GOVERNANCE/COMPLIANCE

Don't get bogged down on small things

By JEFFREY D. SHERMAN

Effective risk management depends upon having a deep understanding of your organization's strategy — strategy dictates what risks are acceptable.

Jeffrey D. Shurman, chartered accountant

What are the 10 the most serious risks that your organization faces in the next 12 months? What will you do if they happen? Anyone who can answer those questions has achieved 75 per cent of an enterprise risk management program, without having to generate hundreds of checklists and flowcharts or sit through interminable meetings.

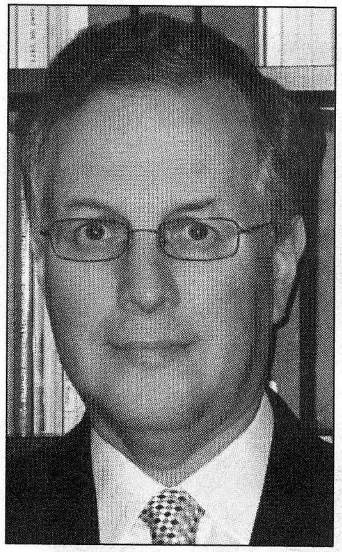
It's easy to get bogged down in the details, but that will ensure you lose perspective. Effective governance requires that the risks that an organization assumes be linked to its strategies. Risk management is an integral part of the governance process — it needs to be a big-picture, see-the-forest-not-the-trees process. That's why it requires focusing on a few critical questions, not hundreds of possible issues.

Governance refers to how an organization is directed and controlled. It starts with strategy, which is why one of the fundamental tasks of a board of directors is to review and approve a corporation's strategic plan.

Effective risk management depends upon having a deep understanding of your organization's strategy — strategy dictates what risks are acceptable. Unacceptable risks can be insured or hedged against, mitigated by doing a good job of running the company or they can be avoided by not being in that particular business.

The Royal Canadian Mint recently grappled with a risk management controversy. The Mint is a much admired institution, and a source of pride to many Canadians. From a public relations point of view one of the worst things that could happen to the Mint would surely be a large theft or fraud. That would challenge the position of solidity, security and integrity that the Mint represents in our national consciousness. In the fall of 2008, the Mint announced that $15.3 million worth of gold was missing from its vaults based upon an inventory count. Predictably, the press got quite excited.

Then in June 2009, the Mint released a report from Deloitte that concluded that the shortfall did not result from accounting errors and recommended that the Mint undertake reviews of physical security, computer systems, technical operations, and prior period accounting. At that time, the press reported that the loss may have been due to fraud, theft, or programming errors, but was not due to accounting errors. The press got even more excited.



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The Mint engaged various additional consulting firms as well as the RCMP and released its conclusions in December 2009. It turned out that a series of mistakes since 2005 resulted in internal records overstating the amount of gold on hand by 17,500 ounces (a shortfall of almost $20 million at today's prices). While there was no fraud or theft, the losses resulted from a series of internal control deficiencies and failures:

- Error in calculation of gold included in slag sold to other processors (loss to the Mint compared to what they should have received): 3,600 ounces
- Error in calculation of gold generated by internal refining processes: 350 ounces
- Underestimation of gold on hand from slag processed internally: 5,400 ounces
- Recovery of gold accumulated within the facility: 1,500 ounces
- Six types of errors from 2007, eight from 2006 and six from 2005 (i.e. inventory count incorrect, calculation of gold in slag incorrect, transactional losses): 6,650

It should be noted that some level of losses is to be expected as part of the complex production and refining process. But the highly public losses exceeded that and resulted from:

- Basic errors in methodology of determining gold quantities.
- Inadequate inventory count procedures.
- Inadequate inventory reconciliation procedures.

The Mint set up a steering committee chaired by their CEO to ensure that all issues are addressed.

There are various risk management frameworks; they all emphasize the importance of management oversight and monitoring to ensure that as needs change so do the controls and the risk management process. The recent saga of the Mint gives a cautionary tale about the importance of effective risk management.

So, think about your own organization: what events should you worry about? What can you do to prevent them from happening, or to reduce your exposure if they do transpire?

Jeffrey D. Sherman, MBA, FCSI, CA, is CFO of Pure Nickel Inc. His interests include accounting and finance, corporate governance, risk management and internal control, restructuring and start-up enterprises. He has lectured and conducted seminars for the Institute of Chartered Accountants of Ontario and has written many magazine articles on finance and treasury, as well about 20books including: 'Finance and Accounting PolicyPro' and the four-volume 'Controllership Guide.'