audit reviews them from time to time. As a result the responsibilities lie with everyone and it is not just down to someone at the top. • There is a need to put in controls in a way in which people feel they are able to breathe and move. • The most important element is to ensure the values of the organization with respect to risk management and internal controls are communicated from the top as the key values of the organization.

	
Philip Wessels	**Rob Shuter**

Nedbank, one of South Africa's largest banks, recently overhauled its approach to risk management. Philip Wessels, Chief Risk Officer, and Rob Shuter, Managing Director, Retail Operations, led the project.

Both men sit on the group's executive committee and report directly to the CEO. Here, they discuss what worked in changing the risk management system, and what didn't.

"Nedbank looks at the different aspects of risk, organizing it into 17 main categories," Shuter says. "Each client-facing business has its own risk teams. Additionally, there is a relatively small risk monitoring and policy setting function at the center to ensure policy is correctly applied and properly monitored. Internal and external auditors provide the final line of defense by ensuring all risks are properly managed and reported."

"We had to make our approach to risk more robust," Wessels said. "We needed to roll out a proper enterprise risk-management system, and that is what we have put in place over the last three years. We needed proper systems, proper management and proper training."

Wessels and Shuter said the restructuring of Nedbank's risk management system was significantly influenced by Basel II – regulations issued by the Basel Committee on Banking Supervision focusing mainly on risk.

For Shuter, the Basel II implementation posed his biggest professional challenge in recent memory. "We had to revaluate and create new processes, for example, in risk-based pricing. It was very complex."

He said the complexity has been heightened by the shortage of risk management skills in South Africa. "We moved into the final stages of Basel II with increased pressure on already stretched resources. He said the bank's initiative to improve employee project management skills has helped put Nedbank back on track for Basel II.

"We have had successes in the operational loss environment. Good internal controls and management information systems have been absolutely critical," Shuter said.

There has also been a big focus on business governance, he says. "We have put a lot of effort into how we manage the business. We reviewed the processes to manage performance. We had to redesign the way the business was run from scratch. We are great fans of sound management and inspirational leadership. Our experience is that the evolution of management philosophies has meant that management has been denigrated. People said: ‘You are too busy managing. We need leadership.’ But management remains an important issue.”

They also tightened credit management control. “A major risk in banks is that you change systems and give yourself an unintended change in credit policy,” Shuter said.

As a result of their experiences, both men can offer others useful recommendations for risk management. “Fix accountability,” Wessels said. “Document and ensure appropriate charters, which lay down the responsibilities of the different governance procedures.”

Shuter agrees with the advice.

“Focus on business governance. It is critical to get the proper mapping of how your business processes are managing the various risks. For example, reputational risk. Typically when you say, ‘What is the process by which you manage reputational risk?’ everyone starts shuffling about and looking out of the window. But if you ask about credit risk they have a file to throw across to you.”

Shuter said the new approach to risk has resulted in fewer failures.

“The most important thing is to change the mindset, the hearts and minds of our staff. You cannot do it if the staff is not all onside.”

“The original failures were partly due to a lack of proper accountability. There have been times when we didn’t manage all the risks. Our risk framework didn’t effectively cover the full spectrum. We hadn’t foreseen some operational risk factors. The stuff was coming to us too late and we had breakdowns through collection. But, in fairness, we should have picked up signals earlier.”

Shuter emphasized that people involved in the business need a way to voice their concerns and that information technology should mitigate risks, not create them. “We had a very complex IT environment,” he said. “There was a complex mix of legacy systems and internet-based systems which tended not to talk to each other.”

Asked what, in hindsight, each would do differently, Wessels said he would have communicated more about the changes. He believes, in fact, that communication is the most important aspect of change management.

“No organization ever does enough on communication to staff and stakeholders. We could always do more. The most important thing is to change the mindset, the hearts and minds of our staff. You cannot do it if the staff is not all onside,” he said.

“You need constant and clear communication to staff, talking to them in an open and honest way. And you need a robust approach to survey staff for their views and attitudes,” Wessels said. “We do internal surveys and through that we could see our staff’s mindset had changed. There is now trust in management, and they are comfortable with the bank’s strategy. Ultimately, that means better returns to investors and stakeholders. You need firm values.”

Shuter said the toughest part of the process was making changes while still running the business.

"If you are white-boarding it, you have the luxury of designing from a clean sheet of paper. But we have to maintain the aircraft in flight," Shuter said. "There will be redundant parts. All this is very difficult to do in a big bank."

"All our positive experiences have been where we have brought in very good people," Shuter said. "You need the best of the best…particularly in retail banking. You need the best people to deliver absolutely the best customer experience. There is a very clear link."

Finally, how satisfied are Wessels and Shuter with the changes they have helped implement?

"Banks face a big challenge in the compliance environment in which we operate," Wessels said. "Take the anti-money laundering procedures, for example. Those have massive systems implications. In addition, we have Basel II. We will run those regulations in parallel through 2007 and go live in 2008. It all means system change and re-training of staff," he said. "We see the regulatory changes in the banking industry in a positive light, and use these as opportunities to enhance our risk management practices even further. And they all tend to come at the same time. The key is sound project management. Getting that right alleviates the challenges."

"It is very critical that we view our risk and control systems as evolutionary," Shuter said. "You need a deep understanding that this thing is always in a state of change. We need to be able to change easily. We are broadly happy, but we strive to be a little more agile."

Key lessons:
• You need constant and clear communication to staff, talking to them in an open and honest way. And you need a robust approach to survey staff for their views and attitudes • Document and ensure the responsibilities of the different governance procedures and get the proper mapping of how your business processes are managing the various risks. • View risk and control systems as evolutionary. You need a deep understanding that this thing is always in a state of change. You need to be able to change easily.

Rob Whiteman

Rob Whiteman is Chief Executive, London Borough of Barking and Dagenham, a large suburban and industrial area lying just to the east of London, England.

Boroughs run most of the day-to-day services across the capital, including education, housing, social services, street cleaning, waste disposal, roads, local planning and many arts and leisure services. The boroughs require, as Whiteman put it, “sound and robust risk and control systems.”

Whiteman runs a budget of £500 million a year, with 8,500 workers providing services to 120,000 residents.

“We see risk management and internal control as the way to realize our ambitions, rather than limiting what we do.”

Whiteman has a fundamental philosophy about his role. “In the wake of Enron and other corporate collapses, there has been a focus on greater regulation and compliance in relation to internal control,” he said. “We need to counterbalance this trend of poor enterprise results and negative feedback with good practice around risk management and internal control that leads to enterprise success and better governance.”

His view is that risk management and internal control are two sides of the same coin. “All organizations face risk,” he said. “Risk is managed by having in place the right controls to safeguard against its occurrence. Internal controls exist only in relation to what they do to mitigate, but never eliminate, risk.”

He says risk management and internal controls are a way of bringing about change rather than simply safeguarding a position. “At Barking and Dagenham, we see risk management and internal control in a positive way; as the way to realize our ambitions for the area, rather than limiting what we do.”

“Since December 2005, we have rolled out a corporate risk-management strategy that enables us to take advantage of the many development and regeneration opportunities the borough has, as well as underpinning our drive for service improvement. The internal control environment is a vehicle to support what we want to achieve, like building communities and transforming lives, not a barrier. We are shifting from a rather timid reliance on internal control for its own sake to a culture of ‘can do’ with a fit for purpose risk management and internal control regime. We are on the road to achieving the aim of having risk management fully embedded across the Authority. The borough has taken an all-embracing approach to risk management, striving to pass on knowledge to all stakeholders in the borough; employees, residents and local businesses."

He explained how this works and how it has changed the way that the local authority provides its services. "Risk Management allows the borough to take an innovative approach to service delivery, opening the door to the possibility of taking risks to achieve positive outcomes. Proper risk assessment enables us to make informed decisions about the challenges and risks that we want to take on, and can help us to target our resources to achieve the best possible results."

He gave some examples. "For example, we have entered into an innovative partnership with the private sector to transform the management of our passenger transport operation. The partnership is based on risk and reward," he said. 'This means that the private partners fees will be a percentage based on them identifying and making savings within the service. We would only fully pay the partner for their work if they achieved pre-agreed savings and performance targets. We are on target to realize around £2m of savings. We could not have taken this step with a robust risk appraisal of the viability of the contract and the projections for savings."

He gives another example. 'We have a very ambitious improvement program for 20,000 properties over the next five years, at a cost of £160m. This capital investment is underpinned by the council's capital appraisal and monitoring approach, which is compliant to government regulations, and "gateways" projects via robust risk assessment and control," he said. "Risk assessment is combined with performance and financial management at all key stages of the project. This same approach to capital spending has enabled us to deliver an award-winning education private finance initiative, called Castle Green." Castle Green is a school and community center.

"We are also using our capital appraisal and risk management techniques to build children's centers, which have already led to improvements in children's health and welfare. This initiative has contributed to our achieving level 3 in our annual performance assessment for children's social care."

The process also works in a wider way. "Our risk-enabled approach, backed by sound financial stewardship and internal control, is also enabling us to transform our borough. Take, for example, the major regeneration of Barking town center. It's also allowing us to enter into partnerships, for example, with Thames Gateway, to develop Barkingside and the southern portion of the borough."

Our borough realizes that partnership, with health organizations, the private sector, government agencies and developers, is fundamental to making the best use of our opportunities. "Our risk management approach extends to, and is shared with, our partners," he said.

Whiteman has had to ensure that the whole process of risk management and internal controls were embedded into the governance process. "We have created a Project and Risk Board to ensure that all of our key projects and activities designed to achieve our objectives of customer care, service improvement and community cohesion through regeneration are adequately risk managed and that there are controls in place to deliver them," he said.

"We have recently set up an Audit Committee, in line with best practice from the Chartered

Institute of Public Finance and Accountancy, (CIPFA), and including, the former Chief Executive of Westminster City Council as an independent member. This committee provides assurance on our overall risk management and internal control arrangements, ensuring that they are focused on service improvement and outcomes. Members have recently received training in value for money and risk management," he said.

Whiteman emphasized the importance of an integrated approach. "Risk management and internal control are part and parcel of effective use of resources and performance. We have therefore integrated risk management and value for money into our balanced scorecard approach to service planning. Heads of service need to consider risk, performance information, financial information and quality and equity outcomes when designing their services to achieve value."

He also emphasized the importance of ensuring that the processes are maintained to a high standard. In the borough, managers do this through internal control assurance and a Statement on Internal Control (SIC).

"We have produced a Statement on Internal Control in compliance with proper practice that has indicated that our systems of internal control including risk management are robust and effective. We are currently working to develop the SIC into an annual governance statement to anticipate the new CIPFA/SOLACE framework on effective governance in local government."

"We undertake reviews of our fundamental financial systems using a private sector internal auditor. Our external auditor is of the opinion that our internal audit arrangements are effective and adequate and our financial control systems are robust."

He also emphasized safeguards. "Effective risk management and internal control are particularly significant as we move from being debt free to taking on the opportunities for prudential borrowing and shifting the balance towards external funding of our capital program," he said

"We are aiming for excellence in Comprehensive Performance by 2008," he said. "It is now about proving value for money arrangements, which means how you prioritize and use resources available to provide the best services you can."

But Whiteman pushes for more improvement because a successful risk management and internal controls system depends on initiating continuous improvement. "We are not complacent," he said. "We must keep our internal control environment under rigorous review. We are implementing a Corporate Audit Strategy that aims to bring together our work on anti-fraud and corruption, assurance on governance, value for money and systems reviews of internal control. This seamless approach to internal audit should ensure that we remain outcome focused so that internal control and risk management produce real performance gains," he said.

"We are using CIPFA's recently published guidance on implementing an anti-fraud culture to assess our internal controls around fraud and to increase awareness of this issue. We will shortly roll out a program of training to promote understanding of anti-fraud and effective internal control. We are thinking of ways in which our Audit and Scrutiny Committees can share information so that issues relating to internal control can benefit from a political perspective, and that internal audit can open a window on service and performance issues."

"So far we have relied on internal audit to provide assurance about the quality of our Best Value Performance Indicators and other performance management information. Recently we have trained staff so that they can take ownership of performance management. This should enhance the quality of controls associated with gathering performance data as well as releasing more internal audit time for controls assurance work," he said

And once process and control ownership is in place, vigilance is also important, as is balance in implementation. "We need to continue to ensure that we have the right balance in terms of risk assessment and effective internal control in relation to our partnerships," he said. "This is a challenge. We need to be confident that the borough's interests and resources are safeguarded without stifling each partnership with unnecessary bureaucracy. We are learning from experience that some partnerships and contracts require more hands-on client management than others, such as housing maintenance. This experience will help us adopt a more fit –for-purpose approach to our risk management and internal control arrangements," he said.

Based on his experiences, his advice to others is straightforward. "For Barking and Dagenham, risk management and the internal control environment is an enabling concept, not a restrictive one," he said. "It gives us the confidence to make the most of the opportunities we now have to build communities and transform lives."

Key lessons:

- Risk management and internal control are part and parcel of effective use of resources and performance. Therefore, you need to consider risk, performance information, financial information and quality when designing services to achieve value.
- Have the right balance in terms of risk assessment and effective internal control in relation to your partnerships to safeguard your interests and resources without stifling each partnership with unnecessary bureaucracy.
- An integrated approach to internal audit should ensure that you remain outcome focused so that internal control and risk management produce real performance gains.

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