

Integrating Corporate Governance Concepts in the classroom with the Risk Assessment Project

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Abstract

The recession of 2008 and the demise of established financial firms served as a reminder that effective corporate governance is important to ensure that businesses remain as going concern. One key area is the implementation of effective enterprise-wide risk management practices. The resulting regulatory oversight enacted through the Dodd Frank Act placed additional responsibility on organizations to develop effective risk management practices. However, business risks are evolving and are now reflected in data breaches and defective parts recalls. Business students, especially accounting majors, must have a working knowledge of risk assessment practices prior to entering the work force. The risk management project was developed to help provide students with this opportunity. It has been used over several semesters at a regional university, and results shows that students are able to identify business risks and perform a basic risk assessment. Students now have a better understanding of the enterprise risk management process and will be more productive as they enter the workforce.

Keywords: Risk management, corporate governance, auditing, COSO, going concern

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INTRODUCTION

Organizations face risks or threats from both internal and external sources. Such risks includes regulatory, environmental, technological, and processing. Risk is the possibility of an event occurring that will negatively impact the organization's ability to achieve its objectives. Therefore, organizations must have effective risk management practices in place to address these threats. Corporate risk management cannot be static since the threats faced continue to evolve. Historically, public companies identify the key risks affecting their businesses and report on their risk mitigating strategies and effectiveness to shareholders via SEC filings. However, the risk assessment methods used by organizations to monitor risk were not standardized and assorted approaches were used with varying degrees of effectiveness.

In response to a need for principles-based guidance to help entities design and implement effective enterprise-wide approaches to risk management, the Committee of Sponsoring Organizations of the Treadway Commission or COSO, issued the Enterprise Risk Management (ERM) – Integrated Framework in 2004. The ERM framework defines essential enterprise risk management components, discusses key ERM principles and concepts, suggests a common ERM language, and provides clear direction and guidance for enterprise risk management. Unlike the COSO framework which is widely accepted as a key element for use in documenting and assessing internal controls to ensure Sarbanes Oxley compliance, the ERM framework was not similarly embraced especially since it was seen as guidance and not a requirement. Therefore, companies ignored its guidance, implemented some elements of the framework, or created their own internal models.

Perhaps the Great Recession of 2008 and the demise of established firms such as Bear Stearns and Lehman Brothers was a reminder that existing risk management practices were not adequate. As a result, The Dodd–Frank Wall Street Reform and Consumer Protection Act (the Act) of 2010 was created to address systematic risk in the economy. One provision of the Act is that it made changes in the American financial regulatory environment that affected all federal financial regulatory agencies and almost every part of the nation's financial services industry. Among the Act's requirements is that the Federal Reserve (Fed) perform an annual exercise or Stress Tests, to assess the capital sufficiency of the largest bank holding companies operating in the U.S.

In spite of the Act, organizations are still struggling to implement effective risk management programs. For instance, Banco Santander was chided by the Fed for failing to meet the regulator's standards on a range of basic business operations, including risk management at a consumer lending subsidiary (Tracy & Neumann, 2015). HSBC paid a \$1.9 billion fine to federal and state regulators for violating banking rules and signed an agreement to improve anti-money laundering controls and other compliance systems (Farrell, 2015). Banamex USA, a Citigroup unit, was fined \$140 million for failing to employ adequate safeguards against illicit financial transactions or other suspicious activities (Corkery, 2015). Discover Bank and two affiliates agreed to pay \$18.5 million in fines and refunds for using illegal practices while servicing student loans (McCoy, 2015).

With increase regulatory scrutiny and reliance on technology, organizations' risks are increasing and evolving. New and emerging risks now include data breaches and defective parts recall and are impacting not just businesses but also government agencies. The following are some of the recent examples of these emerging risks. Home Depot reported data breach impacting 56 million card holders (Hill, 2014). The IRS reported data breach affecting approximately 104,000 taxpayers (Harney, 2015). Toyota recalled 2.7 million cars due to

defective parts (Woodyard, 2015). Fiat Chrysler is recalling approximately 350,000 vehicles over a defective part that could cause a fire under certain circumstances (Jensen, 2015), and agreed to pay a \$105 million settlement to federal regulators (Spector, 2015). Ikea is recalling 27 million chests and dressers because they could tip over if not anchored to a wall (O'Donnell, 2015),

Accounting is considered the language of business and organizations will be looking at graduates for assistance in addressing corporate governance issues, especially risk assessment and/or management practices. Therefore, accounting students graduating into this environment are expected to have an understanding of risk management practices including methods for mitigating risks.

The risk assessment project was created to provide students with the opportunity to understand the challenges that organizations face in developing corporate governance practices especially effective enterprise-wide risk management practices.

THE PROJECT

The risk assessment project is designed to ensure that the project learning outcomes are aligned with the course learning goals. The project also maps directly to the AICPA's Core Competency framework especially risk analysis (a functional competency), and Industry/Sector perspective (a broad business perspective competency). Figure 1 shows the specific course goal as reflected in the syllabi and how it is addressed by the risk assessment project outcomes and the AICPA Core Competencies.

Figure 1: Mapping of Course Learning Outcome to the Project Goals

Course Learning Goal	Project Learning Outcomes	AICPA Core Competencies
Students are able to identify the issues and risks facing companies within a particular industry and how these factors (issues/risks) can impact the audit engagement	1. Students are able to understand, identify, and document the issues and risks facing companies within a particular industry and how these factors (issues/risks) can impact financial results	Industry/Sector Perspective
	2. Students are able to demonstrate their understanding of the risk assessment process that might be used by a business entity to identify and respond to the threats	Risk Analysis Perspective

The Process

The project is broken into two phases – Company/Industry Analysis (Phase One) and Risk Assessment (Phase Two). Students must have a general understanding of business and industry issues in order to perform a risk assessment or to plan an audit engagement, and these topics are often covered in the planning and audit risk chapters of the typical auditing textbook. Therefore, Phase One's completion by the student groups parallels the planning and risk assessment discussions that are occurring simultaneously in the classroom.

Students are assigned to groups of 3-4 members for purposes of this project, and the group selects a leader. The class instructor holds a random drawing in which the leader selects the industry that the groups will research. This ensures that each group works on its own unique industry. The industries are broad in nature and include real estate, oil and gas exploration, and paper and allied products. A brief explanation of the industry is provided to the students as a starting point. The full industry listing with descriptions is provided to students via the course management system. An example of some of the industries covered is provided in Appendix A.

Students brainstorm and identify the key issues (or inherent risk) that would bear on an auditor engaged in that particular industry. Students are reminded that inherent risk is a worst case scenario and identifies the things that could go wrong in the absence of risk mitigating strategies. For instance, in the transportation by air industry, one key risk factor is crude oil prices. So companies in this industry might explore opportunities to hedge against raising crude oil prices, or purchase an oil refinery, as risk mitigating strategies to address this threat. Students are encouraged to use all available resources including the SEC filings, personal knowledge, and business newspapers and magazines, to help identify the issues within their assigned industry. A maximum of ten issues is encouraged.

Students then select a company within the assigned industry and (a) summarize its major products, and explain how one of the risks identified could affect company operations, (b) discuss the most recent financial results, and (c) identify the audit firm, the type of audit opinion issued, and whether the auditor issued separate or combined reports on the financial statements and internal controls. The students are provided with an outline in the course syllabi for use in documenting the results of the Industry Analysis. The written communication rubric which is used for assessment process is also included in the syllabus to assist teams in developing their papers.

To continue the previous 'Transportation by Air' illustration, the group might select Delta Airlines for the company focus. In their paper, students might note that Delta is now the number two domestic airline after the merger of American Airlines and US Airways. They might also note that it operates over 5,400 daily flights and serve approximately 333 destinations in 64 countries on six continents. An example of a completed group project is provided in Appendix B.

Phase Two of the project builds on the earlier phase and the students are tasked with performing a risk assessment of the industry or business risk identified in the previous phase. Students are provided with a 'risk topography' to help categorize their risk factors. The goal is to ensure that students have the appropriate guidance to perform the exercise. The topography provides examples of broad risk categories such as technology, legal and/or regulatory, external forces, and human resources; and sub risk within each category such as disaster recovery planning (within technology). An excerpt from the risk topography used is included as Appendix C.

Students are also provided with a simple risk assessment matrix and are asked to:

- Select 3 broad risk categories from the topography,
- Select at least one sub risk from each category for a total of 5 (that's the maximum and minimum)
- Perform a risk assessment at the company level of the risk factors identified earlier in the project. This includes ranking the risks using a qualitative scale of High, Medium, and Low. A brief explanation for the assigned ranking is also required.

To complete the risk assessment, the instructor introduces and discusses CAAR. This is simply the risk response strategies that an organization might use to help mitigate risk. CAAR means that risks can be controlled, accepted, avoided or reduced. Students are encouraged to share generic examples of each CAAR element with the class so that everyone has a working knowledge of the concepts. An example of a completed group risk assessment project using the risk matrix is provided in Appendix D.

IMPLEMENTATION AND FEEDBACK

This risk assessment project has been used at a regional university in the Southeast for the past six years in the undergraduate auditing class. It is one of several elements that determines a student's final grade and is assigned 30 points (approximately six percent of the total grade). It requires limited instructor preparation time since the project requirements are provided to students as appendices in the course syllabi. The Industry Description and Risk Topography documents are unloaded into the course management system and are available to students when the project commences. The instructor provides direction on the project's objective and deliverables, while covering course concepts, and grades the completed group assignments.

Phase one of the projects is assigned within the first three weeks of the semester, and Phase Two is assigned upon its completion. Students select their own team members to work together on both project phases. They also perform peer evaluations, using instructor provided rubrics that helps to determine individual students' grades. Anecdotal evidence, students' peer evaluations, and class debriefing, indicated that the project's goals were achieved. In terms of time, Project One takes approximately 8-10 hours total group time to complete. Since phase two builds on the information gathered in phase one, it takes approximately one hour to complete.

The project helped students obtain a better understanding (a) of risks by providing them with the opportunity to identify industry and business risks, (b) that risk can vary based on the Risk Topography used, (c) that companies need a have a robust risk management process in place, and (d) that companies have different ways of responding to risk.

Students received averaged scores of 17 (of 20 points) and 9 (of 10 points) on Phase One and Two respectively which demonstrated that the project was also effective in assessing the course learning outcome. The assessment threshold is 70% of higher. The project's results are summarized in Figure 2, which expands on Figure 1 discussed earlier in the paper.t

Figure 2: Project Results

Course Learning Goal	Project Learning Outcomes	Average Scores	Results
Students are able to Identify the issues and risks facing companies within a particular industry and how these factors (issues/risks) can impact the audit engagement	1. Students are able to understand, identify, and document the issues and risks facing companies within a particular industry and how these factors (issues/risks) can impact financial results	85%	Outcome was achieved
	2. Students are able to demonstrate their understanding of the risk assessment process that might be used by a business entity to identify and respond to the threats	90%	Outcome was achieved

CONCLUSION

Risk assessment is an important business activity and students need a working knowledge of it prior to graduation. Therefore, it is important for instructors to provide students with this opportunity. Instructors also need to integrate any project learning objectives to course goals so students understand the importance of any class project or assignment. The risk assessment project achieved both initiatives. Through the risk assessment process, students had the opportunity to explore business and industry risks and to perform a basic risk assessment. In addition, project learning goals were aligned with one of the course's learning goal and used for assessment purposes.

The paper provides a simple risk assessment tool for the undergraduate auditing course. However, it is flexible and can be adapted by instructors in other accounting courses and/or disciplines especially risk management. As noted in the paper, the assignment is completed by students in teams outside of class. The instructor's time is limited to introducing the project, coaching as necessary, and grading the team assignment using their own approach.

The project is successful and achieved its stated goals of introducing students to corporate governance especially the risk assessment process, thus exposing them to terminology that will be beneficial to future employers.

Appendix A: Industry Descriptions (Sample)

1. Agriculture, Forestry and Fishing

This division includes establishments primarily engaged in agricultural production, forestry, commercial fishing, hunting and trapping, and related services.

The classification of agricultural production covers establishments (e.g., farms, ranches, dairies, greenhouses, nurseries, orchards, hatcheries) primarily engaged in the production of crops, plants, vines, or trees (excluding forestry operations); and the keeping, grazing, or feeding of livestock for the sale of livestock or livestock products (including serums), for livestock increase, or for value increase. Livestock as used here includes cattle, sheep, goats, hogs, and poultry. Also included are animal specialties, such as horses, rabbits, bees, pets, fur-bearing animals in captivity, and fish in captivity. Agricultural production also includes establishments primarily engaged in the operation of sod farms, cranberry bogs, and poultry hatcheries; in the production of mushrooms, bulbs, flower seeds, and vegetable seeds; and in the growing of hydroponic crops.

2. Oil and Gas Extraction

This major group includes establishments primarily engaged in: (1) producing crude petroleum and natural gas; (2) extracting oil from oil sands and oil shale; (3) producing natural gasoline and cycle condensate; and (4) producing gas and hydrocarbon liquids from coal at the mine site. Types of activities included are exploration, drilling, oil and gas well operation and maintenance, the operation of natural gasoline and cycle plants, and the gasification, liquefaction, and pyrolysis of coal at the mine site.

3. Construction

This division includes establishments primarily engaged in construction. The term construction includes new work, additions, alterations, reconstruction, installations, and repairs. Construction activities are generally administered or managed from a relatively fixed place of business, but the actual construction work is performed at one or more different sites. If a company has more than one relatively fixed place of business from which it undertakes or manages construction activities and for which separate data on the number of employees, payroll, receipts, and other establishment-type records are maintained, each such place of business is considered a separate construction establishment.

4. Transportation Equipment

This major group includes establishments engaged in manufacturing equipment for transportation of passengers and cargo by land, air, and water. Important products produced by establishments classified in this major group include motor vehicles, aircraft, guided missiles and space vehicles, ships, boats, railroad equipment, and miscellaneous transportation equipment, such as motorcycles, bicycles, and snowmobiles.

5. Life Insurance

Establishments primarily engaged in underwriting life insurance. These establishments are operated by enterprises that may be owned by stock-holders, policy holders, or other carriers.

6. Security and Commodity Brokers, Dealers, Exchanges, and Services

This major group includes establishments engaged in the underwriting, purchase, sale, or brokerage of securities and other financial contracts on their own account or for the account of others; and exchanges, exchange clearinghouses, and other services allied with the exchange of securities and commodities.

7. Hotels and Motels

Commercial establishments, known to the public as hotels, motor hotels, motels, or tourist courts, primarily engaged in providing lodging, or lodging and meals, for the general public. Hotels which are operated by membership organizations and open to the general public are included in this industry.

8. Motion Pictures

This major group includes establishments producing and distributing motion pictures, exhibiting motion pictures in commercially operated theaters, and furnishing services to the motion picture industry. The term motion pictures, as used in this major group, includes similar productions for television or other media using film, tape, or other means.

9. Real Estate

This major group includes real estate operators, and owners and lessors of real property, as well as buyers, sellers, developers, agents, and brokers.

10. Grocery Stores

Stores, commonly known as supermarkets, food stores, and grocery stores, primarily engaged in the retail sale of all sorts of canned foods and dry goods, such as tea, coffee, spices, sugar, and flour; fresh fruits and vegetables; and fresh and prepared meats, fish, and poultry.

- Convenience food stores-retail
- Food markets-retail
- Frozen food and freezer plans, except meat-retail
- Grocery stores, with or without fresh meat-retail
- Supermarkets, grocery-retail

Appendix B: Industry Analysis: Grocery Stores

This project example was written by Valdosta State University students (Karen Butler, Kari Doeppke, Heather Harvell, and Bria McFarland) in the undergraduate auditing class, fall 2014. It continues with Appendix D and is reproduced with the group's permission

Industry

Introduction

Small mom and pop grocery stores have evolved into mega chain supermarkets over the years. The early grocery stores carried your basic needs such as meats, vegetables, dairy products and the essential food making items. They started small because families did not rely on processed foods. Instead, the typical family mom stayed home and prepared meals from her essential items she picked up from the store. The grocery business has adapted to the ever changing needs of shoppers. Now the typical family involves either both parents or a single parent working outside the home, so it leaves little time for preparation of meals. Some grocery stores offer the convenience of a one-stop shop for items such as fresh and processed foods, pharmacy, gas, and entertainment. However, the bottom line of the grocery store industry is to provide the essential food items.

Key Issues

Risks are important in any industry. Risks range from the competitive markets outside the organization to the internal controls that are inside the organization. Risk factors are so important because they affect the bottom line of any industry. Any circumstance that has the ability to affect the company's objectives and processes are business risks. As with many industries, grocery stores are facing several risk factors.

Competitive markets are risks in every industry. For consumers, a competitive market is good because it ideally gives us the best quality products at the lowest prices. However, this does not give the industries a very high profit margin. To win the customer over, grocery stores are competing to have the lowest prices. There are other strategies that the industry can use. For example, Publix says that they cost similar to Walmart because of their "buy one, get one free" deals. This is a competitive strategy by Publix to win over the shoppers from Walmart. Another strategy Publix uses is that they hold themselves up to a higher quality than other grocery stores.

Litigation is a major risk factor for every industry. It costs companies millions every year. For the grocery store industry, litigation can range from consumer safety to employee relations. Consumer safety lawsuits can range anywhere from a customer falling to customers purchasing perishable foods that have gone bad. To maintain a good reputation, companies may settle in a lawsuit instead of going to court. All lawsuits are a risk for the grocery store industry. For example, when a grocery store is in the news about having arsenic in their meat, it hurts their sales. The same goes for litigation. If the grocery store has a lawsuit against them for poisonous foods, it hurts the grocery stores bottom line. Employee relations lawsuits can range from discrimination to physical harm.

Internal controls are a risk factor in every industry, and in the grocery store industry, a big part of internal controls is dealing with the merchandise itself. Millions of dollars in products

are stolen every year in the grocery store industry that could be due to lack of internal controls. There are many internal controls that are already in place in grocery stores such as physical controls, documentation, and independent checks. An example of a lack of internal control would be when employees damage items in hopes of obtaining the items because the store can no longer sell them to the consumers.

Increasing technology has impacted the grocery store industry by having to maintain and implement new systems. Technology is growing at such a rapid pace that it increases its risk factor. Every time a person turns around, new and updated technology is coming around the corner. This is a risk factor because businesses are very dependent on technology to maintain security and continuing operations. If a company does not remain on top of the technology boost, then they lose a competitive edge. An example would be individuals' identities being stolen because technology is not updated. Therefore, having up-to-date technology reduces their risk.

Company

The Kroger Company

We chose Kroger because of their motto and values. Their motto is "Be particular. Never sell anything you would not want yourself (History)." They began their business in Cincinnati, Ohio in 1883. Their motto worked then and it still works today. Mr. Kroger wanted to sell good quality products and grow with the demand by being the first to offer bakery options and meats all under one roof. He grew with the demand of the people's needs while still offering good products and saving the customers money. Mr. Kroger's values of integrity, honesty, respect, diversity, safety, and inclusion have been a stronghold with Kroger for 131 years.

Major Products

Kroger shelves are filled with around 50,000 items ranging from basic grocery items to more innovative products such as organic, natural, and ready-made meals. The major products sold bring in an estimated 94% of total company sales. Approximately 40% of their major products are produced in their own manufacturing facilities which create about 12,000 of their private labeled products. These products bring in 24% of Kroger total sales giving them a significant strategic advantage (The Kroger).

The StateJournal.com, dated July 2, 2014, highlighted an article about Kroger purchasing Vitacost.com which sells vitamins online. This \$280 million deal will add an ecommerce business to Kroger assets. It will help them expand into the home delivery markets like Amazon, Omaha Steaks, and QVC. The acquisition of Vitacost can increase their profitability by being able to tap into a wider market. Vitacost has a strong position in the online nutritional market. This nutritional market will complement their existing products. It also has the ability to open the door to offering delivery of perishable and nonperishable goods to the home (Kroger).

Financial Results/Impact of Key Issues

Kroger has a strong financial standing according to the 10Q with a comprehensive net income of \$508 million for the quarter ending May 24, 2014 compared to last year of \$485

million. Their sales have also increased over the last year from \$29,997 million to \$32,961 million.

Vitacost's customers have increased greatly since 2005 from about 270,000 to 2.3 million and their sales just in 2013 were \$382.7 million. In this aspect the acquisition looks great; however, according to the article Vitacost's operating expenses are high resulting in operating losses for the past four years. According to Kroger net income they can afford to have losses, but in order to maintain their current profit ratios they will need to increase revenues.

This merger will affect the risk factor of increased technologies. Kroger is going to have to implement Vitacost's technology into their system. A risk factor for this is that Vitacost's system may not be compatible with Kroger's already existing system. This is a challenge for Kroger because they are just breaking into the ecommerce business. If Kroger is unable to implement and maintain a state-of-the-art system, it could cost Kroger part of their competitive edge.

Kroger is trying to stay competitive in an increasingly demanding market by improving their strategic plans. Kroger's strategy is that the customer is always first. For Kroger, this has been a good strategy because, as shown above in the graph, their sales have increased. They have stayed competitive by keeping their prices low. From the beginning, Kroger had his principle, "Be particular. Never sell anything you would not want yourself (History)." This principle is the underline of their strategy, and is one reason why they have done so well over the years. Kroger's new strategy is to break into the ecommerce market, and whether this will be successful is still to be determined.

There are other key issues that can affect Kroger's financial standing. They are currently involved in several litigation lawsuits that range from discrimination to injuries. One such case is a man being awarded \$2.3 million in lawsuits against Kroger. The man fell on crushed fruit in the deli area resulting in a spinal injury that required surgery to stabilize his spine. The judge determined Kroger had destroyed and manipulated evidence (Douglasville). In another case, a federal jury awarded a former Kroger employee \$450,000 in a discrimination and harassment lawsuit. The jury found that a manager harassed an employee because of his mental disabilities. The employee reported the harassment and then was ultimately fired (Federal). Like the entire industry, Kroger has to deal with these issues.

Audit Report

The independent accountant is PricewaterhouseCoopers LLP. They completed an audit of The Kroger Company on April 1, 2014 for the year ending February 1, 2014. They issued a combined report on the financial statements and on the internal controls. The type of audit opinion is an Unqualified Opinion.

In conclusion, the grocery industry has become very complex in their strategy, products, services, and technology. Risk factors have also grown in size and complexity. To be profitable and maintain their customer loyalty they need to regularly evaluate their risk factors and strategies to see if there is a need for change. Many small grocery stores have successfully adapted over time to the needs of their customers while learning to manage the new risks associated as they grow.

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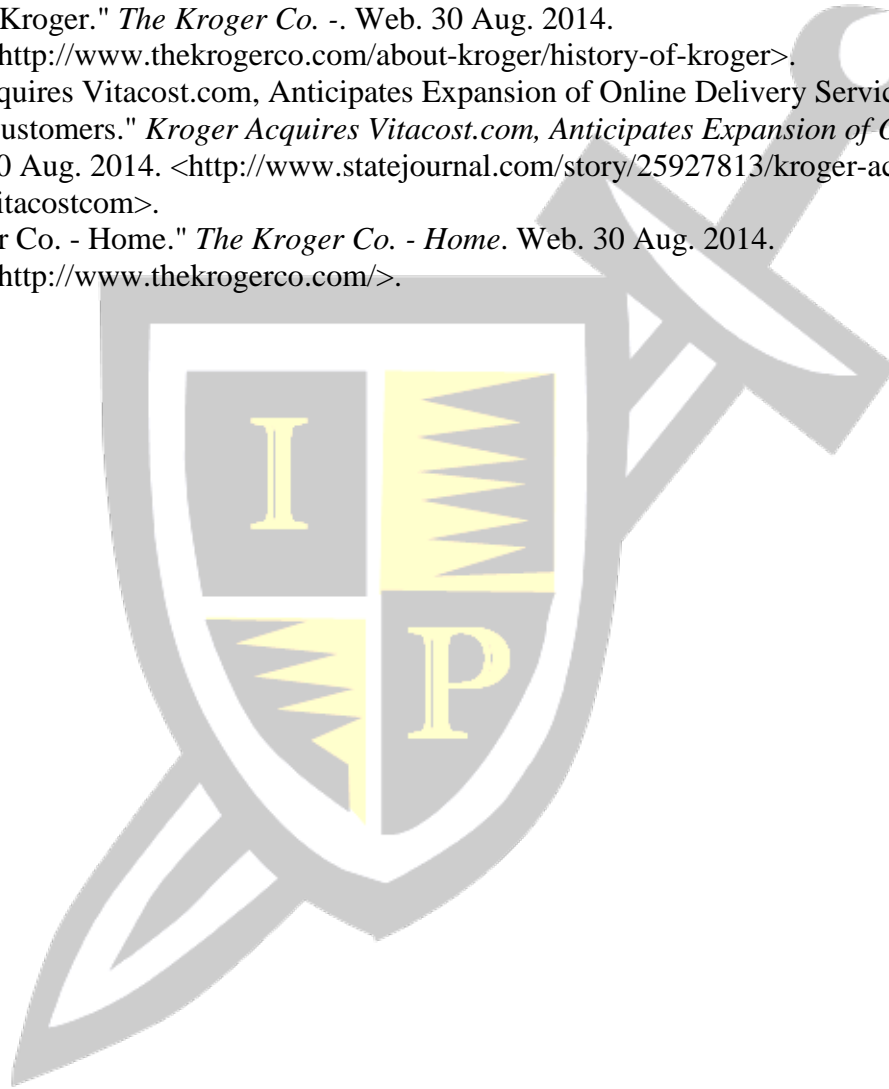
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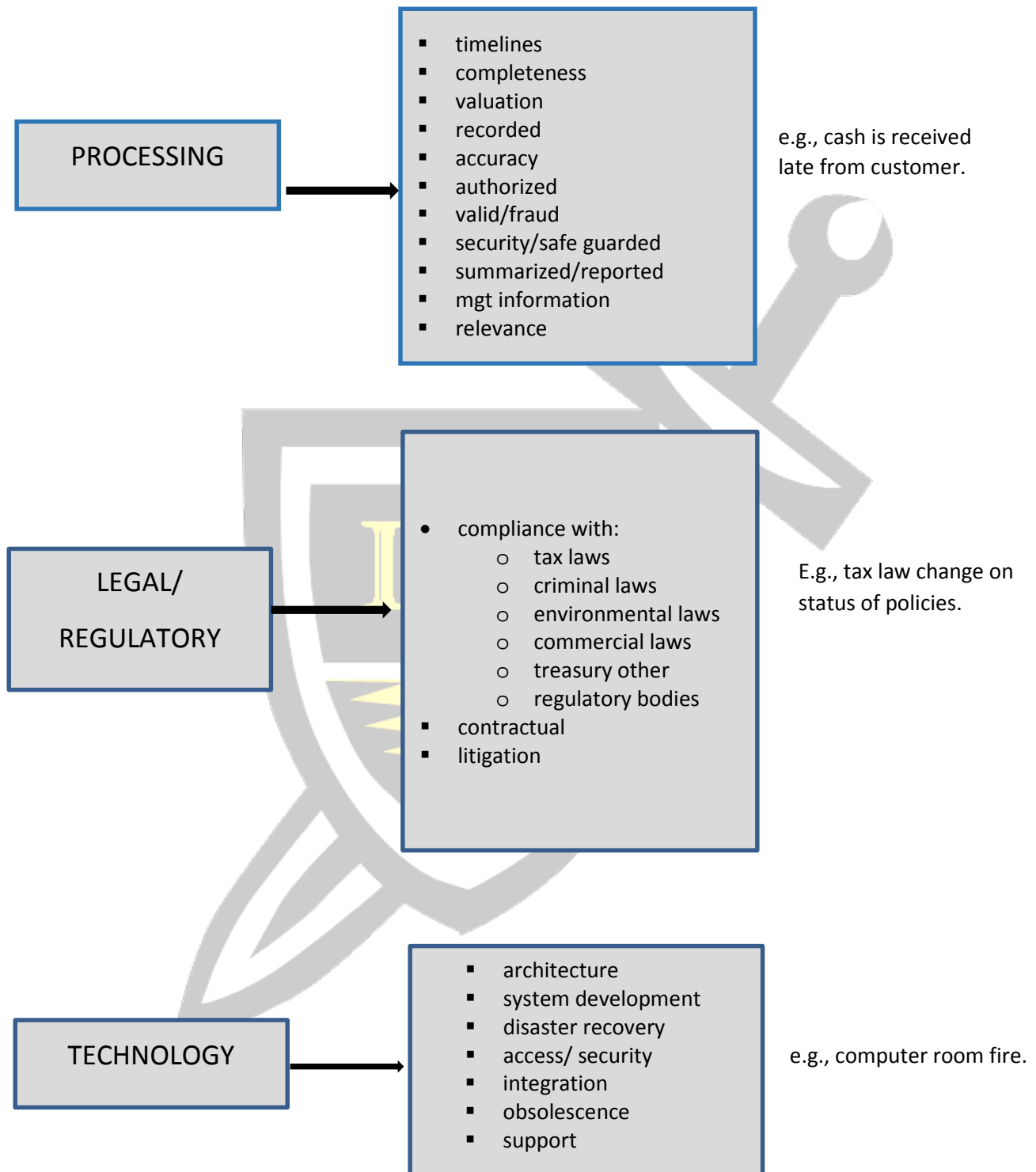
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Appendix C: Risk Topography (Excerpt)



Appendix D: Risk Assessment – Grocery Stores

Risk, Board	Risk, Defined (Sub Risk)	Risk Ranking (H-High, M-medium, L-low)	Risk Response (CAAR)	Example of Risk
Legal/ Regulatory	Litigation	H	Accept	Set up an in-house legal team
	Compliance with laws	L	Control	Internal controls set up to ensure we comply with regulation
Technology	Integration	M	Control	A team can bring two programs together to work efficiently.
	Access/security	M	Control	Use firewalls and passwords to protect the client's information.
Product	Competitor	H	Accept	You know you have competitors so you try to beat them by using strategies.

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