

Enterprise Risk Management

Steven M. Bragg

Table of Contents

| | |
|--|-----------|
| Chapter 1 – Risk Management Overview | 1 |
| Learning Objectives | 1 |
| Introduction..... | 1 |
| Benefits of Risk Management..... | 1 |
| The Interrelationship between Risk and Strategy..... | 2 |
| Risk Retention Strategy..... | 2 |
| Risk Analysis as an Opportunity..... | 3 |
| Special Risk Situations | 3 |
| Risk Management for the Enterprise | 4 |
| The Chief Risk Officer | 4 |
| Risk Management Committee | 5 |
| Responsibility for Risk..... | 6 |
| Risk Management by the Individual Employee..... | 7 |
| Types of Risks | 8 |
| The Risk Management Process Flow | 9 |
| Risk Rankings | 10 |
| Risk Quantification Issues..... | 12 |
| The Risk Profile | 13 |
| Special Risk Situations..... | 14 |
| Risk Planning Timeline..... | 14 |
| Risk Management Best Practices | 15 |
| Risk Management Themes..... | 16 |
| Biases in Risk Management..... | 19 |
| Summary | 19 |
| Review Questions | 20 |
| Review Answers | 21 |
| | |
| Chapter 2 – Treasury Risk Management | 23 |
| Learning Objectives | 23 |
| Introduction..... | 23 |
| Funding Risk..... | 23 |
| Investment Risk | 24 |
| Liquidity Risk..... | 25 |
| Credit Policy Risk..... | 26 |
| Credit Exposure Risk | 26 |
| Internal Credit Rating System | 26 |
| Third Party Credit Ratings..... | 28 |
| Credit Insurance | 28 |
| Terms Alterations | 29 |
| Receivables Financing..... | 30 |
| Outside Financing..... | 30 |
| Portfolio Approach to Risk | 30 |
| Cross-Selling Credit Exposure Risk..... | 31 |
| Credit Concentration Risk | 31 |
| Foreign Exchange Risk Overview..... | 32 |
| Foreign Exchange Risk Management..... | 33 |
| Take No Action..... | 33 |
| Avoid Risk | 33 |
| Shift Risk..... | 33 |
| Time Compression | 34 |
| Payment Leading and Lagging | 34 |
| Build Reserves | 35 |
| Maintain Local Reserves..... | 35 |
| Hedging..... | 35 |

Table of Contents

| | |
|---|-----------|
| Summary..... | 36 |
| Types of Foreign Exchange Hedges..... | 36 |
| Loan Denominated in a Foreign Currency..... | 36 |
| The Forward Contract..... | 36 |
| The Futures Contract..... | 37 |
| The Currency Option..... | 38 |
| The Cylinder Option..... | 39 |
| Swaps..... | 39 |
| Netting..... | 40 |
| Interest Risk Overview..... | 41 |
| Interest Rate Risk Management..... | 41 |
| Take No Action..... | 41 |
| Avoid Risk..... | 41 |
| Asset and Liability Matching..... | 42 |
| Hedging..... | 42 |
| Types of Interest Rate Hedges..... | 42 |
| The Forward Rate Agreement..... | 42 |
| The Futures Contract..... | 44 |
| The Interest Rate Swap..... | 45 |
| Interest Rate Options..... | 46 |
| Interest Rate Swaptions..... | 49 |
| Summary..... | 49 |
| Review Questions..... | 50 |
| Review Answers..... | 51 |
| Chapter 3 – Sales and Marketing Risk Management..... | 53 |
| Learning Objectives..... | 53 |
| Introduction..... | 53 |
| Marketing Governance Risk..... | 53 |
| Brand Repositioning Risk..... | 53 |
| Celebrity Spokesperson Risk..... | 53 |
| False Marketing Claims Risk..... | 54 |
| Advertising Reduction Risk..... | 54 |
| Increased Marketing Cost Risk..... | 55 |
| Socioeconomic Change Risk..... | 55 |
| Product Recall Risk..... | 55 |
| Incorrect Forecasting Risk..... | 56 |
| Customer Loss Risk..... | 56 |
| Contracting Economy Risk..... | 57 |
| Summary..... | 57 |
| Review Questions..... | 58 |
| Review Answers..... | 59 |
| Chapter 4 – Supply Chain Risk Management..... | 61 |
| Learning Objectives..... | 61 |
| Introduction..... | 61 |
| Supply Chain Risk..... | 61 |
| Cross-Firm Effects of Supply Chain Disruptions..... | 62 |
| Supply Chain Risk Mitigation Techniques..... | 62 |
| Project Completion Risk..... | 63 |
| Shifting Risk into the Supply Chain..... | 64 |
| Summary..... | 64 |
| Review Questions..... | 65 |
| Review Answers..... | 66 |
| Chapter 5 – Production and Distribution Risk Management..... | 67 |
| Learning Objectives..... | 67 |

Table of Contents

| | |
|--|-----------|
| Introduction..... | 67 |
| Capacity Failure Risk | 67 |
| Defective Product Risk..... | 67 |
| Loss of Distributor Risk | 68 |
| Summary | 69 |
| Review Questions | 70 |
| Review Answers | 71 |
| Chapter 6 – Human Resources Risk Management..... | 73 |
| Learning Objectives | 73 |
| Introduction..... | 73 |
| Recruitment Risk..... | 73 |
| Incorrect Hire Risk | 74 |
| Downsizing Risk..... | 74 |
| Worsening Employee Morale Risk..... | 75 |
| Discrimination Risk..... | 75 |
| Position Misclassification Risk..... | 75 |
| Inflated Benefits Cost Risk | 76 |
| Increased Unemployment Rate Risk | 78 |
| Performance Incentive Plan Risk..... | 78 |
| Accidents Risk | 79 |
| OSHA Violations Risk | 79 |
| Human Resources Activities to Mitigate Risk..... | 79 |
| Summary | 80 |
| Review Questions | 81 |
| Review Answers | 82 |
| Chapter 7 – Accounting Risk Management..... | 83 |
| Learning Objectives | 83 |
| Introduction..... | 83 |
| Financial Statement Error Risk | 83 |
| Tax Return Error Risk | 83 |
| Budgeting Error Risk..... | 84 |
| Overpayment Risk | 84 |
| Overspending Risk..... | 85 |
| Use Tax Risk | 85 |
| Due Diligence Error Risk..... | 86 |
| Fraud Risk..... | 86 |
| Public-Company Risks | 87 |
| Summary | 89 |
| Review Questions | 90 |
| Review Answers | 91 |
| Chapter 8 – Information Technology and Systems Risk Management..... | 93 |
| Learning Objectives | 93 |
| Introduction..... | 93 |
| Data Security Risk | 93 |
| IT System Failure Risk | 94 |
| Loss of Expertise Risk..... | 94 |
| Incompatible Systems Risk | 94 |
| Changing Technology Risk..... | 95 |
| Catastrophic Damage Risk..... | 95 |
| GRC Software..... | 96 |
| The Use of Procedures | 96 |
| The Need for Procedures..... | 96 |
| The Number of Procedures to Develop | 97 |
| Deviations from Procedures..... | 97 |

Table of Contents

| | |
|--|------------|
| The Use of Controls | 98 |
| Summary | 99 |
| Review Questions | 101 |
| Review Answers | 102 |
| Chapter 9 – Other Risk Management Topics..... | 103 |
| Learning Objectives | 103 |
| Introduction..... | 103 |
| Investor Risk..... | 103 |
| Sole Proprietorship..... | 103 |
| Partnership..... | 104 |
| Corporation | 105 |
| Limited Liability Company..... | 106 |
| Summary..... | 106 |
| Political Risk | 106 |
| Alliance Risk | 106 |
| Reputation Risk..... | 107 |
| Summary | 108 |
| Review Questions | 109 |
| Review Answers | 110 |
| Chapter 10 – Contingency Planning | 111 |
| Learning Objectives | 111 |
| Introduction..... | 111 |
| Contingency Planning | 111 |
| Disaster Communications..... | 111 |
| Disaster Drills | 111 |
| Safety Procedures Training | 112 |
| Emergency Response Team..... | 112 |
| Worker Flexibility | 112 |
| Automatic Detection Systems | 112 |
| Preventive Maintenance | 112 |
| Boiler-Related Activities..... | 112 |
| Hazardous Materials..... | 112 |
| Mechanical Drawings..... | 113 |
| Equipment Positioning..... | 113 |
| Safe Room | 113 |
| Flood Mitigation Activities | 113 |
| Hurricane Mitigation Activities..... | 113 |
| Replacement Facilities..... | 113 |
| Summary | 113 |
| Review Questions | 114 |
| Review Answers | 115 |
| Chapter 11 – Insurance | 117 |
| Learning Objectives | 117 |
| Introduction..... | 117 |
| Insurance Policy Terms and Conditions..... | 117 |
| Deductibles | 117 |
| Limit of Insurance | 117 |
| Co-Insurance..... | 118 |
| Exclusions | 118 |
| Insurance Riders | 118 |
| Perils..... | 118 |
| Boiler and Machinery Insurance | 119 |
| Business Interruption Insurance | 119 |
| Policy Inclusions..... | 119 |

Table of Contents

| | |
|---|------------|
| Additional Coverages..... | 120 |
| Management Actions..... | 120 |
| Commercial Automobile Insurance..... | 121 |
| Commercial General Liability Insurance..... | 121 |
| Cyber Risk Insurance..... | 121 |
| Management Actions..... | 122 |
| Directors and Officers Liability Insurance..... | 122 |
| Management Actions..... | 122 |
| Additional Coverages..... | 122 |
| Inland Marine Insurance..... | 123 |
| Life Insurance..... | 123 |
| Political Risk Insurance..... | 123 |
| Property Insurance..... | 124 |
| Types of Property..... | 124 |
| Policy Inclusions..... | 124 |
| Policy Exclusions..... | 124 |
| Additional Coverages..... | 124 |
| Management Actions..... | 125 |
| Workers' Compensation Insurance..... | 125 |
| Management Actions..... | 125 |
| Insurance Distribution..... | 126 |
| Insurance Company Analysis..... | 126 |
| Insurance Pricing..... | 126 |
| Managing the Cost of Insurance..... | 127 |
| Insurer Messaging..... | 127 |
| Covered Items Analysis..... | 127 |
| Double Coverage Analysis..... | 127 |
| Unlikely Payouts..... | 127 |
| Non-Comparability..... | 127 |
| Deductibles Analysis..... | 127 |
| Job Classification Analysis..... | 128 |
| Delayed Payments..... | 128 |
| Self-Funded Insurance..... | 128 |
| Captive Insurance Company..... | 128 |
| Insurance Claims Administration..... | 129 |
| Summary..... | 129 |
| Review Questions..... | 130 |
| Review Answers..... | 131 |
| Chapter 12 – Risk in Financial Analysis..... | 133 |
| Learning Objectives..... | 133 |
| Introduction..... | 133 |
| Price Setting..... | 133 |
| Dividend Analysis..... | 133 |
| Capital Budgeting..... | 134 |
| Research and Development Funding Analysis..... | 134 |
| Financial Leverage..... | 136 |
| Summary..... | 139 |
| Review Questions..... | 140 |
| Review Answers..... | 141 |
| Chapter 13 – Risk Measurement and Reports..... | 143 |
| Learning Objectives..... | 143 |
| Introduction..... | 143 |
| Core Reports..... | 143 |
| Losses Report..... | 143 |
| Incidents Report..... | 143 |

Table of Contents

| | |
|---|------------|
| External Risk Indicators Report | 144 |
| Insurance Claims Report..... | 144 |
| Cash Basis and Accrual Basis Reporting Variance | 145 |
| Third Party Credit Ratings | 145 |
| Aggregate Counterparty Exposure Report | 146 |
| Staff Turnover | 146 |
| Alliance-Related Staff Turnover..... | 147 |
| Compensation versus Benchmarks | 147 |
| Duration of System Downtime | 147 |
| Security Breaches Report | 147 |
| Error Rates Report..... | 147 |
| Number of Regulator Warning Letters | 148 |
| Customer Complaints Report | 148 |
| Credit Limit to Credit Usage Variance..... | 148 |
| Volume of Derivatives Trades..... | 149 |
| Bottleneck Utilization..... | 149 |
| Reporting Thresholds..... | 150 |
| Cash Forecasting | 150 |
| Summary | 150 |
| Review Questions | 152 |
| Review Answers | 153 |
| Glossary..... | 155 |
| Index | 159 |