

New Framework Relates Risk to Strategy and Performance

COSO updates guidance for changing environments



COSO has been quantifying approaches to internal controls and risk management for twenty-five years, since the initial guidance. *Internal Control — Integrated Framework* (ICIF), was issued in 1992. The Committee on Sponsoring Organizations of the Treadway Commission (COSO) is an American private sector group providing leadership and guidance to help organizations reduce fraud and operate more efficiently through the issuance of formal frameworks for internal control and risk management. The five members are the AICPA, AAA, FEI, IMA and IIA.

Building on the guidance of the original 1992 document, COSO in 2004 issued *Enterprise Risk Management — Integrated Framework* (ERMIF), to broaden the focus. Then, as covered in the February 2012 inaugural issue of the Audit & Accounting Alert, the first major update of the ICIF was announced, which became effective in December 2014. Now, COSO has followed through with the newly updated and expanded ERMIF, renamed *Enterprise Risk Management—Integrating with Strategy and Performance* (ERFISP) released on September 6, 2017.

As stated in the Executive Summary of the ERFISP, the underlying ICIF is “suitable for designing, implementing, conducting, and assessing internal control, and for consequent reporting.” ERFISP goes beyond just internal controls, pervading all aspects of “strategy-setting, governance, communicating with stakeholders, and measuring performance. Its principles apply at all levels of the organization and across all functions.”

Because of the rapidly changing and increasingly more complex operating environment, the ERFISP demonstrates the importance of integrating enterprise risk management throughout the organization from the formation of strategy through to performance. To help accomplish this objective, the ERFISP document states that it:

- More clearly connects enterprise risk management with a multitude of stakeholder expectations;
- Positions risk in the context of an organization’s performance, rather than as the subject of an isolated exercise;
- Enables organizations to better anticipate risk so they can get ahead of it, with an understanding that change creates opportunities, not simply the potential for crises.

Five components summarize a set of twenty principles that make up the ERFISP, as follows:

1. Governance and Culture
2. Strategy and Objective-Setting
3. Performance
4. Review and Revision
5. Information, Communication, and Reporting:

Interestingly, the ERFISP will be useful to all organizations. "Enterprise risk management can be used by organizations of any size. If an organization has a mission, a strategy, and objectives—and the need to make decisions that fully consider risk—then enterprise risk management can be applied. It can and should be used by all kinds of organizations, from small businesses to community-based social enterprises to government agencies to Fortune 500 companies."

In September, 2017, a paper, *Leveraging the COSO Internal Control—Integrated Framework to Improve Confidence in Sustainability Performance Data*, was published by Robert Herz, board member of the Sustainability Accounting Standards Board, Jeffrey Thomson, Institute of Management Accountants (IMA) president, and Brad Monterio, former IMA board member. The authors noted that while interest in sustainability information is high, with 81% of S & P 500 companies having issued sustainability reports in 2015, confidence in the reliability of the information included was questionable, with less than half of institutional investors finding the reports useful or essential.

In a practical analysis, the paper uses case studies from eight prominent corporations to illustrate approaches for presenting data in ways that can be effectively evaluated for a higher degree of confidence. An example points out the importance of the following principle: "The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives."

The controversial topic of climate change took on a whole new meaning for me, when the discussion turned to the risks that could impact the supply of beer. Descriptions of the water supply were compared between the Molson Coors and Diageo (owner of Guinness) reports. Molson Coors was considered vague and nonspecific:

"Climate change and water availability may negatively affect our business and financial results....Clean water is a limited resource in many parts of the world and climate change may increase water scarcity and cause a deterioration of water quality in areas where we maintain brewing operations. The competition for water among domestic, agricultural and manufacturing users is increasing in some of our brewing communities....The above risk, if realized, could result in a material adverse effect on our business and financial results."

Diageo provided detail that could be identified and assessed:

“Overall this year, Diageo has delivered improved performance across all water and other environmental target areas versus the prior year, and progressed towards meeting 2015 goals. We reduced absolute water use by 9% or 2,268,000 cubic meters while water efficiency improved by 2.4% compared to the prior year. In water-stressed locations, we have reduced water wasted by 12%, an important contribution towards our target of a 50% reduction versus the company’s 2007 baseline.”

If nothing else, I’ll enjoy my Guinness with a clearer conscious now, knowing that Diageo is in the forefront of addressing the water supply that this precious commodity (at least for some of us) depends on. All kidding aside, when the ICIF went into effect, the foreword stated among other things that “The Framework has been enhanced by expanding the financial reporting category of objectives to include other important forms of reporting, such as non-financial and internal reporting.” The non-financial components of environment, social capital, human capital, business model and innovation, and leadership and governance continue to increase in importance for considering long-term longevity.

Further details can be found at [COSO and COSO Framework and sustainability](#).

(<https://www.coso.org/Pages/default.aspx>) and (<https://www.imanet.org/-/media/73ec8a64f1b64b7f9460c1e24958cf7d.ashx>)