



**The North Carolina
Office of the State Controller**

**Taking A Fresh Look at Managing
Risks Within Your Organization**

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COSO's Definition



Internal control is

"a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives"

Internal Controls Exists Because of...



- That the objectives are not achieved
- Without a risk, there is no need for an internal control

As a result...



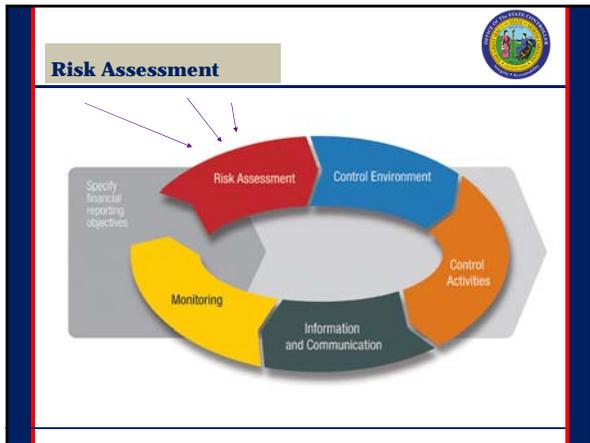
- *Our internal controls are only as good as our risk assessment*



- Risk is defined as the possibility that an event will occur and adversely affect the achievement of objectives

Risk Assessment – Fundamental Component



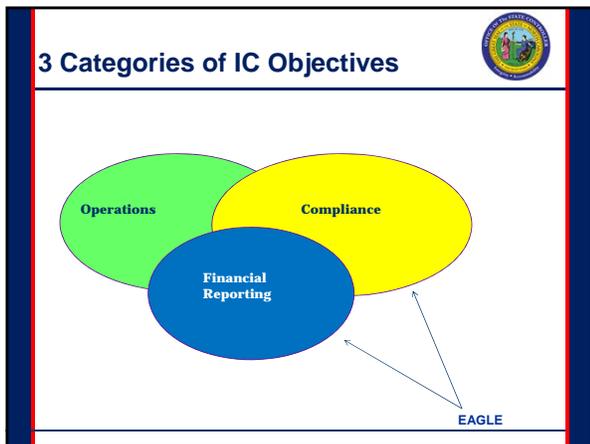


Risk Assessment per COSO

Risk assessment involves a

- Dynamic
- Interactive

Process for identifying risks to the achievement of objectives.



5 Challenges to Risk Assessment



1. Overlooking Details of Objectives
2. Focus on the Known
3. Human Biases
4. Reality of Assumptions
5. Criteria to Assess Risks

Challenge #1: Overlooking Details of Objectives



Eagle requires assessment at different levels:

Financial Risks

- Account level
- Process level
- Location level, if applicable

Compliance Risks

- Program/grant level
- Specific requirement level

Challenge is breaking those into sub-objectives

Breaking Down Objectives



Accounts, Transactions, Locations

Objective: "Reliable Financial Reporting"



Sub-Objectives: Assertions

- Assets recorded *exist* and transactions recorded *occurred*
- All existing amounts and transactions *completely* recorded
- An asset or liability is recorded at appropriate *value*
- Recorded transactions are *measured* and recorded at appropriate amounts and amounts valued correctly
- The entity has *rights* to assets and *obligations* for liabilities.....
- An item is *presented* and *disclosed* in accordance with statutory accounting principles

Internal Controls are Needed Because...



- There are **risks** that the assertions are not achieved
 - Internal controls help reduce the risks that a violation of one of these assertions leads to a material misstatement
- ?
- Are we breaking down our thinking from an account or transaction to a specific assertion for the account or transaction?
 - Is our risk assessment thorough along each assertion?

Challenge #2: Overreliance on Knowns



- **Known, knowns**
- **Unknown, but Knowable**
- **Unknown, Unknowable**



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- What are you doing to make sure your group is thinking outside the box?
- Risks are continually evolving – to what extent has your assessment of risks changed over time?
 - 2010, 2011, 2012, 2013....
- How have your sources for thinking about risks evolved over the last few years?
 - Avoiding the “SALY” tendency

Challenge #3: Bias



- **Common Tendencies Leading to Bias**
 - Rush to Solve
 - Are we too quick to draw a conclusion re: risk?
 - Overconfidence
 - Are we overconfident in our assessments about the risk?
 - Confirmation
 - Are we only seeking information that is consistent with our belief?
 - Anchoring
 - Are we starting with an initial assessment of the risk and now biased by that?
 - Availability
 - Are we only using “easy to obtain” information to make an assessment?

Exercise 1



Linda is 31 years old, single, outspoken, and very bright. She majored in philosophy. As a student, she was deeply concerned with issues of discrimination and social justice, and also participated in anti-nuclear demonstrations.

Rank the following statements from most probable to least probable:

1. Linda is a teacher in elementary school
2. Linda works in a bookstore and takes yoga classes
3. Linda is active in the feminist movement
4. Linda is a psychiatric social worker
5. Linda is a member of the League of Women Voters
6. Linda is a bank teller
7. Linda is an insurance salesperson
8. Linda is a bank teller and is active in the feminist movement

Exercise 2



- You are told the following numbers are part of a sequence that includes other numbers:

2, 4, 6

- You can ask whether one particular number is part of the sequence to help you identify the rule for the number sequence
- Write down your initial theory about the rule and the one number you would want to query

Challenge #4: Recognizing Assumptions



- Achievement of an Objective is often dependent on some assumptions
- Assumptions \neq Fact
- Wrong assumptions.....Risk

Challenge #5: Challenge Criteria to Assess Risks



- Typical Dimensions
 - Likelihood of a risk occurring
 - Impact if risk occurs
- **The Dark Side of Optimism***
 - Negativity vs. "power of positive thinking"
 - Bias against critical thinking
- **Black Swan possibilities**

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- Are you considering other dimensions:
 - Velocity or Speed of onset
 - Momentum
 - Persistence

Varying Methods – Helps Identify Unknowns



- Interviews
- Workshops
- Surveys and Checklists
- Scenario Analysis
- Internal/External Audit

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Risks to Objectives

“Pre-Mortem” Analysis



The Charlotte Observer
October 22, 2015

New York – Just two years ago, the reputation and brand related to the financial management of the NC Department of XYZ were at all time highs.

What a difference a couple of years make, with the Department's financial mismanagement significantly tarnished.....

Identify 3 of the most like causes for this headline

Avoiding Bias*

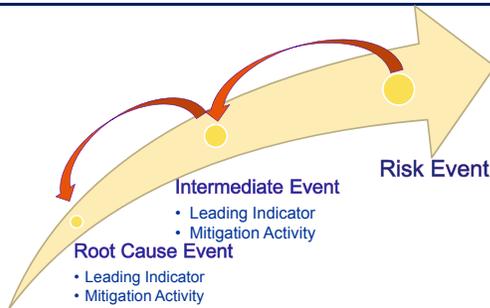


Mitigating Strategies:

- Begins with being aware that bias IS present.
- Challenge “expert’s” or “advisor’s” assessment.
- Recognize presence of assumptions and challenge them.
- Make the opposing case.
- Seek disconfirming information.
- Solicit input from others.
- Consider why something comes to mind.

*Source: COSO’s *Enhancing Board Oversight: Avoiding Judgment Traps and Biases*, www.coso.org

Root Cause Analysis to Pinpoint Risk Drivers

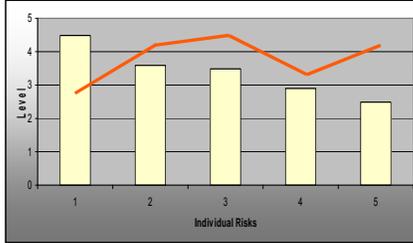


“Bow-Tie” Analysis



PROACTIVELY MANAGING “CAUSES”		RISK EVENT DESCRIPTION	PROACTIVELY MANAGING CONSEQUENCES	
CAUSES	TREATMENT		TREATMENT	CONSEQUENCES
Decline in federal research funding	Communicate impact of federal research funding on economic growth Advocate for research funding with federal delegation and business leaders	Decrease in federal funding will lead to a loss of valuable research initiatives, resources and federal financial aid	Diversify research funding sources, i.e., industry & foundations Improve competitiveness with training and proposal development assistance	Inability to recruit and retain quality faculty, staff & grad students

Gap Analysis – Over or Under Managed Risks



█ Management Effectiveness (where 5 represents best in class RM processes)
— Inherent Risk (Where 5 represents highest inherent risk)

Considerations



- Design of controls
- Implementation of controls

Do controls prevent, detect, and/or correct misstatements?



17 Principles



4 Principles →



4 Risk Assessment Principles



6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. The organization identifies risks to the achievement of objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.
9. The organization identifies and assesses changes that could significantly impact the system of internal control.

Risks Threatening Objectives



- Entity-level risks
 - What factors might be entity-wide that might impact the ability to meet these objectives?
- Account specific risks
 - How do account specific risks differ from entity-level risks?
 - Given these differences, how might controls need to differ?

Entity Level Risks



Arise from external and internal factors:

- External
 - Economic changes
 - Technological developments change the nature of business
 - Changing “client/constituent” needs or expectations
 - “Competition or alternative providers
 - New legislation and regulations
 - Natural catastrophes

Entity Level Risks



Arise from external and internal factors:

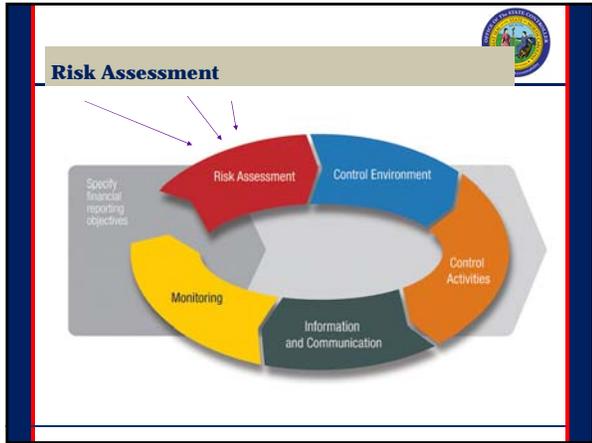
- Internal
 - Changes to or disruption in systems processing
 - Quality of personnel hired and retained
 - Change in management responsibilities
 - Changes in processes or access to assets
 - Rapid growth
 - Weak or unsupportive tone at the top

Relationship to Other Components



Assessment of Risks of Other Components





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