



A Tricky Road In Managing Corporate Risk



These are exciting times for business on a global scale, where the speed of transactions and the sheer volume of demand and supply can lead to unprecedented levels of growth for any company.

The global platform is also an excellent indicator of where a company stands in terms of competitiveness, diligence, and overall performance, where international high standards are visible for all to see.

However, globalisation can also become a double-edged sword when things go wrong — considering the speed at which things happen, where news of negative events can spread over social media and be blown out of proportion before one realizes it.

Take Starbucks¹, for example, which generated a lot of controversy when it made its employees undergo sensitivity training. Another big company that made the headlines was Nestlé², which had to deal with the aftermath of news revelations that its seafood operations in Thailand made use of modern slave labour.

Malaysian companies are not exempt from this problem, with the likes of IJM Corp Bhd³ and 1Malaysia Development Bhd (1MDB)⁴ receiving a run of bad publicity over bauxite mining and Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA) breaches respectively.

1. *TIME Magazine*, "Was Starbucks' Racial Bias Training Effective? Here's What These Employees Thought"
<http://time.com/5294343/starbucks-employees-racial-bias-training>.

2. *The Guardian*, "Nestlé admits slavery in Thailand while fighting child labour lawsuit in Ivory Coast"
<https://www.theguardian.com/sustainable-business/2016/fb/01/nestle-slavery-thailand-fighting-child-labour-lawsuit-ivory-coast>.

3. *The Star*, "The bauxite boom or bane"
<https://www.thestar.com.my/business/business-news/2015/12/19/the-bauxite-boom-or-bane/>.

4. *New Straits Times*, "1MDB: RM2.973 billion deposited into Najib's personal account"
<https://www.nst.com.my/news/nation/2018/09/411007/1mdb-rm2973-billion-deposited-najibs-personal-account>.

What actually went wrong?

Could these companies have avoided the backlash of the controversies raised? When looking for the root causes, it could be speculated that a weak control environment — running the gamut from the lack of Board oversight, poor ethical climate, management override and employee collusion, to inadequate policies and procedures — was the cause.

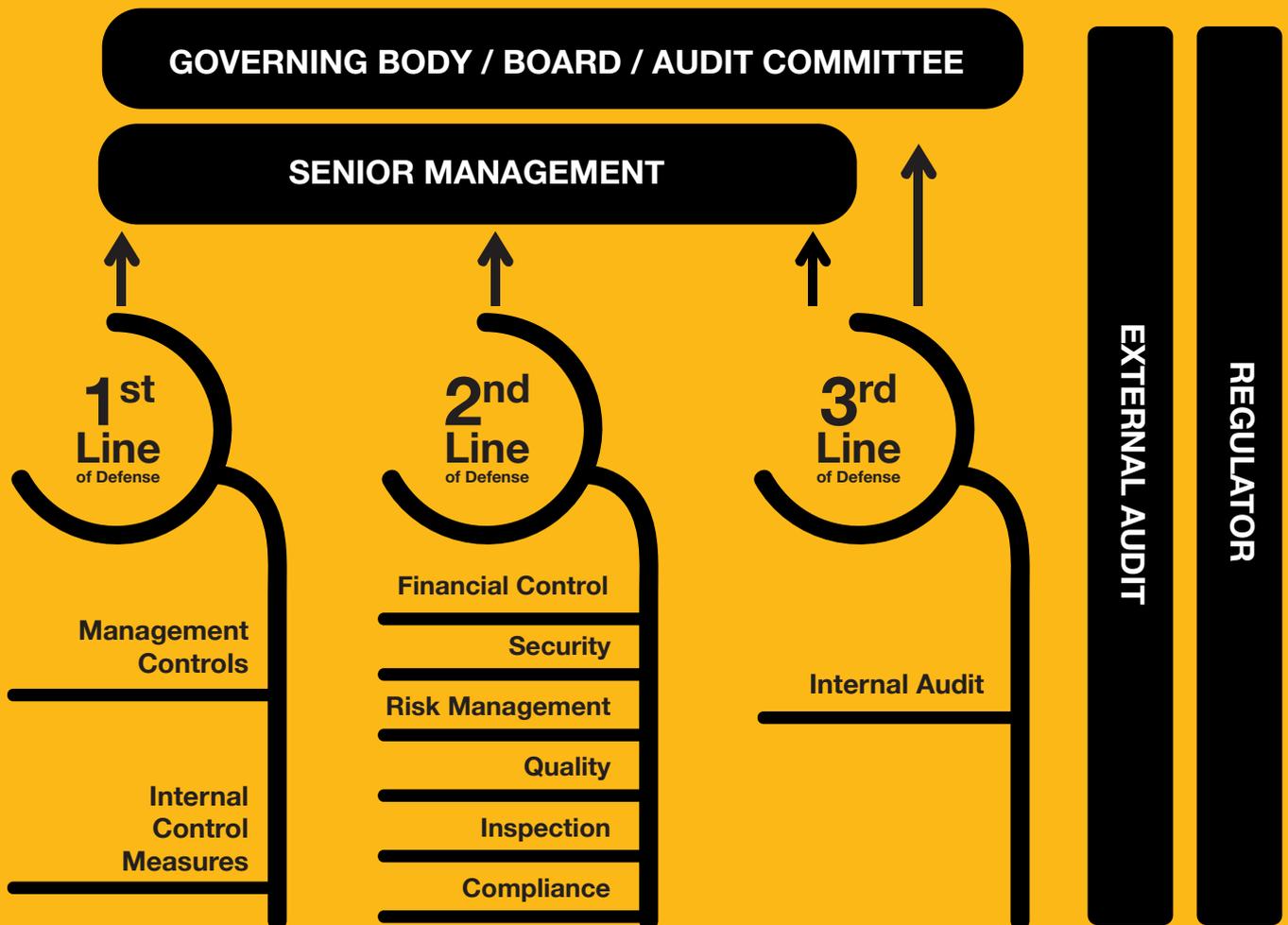
Or could it have been something as simple as a lack of safe whistle-blowing avenues and protocols?

In the case of Starbucks, after the furore had died down, it was found that the training was in response to the unfortunate incident of two innocent black men being wrongly arrested — which actually showed great sensitivity and awareness on the part of the corporation in responding to a current issue.

Meanwhile, Nestlé handled the issue in a professionally astute manner by not only acknowledging the veracity of the reported findings, but also outlining clear steps that it would take to solve the issue. They also pointed out that all other companies sourcing seafood from Thailand could not avoid the same issues.

Some local companies may sometimes be slower to counteract bad news or address credibility issues due to top-down management structures that keep crisis management teams waiting on the go-ahead from the boardroom or owner.

THE THREE LINES OF DEFENSE MODEL



Source: Institute of Internal Auditors

Lessons to be learned

In retrospect, it is the unrestrained nature of sharing through social media that is the bigger problem to be tackled; as such, firm control of their communication tools coupled with reason and guidance for their responses would be of the utmost importance for any given firm.

Of course, this would not only require vigilance and sensitive analysis of the company's affairs and all issues that could possibly affect it, but also the will to implement the hard decisions that need to be taken if the circumstances require them.

As mentioned in the article "Good Corporate Governance Towards a Competitive Advantage"⁵, the new Malaysian Code on Corporate Governance released by the Securities Commission Malaysia in April 2017 is based on three key principles of good corporate governance: board leadership and effectiveness; effective audit and risk management; and integrity in corporate reporting and meaningful relationship with stakeholders.

A firm is guided by the Code to uphold that integrity, accountability, and sense of responsibility, failing which any company could easily fall victim to acts of immorality.

For effective risk mitigation and control, there should be adequate line functions — including monitoring and assurance functions — within an organisation, according to the Institute of Internal Auditors (IIA)⁶.

Briefly, the lines of defence deal with the following:

First Line of Defence:

functions that own and manage risk (where operational management has ownership, responsibility and accountability for directly assessing, controlling, and mitigating risks);

Second Line of Defence:

functions that oversee or specialize in risk management and compliance (which are activities covered by several components of internal governance, such as compliance, risk management, and other control departments); and

Third Line of Defence:

functions that provide independent assurance, especially internal audit (where an independent internal audit function will cover how effectively the organisation assesses and manages its risks, as well as including assurance on the effectiveness of the first and second lines of defence).

The IIA does warn, however, that the Three Lines of Defence method is not a magic silver bullet that will automatically guarantee the desired results; for it to have maximum effectiveness, all three lines need to be given the right resources, independence, and trust in order to create the right conditions for success.

5. *Crowe Horwath Insights*
<https://www.crowe.com/my/insights/good-corporate-governance-towards-a-competitive-advantage>.

6. *IIA Position Paper*,
<https://global.theiia.org/standards-guidance/Public%20Documents/PP%20The%20Three%20Lines%20of%20Defense%20in%20Effective%20Risk%20Management%20and%20Control.pdf>.



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