Evolve your DNA to take control of disruption

Cybersecurity risk has been the top risk in the Chartered IIA's Risk in Focus report for many years. It is a familiar risk to Chief Audit Executives (CAEs). You know the controls. But what about disruption? Like cybersecurity risk, disruption risk is inevitable and comes in many guises. We live in an age of uncertainty which leads often to disruption.

Like cybersecurity, disruption risk it is not about *if* but *when*. Your organisation's response will determine success when the risk materialises. And it will materialise despite well managed controls.

This article looks at how organisations can start to take back control of disruption risk, and how you, as a CAE, can start to think about assurance as to how the risk is being managed.

Wondering why the photo of a lizard?

Let's begin by looking at nature for inspiration.

The green anole lizard, when caught by a predator, can lose its tail and then grow it back. Within its tail are receptors that are *switched on* enabling it to disengage and then regrow. Its DNA includes a control mechanism that enables it to manage extreme risk and not only survive but to regrow.

Taking control of disruption risk

Years of evolution have taught the green anole that a long tail can be a weakness (risk) within an otherwise sound body (business model). Deploying a timely response to danger (disruption) is the difference between life and death for the green anole.

The same is true in the boardroom. Timely responses were required in March 2020 when the first lockdown was introduced to curb the spread of coronavirus. Likewise, when ransomware strikes, a hurricane blows through or wildfires draw near.

According to research by Accenture, 71% of organisations were either impacted or expecting to be impacted by disruption in 2018. Since then, everyone has experienced a global pandemic and the IPCC (Intergovernmental Panel on Climate Change) has issued a stark warning about climate change risk. The risks associated with disruption have made a seismic shift from planned events like mergers and acquisitions to unplanned events such as the blockage at the Suez Canal, extreme weather events and resource shortages across wide ranging industry from microchips in car manufacturer to glass vials for blood test in the NHS.

Disruption risk is part of the context within which all organisations operate.

But how can a board manage the risk? Is it ill-defined, too complex and too uncertain? What disruption will happen next? Will it be material to the organisation?

In his 2016 report Innovation and ERM: partners in managing the waves of disruption, at a time when technology was considered the greatest driver of disruption, Dr Paul Walker notes that "companies must learn to adapt the business model and not just introduce innovation or technology changes." Speaking to RIMScast in August 2021, Walker said that during an executive roundtable at the height of the pandemic, the top risk for executives was their business model. A seismic shift from being a novel suggestion in 2016. Such is the speed of risk. And the power of disruption.

So, like the green anole, our organisations need to focus on their business model risk. Identifying their long tail. And build their response mechanism into the organisation's culture. Their DNA.

The importance of culture is familiar to internal auditors, from organisational culture through to more granular aspects such as risk culture and cyber security culture, as discussed in the Chartered IIA's Mind the Gap: Cyber security risk in the new normal.

Business model risk

Business model risk is typically the risk that an alternative way of delivering similar or equivalent goods or services is developed. This could be innovative such as Airbnb's impact on the hotel industry, efficient such as Uber's evolution of the way a taxi is ordered or disruption as we are witnessing the pandemic's impact on the high street.

John Lewis Partnership has much in common with the green anole. Having accelerated store closures due to the pandemic, it then announced plans to build 10,000 rental homes on various sites and separately has entered a partnership with Nutmeg for financial investments. John Lewis was established with an objective to put people and the community ahead of profit. Its DNA has enabled it to respond to disruption?

Is business model risk the same as strategic risk?

Essentially yes.

Is business model risk the same as viability risk?

Essentially yes.

Is business model risk the same as going concern risk?

No. Going concern is short term and considers only financial risk.

The Government proposes to introduce a requirement for an annual Resilience Statement, consolidating and building on the existing going concern and viability statements (See Section 3.1 of the BEIS White Paper: Restoring trust in audit and corporate governance).

Lessons on what constitutes a good viability statement were published by the FRC in 2018, many of which will likely carry across to the new requirement.

Understanding the risks that sit at the heart of resilience, viability, the business model and strategy are the foundation for gaining an element of control over disruption.

Internal audit's role

Understanding the risks that can lead to disruption on a significant scale is an art, not a science.

The late Donald Rumsfeld famously referred to some of them as unknown unknowns. Those risks that are not in plain sight. Risk management processes often focus too much on known risks which can be a barrier to discovering these unknowns. It can also be a more comfortable place to operate than considering known unknowns such as climate change risk. Those hard to handle risks. The pandemic would surely have been in that category prior to 2020.

Risks that disrupt are not always unknown.

They might just be unknown to your board, or perhaps your board, senior management team doesn't know how to manage or mitigate the known unknown risk and so 'kicks it into the long grass' for now.

Risk maturity is fundamental to unlocking the unknowns. And risk maturity is the product of a strong risk culture.

To get into more detail about risk culture take a look at this comprehensive guide for internal auditors produced by IIA Australia.

So back to those unknown, unknowns. Let's take a moment to reflect on a familiar but relevant concept that helps identify unknowns before we come back to risk maturity.

When learning about self-awareness, communication and teamwork, you will undoubtedly have come across the Johari Window tool. It helps people better understand their relationship with themselves and others by opening windows. The goal is always to move the lines and reduce the size of your unknown window by being more transparent, open to feedback and listening.

The same premise sits at the heart of risk maturity. Moving the lines to minimising the unknown unknowns enables the management of known risks. That's not to say all risks can be mitigated some might simply be tolerated and a response plan prepared either because they cannot be influenced or because they fall within risk appetite. When disruption calls, having a response plan puts an organisation at a distinct advantage to those that have been taken by surprise.

Fewer surprises cross the threshold of boardrooms in risk mature organisations.

Our article Board level risk identification explores this in more detail looking at the boards attitude to risk, barriers to risk identification and the role of internal audit.

So, where does internal audit fit into this?

Advising, influencing, facilitating and promoting risk maturity is fundamental to a relevant, valued and twenty first century internal audit activity. If a CAE also has responsibility for risk management it's not even a debate!

Risk management is one of the three fundamentals for internal auditors alongside internal controls and governance. It is not optional. When did you last audit risk culture, the risk framework or anything more than a nod to the risk register being updated?

In our age of disruption, volatility and potentially increasing likelihood of unknown risks the bar on auditing risk management must be raised. Risk maturity cannot be a long-term goal, a steady progression year on year of improving risk identification, refining risk registers or considering including risk in personal objectives.

How risk mature is your organisation?

Is your risk culture intentional or evolving organically?

Is your organisation in a good place or is it time for a revolution?

Risk management concepts that can aid with thinking about disruption include:

- Risk velocity: Velocity is the time between the risk event occurring and the point at which an organisation first feels its effects. The pandemic was relatively high velocity. Climate change however has had low velocity. It is not about the magnitude of the impact but the time to respond to the event before the impact is felt.
- Risk clockspeed: This is about decision making. For risks with a fast clockspeed, the information needed to manage them only becomes available at the last minute, close to or at the time of the event. Outcomes can be unpredictable, the risks are harder to control and need to be managed creatively, based on principles. Often subject matter experts take the lead as there is limited time for debate. On the flipside slow clockspeed risks benefit from information being readily available to establish facts, define rules, together with plans and processes to manage the risk.
- Risk appetite: The board's view on what risk-return trade-off is acceptable for the organisation. Communicated to the executive and management to enable day to day decision making and operations including enabling or inhibiting innovation. This fluctuates, particularly during times of disruption.

Are you familiar with these? Are your internal auditors?

Your board will not cope with these complex concepts if they currently avoid thinking about inherent and residual risk, put a token slot on the agenda to discussing emerging risk or happily nod through a risk register that management has put together on an annual basis. A lack of risk maturity filters through into governance practices too, such that focusing too heavily on compliance risk can lead to being overly cautious and stifling disruption opportunities and on the flipside the absence of a risk assessment in a business case can lead to over optimism.

When you think about this do you have time for evolution or is it time for a revolution?

Closing thoughts

Internal auditors are familiar with thinking like a fraudster to manage fraud or thinking like a hacker to address cyber risk. Perhaps now is the time to add think like a disruptor. Disruption risk, like rising sea levels or more recently Brexit can be at a macro level. Internal auditors and risk managers can help their organisation to translate those risks into micro risks that are relevant and meaningful to the organisation. To a level where risk treatment can be applied – treat, tolerate, transfer or terminate.

Until 2020, despite the looming cataclysmic risk of climate change, organisational disruption was primarily driven by technology. The pandemic put mother nature to the front of the stage which brings us neatly back to our friend the green anole who evolved to manage its disruption risk and survive.

"The greatest danger in times of turbulence is not the turbulence, it is to act with yesterday's logic."

Peter Drucker, Management Guru