CENTRE FOR PROFESSIONAL TRANSFORMATION IN ACCOUNTING & FINANCE (CPTAF) NEWSLETTER

SEPT 2015

THEME: RISK MANAGEMENT

INTRODUCTION

The Centre for Professional Transformation in Accounting & Finance (CPTAF) was set up with the aim to promote research and to further develop the Accounting & Finance qualification in APU. Our lecturers have presented papers in both international and local conferences, and also published in journals in the past years. We have organised several events to enhance the knowledge and exposure of our students, some of which will be published in this newsletter. This bi-annual newsletter is created to mainly benefit our students. The articles contributed serve as additional materials to assist them in their own research areas and enhance their module knowledge. Each newsletter would discuss different themes. The CPTAF's main focus is to research the enhancement of Corporate Reporting, facilitated by Integrated Reporting (IR). IR promotes integrated thinking and value creation, in order to improve the quality of information available for a more cohesive and efficient reporting as well as decision making over the short, medium and long term. One of the components under IR is **Risk Management**, which frames the theme for our first newsletter. We welcome any feedback and article contributors from our colleagues and students in APU. On behalf of CPTAF, we would like to thank everyone who has supported our efforts. Please liaise with our team for any queries.

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Thank you

Geetha

MS GEETHA A RUBASUNDRAM

CHAIRPERSON – CPTAF

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ASIA PACIFIC UNIVERSITY OF TECHNOLOGY AND INNOVATION

ACCOUNTING & FINANCE STUDIES

The Accounting and Finance degree programme provides a globally-recognized professional education for students who aim to be professionals in the field. Strongly emphasizing the development of analytical skills, the degree programme provides a solid ground of professional competencies in all aspects of accounting and finance required for careers in numerous sectors. The degree programme covers both in depth accounting and finance modules as well as other relevant courses such as business research methods, business communication and management ethics.

Through a fusion of examinations, assignments and projects – including a Final Year Project to be completed during the last year of study – as well as experiential learning, students will acquire the relevant skills to manage local and cross-border issues in complex and challenging business environments. They will also gain valuable industry knowledge from their internship positions with top-notch companies. Our graduates will gain entry into the professional level of ACCA, CIMA, ICAEW,CTIM, CPA Australia and others. This course will also equip graduates to pursue further professional qualifications with CFP, CIMA, ICAEW, MIA, CTIM; relevant electives may be taken to maximize exemptions. Students will receive equal recognition and certification from both Asia Pacific University and the Staffordshire University, UK.

AN INTRODUCTION TO INTEGRATED REPORTING & INTEGRATED GOVERNANCE RISK COMPLIANCE (GRC)

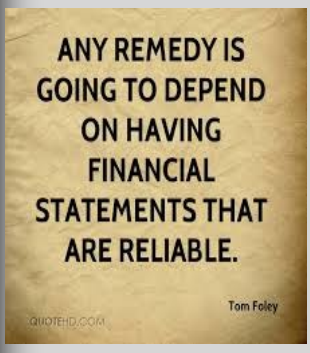
GEETHA A RUBASUNDRAM

Chairperson CPTAF & Senior Lecturer

Integrated reporting (IR) has been developed and promoted by the International Integrated Reporting Council (IIRC), a global coalition of regulators, investors, companies, standard setters, the accounting profession and non-governmental organisations. Integrated Reporting demonstrates the linkages between an organization's strategy, governance and financial performance and the social, environmental and economic context within which it operates. By reinforcing these connections, Integrated Reporting can help business to take more sustainable decisions and enable investors and other stakeholders to understand how an organization is really performing.

According to the International Integrated Reporting Committee, Integrated Reporting combines the different strands of reporting (financial, management commentary, governance and remuneration, and sustainability reporting) into a coherent whole that explains an organization's ability to create and sustain value in the short, medium and longer term. Each element of an Integrated Report should provide insights into an organization's current and future performance.

Integrated Reporting reflects what can be called "integrated thinking"— an application of the collective mind of those charged with governance (the board of directors or equivalent), and the ability of management, to monitor, manage and communicate the full complexity of the value-creation process, and how this contributes to success over time. It will increasingly be through this process of "integrated thinking" that organizations are able to create and sustain value. The effective communication of this process can help investors, and other stakeholders, to understand not only an organization's past and current performance, but also its future resilience



The Framework has 3 core parts:

- Fundamental Concepts that explain the foundations or conceptual underpinning of <IR>,
- Guiding Principles that inform the content of an integrated report and how information in the report is presented, and
- Content Elements, which are essentially categories of information that are to be included in an integrated report.

Fundamental Concepts: An integrated report aims to provide insight about the resources and relationships used and affected by an organization – these are collectively referred to as "the capitals" in this Framework. It also seeks to explain how the organization interacts with the external environment and the capitals to create value over the short, medium and long-term. The capitals include Financial, Manufactured, Intellectual, Human, Social & Relationship and Natural.

Guiding Principles underpin the preparation of an integrated report, informing the content of the report and how information is presented.
These Guiding Principles are applied individually and collectively for the purpose of preparing and presenting an integrated report; accordingly, judgement is needed in applying them, particularly when there is an apparent tension between them (e.g., between conciseness and completeness).

A Strategic focus and future orientation
B Connectivity of information
C Stakeholder relationships
D Materiality
E Conciseness
F Reliability and completeness
G Consistency and comparability

The Content Elements are questions that should be answered in a way that best expresses the organization's unique value creation story, and makes the connections between the Content Elements apparent. They are not intended to appear in a set sequence, and they are not isolated – they are fundamentally linked to each other and are not mutually exclusive.

⇒ Organizational overview and external environment
⇒ Governance
⇒ Business model
⇒ Risk and opportunities
⇒ Strategy and resource allocation
⇒ Performance
⇒ Outlook
⇒ Basis for preparation and presentation
⇒ General reporting guidance

Integrated Governance, Risk & Compliance has been defined as an integrated, holistic approach to organisation-wide governance, risk and compliance ensuring that an organisation acts ethically correct and in accordance with its risk appetite, internal policies and external regulations through the alignment of strategy, processes, technology and people, thereby improving efficiency and effectiveness.'

GRC means different things to different people. One perception is that integrated GRC is nothing more than enterprise risk management (ERM) repackaged by solution providers to drive a new market. Others consider ERM and GRC as distinct subsets of one another. ERM practices have traditionally focused on strategic, financial and operational risks, whereas GRC derives its origins largely from a compliance focus. GRC practices have evolved over a long period of time and place greater emphasis on integrating various risk and compliance functions. On closer review, ERM and GRC differ in terms of their moniker origins and related market practices, but are similar in definition.

Integrated GRC results in a clearer articulation of objectives, roles, responsibilities and accountabilities, leading to more effective risk and compliance process design and improved transparency into GRC performance through effective metrics, measures and monitoring. This all leads to more effective risk-based decision-making and an increased ability to anticipate issues and reduce reaction time.

Therefore, the focus of both frameworks is on integrated thinking and embedding it within the business environment in order to create value for an organization. Both of these concepts are growing in the corporate world and should be taken into consideration by all.

JOURNALS

GEETHA A RUBASUNDRAM (2014), *FRAUD RISK ASSESSMENT: A TOOL FOR SME's TO IDENTIFY EFFECTIVE CONTROLS*.

Research Journal of Accounting & Finance: http://iiste.org/Journals/index.php/RJFA/article/view/14795

ABSTRACT

In recent years, the importance of good control mechanisms has increased significantly due to the number of high-profile corporate failures caused by top management fraudulent acts. Sarbanes Oxley Act 2002, Section 404 says that it is the management's responsibility to maintain and assess the effectiveness of its own internal control structure for financial reporting. The Act also states that it is the auditor's responsibility to attest and report on the management's assessment and the state of the overall financial control. Previous research that had been carried out was from the perspective catered mainly for the auditors or audit committees that had been set up by the management of the organization

Keywords: Fraud Risk Assessment, Internal Controls Fraud Scheme, Fraud, Small & Medium sized, Community Manager

PAPERS PRESENTED IN CONFERENCES

AN ALTERNATIVE MODEL OF THE WAQF BANK by NUR AZAM ANUARUL PERAI

Presented in the International Conference on Cash Waqf 2015 (ICCW2015) 28, 29 & 30 May 2015 at Sepang, Malaysia

ABSTRACT

The practice of cash waqf is no longer a new phenomenon in Malaysia. Many states as well as private sector organisations have established units engaged in mobilising cash for waqf purposes. Laws have also been enacted to administer waqf activities. Given the consensus on the permissibility of cash waqf, this paper will not dispute the practice but instead will present an alternative view of cash waqf by looking at cash and waqf as two distinct and separate variables. This presentation treats cash as the instrument used to achieve the goals and objectives of waqf. It will then proceed to redefine the Waqf Bank and propose an alternative model of the bank. In addition to complementing the existing institutions involved in managing cash waqf, this alternative proposal will look at the bank as the vehicle, a conduit to mobilise and utilise the cash using Shariah compliant modes of financing.

Keywords: Waqf, cash waqf, Waqf Bank

ASSESSING THE PERCEIVED "TONE FROM THE TOP" DURING A FRAUD RISK ASSESSMENT by GEETHA A RUBASUNDRAM

Presented in the International Conference On Financial Criminology (ICFC 2015) 13th -14th April, 2015 at the Oxford University, UK

ABSTRACT

In recent years, the focus on good governance and control mechanisms has increased significantly due to the number of high-profile corporate failures caused by top management fraudulent acts. Recent fraud cases reflect the deceptive "tone from the top", even though the organisation had reported good governance and control systems. This research analysed the importance of the perceived management support and its effect on the organisation culture during a fraud risk assessment. The study used Action Research as the researcher intended to have a more in-depth study on the factors affecting organisational fraud.

Keywords: Fraud Risk Assessment, Internal Controls, Culture, Tone from the Top, Corporate Executive Fraud, Occupational Fraud

CAN YOU HANDLE A CRISIS???

Meera Eeswaran

Programme Leader & Lecturer

The APU-ACCA Crisis Management Competition was held on 9th April 2015. Firstly it is crucial to define crisis management and risk assessment. A sudden and unexpected event leading to major unrest amongst the individuals at the workplace is called as organization crisis. In other words, crisis is defined as any emergency situation which disturbs the employees as well as leads to instability in the organization. Crisis affects an individual, group, organization or society on the whole.

Risk is inherent to business and needs to be analyzed in terms of potential threats from within the organization (employees, production, administration, etc.), potential threats from outside the organization (customers, vendors, partners, products, services, etc.) and from the supply chain(s) in which it exists (raw materials, original equipment manufacturers, etc.)

Therefore it is important for employees to be able to handle a crisis situation, as part of mitigating business risks.

Therefore, a team of lecturers from SAFIQS came up with the idea of having a competition on crisis management to enhance student's ability in putting theory into practice, in handling a crisis situation.

The theme was 'Airline Disaster' being the current calamity besetting the airline industry. The participants were judged on their ability to manage the crisis in terms of financial analysis, corporate communication, crisis leadership, resource allocation, corporate governance and risk management.

A short opening and welcome speech was given by Professor Ron Edwards, Deputy Vice Chancellor, Asia Pacific University.

The teams used their ability to bring forward the criteria above by re-enacting a tense situation for 15 minutes, detailing their method of handling the crisis. They used various methods of presentations, for example, power point slides, videos as well as acting out a scene themselves. There was a 15 minute Question and Answer session with the Industrial and Academic members of the panel.

ACCA brought in 2 industry experts as judges for the competition, **Mr. Francis Cyril, BDO** and **Ms. Amy Lai, DRB HICOM** joining our team of academic panelists. The academic team representing APU were **Professor Dr. Ir. Vinesh Thiruchelvam, Associate Professor Dr. Benjamin Chan, Ms. Geetha Rubasundram, Mr. Gunaseelan Kannan**.

Approximately 200 accounting and finance students from various intakes and levels attended the competition, observing the 6 participating teams, competing for a total prize money of RM2,000. ACCA also engaged our students with some questions on the history of ACCA and rewarded students with some gifts and goodies.

We, from the School thank ACCA for their contribution and support in ensuring the smooth flow of a successful event.

UNIQUE RISKS IN ISLAMIC BANKING AND FINANCE

NUR AZAM ANUARUL

PROGRAMME LEADER & LECTURER

Risk is an exposure to uncertainty; it may or may not happen and the only thing certain about risk is that its occurrence will lead to a negative consequence such as financial loss or reputational damage. Risk therefore can be defined as a threatening element that leads to the probability of an adverse outcome. If this threat materialises, it could negatively affect the performance of a financial institution; in extreme cases, it may even threaten the solvency of the institution. To avoid these catastrophic consequences, a bank (or any organisation for that matter) is required to take calculated risks by managing their exposure to those threats. Managing the threats however, will not totally eliminate the risks. Something adverse that will certainly happen is no longer considered a risk; it will instead be called a constraint. Risk management is not an effort to eliminate risk, it is instead an attempt to optimise of the risk reward trade-off and to prepare the bank to face the unfavourable situation if the risk materialises. The competitive advantage of a bank is therefore dependent on how well it manages risk.

Risk management is an analytic discipline with four parts; assessment, management, communication and control. Risk assessment is the first stage in managing risks where the potential threats are identified. Once the threats are identified, alternatives to mitigate the risks will be evaluated and initiated, policies and guidelines are drawn up, to prepare the organisation in the event the risks materialise. The third stage of risk management is to communicate the policies to the whole organisation, it's crucial that everyone in the organisation is aware of the risks and understand the mitigation methods. Finally, once all the risk mitigation measures are in place, the risks are monitored and the policies are reviewed to ensure new threats are identified and mitigation methods are kept up-to-date and effective.

Islamic financial institutions face similar risks as their conventional counterparts such as credit risk, market risk, liquidity risk and operational risk and therefore apply similar risk management methods. However, there are additional risks that are unique to Islamic Banking which are not present in conventional banking operations; Shariah non-compliance risk and displaced commercial risk.

Shariah Non-compliance Risk

The risk of Shariah non-compliance arises when banks fail to fully adhere to Shariah guidelines in designing and marketing products and services. This can be found in three main areas; product specification, process and documentation.

Islamic banking and finance products are based on Islamic trade and financing contracts and the risk of non-compliance arises when the terms and conditions of the contract is not fully observed in designing the product or service. For example, a Mudharabah based product cannot have a predetermined pay-out rate; the contract stipulates that only the profit sharing ratio is predetermined and any pay-out will be based on actual returns which will be distributed based on the pre-agreed ratio. The contract further prescribes that capital cannot be protected and the capital provider faces the risk of losing part or all of the capital if the investment fails. Given this preconditions, any Mudharabah based product that provides a fixed and predetermined rate of return or promises capital protection will be in contravention of the rules set by Shariah for Mudharabah contracts and would be classified as a non-compliant product.

Another example of Shariah non-compliance is when banking products and services are marketed using methods which are not approved by Shariah such as using inappropriately dressed models in the advertisements. The products and services may adhere fully to the rules of Shariah but if the method of marketing does not, strictly speaking, it would still be rendered non-compliant, albeit on a lesser scale. The risk of not complying with the rules of Shariah when designing products and services will have huge negative consequences to the financial institution, exposing it to potential financial as well as non-financial loss. Non-compliance will result in reputational damage which will lead to the loss of customers. The financial institution may also face lawsuits for selling products and services which do not comply with Shariah rules and regulators will take action against the bank which could further damage its reputation and drive more customers away.

Accounting was the course that helped me more than anything.

Displaced Commercial Risk

Displaced commercial risk is a unique risk only found in Islamic banks particularly those operating in a dual banking system. It is the risk of the Islamic bank having to pay their investment account holders more than the actual earnings of the invested assets. Islamic banks may find themselves in this situation due to commercial pressures and as a result are forced to forgo a portion or in some case, all of its share of profit in order to prevent customers from withdrawing their funds. Displaced commercial risk is something very difficult to manage in the current Islamic banking environment as it runs on a conventional platform and hence are governed to a certain extent, by conventional banking norms, including rates of returns.

This risk can be mitigated and is managed through the use of Profit Equalisation Reserve (PER) accounts where a portion of the bank's share of profits is put aside in this account for future use. The funds in the PER account will be used to compensate Islamic banking depositors when the actual returns on a profit and loss sharing investment account is lower than the conventional banking's rate of return on deposit accounts.

Another tool used to manage displaced commercial risk is the Investment Risk Reserve (IRR). The IRR is set aside from the part of profits allocated to investment account holders based on the applicable profit share ratio. Such a reserve belongs to the investment account holders and may be used only to absorb losses other than those due to misconduct or negligence incurred by a profit and loss sharing investment account.

The practice of PER and IRR ended with the enactment of the Islamic Financial Services Act in 2013. The new act which replaces the Islamic Banking Act 1983 stipulates that banks cannot compensate investment account holders in cases where the returns on their profit and loss sharing accounts falls short of expectations or is lower than the corresponding returns paid by conventional banks. The provisions in the new act effectively eliminated displaced commercial risk and at the same time minimises the Shariah non-compliance risk by ensuring core conditions of the Shariah contracts are adhered to.

Conclusion

Shariah compliance is the core requirement of the Islamic banking and finance industry and is the main factor that differentiates Islamic banking from conventional banking. The nature of the Islamic banks' balance sheet and the need to comply with the rules of Shariah presents additional risks to the banks. It is therefore crucial to identify and manage these unique risks to ensure acceptance, validity and enforceability of the trade contracts used in Shariah based financial transactions.

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FINANCIAL INNOVATION: RISK AND REGULATION

Hafinaz Hasniyanti & Ng Hui Chen
Lecturer

Overview of Financial Innovation

Over the years, there has been a massive amount of innovation in the provision of financial services in order to remain competitive especially in the era when there are new global trends and changes. These changes in global economic condition , technology advances, competitive landscape and stakeholders' requirement. Apart from that, the public are also one of the factors that spur the growth of financial innovation as they are relentlessly looking for ways to maximize returns along with minimize risk. The term 'innovation' is defined as the action of introducing new methods, products, ideas, services and etc. Financial innovation can be described as an ongoing process whereby private parties try to differentiate their product and services to respond to sudden and gradual changes in economy (Casu et. al, 2006). It includes action of creating and marketing new financial instruments as well as new financial technologies, markets and institutions. According to Case et. al (2006), financial innovation can be classified into three categories as follows:

Category	Details
Financial system/ institutional innovation	This type of innovation can impact the whole financial sector. It involves changes in the structure of the financial sector such as establishment of new types of financial intermediaries, or to change in the legal and supervisory framework.
Process Innovation	This type of innovation relates to the introduction of new business processes leading to increased efficiency or market expansion. Process innovations are often associated with technological progress. The example of process innovations are online banking, telephone banking and also new innovation implementation of science and technology in the financial field.
Product Innovation	Product innovations are the introduction of new or modified financial services, such as new credit, savings, insurance, leasing, hire purchase or other financial products. Such innovations are introduced to respond better to changes in market demand and better efficiency.

The aim of many financial innovations, including those most heavily implicated in the crisis, has been to intermediate risks between market participants. The risks of financial innovation for different client types take time to emerge and may be ill-understood by financial services providers, regulators and clients. At worst, providers with profit-seeking motivations may take advantage of investors with relatively limited knowledge (World Economic Forum, 2014).

Factors that drive Financial Innovation

Technology

The invention of information technology has altered many aspects of the financial sector. The financial sector now is heading the stage of greater efficiency that ultimately stimulates the growth in the economy due to the rapid innovation. For instance, the creation of ATM has reduced the processing time for the customers which lead to improved efficiency and greater customers' satisfaction. For banks, they could cut down on their operating costs. Apart from that, technology innovation introduces automated channel that allows face to face contact between customers and banks' staff such as video banking. Customers can experience efficiency together with personal contact with this new introduction. In addition, people's requirements and expectation changed with the advent of information technology. For example, young people or working adults tend to use online banking compared to visit Financial institutions have to keep up with the latest trend in order to remain relevant and competitive.

Regulation

The financial sector is undergoing dramatic change as a result of deregulation. According to Rose–Hudgins (2013), the deregulation in a number of nations and international treaties open up new financial service opportunities. For instance, the federal government in US liberalized the financial sectors by allowing nationwide acquisition of the American banks by holding companies. However, in recent years, the regulations on financial sector especially banking industry are getting stricter. Banks are required to comply with tones of regulatory rules such as Basel Requirement, Anti-Money Laundering and Financing of Terrorism Act, Dodd Frank Act in US and etc. These regulatory rules are giving the banks hard time in compliance and risk management. Banks squeeze their credit lending business due to the higher cost of capital. Consequently, shadow banking garners stronger footprint in financial sectors.

Customers' Needs

Products and services exist to fulfill the needs and requirements of the people. Likewise, financial innovation is created to respond to the needs and demands of the users. Fundamental needs of the users of financial products include financing of public and private ventures, transferring the funds securely, risk reallocation, facilitation of savings and investment. Robert Shiller has made a strong argument that financial innovation should be deployed to manage the society's largest economic risks. Shiller suggests that the most powerful drivers of financial innovation, the desire to reduce income volatility and insure against adverse events. In fact, the concept of hedging is not new in the market. It can be traced back to as early as 2000 BC when Chinese farmers and merchants were selling the rice for future delivery. The farmers then engaged into forward transactions in order to ensure that there will be market for their future harvest. On the other hand, the merchants would get the rice at specific quantity and price.

Risks of Financial Innovation

Financial innovation has been blamed for the spark of financial crisis in 2007. Most experts concur that financial innovation is one of the significant factors that contributed to financial crisis alongside other fundamental factors such as cheap credit, global macroeconomic imbalances, excess leverage and governance and regulatory failings (World Economic Forum, 2012). The innovative financial instruments namely mortgage backed securities, asset backed securities, collateralized debt obligations, credit default swaps and etc were identified as the drivers of financial crisis. These instruments are complicated and less transparent to the customers. On top of that, it could be easily abused by irresponsible parties for their personal advantage. Apart from the above, banks could also encounter the following risks as a result of financial innovation.

Risk of Out-dated Technology Technology changes every day. The banks may encounter the risk of investing in technology resources that become obsolete quickly. Before develop any new application or new system, banks have to undergo the 6 basic stages ie. Requirement analysis, system analysis, system design, coding, testing and implementation. The new system must be able to integrate into other system. All these processes are time consuming. Therefore, the technology may become outdated by the time of launching. Banks may possibly lose their investment injected into the project.

Regulatory/ Legal Risk As pointed out by Casu et. al, 2006, legal risk is related to the uncertainty on the laws and regulation on certain aspects such as legal status of remote banking, validity and proof of transactions, customer privacy and etc. Apart from that, banks may be penalised arising from violations of rules, regulation and non-compliance with internal policies or ethical standards. There is possibility that financial innovation may be further stimulated to circumvent existing regulations.

Operational Risk Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events (Basel, 2011). Banks often innovate with the use of technology. In view of this, banks could be caught with risks associated with system failure. They need to undergo major change and update of the operating environment.

Systemic Risk Financial institutions are interconnected with each other especially in the era of information technology. Information technology links the banks together. Banks often lend, borrow and invest in one another. Therefore, problems in one institution could easily be spread to the other institutions. A good example is the banks' liquidity problem. When one bank suffers from liquidity crisis, it can lead to a panic in banking industry. Customers would rush to withdraw funds out from the banks as they no longer have confidence in banks. The excessive withdrawal of customers could present great challenge to banks especially when banks practice fractional reserve banking. Systemic risk does not only confine to liquidity problem. This was proven when financial crisis in 2007 was triggered as a result of the failure of Lehman Brother.

Risk Management of Financial Innovation

Role of Regulators Financial regulation and supervision can help to increase the effective functioning of the financial system and main tain financial stability. The most important objective of the financial regulation is to promote the economy. For this reason, regulators must play their role in nurturing and developing sound and reliable markets, institutions as well as systems. On the other hand, innov tion in financial services also is a foundation of economic growth and enhanced living standards over the long run. While the financial crisis did emphasize risky consequences of innovation, there are still too many of innovative financial products and services available. Hence, this also means that the regulators should also play their important role in the financial crisis management and prevention as well. Cruana (2015) said that the role of financial regulator is threefold. First is to complete the reforms to repair the cracks in the system exposed by the global financial crisis. Second is to implement regulations consistently and third is to monitor evolving markets and evolving risks. The risks associated with innovation in financial services cannot be specifically addressed by any explicit financial innovation policy due to the fact that financial innovation embraces a vast range of inventions that come together with corresponding vast array of risks. Relatively, more focus should be at developing a well-equipped and flexible strong system to handle new and emerging risks.

The policy and regulatory environment is crucial if the regulated financial institutions are to offer innovative financial services. According to Bernanke (2007), central bank should strive to develop common, principles-based policy responses that can be applied consistently across the financial sector to meet clearly defined objectives in offering new financial innovations. He also mentioned that when proposing or implementing regulation, the central bank must seek to preserve the benefits of financial innovation although there are risks that may accompany the innovation.

Type of Regulation Regulation is of critical importance in shaping the welfare of economies and society. The objective of regulatory policy is to ensure that regulation works effectively and is in the public interest. There are three major categories of regulation as mentioned by White (1997) in his paper:

- Economic regulation – this encompasses direct controls on prices, entry, and/or exit, including the requirements. With respect to finance, this regulation would apply to any limit on interest rates that can be charged on loans or paid on deposits, limits on fees for other financial services and limits on entry by domestic or foreign enterprises.
- Health-safety-environment regulation – this encompasses restriction on production processes and product types and qualities. In finance, this form of regulation focuses on safety and soundness considerations that aims primarily to prevent the insolvency of banks and other depositories, insurance companies and certain kinds of pension funds. Regulation provisions with respect to corporate governance for publicly traded companies could also be considered as a form of safety regulation such as restrictions to the forms and methods of securities issuance and trading.
- Information regulation – this involves requirements that specific types of information be attached to products and services. The examples of information regulation in finance include requirement for the banks to provide standardized information on deposit rates and loan rates their to customers and requirement for insurance companies to provide standardized information as to terms and coverage to their insured clients.

These three categories are not mutually exclusive. It helps to organize the financial regulation into comprehensive packages and also relate the types of financial firms, the motives for regulation as well as the forms of regulation (White, 1997). The Porter hypothesis and the relevant literature indicate that environmental, health and safety regulation can induce dramatic innovations, not only by encouraging the development of new products or services by incumbent producers, but also by creating conditions in which new producers can enter the field (Ashford and Hall, 2011).

Innovation is a natural force in the competitive financial services industry and it is also necessary to meet the growing needs of its customers. Despite intermittent crisis and breakdowns, innovation has proved beneficial in many ways. Therefore, it is useful for the regulators to adopt a common principles-based policy that can be applied consistently across the financial sector to meet clearly defined financial innovation objectives.

In dealing with the challenges and the risks that financial innovation may create, we should also always keep in view the enormous economic benefits that emerge from a healthy and innovative financial sector (Bernanke, 2007).

Regulation of Financial Innovation

Consistent Regulatory Strategy

Any regulatory changes should fulfil the test of consistency, across both institutions and instruments. Rather than addressing specific institutions or instruments in isolation, regulators should begin by identifying their objectives and then address the implications of the broad range of financial innovations for those objectives. By returning to the basics, the bank can increase the coherence, consistency, and effectiveness of the regulatory framework. A consistent regulatory strategy needs to be tailored to the essential characteristics of institutions or instruments that pose risks for policy objectives, not to arbitrary categories (Bernanke, 2007). Caruana (2015) has highlighted four points about the need for more consistency regulation:

⇒ Risk sensitivity is the cornerstone of the prudential framework.

⇒ Evidence suggests that differences in supervisory and bank practices play a significant role in very inconsistent risk-weighted assets outcomes.

⇒ Transparency in the system's outcomes.

⇒ The ultimate test of regulator's efforts to promote greater transparency and comparability of outcomes is the stronger confidence in the framework on the part of market participants (bank stock analysts and investors in bank bonds).

Public Policy Objective According to Bernanke (2007), as public policymakers, there are three principal objectives in the financial field in which the objectives have remained essentially unchanged over many decades even as the pace of financial innovation has accelerated. These objectives are financial stability, investor protection, and market integrity. These goals are widely shared by policymakers around the world and thus provide a basis for international cooperation. The rapid movement of financial innovation creates challenges for policymakers with respect to each of these policy objectives. However, the objective to ensure financial stability still remains critical in central bank's view. In particular, financial stability also depends on adequate risk measurement and risk management by market participants. The policymakers or regulators cannot prevent the financial distress but they can try to mitigate the effects and ensure the system is fundamentally reliable. The recent vital public objective is on the investors' protection. Bernanke mentioned that a loss of confidence in the financial system by investors, too, could undermine the system's stability and functioning. Therefore, investors must be entitled to the information that they supposed to know in order to make decisions appropriate to their personal circumstances. They also must be allowed to bear the consequences of the decisions they make and the risks they accept. The stability and the efficiency of the market depend on a common understanding of and adherence to the preset rules. Thus, policymakers must attach a high priority to prevent insider trading, market manipulation, and other activities that mock up the rules and undermine public confidence in order to preserve the integrity of the market.

Risk-Focused Approach

A risk-based approach seeks to achieve real outcomes whereby it directs the resources to where the risk is greatest. It cannot be uniformly applied as each sector and firm faces different risks. This approach requires thorough understanding of current risks and places an importance of public-private information sharing. Bernanke (2007) mentioned that the investor protection can also be addressed in a risk-focused, principles-based manner. Most importantly, the disclosures and protections should be tailored to the level of sophistication of the investor. In addition, consistent with the principles-based approach, U.S. securities laws against insider trading and market manipulation apply broadly to all financial institutions, including hedge funds, and to trading in a wide range of financial instruments, including securities-based over-the-counter derivatives transactions.

Conclusion Financial innovation is neither a good or bad idea. Notwithstanding of this, it is impossible to deny the importance of financial innovation. It is a natural outcome that every business including financial industry has to undergo in order to be sustainable in the long run. In simple words, banking industry needs innovation. Having said that, we cannot deny the link of financial innovation with financial crisis. Therefore, the banking industry should be looking for a sustainable innovation that does not comprise the safety and soundness of financial system and economy.

FINANCIAL RISK MANAGEMENT AND IT'S EFFECTS ON SME

Lai Siew Fong, Lecturer

The National SME (Small and Medium Enterprises) Development Council (NSDC) has reviewed the definition of SME in 2013 and a new SME definition was endorsed at the 14th NSDC Meeting in July 2013. The following is the simplified definition:

Category	Small	Medium
Manufacturing	Sales turnover from **RM300,000 to less than RM15 million** OR full-time employees from **5 to less than 75**	Sales turnover from **RM15 million to not exceeding RM50 million** OR full-time employees from **75** to **not exceeding 200**
Services & Other Sectors	Sales turnover from **RM300,000 to less than RM3 million** OR full-time employees from **5 to less than 30**	Sales turnover from **RM3 million to not exceeding RM20 million** OR full-time employees from **30** to **not exceeding 75**

A business will be deemed as an SME if it meets **either one of the two specified qualifying criteria,** namely sales turnover or full-time employees, **whichever is lower**. The establishment of risk management system is essential to the survival of SMEs. It affects the ability of their continuation in business under this competitive environment.

The main types of financial risks are:

Credit risk: this is the risk of a financial loss to an organisation if a customer or counter party to a financial instrument fails to meet its contractual obligation. The organisation's exposure to credit risk principally arises from trade and other receivables.

Liquidity risk: this is the risk that the organisation will not be able to meet its financial obligation when it falls due. The organisation's exposure to liquidity risk arises mainly from mismatches of the maturities of financial assets and liabilities.

Interest rate risk: this is the risk that the value of the organisation may be affected through the changes in market interest rates. An organisation may be exposed to this risk through the borrowings and cash investment.

Foreign exchange risk: this is the risk that an organisation's value is affected by a change in foreign exchange rates if the organisation has sale or purchase transactions denominated in currency other than the functional currency of the organization.

Credit risk in SME

SME is particularly vulnerable to this type of risk when it relies heavily on small numbers of big customers to which it has given large amounts of credit. Some SMEs are facing prolong credits from their big customers to beyond 90 days. The challenges normally faced by SMEs are: increasing costs, intensified global competition, lack of expertise, minimal technological utilisation. These factors make SME difficult to become more competitive.

"We have no future because our present is too volatile. We have only risk management." **William Gibson**

SMEs may resort to the following measurements to assess their credit risk:

- Financial ratios: ratios like Accounts Receivable Turnover and Average Collection Period indicate the effectiveness of an organisation's credit policy.
- Exposure of credit: this is to measure the net outstanding amount due by a counter party at different points in time.
- Estimated rate of recovery: this is the estimation of percentage of an amount of the debt that can be recovered.

Credit risk may be mitigated by the following methods:

⇒ Credit policies: Clear and well defined credit policies with clear credit limits and credit terms setting would help the organisation to manage its debts. Once set up, these credit policies need to be complied and adhered to at all time. To be effective, the credit policies need to be reviewed regularly and changes may need to be made according to changes in marketing conditions and environment.

⇒ Credit evaluation of clients: vetting potential clients via credit reporting agencies may assist an organisation to select the credit-worthy customers.

⇒ Monitoring and reporting: regular monitoring of debtors ageing reports can assist in controlling the overdue amounts. Prompt highlighting of unusual collection patterns can provide avenue for appropriate corrective actions.

⇒ Enhance sales to broader customers: organisation may minimise the credit risk by extending sales to a broader customers' base instead of depending on the small numbers of big customers.

Liquidity risk in SME

It is very common for banks and financial institutions not to or reluctant to offer loans to SMEs due to their sizes and lack of appropriate collateral. Some SMEs have insufficient documents and lack of or without any financial track records.

Some SMEs do not have experience and well-trained staff in cash management techniques and hence sources of committed funding are not available as a buffer for unexpected requirements, to overcome timing differences or to accommodate short-term systemic fluctuation in cash flows.

SMEs may use the following financial ratios to measure liquidity risk:

◊ Current ratio which indicates the organisation's ability to pay its short-term debts.

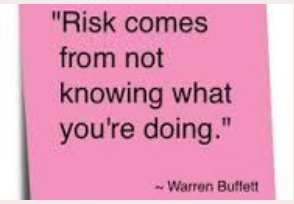
◊ Acid test or quick ratio which indicates the extent to which current liabilities can be paid immediately out of quick or liquid assets.

◊ Debts to gross cash flow which indicates the number of cash flow would be required to repay all debts assuming debt or equity rising.

◊ Times interest earned (or interest coverage ratio) which indicates the degree of risk to lenders that an organisation will default on its interest payments.

◊ Debts to equity which measures the degree to which the organisation's assets are financed by the debts and shareholders' equity.

◊ The unavailability of undrawn banking facilities as a percentage of current liabilities which indicates the existence of a buffer in case of unexpected cash requirements.



"Risk is a part of God's game, alike for men and nations."

SMEs can use the following to manage their liquidity risk:

Annual budget The person who has the responsibility for managing the cash should have responsibility for planning the cash flow and participate in the development of the annual operating budget. A well-prepared annual budget of gross cash receipts and payments for the financial year should include capital expenditure, acquisitions, tax payments, etc. and also the committed or uncommitted undrawn funding sources. Considerations of the worst case scenario and whether the organization could survive under those conditions should also need to be included in the annual budget.

Cash flow forecasts The daily, weekly or monthly cash flow forecast is required to be reviewed and reconcile to the operating plan and may need to revise frequently to reflect significant changes. Any unusual payments or changes in the amount and timing of the receipts need to be updated and communicated effectively.

Accounting system The accounting system should be able to gather information and generate reports as frequently as required and in a user friendly format that can assist the management to make decision.

Liquid assets All the liquid assets need to be monitored closely and constantly. Objectives and the policies of investing any surplus funds and the criteria for the use of short-term fund may need to be clearly defined.

Financing and funding Consultation with different banks or other sources of funding provide the avenue for updated market conditions and funding opportunities. Consideration of converting the unproductive or under-utilised assets into cash reserves may improve the liquidity ratios.

Good relationship with bankers It is advisable to have close relationships with bankers and keep them fully informed of the latest position of the business in terms of financial standing and operational activities. This will assist the organisation to obtain loans to meet contingencies when required.

Internal controls Adequate systems to monitor, measure and manage the daily collection and disbursement of cash and daily investment of cash can minimise the liquidity risk. To be effective, the internal control system over cash collection and disbursement, cash investment and liquid assets need to be assessed periodically.

Interest rate risk in SME

It is very costly and difficult for SMEs to obtain loans especially when interest rates of borrowing are going up. Many SMEs have the insight that they are not in the position to control and manage the interest risks. This is due to the lacking of awareness in measurement tools and methods in handling interest risk. They may not have the opportunity to obtain the updated information on market condition and the latest products that are available in the market.

Interest rate risk may arise from:

- if there are changes in interest rates relating primarily to the organisation's cash deposits with licensed commercial banks and investment banks.
- if there are changes in interest rates of borrowed funds.
- if there are changes in interest rates in short-term investments.

The following methods may assist SMEs to measure the interest rate risk:

* Simple sensitivity analysis: measures the impact of small changes of interest rates on accounting income or economic value.
* Advanced sensitivity analysis: measures the impact of multiple changes in interest rates and other related variables on the organization's financial health.
* Stress test: measures the impact of a large change in interest rates on borrowings or investments in accounting terms or risk outcomes.

***"If you don't make mistakes, you're not working on hard enough problems. And that's a big mistake."* — Frank WIlczer 2004 Nobel Prize winner in physics**

SMEs may mitigate interest rate risk using the following methods:

- To arrange with lender on fixing the interest rate of the loan obtained for the entire period of the loan.
- Mixture of fixed and floating rate debt with a range of maturity in the liability portfolio.
- Interest rate swaps: this agreement allows the borrower with a fixed interest rate obligation to swap for a floating interest rate, and vice versa.
- Interest rate options: this agreement allows the holder the right to either buy or sell a financial instrument at a rate determined by the interest rates in the future.
- Forward rate: fixing the interest rate that will apply to a loan or deposit commencing on a given future date.
- Cross currency swap: this allows the exchange of principal and interest payments in separate currencies.

Foreign currency risk in SME

Foreign currency risk becomes more critical when there are fluctuations in exchange rates between currencies especially for SMEs which have transactions that deal in more than one currency.

SMEs usually have little knowledge or expertise in measuring the foreign currency risk and they may not be aware of the various methods to manage this risk which results in high cost and low profits.

Foreign currency risk can be measured in the following ways:

⇒ Record of foreign currency exposures

⇒ Forecasts or projections of foreign currency inflows and outflows

⇒ Sensitivity analysis: to measure the potential impact on the business of an adverse movement in exchange rates.

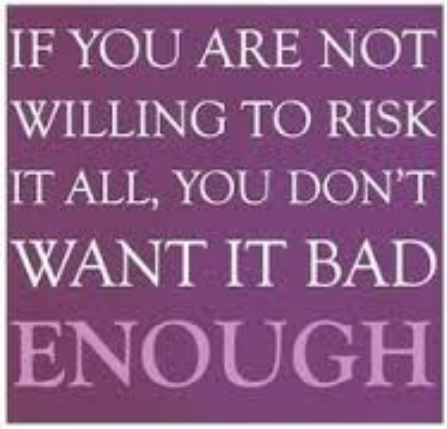
⇒ Probability of currency moments.

Once identified and measured the potential exposure, SMEs may need to set the acceptable level of the risk before using various methods to manage the risk. Methods available for SME to manage foreign exchange risk are:

* Foreign Exchange Forward Contract: this contract allows buying or selling a certain amount of foreign currency at a pre-agreed rate, on or before a pre-agreed date.
* Foreign Exchange Option: this provides the right to the holder to buy or sell currency at a specified rate during a specified period of time.
* Currency hedge: to arrange the inflow and the outflow of the foreign currency at exactly the same time.
* Foreign currency bank accounts: to deposit any surplus foreign currency in this foreign currency account for later foreign currency purchases or payments.

Conclusion

It is important for SME to understand the elements of financial risks, the extent of their exposure to each risk, and the options that are available to manage such risks. This knowledge enables the SME to manage the financial risks effectively and in turn will boost up their profitability and be able to sustain in this rapid changing global business environments.



FRAUD RISK ASSESSMENT

GEETHA A RUBASUNDRAM

After the collapse of high profiled corporations due to fraudulent activities, many organisations, and stakeholders around the world have focused their efforts to minimise the risk of fraud within their organisations. Fraud is an intentional act designed to deceive others, resulting in the victim suffering a loss after relying on the deceit and the perpetrator achieving a gain. There are many types of fraud, which can be perpetrated by parties external to the organisation, as well as internally.

This article focuses on Occupational Fraud. Occupational Fraud can be defined as the misuse of one's occupation in order to achieve personal enrichment through the deliberate misuse or misapplication of the employing organizations resources or assets. Perpetrators of fraud can be committed by anyone within the firm, regardless of position and stature. However, studies have shown that it is usually the long term and highly trusted employees that violate the position of trust given to them.

The Fraud Triangle states that there are three factors that explain to why an employee in a position of trust would violate the trust. One factor is whereby an **Opportunity** presents itself in terms of perhaps non-existent or poor controls or lack of fear of being caught, the other **Rationalisation** that the fraudulent act was justified i.e. it could be that the employee feels that he / she deserves the extra money due to hours or efforts put in. **Motivation** based on need or greed. The Fraud Triangle has developed overtime. We now have various models such as the Fraud Diamond, The New Fraud Triangle and the New Fraud Diamond. However, this would be discussed in subsequent newsletter articles.

Keeping that in mind, here are some general red flags to look out for:

- Employees whose lifestyle does not match their earnings or facing financial difficulties
- Possible management over riding of controls
- No separation of duties and proper checks in place for typical daily operations
- Employees who prefer not to take vacations
- Missing reports or documents including those for expense claims, bank accounts including trustee accounts etc.
- Circumstances where there is a conflict of interest between the employees role and outside business interests, especially in relation with key personnel of the firm.

Management can never completely wipe out the risk of fraud, but can only focus on reducing the threat of fraud by instilling a culture and adherence to internal controls by having a clear policy. Both rationalisation and motivation are more personal to the perpetrator, and it is difficult to clearly identify methods of prevention based on that. Hence, it is easier to focus on creating internal controls to eliminate the opportunity to carry out fraudulent activities.

Internal Controls, when applied properly to all departments and processes in the firms, only serves to ensure that the firm runs more efficiently and effectively. However, the firm should ensure that it does not overdo the implementation of controls which may lead to higher cost and bureaucracy. The norm would be to actually identify the risk appetite of the firm, identify the possible fraudulent activities or opportunities (based on the typical breakdown of fraud into financial reporting fraud, asset misappropriation and corruption) which may prevail in the firm and assign the ranking of risk based on possibilities and impact. Those opportunities with high impacts and high possibilities should be focused on first. By carrying out this exercise, the management might be able to improvise the processes and documents involved as well as being more in touch with the business aspect of the firm as a whole.

Risk models only have value if they are used effectively in combination with a limit management and control process.

As can be seen in the above suggested controls, the role of management is important to ensure the success of the anti fraud controls and policy. Management should ensure that there is proper oversight of all operations and departments and should not leave the control to one or two individuals in case of collaborations. By having a clear, written and stringent policy in place, employees are made aware of the policies and gradually with training and implementation, the right culture and ethical behaviour could be built within the firm. This should include a reporting mechanism and whistle blowing mechanism which supports and protects the whistle blower from any reprisals. However, a reporting programme is only successful if there is a proper follow up on the accusations of irregularities, as otherwise it would be seen that management is not serious about the entire program. Employees could also be asked to sign non-disclosure agreements or agreements to denote their cooperation, understanding and agreement in combating fraud within the firm. When there is physical proof of this, employees tend to take the fraud detection and prevention program more seriously as well.

Being proactive is much better than being reactive. Know the person that is being employed in the firm. Carry out background checks on new employees and proper reference checking. Existing employees should also be checked on, for any changes in behaviour or lifestyles. There are many red flags and controls that can be implemented for a firm, but note the significance of a cost benefit analysis. A flexible approach is recommended when analysing the controls that should be in place, as each firm will have its own processes and procedures which may differ with another. However, by following the general guidelines provided in this article, the risk of fraudulent activities in the firm may reduce significantly. It is noted that reviews of the Internal Controls in place should happen periodically, as eventually there maybe changes to the environment or employees could also note the lack of the management's seriousness in curbing fraud. Management should reiterate its commitment to the anti-fraud program periodically as it is believed that employees who know their employers take the culture and ethics seriously, as well as has strong controls and restrictions in place maybe less likely to attempt to commit fraud.

To summarise, the following steps can be taken to carry out a Fraud Risk Assessment:-

⇒ Set goals, objectives and the fraud risk appetite of the organization.

⇒ Carried out brainstorming activities, process mapping, necessary checks, audits & tests and discussions / interviews with other personnel to understand the following:

* The organizations environment, management, business, departments, processes , functions and owners
* Potential fraud scenarios and schemes, taking into account red flag areas such as management override of controls and personnel who may have the three factors identified in the Fraud Triangle – Opportunity, Rationalization and Motivation
* Identify the categories required and assess the likelihood and impact of the fraud schemes accordingly
* Based on the above, do a review and gap analysis of the current controls in place and any additional or revised controls needed, in line with the organizations risk appetite and decided risk strategy
* Implement and monitor controls with periodic evaluation

"A good rule of thumb is to assume that "everything matters." Richard Thaler

The Fraud Risk Assessment can be then tabled in a Fraud Risk Matrix, as per the sample below:-

FACTOR / RISK AREA	DEPT.	LIKELI-HOOD	IMP-ACT	INTERNAL CONTROLS IDENTIFIED
CORRUPTION				
Conflicts Of Interest				
Purchases Schemes – Items purchased at a higher price from a company in which one of its employees has a hidden interest.	C&P	High	High	Ensure strict policy of disclosure of any positions of conflict of interest. Monitor repeat orders Compare with market prices and current vendor's Review of vendor file
Bribery – Kickbacks & Bid Rigging Schemes				
Kickbacks to senior management / employees by a supplier receiving favourable treatment	C&P	High	High	Clear anti bribery policies including reporting of receipt of gifts.

For further reference on this topic, please refer to a journal article published by the author :-

RUBASUNDRAM, GEETHA (2014), *Fraud Risk Assessment: A Tool For SME's To Identify Effective Controls*. Research Journal of Accounting & Finance

http://iiste.org/Journals/index.php/RJFA/article/view/14795

ENTERPRISE RISK MANAGEMENT FRAMEWORK

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Risk Management is not a new concept to Management whilst in fact Risk Management has been in existence from beginning of world trade. Risk Management has evolved significantly in the last few years as a result of fraudulent financial reporting and mismanagement of enterprises. This led to the development of COSO Framework that emphasize on independent report on fraudulent financial reporting and developed recommendations. Hence organizations begin to see the importance of Risk Management in managing their business risks.

Risk Management framework has evolved further into integrated framework known as COSO ERM Framework. The Enterprise Risk Management Framework (ERM) has broadened the coverage of risk in the organization. ERM is a systematic and structured way of aligning an organization's risk with its strategy.

Enterprise Risk Management has eight fundamental concepts and four objectives of enterprise wide to achieve and enable the enterprise to manage its risk effectively. The fundamental concepts and objectives of the enterprise wide are discussed in detailed below. Enterprise Risk Management can incorporate Management Models/Tools to enhance the Risk Management Exercise.

Enterprise Risk Management has been implemented by business entities and Risk Management exercise is carried out on yearly basis to assess the risks. The exercise has been conducted on a half yearly basis, with the Corporate Risks assessed on a quarterly basis to better managed and control over the risks that facing the entity as a whole. All risks faced by business entities have been identified and reported to the Management for their attention.

Risk Management exercise does help the Management to achieve and manage its objectives. Enterprise Risk Management does not ensure the organization's success, no matter how well Risk Management exercise is designed and operated. Enterprise Risk Management does have its limitations due to management processes, human factors, resources available and cost incurred in implementing Enterprise Risk Management Framework.

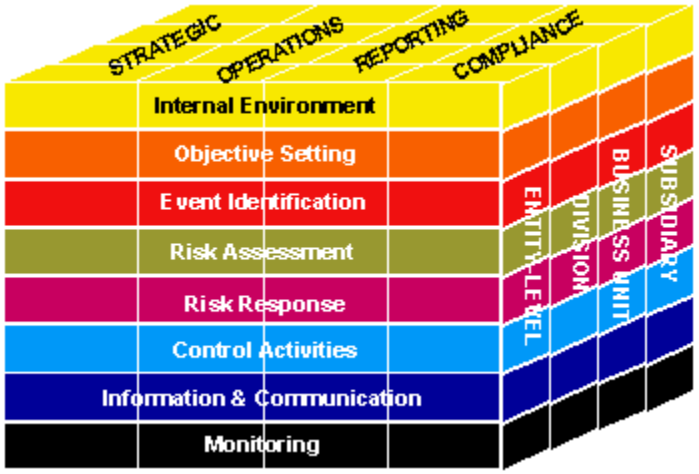
Enterprise Risk Management (ERM) is the way forward to manage the organization in globalized world due to rapid change in information technology, industry regulations, restructuring of the organizations, changing markets and economic competitiveness.

COSO - Introduction

COSO was originally formed in 1985 to sponsor the National Commission on Fraudulent Financial Reporting (commonly known as Treadway Commission), an independent private sector initiative which studied the causal factors that can lead to fraudulent financial reporting and developed recommendations for public companies and their independent auditors, for the SEC and other regulators, and for educational institutions.

Issuance of COSO ERM – Integrated Framework

The COSO Enterprise Risk Management - Integrated Framework, issued in September 2004, defines ERM in broad terms that underscore some fundamental concepts and provides a common language as well as guidance on how to effectively manage risk across the enterprise.



Definition of ERM

"ERM is a process, affected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage the risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objective."

Components of COSO ERM Framework

Business entities endeavour to ensure that the ERM implementation is in accordance with the ERM best practices is on going, as part of its objective to provide quality services, in tandem with the Company's aspirations. There are 8 components and strategy objectives of COSO Framework as follows:

Internal Environment **–** The internal environment encompasses the tone of an organization, and sets the basis for how risk is viewed and addressed by an entity's people, including risk management philosophy and risk appetite, integrity and ethical values, and the environment in which they operate.

Objective Setting **–** Objectives must exist before management can identify potential events affecting their achievement. Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.

Event Identification **–** Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities. Opportunities are channeled back to management's strategy or objective-setting processes.

Risk Assessment **–** Risks are analyzed, considering likelihood and impact, as a basis for determining how they should be managed. Risks are assessed on an inherent and a residual basis.

Risk Response – Management selects risk responses – avoiding, accepting, reducing, or sharing risk – developing a set of actions to align risks with the entity's risk tolerances and risk appetite.

Control Activities – Policies and procedures are established and implemented to help ensure the risk responses are effectively carried out.

Information and Communication – Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.

Monitoring – The entirety of enterprise risk management is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations,

Entity's Objectives

Entity's objectives can be viewed as four major categories:

- Strategy is relating to high level goals, aligned with and supporting the entity's mission and vision statement.
- Operations is relating to effectiveness and efficiency of the entity's operations, including performance and profitability goals. They vary based on management's choice about structure and performance.
- Reporting relates to internal and external reporting and may involve of financial and non-financial information. Reporting mechanism will determine the effectiveness of the entity.
- Compliance relating to legal and regulatory framework that entity must compile with applicable law and regulations.

ERM Framework

Components	Factors
Internal Environment	Risk Management philosophy.
	Risk culture.
	Board of Directors.
	Integrity and ethical value.
	Commitment to competence.
	Management's philosophy and operating style.
	Risk appetite.
	Organizational structure.
	Assignment of authority and responsibility.
	Human resources policies and practices.
Objective Setting	Strategic objectives
	Related objectives
	Selected objectives
	Risk appetite
	Risk tolerance (Acceptable Variations)
Event Identification	Events
	Factors influencing strategy and objectives.
	Methodologies and techniques
	Event interdependencies
	Event categories
	Risks and opportunities
Risk Assessment	Inherent and residual risk
	Likelihood and impact
	Methodologies and techniques
	Correlation
Risk Response	Identify risk response
	Evaluate possible risk response
	Select responses
Control Activities	Integration with risk response
	Types of controls activities
	General Controls General controls are non IT control e.g. Signature verification process.
	Application Controls Application controls are IT controls. Application controls are design to ensure completeness, accuracy, authorization and validity of data capture and transactions processing.
	Entity specific

"The first step in the risk management process is to acknowledge the reality of risk. Denial is a common tactic that substitutes deliberate ignorance for thoughtful planning."

Management Models / Tools

Enterprise Risk Management can incorporate many Management Models/Tools to conduct Risk Management exercise. However, Business entity does not make use of such Management Models/Tools in Risk Management Exercise.

Management Models/Tools are as stated below:-

- P.E.S.T. Analysis – Political, Economic, Social and Technology.
- S.W.O.T Analysis - Strength, Weakness, Opportunities and Threat.
- Five Forces Model by Michael Porter
- Value Chain Analysis.

By incorporating these Management Models / Tools will enhance the Risk Management exercise as conduct by business entities, to identify all the risks faced by these business entities.

Enterprise Risk Management can be enhanced further by developing Management Tools to manage and to have better control over the risks that identify and faced by the business entity. However business entities further enhance by Management Tools to monitor the risks that are identified during Risk Management Exercise. Management can monitor these risks using the following Management Tools.

- Key Performance Indicators (KPI)
- Key Results Area (KRA)
- Balance Scorecard (BSC)

Business entities can monitor risks by holding monthly/ quarterly/ half yearly Management meetings. The business entity prepares Management Committee Meeting (MCM) monthly report that indicates the monthly performance of the entity. To further enhance the monthly reporting process, the entity prepares the productivity report which highlights throughput by business activities of the entity.

Conclusion

Risk Management exercise is valuable management tool that Management can use to assess the risks that are faced by business entities. Risk Management exercise does have its advantages and disadvantages in implementing the Risk Framework.

Risk Management has been implemented by business entities, this is definite forward move in managing its operations in globalize economic environment and managing its businesses risks.

CREDIT RISK MANAGEMENT IN COMMERCIAL BANKS

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It has become essential for commercial banks to manage the risks, which are faced by them, in order to estimate its affects and to know how to minimize it. Credit risk management is the most frequent type of risk assessment methods which has been used over the past decades in each and every bank whether it is a commercial bank or a public bank.

Credit risk management affects the performance of the commercial banks in many different aspects. It is essential for commercial banks to identify the relationship between credit risk management and its performance, in order for it to avoid any crisis and to increase or maintain its performance.

Commercial banks have always been one of the major sources of income and economy growth for any country (Funso, Kolade, and Ojo, 2012). Its role is considered important, since it is one of the major fundamental aspects of the financial market (Aghababaei, Ataei, and Azizkhanai 2013). Commercial bank is an institution which will provide several financial services, which include receiving deposits of money, issuing money in various forms, processing transactions, and lending money. Credit creation or issuing of loans is considered the most major source of revenue in commercial banks, as a result of that credit risk will approximately take almost 70 percent of the entire risk in commercial banks. This is an indication that credit risk management is the most important type of risk management in commercial banks (Abiola and Olausi, 2014).

Credit risk management is one of the structured methods used in order to manage uncertainties through assessing the risk, developing of strategies in order to manage it, and mitigate the risk using managerial resources (Afriyie, and Akotey, 2012). Credit risk is defined as the existing possibility that a borrower will fail to meet the obligation of the outstanding loan, due to credit events (Abiola and Olausi, 2014). Credit risk management is considered important to commercial banks, as it is a complete part of credit creation. Credit risk management will minimizes the bank risk and maximize the adjusted risk of the rate of return by maintaining credit risk exposure (Fredrick, 2012). Credit risk management could affect the performance of any commercial bank in terms of managing loans, which is the major source of revenue in commercial banks, thus increasing the profitability level. It also could add value to the shareholders, and attracting more clients for the commercial bank, which will influence the commercial bank's performance. So, it is important to understand the relationship between credit risk management and the performance of the commercial banks in order to know how to increase that performance and maintain it.

"Risk varies inversely with knowledge"

Credit risk management

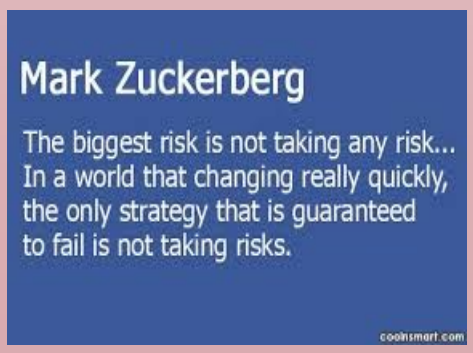
Credit risk management is an important core in any financial institution. Credit risk management in banks is the result of the risk, which arose when a bank construct an agreement with a borrower, in which it is stated that the borrowers will receive a valuable asset from the bank in terms of money and agrees to repay that amount of money at a period of time (Tefera, 2011). Credit risk arises from non-performance by a borrower, in other words the unwillingness or inability of the borrower to pay the amount, which the banks lend to him. Commercial banks manage the credit risk through measuring, identifying, controlling, and monitoring the risk in terms of different aspects to ensure that the risk will not exceed a specific limits and the rewards will be higher than that risk (Tsorhe, Aboagye, and Kyereboah-Coleman, 2011).

Credit risk management principles

According to Basel Committee on Banking Supervision, credit risk management involves five main principles. The first principle is to establish a clear credit risk management environment. The second principle is to operate a sound credit granting process. The third principle is to maintain a suitable credit measurement, administration, and monitor process. The fourth principle is to ensure that there is an adequate controls regarding the credit risk. The fifth principle is conduct supervisory actions in terms of identifying, monitoring, measuring, and controlling the credit risk as an overall credit risk management approach (Ghosh, 2012). Those principles are set in order to measure the risk factors, to define techniques in order to manage those risk factors, to limit those risk factors to the most acceptable level, and to encourage the authority, who are responsible for decision making, to make a decision in order to manage the risk in a way which is consistent with the commercial banks' objectives and goals (Afriyie, and Akotey, 2012).

How credit risk management works

Credit risk management manages the most significant type of risk in terms of potential losses and size. In banks the extension of credit has been always the core operation within it, which explains the reason why credit risk management is considered to be the focus area of managing the risks in banks. Credit risk management in commercial banks is usually applied to the investment portfolio and bank loan. In order to manage the credit risk, commercial banks must follow up the credit commitments, through monitoring and reporting their process. This will allow the commercial bank to make credit decision, which is mainly based on the judgmental assessment and the financial data of the markets outlook, management, shareholders, and borrowers. When constructing the policy of credit risk management the commercial bank should consider major factors that limit the organization risk exposure. Those factors are influenced by the board of the directors, the expected returns from having that risk, the availability of the capital in order to deal with the losses of the risk, and the objectives and business strategies which were established by the bank (Hosna, Manzura, and Juanjuan, 2012).



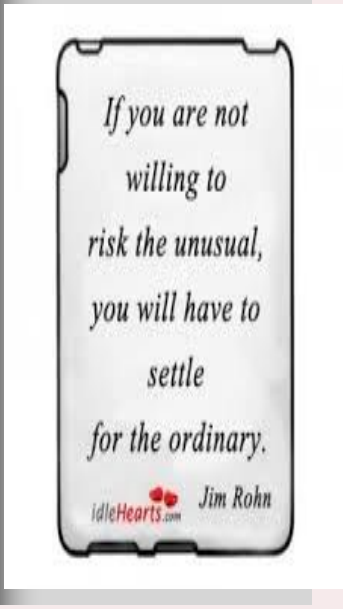
Credit risk management involves risk assessment which should be conducted before providing any sort of loan and at least on annual bases. This assessment will provide in the Credit Application, which originates from the relationship account officer. Through the assessment process of the credit risk the details of the purpose of the loan, the amount of the loan required, the loan structure, the borrowers historical financial position analysis, the industry analysis, and the security measures regarding paying the loan analysis must be identified (Apostolik, Donohue, and Went, 2009),

Credit risk management Strategies

In order for commercial banks to minimize or avoid the adverse effects of credit risk management, they need to practice some measures which are known as credit risk management strategies. The major principles in credit risk management strategies phases are the allocation of responsibility, establishment of clear structure, prioritize and discipline of the processes, and clearly communicate the responsibilities and accountabilities which were assigned. Under credit risk management strategies, commercial banks will consider credit derivatives, credit securitization, compliance to Basel Accord principles, adoption of the policy of sound internal lending, and comply with the credit bureau in order to maximize the efficiency of credit risk management (Funso, Kolade, Ojo, 2012).

Components of credit risk management

Managing the credit risk in commercial banks involves managing three components of credit risk, which are transaction risk, intrinsic risk, and concentration risk (Horcher, 2005). Transaction risk is a type of risk which focuses on the volatility in terms of credit quality along with the earnings, which results from the banks' measurements in underwriting the loan transaction for an individual. It consists of three dimensions, which are underwriting, selection, and operation. Intrinsic risk is a type of risk which focuses on the risks that are inherent in certain business as well as loans provided to certain industries. Intrinsic risk focuses on the sensitivity of business or industry towards predictive, historic, and lending risk factors. Concentration risk are a type of risk which arises from the accumulation of the transaction as well as the intrinsic risk within a portfolio, which may result from providing loan to a borrower or industry.



RISK MANAGEMENT IN HIGHER EDUCATION

Suresh Balasingam

Programme Leader & Lecturer

The necessity to manage risk is extensively recognized throughout the corporate world, and a well-built body of knowledge is available to monitor efforts to do so. Execution of principles into practice, however, is varied; often do not just to a lack of the right skills, but also because of lack of commitment from senior management in higher education institutions. According to the 2011 AON Global Risk Management Survey, the top three risks for higher education are ranked as follows:

⇒ Regulatory and legislative changes

⇒ Economic slowdown

⇒ Damage to brand or reputation

Higher education institutions must conduct fragmentary assessments of risk and control systems and use audits to gauge the effectiveness of existing controls. Risk managers should assess risk on a broad scale, ascertaining the root causes of existing hazards, correlating those causes to existing controls, and holding departments and employees accountable for effective implementation of controls. Once risks are identified, the organization must take appropriate action. By evaluating new exposures, higher institutions can design and implement effective controls before incidents occur.

The top management of higher education institutions must recognize the significance of risk management in care of their organizations safe and financially health, and their school's reputation immaculate. The top management team should comprehend the risks their organization faces and play a part in creating priorities for the risk management plan. The team's awareness of risk, and their understanding of the university's current abilities to manage those risks, will help them in making assessments that are directly or indirectly related to loss potentials. In many cases, a Risk Management Executive Steering Committee provides the venue for campus leadership to be involved with establishing priorities, direction and commitments for the risk management process (Bubka, 2010).

According to Forbes, there are top ten risk management issues faced by higher institutions in the year 2014.

In executing risk management, governance, policy and procedures for predicting, evaluating and managing risk are very vital. According to the International Risk Governance Council (2005), risk governance includes the totality of actors, rules, conventions, processes and mechanisms and is concerned with how relevant risk information is collected, analyzed and communicated, and how management decisions are taken. Within this definition, it entails organizations to evidently define how strategic decisions are made taking into consideration of risks, risk management framework, role and responsibility, structure and governance with regard to organizational wide risk management implementation. It also involves stipulating assurance and involvement of pertinent parties and mandate to be given to those who are directly and indirectly involve in the risk management implementation.

According to Eduventures (2014), higher education is facing more critique than at any other point in recent history. From the college scorecard to President Obama's focus on the affordability of a college education, 2013 was the year during which higher education, as a whole, went under the microscope. To stay competitive and to thrive in the current higher education landscape, it is critical that college and university leaders prioritize, focus, and evolve their operations and their offerings. There are five critical risk management issue that faced by the higher education leaders in the year 2014.

* The continued scrutiny of higher education
* The prioritization of outcomes
* The retention culture
* The blended learning opportunity
* The regionalization of online higher education

Institutions in the higher education are moving from achieving technical compliance with the related authorities and regulators and are now looking to realize the benefits of having implemented risk management. These include the ability to take better-informed decisions about opportunities, and to constructively address new patterns of risk. In the best-run organizations, risk management is synonymous with good management and good governance. It is not considered as a bolt-on to existing practices, or a separate exercise simply to meet regulatory requirements.

Higher education institutions that have established stand-alone risk management systems do not benefit from the more inclusive approach adopted by others. In such cases there is sometimes misperception over how the system's outputs link into other operational and business planning processes. While stand-alone systems may be effective to some degree, they are often symptomatic of institutions where there are difficulties in convincing managers and staff of the benefits of risk management.

"The risk to be perceived defines the duty to be obeyed"

STUDENTS ACTIVITIES

FYP KNOWLEDGE SHARING SESSIONS: FOR STUDENTS, BY STUDENTS

We have organised two sessions since the inception of the CPTAF. The first was held on 04th December 2014 and the second, on 12th March 2015. The students who presented, had volunteered to present their FYP's in front of their fellow students, which mainly consisted of those students who had just started their FYP's. These sessions assisted to provide guidance as well as motivation for the more junior students. It also opened their minds to possible research topics for the FYP's.

We would like to acknowledge the following students who have presented in the two sessions:-

- Fatma Salleh Mohamed Barkey
- Kee Wan Nee
- David Tai Da Wei
- Arina Kungeibayeva
- Samiha Salim Al Muhaidri
- Presha Nair Sadashivan
- Kong Pei Yeun

We wish them all the best in their future. If any student would like to volunteer for our next session, please contact Ms Geetha Rubasundram or Mr Suresh Balasingam for details.

DISASTER MANAGEMENT—A HANDS ON MISSION

The School of Accounting, Finance & Quantitative Studies (SAFIQS) organised a Donation Drive and a Clean-Up Session to assist our fellow Malaysians affected by the recent floods.

Cash Donation Drive – Mercy Malaysia

The donation drive for **Mercy Malaysia** was carried out from 5th January till 13th January 2015 , and resulted in a collection of **RM 2,713.20 in cash**.

Clean Up Session – Temerloh, Pahang (10th January 2015)

A total of 7 lecturers and 58 students participated in the clean-up session in Kampung Lipat Kajang, Temerloh, which was an eye opener for many of our students who were able to see the damage caused by the floods.

Good job to the organising team, which was led by **Mr Megat Abdullah bin Megat Mahmud and Ms Geetha Rubasundram from SAFIQS,** and thank to all lecturers and students from APU who contributed to the success of the activities!