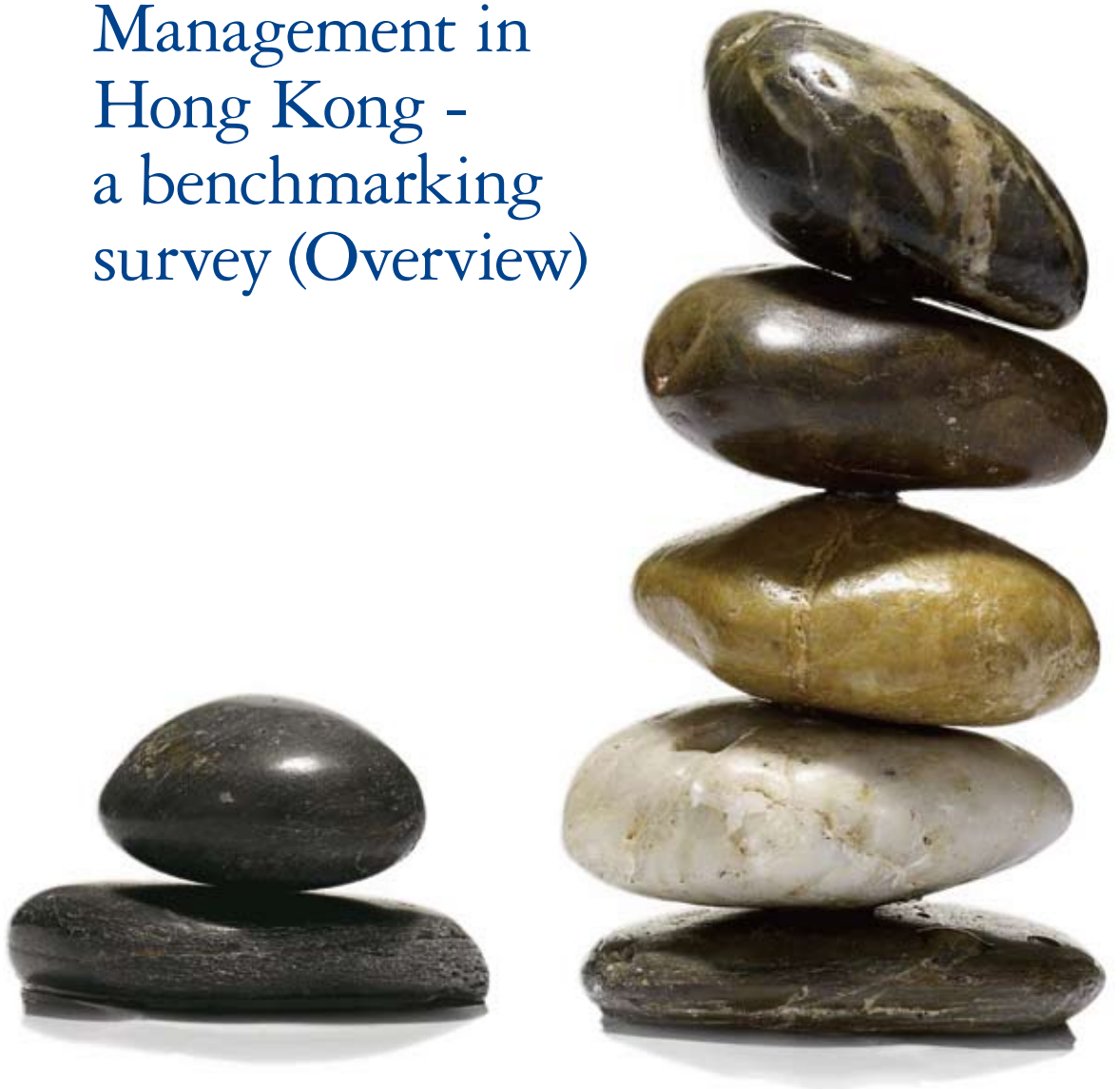


Perspectives on
Enterprise Risk
Management in
Hong Kong -
a benchmarking
survey (Overview)



Survey indicates that Hong Kong needs to implement improved enterprise risk management to address financial crisis and improve competitiveness

Introduction

There has been a significant worldwide increase in interest in Enterprise Risk Management (ERM) over the last few years, as shown by the results of a global survey performed by Deloitte US in early 2008. This interest has recently increased even further following the global financial crisis late last year as organisations search for ways of addressing the crisis and consider how better ERM might have prevented it.

In response to this greater interest, Deloitte Hong Kong's Enterprise Risk Services practice, with the support of The Hong Kong Institute of Directors, launched an ERM Benchmarking Survey to capture and report information on ERM in Hong Kong. The purpose of the survey is to provide local organisations with insights into prevailing perceptions and practices in Hong Kong relating to ERM, as well as make international comparisons. A further aim of the survey is to provide guidance on the direction Hong Kong organisations should take in order to improve their ERM practices.

Organisations were invited to participate in the survey, which consisted of 40 questions, by submitting online responses through Deloitte's website or by mail. A total of 111 responses were received from both listed and private entities in a wide range of business sectors, as well as governmental organisations.

What is ERM?

ERM is an enterprise-wide, consistent process driven by an organisation's management to identify, understand and address the strategic, operational, compliance and financial risks that threaten the achievement of its objectives. ERM refers to the people, tools, systems and structures to improve risk intelligence.

Risk intelligence is the enterprise's integrated capability to gather, analyse, interpret and deploy responses to risks that are critical to the enterprise. It is about being smarter about the risks that need to be taken, and those that need to be avoided, and is the ultimate form of ERM.

Why are ERM and Risk Intelligence so important?

A strong ERM programme, especially one that achieves risk intelligence, is the key mechanism by which risk information is incorporated into business decision-making for competitive advantage. ERM is therefore an important driver for increasing growth and creating value in any organisation.

As a company becomes more risk intelligent, it is able to give more attention to "rewarded risks" - those that, if properly managed, provide a return to the company and increase its value (i.e. such as those relating to investment or product development decisions). It will be able to afford to spend less resources simply focusing on "unrewarded risks", those associated with asset protection and compliance obligations. The more a company focuses on managing its rewarded risks, the greater its value, growth and competitive advantage.

For organisations to implement ERM systems that contribute to their businesses in this way takes commitment and requires development over a period of time. It generally requires them to undergo a five-stage evolution before they can demonstrate genuine risk intelligence, as depicted in Deloitte's Risk Intelligence Maturity Model (Exhibit 1).

The survey examined the extent to which organisations in Hong Kong have adopted the detailed practices associated with risk intelligence. These practices are summarised in a set of principles that Deloitte has developed, the Nine

Fundamental Principles for Building the Risk Intelligent Enterprise™ (the "Nine Principles"). The Nine Principles address such matters as consistency and integration of the approach to, and systems for, ERM, clarifying responsibilities of different parties in the organisation for ERM, and the communication of risk information. They are linked to an overall framework for risk intelligence, the Framework for the Risk Intelligent Enterprise™ (the "Framework"), comprising Risk Governance, Risk Infrastructure and Management and Risk Ownership. The Nine Principles and the related Framework are shown in Exhibit 2.

Exhibit 1: Deloitte's Risk Intelligence Maturity Model

The Model displays the various attributes that define the different stages of maturity of an organisation's ERM practices.

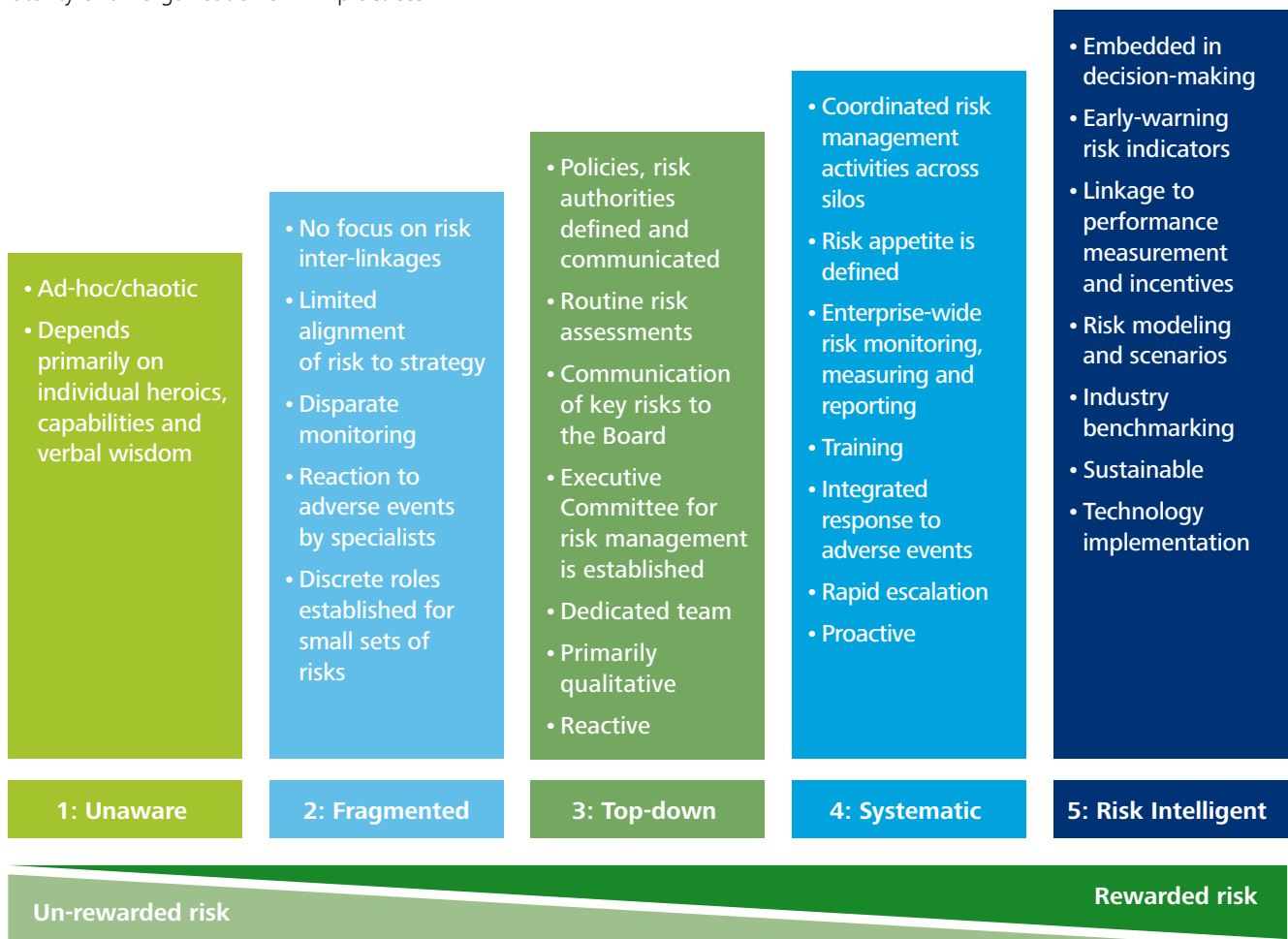
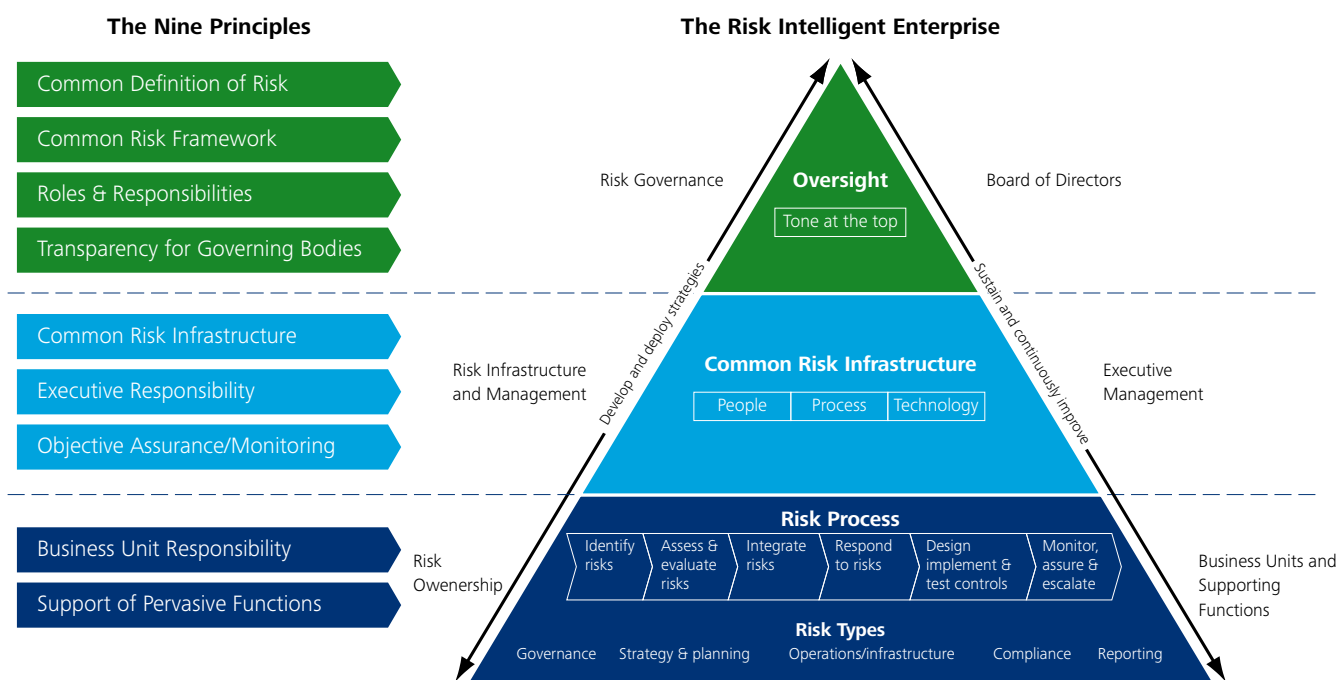


Exhibit 2: Framework for the Risk Intelligent Enterprise™ and the Nine Fundamental Principles for Building the Risk Intelligent Enterprise™



In a Risk Intelligent Enterprise:

Principle #1	A common definition of risk, which addresses both value preservation and value creation, is used consistently throughout the organisation.
Principle #2	A common risk framework, supported by appropriate standards, is used throughout the organisation to manage risks.
Principle #3	Key roles, responsibilities and authorities relating to risk management are clearly defined and delineated within the organisation.
Principle #4	Governing bodies (e.g., boards, audit committees, etc.) have appropriate transparency and visibility into the organisation's risk management practices to discharge their responsibilities.
Principle #5	A common risk management infrastructure is used to support the business units and functions in the performance of their risk responsibilities.
Principle #6	Executive management is charged with primary responsibility for designing, implementing and maintaining an effective risk programme.
Principle #7	Certain functions (e.g., internal audit, risk management, compliance, etc.) provide objective assurance as well as monitor and report on the effectiveness of an organisation's risk programmes to governing bodies and executive management.
Principle #8	Business units (departments, agencies, etc.) are responsible for the performance of their business and the management of risks they take within the risk framework established by executive management.
Principle #9	Certain functions (e.g., finance, legal, IT, HR, etc.) have a pervasive impact on the business and provide support to the business units as it relates to the organisation's risk programme.

What are some of the practical features of companies that have stronger ERM practices or are more risk intelligent? As examples, these may include such measures ranging from making it a standard requirement to consider risk issues in all board meetings on a formal basis to more complicated scenario planning and risk modeling that support strategic planning and investment decisions. It will involve having strong and transparent communication around the group regarding potential risks and on risks that have arisen. Such organisations will perform risk assessment on a comprehensive basis across the organisation to ensure that no key risks, especially those that relate to issues that affect these companies' value, are overlooked. Overall, to achieve this, ERM will need to be integrated into key processes and become part of the way the organisation is managed. ERM is not about enterprise risk management but about enterprise management.

Survey highlights

The highlights regarding ERM in Hong Kong that emerged from the survey are:

Attitudes to risk

Hong Kong companies do not feel well prepared for major risk events, such as the current financial crisis. Only 30 percent of the respondents are confident that their organisations have even identified all mission-critical risks. Only 34 percent felt that their organisations have effective processes for handling major risk events.

Current ERM practices

1. A small core of organisations in Hong Kong appears to be adopting a number of sound ERM practices.
2. However, a far larger number of organisations demonstrate a low overall level of ERM maturity and risk intelligence. Their ERM practices are only performed in a manner that appears to be irregular, infrequent, inconsistent, informal and not comprehensive.
3. Many Hong Kong organisations have not attempted to put in place the most basic elements of ERM.

4. Organisations tended to focus only on "unrewarded risk", giving inadequate attention to "rewarded risk".

Interest in and plans for ERM

1. The overall level of interest in ERM in Hong Kong is increasing. However, organisations are still struggling to understand how the benefits of ERM can exceed its costs, therefore making them reluctant to act on their increased interest with actual implementation.
2. As a result, only 11 percent of the respondents indicated that their organisations had clear plans to implement ERM or to enhance and develop their existing ERM programmes.

Listed versus private companies

1. In relation to many ERM practices, there is no discernible difference in the extent of adoption by listed companies and by their non-listed counterparts. This is surprising given the greater risk exposure that public companies have in terms of investor scrutiny and governance compliance.
2. As a result, it is apparent that Hong Kong's regulatory regime is not sufficiently supportive of the development of ERM in listed companies. This is in spite of the fact that regulatory requirements have been an important stimulus to the development of ERM in a number of other jurisdictions, including Mainland China.

Hong Kong versus global

1. Hong Kong is lagging behind other key global jurisdictions in planning for ERM deployment and in its actual implementation. Again, this partly relates to the fact that regulatory requirements pertaining ERM implementation are stronger in other jurisdictions than in Hong Kong.
2. Hong Kong organisations regard ERM as being more challenging to implement than organisations in other markets.

Hong Kong's regulatory environment for ERM

As mentioned above, one of the conclusions of the survey was that Hong Kong's regulatory regime appeared not to be sufficiently supportive of the development of ERM.

Any ERM programme should be founded on management's conviction that it will bring benefit to the organisation and create value. Also, with ERM, the substance is more important than the form. The current global financial crisis provides plenty of examples of organisations that were perceived to have good ERM practices and were subject to regulation in this area, but which still failed or suffered significant losses.

However, international experience suggests that rigorous regulations for ERM implementation provide a stimulus for ERM development. For example, Mainland China issued a 'Basic Standard for Enterprise Internal Control' (effective 1 July 2009) requiring companies to undergo a self-assessment of their internal controls, including risk assessment procedures. Also, state-owned companies are required to implement ERM frameworks under rules promulgated by the State-owned Asset Supervision and Administration Commission. In Europe, certain corporate government regimes require mandatory disclosure of ERM-related practices in annual reports. Deloitte therefore recommends that improvements to Hong Kong's regulatory requirements relating to ERM should be made.

Stronger regulations on ERM of this nature would support its development and would reduce the risk of corporate failures and thereby enhance the standing of the Hong Kong market. They would also support Hong Kong companies in dealing with the increasingly complex and competitive global business environment that they face.

ERM and Value - Catch 22

ERM can be a tough sell. It is much more difficult to quantify the costs of failing to adopt ERM than it is the costs of adopting it. In addition, as mentioned above, time and effort are needed before ERM can serve as a tool for growth and value, and before its true benefits can be realised. However, it cannot be sold to boards and executives without proof it is a good investment - a Catch 22 situation. This accounts for Hong Kong organisations' misperceptions regarding the relative costs and benefits of ERM implementation, mentioned above.

Actually, there should be no doubt as to value ERM can bring. Common sense and knowledge of newsworthy events, such as the financial crisis, terrorist attacks, natural disasters or pandemics, show that the gains to be made from having strong ERM practices are very likely to exceed their costs.

Also, the integrated and comprehensive approach to managing risk that ERM and risk intelligence promote is highly relevant to the global environment in which most businesses operate. Globalisation requires companies to address a wider range of more rapidly changing risks. ERM provides an appropriate comprehensive framework for them to do this.



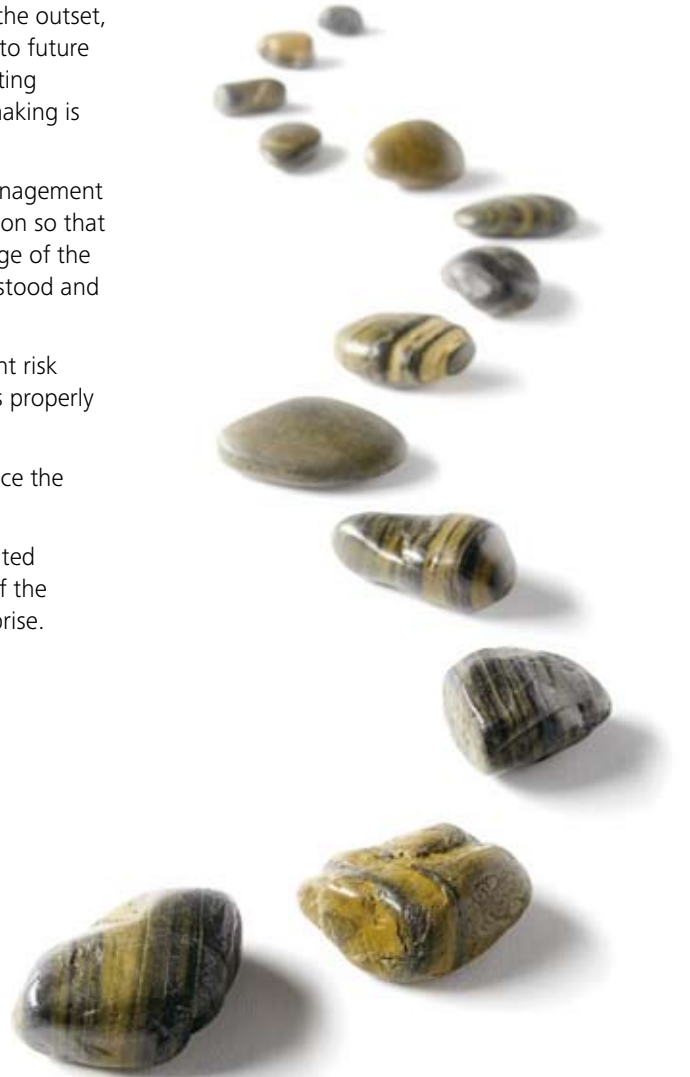
Conclusion - Next steps for ERM in Hong Kong

In spite of these positive forces for ERM, it is still necessary for companies to resolve the dilemma relating to the fact that ERM needs time and effort before it serves as a tool for value but can only be easily sold to boards if there is already proof that it is a good investment.

As a solution to this, Deloitte recommends that Hong Kong companies should:

- Design their ERM implementation so that this focuses on bringing value right from the outset, by ensuring that ERM addresses risks to future growth and by integrating it into existing business processes so that decision-making is better informed.
- Clearly communicate this focus to management in all ERM planning and implementation so that the relevance and benefit of each stage of the ERM programme's evolution is understood and management buy-in achieved.
- Assess the effectiveness of their current risk assessment activity to ensure that this properly addresses risks to value.
- Deploy software technology to enhance the integration of the business and ERM.
- Adopt the Nine Principles and the related Framework to promote consistency of the deployment of ERM across the enterprise.

In this way, such efforts with ERM by companies themselves, together with support from an appropriate regulatory regime, would enhance the competitiveness of Hong Kong organisations and Hong Kong's overall competitiveness.



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