MANAGEMENT ACCOUNTING – RISK AND CONTROL STRATEGY

Steve Whittenbury casts a critical eye over recent events to highlight how business risks are created and managed – effectively or otherwise.

It was the night before the 1997 UK general election in the south Devon seaside town of Torbay. Having finished his re-election campaign, the constituency's Tory MP, Rupert Allason, dined in a local restaurant. During his meal he is reputed to have insulted the staff, all of whom had been planning to vote for him. The following day, the seven employees switched their allegiance to the Liberal Democrat candidate. Allason went on to lose his seat to the LibDems – by 12 votes.

If this tale is to be believed, it illustrates the foolishness of ignoring risks and the impact that inappropriate acts can have. But surely this is common sense? If you pre-empt all your risks, you can manage them away and minimise their impact. This theory seems sound and it underpins the P3 syllabus, yet the following problems remain:

- Many employers continue to ignore some of the fundamentals of this subject (often at their peril, as we will see later).
- Students have great difficulty seeing how this fits in with what is required by P3, because many of them do not appreciate the nature of risk and control in the real world.

A quick look back over the past year shows us that the real world is full of uncertainty, which must be dealt with in a variety of ways. Royal Mail, for example, has attempted to introduce new working conditions to modernise its service and ensure that it's able to compete in the 21st century, but change has brought its own problems. Employees were unhappy about its plans and took industrial action in July and again last month. Although Royal Mail and its trade union are trying to negotiate a way forward as *FM* goes to press, they have to balance two competing demands: keeping the company financially viable while ensuring that its human resources are properly valued.

Postcomm, the industry regulator, has allowed private companies to compete with Royal Mail for daily postal deliveries. The expected outcome is cheaper postal rates and improved service through efficiencies – for example, through the introduction of size- as well as weight-related prices. Its "Pricing in proportion" structure is designed to match the revenue earned by transporting printed matter with the true cost – an issue that the previous system, based on weight alone, did not address.

It remains to be seen how these changes will affect consumers. But both Royal Mail and its rivals need to address the impact that the virtual world is having on the postal business. The advent of e-mail means that it's no longer the case that vital correspondence needs to be finished by 5pm in order to catch the last post and so be guaranteed to arrive on the recipient's desk by 9am the next day. Postal services must, therefore, be aware that they risk becoming a redundant part of business communication in the 21st century.

Is the real world now subject to risk as a result of the technology we take for granted? Telephone communications between Washington DC and New York were restricted recently when a maintenance crew in New Jersey accidentally cut a fibre-optic cable and calls had to be rerouted. Thanks to its contingency arrangements, cable operator MCI was able to report that its long-distance services hadn't been affected. But this case does show the potential impact that the physical environment can still have on its virtual counterpart.

Across the Atlantic, environmental factors of a different type proved to be the big talking point of the summer. The wet weather affected the quantity and quality of produce grown across northern Europe to such an extent that it has threatened the supply of goods to supermarkets. If retailers have to obtain more costly substitutes from alternative sources, farmers' revenues could

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be greatly reduced and store prices could rise, hitting consumers' pockets in turn. This is an example of unpredictable risk that isn't easy to manage. Perhaps this is one instance where it would be better to treat the symptoms rather than the cause.

As the floodwaters rose in the summer, so did mortgage interest rates, making life more difficult for UK homeowners, many of whom are now struggling with their increasing loan repayments. In an attempt to restrain the housing market, the personal credit boom and the resultant inflationary economic pressures, the Bank of England increased its base rate from 3.5 per cent in July 2003 to its current level of 5.75 per cent. As a result, the proportion of fixed-rate mortgages in the same four-year period grew from 44 per cent to 88 per cent. HM Treasury research has indicated that over the past 30 years borrowers have taken far more notice of short-term interest rates than anything else when financing a mortgage, predominantly because of the perceived benefits of competitive rates offered by lenders in the short term. This has inevitably led to a far more volatile market – a factor that longer-term fixed-rate loans are intended to address.

Another economic pressure, felt by homeowners and businesses alike, is the volatility of energy prices. This has been caused by political turbulence in various oil-producing regions – including the Gulf, Venezuela and Russia – and exacerbated by the huge increase in demand for energy from Asia's booming economies. All this has encouraged many consumers, both commercial and domestic, to make advance arrangements to fix their supply price in order to avoid unpredictable future cost increases.

Many of these economic trends have led to more widespread uncertainty that's best illustrated by the recent fluctuations in stock market prices. Shareholders have seen the value of their investments shrink as a result of interest rate increases, energy price inflation and the resulting threat to consumer spending. But they will be reassured to know that, while their investments may fluctuate owing to factors that are mostly beyond their influence, there are controls in place to ensure that the organisations they invest in are scrutinised by corporate governance watchdogs. Unfortunately, however, there are problems here as well.

A master of risk management? The precocious Ferris Bueller, ever on the alert for danger.

On July 13 the former chairman and chief executive of publishing company Hollinger, Conrad Black, was found guilty of fraudulently obtaining funds from his employer, which until 2004 had included the *Daily Telegraph* in its substantial portfolio. The money had represented payments from publishers that had bought titles from Hollinger and did not want it to set up new publications that would compete against them. These so-called non-compete clauses were agreed by the board and were all part of the deal, according to Black, and he and his colleagues shared nearly £30m as a result. But the trial in the US concluded that the payments had been clandestine and that Black had not acted lawfully.

What conclusions can be drawn from these events? This year has been a time of significant uncertainty, brought on by political, economic and environmental factors. Some of them are beyond control; others are being handled in a wide range of ways. All of these examples are both topical and typical – very much the subject of P3, which aims to cover the following areas:

- The identification and categorisation of risks faced by organisations.
- The management of such risks by an appropriate response (taking corrective action through the use of both proactive and reactive measures).
- Different types of control – organisational, accounting, financial, human resource, information and even ethical.
- The use of accounting and other systems as a form of control.
- Assessing these systems and other risks through the use of internal audit.

The crucial word to consider when assessing both risks and controls is "appropriate", as it sums up what risk management is all about.

The eponymous hero of the 1986 comedy film *Ferris Bueller's Day Off* tells the audience that "life moves pretty fast. If you don't stop and look around once in a while, you could miss it." Admittedly, he's saying this to justify playing truant from high school, but managers need to take Bueller's maxim one step further. Life does move pretty fast and things do change: unless you keep your eyes open and ensure that appropriate controls are in place at all times, you may miss the danger and find yourself no longer in business.

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