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RISK MANAGEMENT, AUDIT AND INTERNAL CONTROL

Abstract. Micro and micro risk management has become more relevant in recentyears due to increased turbulence in the markets and global financial instability. Acceleration of technology-related innovation processes also makes a definite contribution to increasing relevance of the topic. The pace of production processes and the speed of management decision-making are increasing. Company risk management can be vividlycompared to a brake gear of racecar. The task of effective risk management system is not about slowing down the pace, but rather ensuring safety in tight bends.

Key words: risk management, audit, internal control.

Introduction. The article serves to board of directors (the board) of national companies. It is no secret that extensive professional knowledge in this area requires special education and subject knowledge, varying greatly within subject and industry specifics. Understanding the general principles of risk management allows decision makers to address risk management topic properly and undertake right steps establishing a supervisory system to ensure competent risk management.

Methods. The article provides a general understanding of risk management, describes the role of individual management bodies in national companies, defines the main elements of a risk management system (RMS) and describes the phased actions of the board.

Results. Whatever risk management approach the board takes the most important is to form a proper control environment of the risk management culture, establish appropriate risk assessment procedures and provide support for control processes ensuring reasonable confidence in achieving company goals. The board (including non-executive and independent directors) takes ultimate responsibility for monitoring company's risks and prioritising resources of risk management.

1. Effective Risk Management. All companies face uncertainty at different stages of their development. This can be financial market fluctuations, changes in key resource value, new competition and political changes. These events may have both positive and negative effect on company development. Company success depends largely on the ability of its leadership to use the emerging opportunities, turning them into an advantage, and, at the same time, ensuring the viability and long-term business growth.

Any company is committed to creating value for shareholders and key stakeholders. However, companies inevitably face uncertainty setting strategic goals. The main challenge for the management is to achieve an optimal balance between the growth rate of shareholder value and risks.

This type of uncertainty generally contains both risks of value loss and opportunities for value creation. A company achieves value maximisation by maintaining optimal balance between growth rates, profitability and associated risks.

These qualities of RMS help a company management to achieve strategic goals and the desired level of profitability and prevent losses. RMS also should ensure effective accountability and compliance with laws and regulations and prevent damage to the company reputation.

Risk management is generally defined as the measures of identifying and assessing potential threats to a company's capital undertaken by the board, management and employees of the company in order to

maintain an acceptable level of risk appetite and to ensure reasonable confidence in achieving company goals.

2. The Role of Management Bodies in RMS. Well-developed organisations have their risk management naturally built in the decision-making system at all levels, from the board all the way to low-level employee.

Following the best practice, the board determines principles and approaches to the organisation of risk management and internal control systems, approves the management policy, exercises control over the risk management and internal control system.

The Corporate Governance Code emphasises the need to achieve a balance between risk and profitability for the society as a whole, while complying with the legislation, the requirements of internal documents and the company charter, the development of adequate incentives for the company executive bodies, its structural department and individual employees. The code recommends the board to analyse and assess the risk management and internal control systems at least once a year. The analysis should be based on both management reports and internal and external audit reports. Some companies invite independent external consultants periodically (once every three years) to evaluate the risk management and internal control systems.

According to the Code, the board takes responsibilities for controlling risk disclosure and the role of the board in risk management and internal control.

The Principles of Corporate Governance emphasise the role of the board in determining risk management policies, approving risk appetite, and controlling risk disclosure.

An area of growing importance to the board that is closely related to corporate strategy is risk policy. The policy determines the types and degree of risk that the company is ready to accept to achieve its goals. Thus, it is crucial for management that must manage risks in order to maintain the desired risk profile of the company.

The board is responsible for ensuring the accuracy of company accounting and financial reporting systems, conducting independent audits and internal control systems, including risk management, financial and operational control systems, and compliance with legal requirements and relevant standards.

The board should also ensure proper oversight by the executive management. However, the board takes ultimate responsibility for ensuring the accuracy of the accounting and financial reporting systems. In some countries the chairperson of the board shall provide a report on the internal control system.

Financial information users and market participants want to be informed about significant risks that are reasonably amenable to forecasting.

Some companies create a separate risk management committee of the board. Basel Committee on Banking Supervision strongly recommends establishing such a committee in the large financial institutions. The committee can work together with company management, analysing key risk factors, identifying risk concentration scenarios, giving a more accurate risk assessment. Although the committee can be very useful in the assessment process, it should not be a substitute for the board, which should understand and feel the most significant risks for the company. If there is not a special risk committee of the board, the audit committee shall perform the risk management functions.

The risk management committee shall:

– Supervise the quality, efficiency and objectivity of control systems and the risk management and effectiveness of established risk management policies and strategies;

– Overview the culture, philosophy and strategy of risk management and establishment of policies, risk management procedures and requirements for risk notification used in the management and risk notification;

– Review information on the most significant risks and actions undertaken by management and department to control these risks within acceptable limits;

– Ensure compliance with risk policies and the overall risk profile;

– Receive and review reports from any risk assessment group, including the risk management committee and the internal audit service.

The company executive management is primarily responsible for establishing and functioning of the effective risk management and internal control system. At the same time, the relevant procedures should provide for timely notification of significant shortcomings in the internal control system.

Some companies establish the risk management committee under executive board. The committee is accountable to executive board and operates under the authority granted by the board. Committee within its competence provide advice to executive board.

The risk committee of executive board may perform the following:

1. Assist identifying significant risks by:

– submitting any material risks for consideration identified during the past assessment periods;

– considering any internal or external circumstances that may increase the risk or cause new risks.

2. Manage the work on periodic risk assessment by:

– identifying participants in the risk assessment process;

– ensuring that a risk assessment is carried out at least once a year or when significant changes in external or internal factors occur;

– analyse risk assessment results to identify areas of high risk, significant concentrations of associated risks and any deviations in results that may require further study or analysis;

– prepare reports on risk assessment results for the audit committee of the board.

3. Analyze, prioritize, and approve risk mitigation strategies by:

– analysing risk management reports and identifying areas requiring risk mitigation strategies;

– providing relevant assistance in developing measures or action plans to reduce unacceptable risks;

– analyse and / or develop risk mitigation options to control significant risks;

– approve those projects that are necessary for the implementation of risk reduction measures.

4. Monitor the implementation of risk mitigation measures by:

– receiving reports and follow-up requests for the implementation of a risk mitigation plan;

– providing recommendations for the modification and adaptation of the risk management process to ensure compliance with the requirements of the board and management.

Some companies (typically large ones) establish a risk management department. The risk management department can:

– organise the work of a risk management unit;

– create action plan for RMS annually;

– control the implementation of internal risk management documents by the company departments;

– control the process of identifying risks / organise the process of identifying the risks (identifying risks and creating a registry and identifying and registering new risks);

– form proposals assigning risk owners;

– control annual update of the risk register and risk map;

– make proposals to the audit/risk committee regarding the level of acceptable risk appetite;

– monitor the implementation of the identified risks assessment / implement risk assessment process with company experts.

There is also a practice of appointing so-called risk leaders. The risk leader acts as a risk management coordinator within each company department which is identified as a participant in the risk assessment process. Risk leaders do not have to be the leaders of their departments. They are usually appointed from among the heads of these departments. Risk leaders must fully understand the activities, processes and personnel of department, be able to organise projects and manage them. If the risk leader is not the head of the department, once appointed one receives full support from the head of the relevant department.

Risk leaders perform or delegate and manage the following activities:

– coordinating with the department management;

– supporting the activities of the risk management committee;

– identifying and analysing department risks;

– drawing up reports on identified risks of a department;

– developing risk mitigating strategies, plans, measures etc.;

– monitoring and reporting to the risk management committee on implementation risk mitigating strategies, plans, measures etc.

3. RMS Elements. Effective company risk management is not necessary to reassure shareholders or investors, but primarily to increase the likelihood of achieving company goals. Let us consider the 'brick' elements of effective RMS.

Firstelement is a control environment, which is the general atmosphere and company attitude regarding internal control. What do staff members think about the importance of control? Do they perceive the internal audit service and regular inspections a necessary thing, or rather an “inevitable evil” that waste the time? Do they consider honesty and transparency to be a requirement in their activities, or rather they share the idea “innocent till proven guilty”?

The control environment is the foundation for the entire system of internal control and risk management. The factors affecting the quality of the control environment are ethical principles, competence, honesty of employees, ethics and management style, power and responsibility distribution, and attitude of top management and the board to control issues. To establish an effective control environment the board should:

– Form the culture projecting the right attitude to the internal control and risk management top-down. If board members and the top management fail not follow the established principles, rules and procedures, the employees will hardly ever follow them as well.

– Ensure that the principles and rules are clearly articulated and understood by company employees. To this end, the board can initiate an internal survey, establish or revise internal documents like regulations, procedures, code of ethics.

– Establish a transparent organisational structure and power and responsibility distribution in the company.

The second element is a clear process for defining company objectives. In this regard, the board should ask the following questions:

– Is vision, mission and priorities of the company defined clearly?

– Are the goals properly communicated to the employees?

– Are the goals and objectives of the company clear?

The third element is risk assessment. It provides for identifying and analysing events that can possibly affect the achievement of company objectives. This is necessary to develop an adequate risk response. Effective risk assessment assumes that company management and the board:

– Identify, assess internal and external factors that may adversely affect the achievement of the company goals. The risks are usually assessed on the scale of "significance" (estimated amount of potential financial damage) and "probability" (in points, categories or percentages).

– Establish acceptable levels of risk (risk appetite), which the company and its divisions can (should) assume to achieve their goals (considering the strategy and shareholders' opinions).

– Develop relevant procedures and processes aimed at identifying and tracking changes and controlling risks.

Generally, this is the stage when a company forms the risk register, that classifies risks into groups (eg. by risk sources). What does a typical organization risk map look like today? What risk groups are the boards of the largest companies facing?

There are multiple sources of strategic risks like political events, technological and social changes, the macroeconomic situation, industrial changes, competition, etc.

Financial risks are, perhaps, the most common subject of discussion at the board meetings. How will the change in interest rates affect business? What factors influence credit ratings? What is the financial sustainability (debt to EBITDA ratio), is there enough cash flow to service the debt? What are the possible threats to the company liquidity?

Operational risks can be associated with personnel, cost management, production capacity, suppliers and contractors, quality inventory management, information technology, etc.

Compliance risks may be associated with compliance with regulatory requirements and changes in legislation.

For several companies, the environment interaction risks, which may be caused by natural phenomena or otherwise are beyond their control, are of great importance.

Most often, companies utilise an expert method to identify, classify, and assess risks. A company usually choses experts from among the top management (eg. the risk committee of the board) or board members. Another effective approach is to organiыe the board independent discussion and assessment of key risks, and then compare them with management's assessment. As a result of a joint discussion, the board members produce a common understanding of the company's risk matrix. When all stakeholders

provide their reasonable estimates, they compile and discuss the results to find out how different group members assess the risks of the company and why.

Risk assessment should be completed annually. If some areas are highly exposed to specific risks, their assessment should be done more often. If the board considers certain risks particularly significant, it can monitor and reassess these risks at each board meeting. Thus, during the financial crisis, many companies that were exposed to credit and investment risks carried out this activity.

Some companies create so-called "heat maps", highlighting the most significant and probable risks that requires increased attention of the board and senior management.

Determining company risk appetite is an important step. When establishing risk appetite, the board should consider their own business judgment and additional factors:

– What stage of the life cycle is the company in? It is typical of start-ups to be more risky ventures than of mature companies.

– Opinion of key stakeholders. Shareholders, lenders, bondholders, etc., may have a different opinion about risk appetite. The board should consider their opinion when establishing risk appetite.

– Environmental factors. For example, an economy recession or a significant regulation change, fundamental structural changes in the industry can significantly affect risk appetite.

There is a simple principle in establishing risk appetite – do not bite more than you can chew. Companies of different industries and different life cycle stage can formulate the risk appetite quantitatively (the sum of potential losses, limit values or coefficient corridors, etc.) or qualitatively (description). For example:

– capital adequacy to cover damage of a certain level;

– range for debt coverage (debt / EBITDA);

– solvency i.e. the company must be able to fulfil its obligations;

– income structure i.e. the company considers critical the loss of more than a certain percentage of income or wants to establish a maximum percentage of income depending on one or several large customers.

The fourth element is a risk-response development that involves developing a strategy for responding to each identified risk. Basic risk-response strategies usually involve:

– Risk avoidance. The company decides not to start or stop projects or activities that lead to a risk that goes beyond the risk appetite.

– Risk minimisation. The company takes measures to reduce the impact or probability of risk by developing and implementing an appropriate strategy, action plan, and relevant control procedures. In this case, several companies also estimate the level of residual risk – risk after applying control procedures and risk reduction measures.

– Risk acceptance. The company decides that minimising risk is not feasible or economically viable, and the benefits derived from projects, procedures or activities are worth the accepted risk.

– Risk transfer. The company shares possible losses or benefits from a risk with other party.

Managers and / other key company positions related to risk management activities take the responsibility for the development of measures for managing priority risks.

The board shall exercise control over the implementation of key risk management measures, while the management shall control the risks of the "yellow" and "green" zones ensuring adequate control procedures for managing all risks.

Thus, the next important element of RMS are control procedures that ensure acceptable range for the risks. The board shall do the following to exercise adequate control:

1. Create the necessary infrastructure to ensure the effectiveness of control procedures:

– control procedures are implemented at all levels of management;

– control measures are built into daily routine;

– adequate separation of duties and absence of conflicts of interest in operation.

2. Ensure periodic company checks on the compliance with the established policies and procedures for all areas of activities.

3. Ensure adequacy, completeness and accuracy of financial and management reporting, information at all levels of management.

4. Ensure compliance with the legislation.

There are several forms of control procedures: preliminary control, current control, follow-up control.

Preliminary controls may include:

– appointing a responsible officer;

– setting quality standards;

– establishing strict procedures for tender and commercial proposals of calculating the cost of construction;

– creating the management accounting and reporting system.

Current control may include:

– verifying materials and goods as they progress through the production process;

– ensure feedback of production and responsible persons on the implementation of planned indicators for a shift, day, month, quarter, year;

– ensure feedback to employees on quality indicators during the production process;

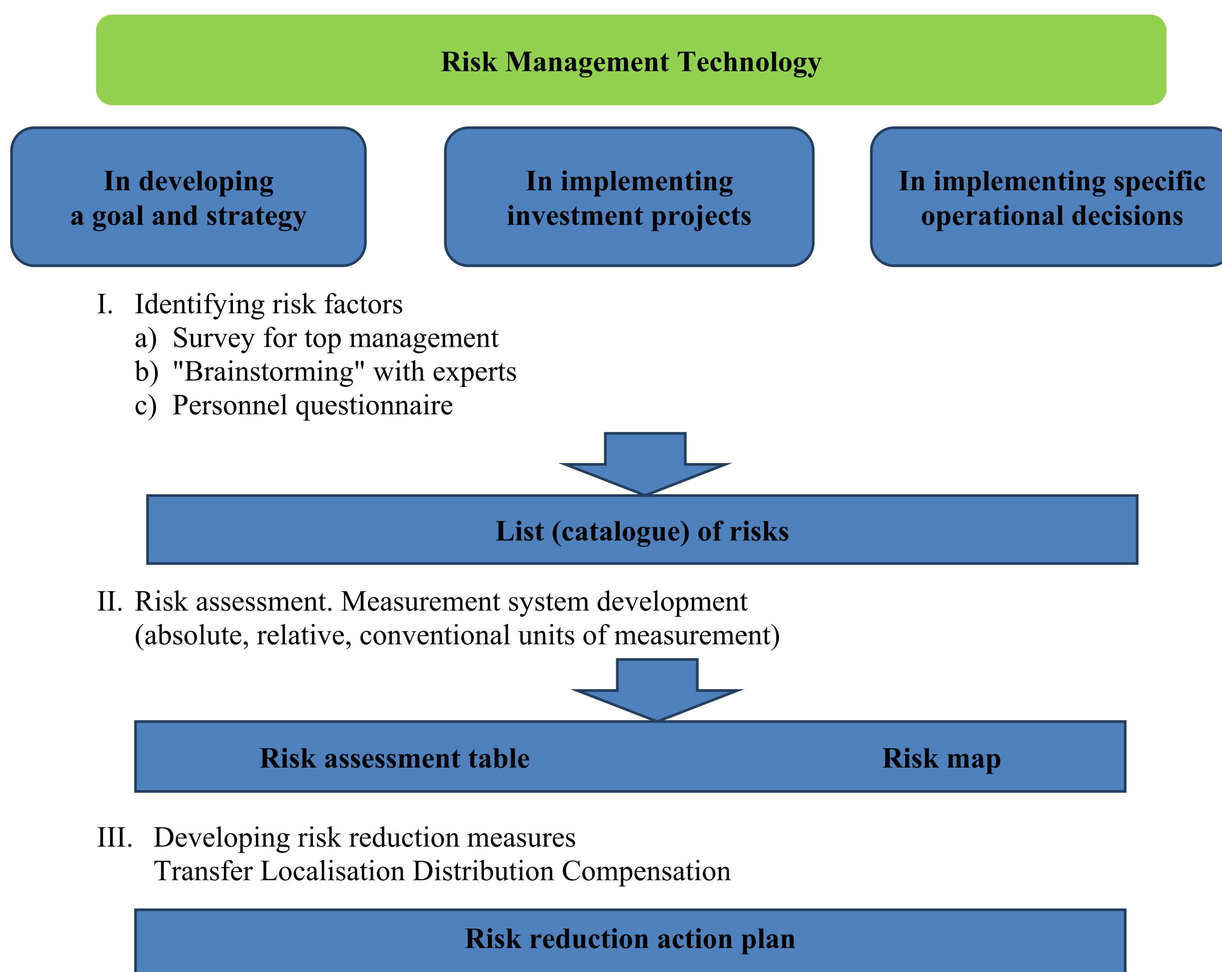
– creating a business performance assessment system;

– monitoring key performance indicators.

Follow-up control may include:

– ensuring quality control of finished products and services by quality service to determine the amount of flaw;

– assessing production volumes to determine the bonus for a department for implementing key performance indicators (KPIs) and targets.



Risk Management Technology.

An adequate monitoring system is also a necessary element of effective RMS. The board may initiate creating an early warning system – a system of key risk indicators that signal the upcoming risk events. Each company has its own set of risks, but there are some common elements:

– excessive self-confidence of the higher management;

– changes in accounting rules or statements that improve the picture;

– reduction of work efficiency and change in the cash flow structure in favour of one-time sources;

– outpacing growth of costs (especially overhead costs) in relation to revenues;

– negative reports of financial analysts, rating agencies, negative reactions of investors to the company results;

– unwillingness of creditors to provide additional financing;

– high staff turnover, including managerial;

– strange and unexpected actions of competitors (eg. withdrawal of investments or atypical investments);

– public sentiment, which can stimulate the actions of regulators;

– tangible customer dissatisfaction;

– substantial criticism in the media (monitoring of so-called websites of disgruntled employees or customers may be useful);

– unreasonably high activity in merging and acquisitioning.

Each company chooses its own path, which is optimal at this stage of development. At the same time, figure displays one of the options for risk management technology.

For effective monitoring, the board can take advantage of its extensive control toolkit. Each company uses several processes to obtain information about its activities and market conditions. Generally, this data gathering allows for early warning signals of a possible crisis.

Thus, adequate information and communication is also a necessary element of effective RMS. Relevant information should be collected, analysed and provided in time to company management for decision making.

The information from the following sources shall be analysed and used in strategic decision-making:

1. Reports of external auditors. Audit reports, especially the so-called letters of the auditors to the management of the company. The external auditors voice their conclusions and results that go beyond a simple verification of figures, which can be very informative. It is important for the board to communicate with external auditors directly and study their findings. The external auditors shall be appointed by the board of directors, not by the executive board to ensure their independence and critical point of view [20].

2. Reports of internal auditors and compliance reports. They can draw the board's attention to dangerous trends in operating activities (rather than individual incidents) that can put the company at significant risk (eg. systematic fraud in the form of a growing gap between the book value and the actual value of goods in stock) [21].

3. Reports of regulatory actions that track company problems with regulatory compliance or issues related to compliance with established rules (eg. fines for breach of safety standards by the BP's Deepwater Horizon oil platform were well above the industry average even before the rig accident).

4. Reports on industry trends. Industry trends (ascending and descending) can often be tracked even before they affect a company, which makes it possible to take the necessary precautions and avoid both excess and insufficient capacity problems.

4. Implementation of RMS

The level RMS depends certainly on company size, industry, development stage, etc. Here are general stages of introducing RMS:

1. Appointing a responsible person (risk manager) for system management;

2. Developing risk maps, models and risk indicators, approving the level of risk appetite by the board;

3. Introducing regulations for risk monitoring and identification within the approved control procedure;

4. Developing a mechanism for registering and accounting values of risk indicators in the company databases.

5. Establishing a system of staff motivation, considering the risk they assume.

6. Creating documentary reports on current values of risk indicators for company management and employees responsible for that.

7. Regular hearing of reports by top management on the actual values of risk indicators and monitoring their location within the established standards.

The board is responsible for the long-term company development. Therefore, monitoring the existence and efficiency of RMS is one of the most important priorities of the board. Based on the specifics of the business and its priorities, the board can develop various requirements for RMS.

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**ТӘУЕКЕЛДЕРДІ БАСҚАРУ, АУДИТ
ЖӘНЕ ІШКІ БАҚЫЛАУ**

Аннотация. Соңғы жылдары тәуекелдерді басқару тақырыбы өзекті болып отыр, бұл нарықтардағы турбуленттілік пен жаһандық қаржылық тұрақсыздықтың өсуіне байланысты. Технологиядағы инновациялық процестерді жеделдету де тақырыптың өзектілігін арттыруға нақты үлес қосады. Өмірдің қарқыны мен шешім қабылдау жылдамдығы артып келеді.Компаниядағы тәуекелдерді басқару рөлін көрсету үшін келесі салыстыруды пайдалана аласыз. Ең жылдам машиналар ең жақсы және ең сенімді тежегіштермен жабдықталғаны белгілі. Осылайша, тәуекелдерді басқарудың тиімді жүйесінің міндеті қозғалысты бәсеңдетпеу емес, керісінше, күрт бұрылыстарда қауіпсіздікті қамтамасыз ету болып табылады.

Түйін сөздер: тәуекелдерді басқару, тәуекелдерді басқару, аудит, ішкі бақылау.

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**УПРАВЛЕНИЕ РИСКАМИ, АУДИТ
И ВНУТРЕННИЙ КОНТРОЛЬ**

Аннотация. Тема управления рисками на микро- и макроуровнях в последние годы становится актуальней, это связано с повышенной турбулентностью на рынках и мировой финансовой нестабильностью. Свой определенный вклад в повышение актуальности темы вносит также ускорение инновационных процессов в технологиях. Темп производственных процессов и скорость принятия управленческих решений нарастает. Чтобы проиллюстрировать роль управления рисками в компании, можно использовать следующее сравнение. Известно, что самые быстрые автомобили снабжены самыми лучшими и надежными тормозами. Так, задача эффективной системы управления рисками – не затормозить движение, а, наоборот, обеспечить безопасность на крутых поворотах.

Ключевые слова: риск менеджмент, управление рисками, аудит, внутренний контроль.

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