



Hot Topics

The board's role in cultivating a risk-intelligent culture

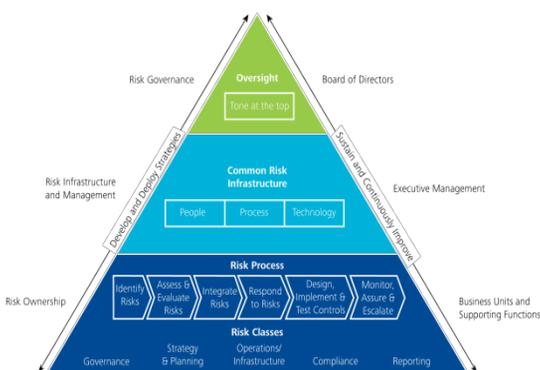
Cultivating a risk-intelligent culture is more than establishing a code of ethics and completing a risk assessment. Economic events have highlighted weaknesses in many organizations in the area of risk governance and management. They have also catalyzed many organizations to devote significant time to developing and implementing enterprise risk management frameworks, policies, procedures, and technologies. Recent studies, such as **2012 Board Practices Report: Providing Insight into the Shape of Things to Come**, a publication from the Deloitte Center for Corporate Governance and the Society of Corporate Secretaries and Governance Professionals, suggest that there has been progress in revamping governance practices and establishing infrastructures, but there is still a considerable need for cultivating risk-intelligent cultures.

What is risk intelligence? Leo Tilman, a Columbia University professor and author, defines risk intelligence as “The organizational ability to think holistically about risk and uncertainty, speak a common risk language, and effectively use forward-looking risk concepts and tools in making better decisions, alleviating threats, capitalizing on opportunities, and creating lasting value.” He notes that risk intelligence is essential to the survival, success, and relevance of companies and investors.

Deloitte suggests that a risk-intelligent enterprise is one where leaders understand that every action that can create value also carries the potential for risk. These leaders recognize that discussions of risk and value cannot be separated, and they view risk as a decision-driver rather than a consequence of decisions that were already made. They endeavor to make risk-intelligent choices that expose the enterprise to just the right amount of risk needed to create value. Risk is considered on the front end of every decision, both to identify potential threats and to strategically select the risks needed to pursue value.

A risk culture encompasses the general awareness, attitudes, and behaviors of an organization's employees toward risk and how it is managed; a risk-intelligent culture recognizes the people aspect of risk management but also includes the notion that organizations must accept sufficient risk to create value. This is critical, because people take responsibility for managing risk, documenting the lessons learned, and executing the risk plan. By encouraging a

Figure 1: The Risk Intelligent Enterprise™

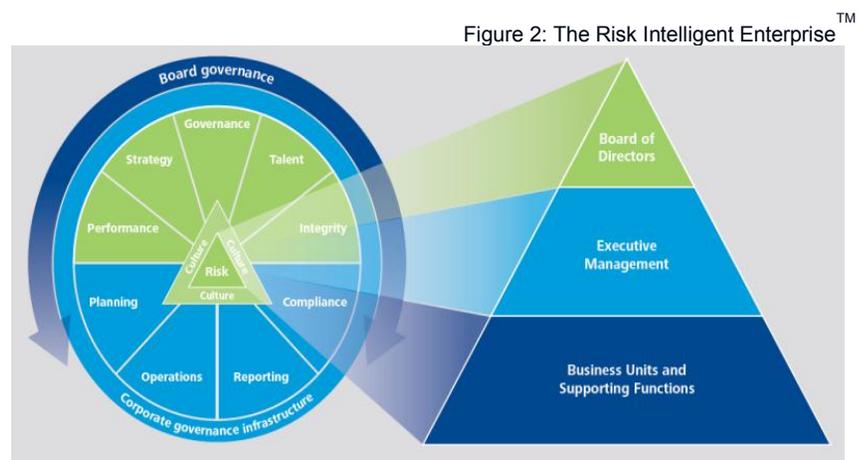


sound risk culture, organizations can thrive by creating value for their operations, employees, shareholders, and customers.

The February 28 Deloitte Dbriefs webcast, titled “Cultivating a Risk-Intelligent Culture: Boards and Management Perspectives,” explored why organizations need a risk-intelligent culture, the challenges of corporate governance, and the role of a strong framework in establishing an effective governance program. The session was hosted by Donna Epps, a partner in Deloitte Financial Advisory Services LLP and the co-lead of Deloitte’s national governance, risk, and compliance practice. Participants heard insights from Eddie Barrett, a director in Deloitte Consulting LLP, and Kevin Blakely, a senior adviser to Deloitte & Touche LLP’s governance risk and regulatory strategies practice.

The webcast began by emphasizing that a risk-intelligent culture affects the entire organization. Everyone in the organization carries responsibility and every action that could create value also carries the potential for risk. The speakers analyzed the **Risk Intelligent Enterprise** framework (Figure 2) and explained how developing, sustaining, and continuously improving this framework is the work of each employee, management team member, and board member.

Risk and culture are at the core of the Deloitte Governance Framework (see **Framing the Future of Corporate Governance: Deloitte Governance Framework**). When implemented effectively, risk intelligence is the foundation for everything the board and management do to govern the organization.



Risk-intelligent culture encompasses three levels of the organization. The bottom level comprises the business-unit and supporting functions, which are essential because they identify and continually assess risks. The management team and c-suite executives form the middle level. The chief executive officer has overall responsibility for risk management, but the chief risk officer and/or chief financial officer establish the infrastructure, technologies, procedures, and framework the business units and supporting functions will follow. The top level is the board of directors, which sets the tone for prioritizing risk and overseeing that management is putting effective programs and policies in place. It is essential for all of these parties to communicate and work together.

The board of directors may find it helpful to consider its risk-related activities in two parts: risk governance and the oversight of enterprise risk management (ERM). An effective board understands and monitors ERM resources, output, and the performance of key personnel, including the chief risk officer.

Shaping a Risk-Intelligent Culture

Speakers on the February 28 Dbriefs webcast identified four risk themes that help shape the behavior of a risk-intelligent culture:

- **Build risk competence.** The collective risk management competence of the organization fosters collective wisdom and helps people understand the risks the organization is taking. This comes from proactive sharing of leading practices and consulting others when in doubt.
- **Align motivational systems.** The board and management should have an understanding and clear communication as to why the organization manages risk the way it does. Secondly, there should be a consistent theme as to what organizations are motivating people to do. How does an organization convey that its employees can admit to making mistakes? An effective risk-intelligent organization is one in which everyone takes personal accountability for managing risk.
- **Strengthen relationships.** This focuses on how people in the organization interact with others. Do employees, management, and directors all have a clear understanding and commitment to a risk-intelligent culture? Does management provide a trusting environment and constructive response to challenges? Is there open and honest dialogue about risk? These are a few questions that boards can ask to strengthen and foster relationships at each level of the organization.
- **Promote an organizational risk management infrastructure.** Consider how the organizational environment is structured and what is valued. Each organization typically sets up standards of expectations in the form of policies and procedures. Following the risk management policies and involving risk professionals in risk decisions are building blocks in establishing an effective board.

These risk themes are examples that can be adapted to help organizations understand their current states. Shaping a risk-intelligent culture requires focused efforts and commitment on the part of leaders. Organizations that seek to achieve a risk-intelligent culture should set metrics against which they can define next steps and measure progress. For more information on cultural metrics and Deloitte's Risk Cultural Framework, please see [Cultivating a Risk Intelligent Culture: A Fresh Perspective](#).

Characteristics of a Strong Risk Culture

Commonality of purpose, values, and ethics
Universal adoption and application
Learning organization that emphasizes risk culture
Timely and honest communications
Understanding of the value of effective risk management
Responsibility and accountability, both individually and collectively
Encourage an environment of constructive challenge

As reported in the [2012 Board Practices Report: Providing Insight into the Shape of Things to Come](#), risk oversight is becoming more prevalent and prominent at public companies. Thirty percent of respondents said that the full board is responsible for overseeing the organization's risk management program; almost an equal number of respondents (29 percent) said that the audit committee has the primary responsibility, and 25 percent indicated that risk oversight responsibilities are spread across all board committees. The variation in who is responsible for risk oversight does not diminish the importance of the topic. Forty-five percent of respondents indicated that their organizations provide board education in the area of risk oversight and 59 percent said they provide board education on company policies. Risk intelligence, risk culture, and risk oversight are emerging topics that will continue to be on the agendas of boards and audit committees.

Risk oversight model

The Deloitte Governance Framework provides a model of leading practices for boards to consider in executing oversight responsibilities. Underlying each governance element are four attributes to help measure effectiveness: skills and knowledge, process, information, and behavior. A board's maturity with respect to each element may range from low to high, but the board should take the time to assess how well it believes it is performing. The following table outlines a maturity model that can be used to evaluate what likely constitutes a high-performing board for each attribute with respect to risk governance.

Risk governance oversight model

Skills and knowledge	<ul style="list-style-type: none">• Possesses a thorough understanding of the organization, its businesses, and underlying drivers• Possesses relevant, recent risk management and industry expertise• Possesses knowledge of key risks specific to the organization
Process	<ul style="list-style-type: none">• Monitors the company's strategic, operational, financial, and compliance risk exposures• Approves the organization's risk appetite and tolerances and monitors adherence• Confirms adherence to regulatory and stakeholder expectations regarding risks• Oversees the adequacy and transparency of disclosures and other communications to stakeholders about risks• Considers the impact of incentive compensation plans on executive risk-taking
Information	<ul style="list-style-type: none">• Receives timely and concise periodic reports from executive management, including the chief risk officer• Supplements risk information provided by management with internal discussions with risk owners, executives, and external sources such as industry and analyst reports• Confirms that risk reports are of adequate depth, are supported by reliable and validated data, and address internal and external drivers and trends
Behavior	<ul style="list-style-type: none">• Sets clear expectations for risk management, including the ability of the chief risk officer to communicate directly to the board and its committees• Accepts responsibility for risk governance regardless of processes delegated to various board committees• Challenges management's assumptions inherent in risk programs and applies a healthy degree of skepticism in all board deliberations

Concluding thoughts

A robust and pervasive risk culture is essential. This risk-intelligent approach should be embedded in the way the organization operates and should cover all activities and areas. Risk management should not be limited to specific business areas or operate only as a control function or audit. Developing a risk-intelligent culture can be challenging, but the benefits are significant. Effective boards help cultivate a risk-intelligent culture.

Additional Resources

- **Risk Angles: Five Questions on Cultivating a Risk Intelligent Culture, Deloitte Development LLC, 2012**
- **Cultivating a Risk Intelligent Culture: Understand, Measure, Strengthen, and Report, Deloitte Development LLC, 2012**
- **The People Side of Risk Intelligence, Deloitte Development LLC, 2012**
- **Risk Intelligence: A Board Imperative, Deloitte Insights podcast, Deloitte LLP, 2012**
- **A Risk Intelligent View of Reputation: An Outside-In Perspective, Deloitte Development LLC, 2011**

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