


## Chapter 9

# Enterprise Risk Management and Shadow Banking Systems: The Case of European Union

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### ABSTRACT

*Banking regulations are beneficial to limit bank' portfolios against excessive risk-taking. The introduction of enterprise risk management (ERM) allows banks to enhance their capabilities to identify risks accurately and manage them to minimize unexpected costs or losses. During the last few years, the European Court of Auditors highlighted the importance of "special reports" that examine the economy, efficiency, and effectiveness of EU spending. This European institutional focus argues that shadow banking improves welfare because it provides a channel to escape excessive regulation that is asymmetrically more valuable for banks or European paying agencies with access to efficient investment opportunities. Performance audits, alongside traditional financial and compliance audits, allow the EU to understand, validate, and reform their own policies and programs. This study contributes theoretically and empirically regarding the fraud and management bad practice of agile marketing concepts in the context of digital transformation and international business.*

### INTRODUCTION

The fraud and scandals that occur in dynamic and highly competitive business environments shed light on traditional risk management deficiencies (DeNichilo, 2021b & 2022, Nakitende *et al.*, 2021). This situation has pushed experts towards designing robust risk management practices, which consider a more coordinated and broader approach, resulting in the development of new enterprise risk management (ERM) frameworks (Hoerner & Stephenson, 2012). The increasing responsibilities toward stakeholders have pressured companies into adopting ERM frameworks, one of which, the Committee of Sponsoring

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## **Enterprise Risk Management and Shadow Banking Systems**

Organizations of the Treadway Commission (COSO, 2004) framework, is regarded as the main reference worldwide (Anderson & Dekker, 2014).

This chapter examines the developments of ERM, the COSO framework and the problems experienced by firms during implementation (Mendez & Bactler, 2011). Risk identification practices are described by outlining the stages of risk assessment and risk response. A discussion is presented on how the crisis impacted ERM and how ERM mitigated the crisis, with the last paragraph briefly concluding the paper (Balint, Bauer & Knill, 2008).

In recent decades, significant attention has been dedicated to risk management advances in the accounting and management literature. Academics and practitioners have experienced a crucial shift from the traditional method of managing risks, called “risk silo management”, to more integrated management of all risks, known as enterprise risk management. Risk silo management represents a fragmented and narrowly focused approach (Caiden, 1998).

*Firstly*, a fragmented approach to risk management implies that the numerous organizational units inside the same firm manage interdependent operational, financial, and technical risks in isolation. As the aggregation of risks in such an environment could make delivering results difficult, a firm is unable to conduct an integrated risk analysis. This methodology leads to the potential misalignment of business strategy with risk appetite at the aggregate level resulting in a lack of awareness of and accountability for the risks borne across the company (Hagen, Zucchela & Ghauri, 2018). *Secondly*, an ad hoc approach means that the execution of risk management is employed sporadically, which contrast with the routine and systematic controls that are typical of the best management accounting procedures. *Thirdly*, a narrowly focused approach implies that risk management is geared towards protecting mainly tangible assets while ignoring intangible assets, employees’ capabilities, and entity brands.

Heightened concerns about risk management, due to financial reporting scandals, have cast serious doubt on its ability to manage risks adequately. Furthermore, nowadays, shareholders and bondholders place growing importance on poor results, a lack of transparency and reputational losses. To provide a framework that could respond to past calls for enhanced risk management, the COSO represents the most important and recognized standard of reference for ERM.

Due to the above-mentioned traditional risk management limitations, the COSO framework is widely implemented in practice. The framework defines ERM as “*a process, effected 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 risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives*” (Ansoff, 1975). ERM incorporates risk management. Moreover, COSO supports the view that ERM is an ongoing activity and applicable worldwide. It was developed by a professional group made up of distinguished members from different backgrounds, such as accounting professors, partners of accounting firms, managers, and board members, and was promoted by five major professional associations in the US. The COSO framework supports a three-dimensional model that consists of eight components represented by horizontal rows, with four objectives represented by the vertical columns and four units displayed in the last dimension of the cube. This depiction clearly emphasizes two features: the strategic contribution and integration of the ERM system.

Unfortunately, not all organizations are adopting ERM. Previous studies indicate that firms experience problems during the transition from risk management to ERM. Particularly, Prison and Turnbull (2011) find that boards have limited access and are not informed about firm risk management strategy, while Viscelli, Hermanson and Beasley (2017), by interviewing ERM champions, report that the lack of

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