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Research Article

The Implement of COSO Enterprise RiskManagement in Banking Sector

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Abstract

Every organization faces risks that threaten its existence and reputation, whether private, public or not-for-profit, and regardless of size. The need to manage these risks has become an issue of international importance and much effort has been made in this area to institutionalize risk management procedures. In response to this, COSO published Enterprise Risk Management (ERM) – Integrated Framework in 2004. This ERM framework includes ERM components, principles and concepts, demonstrates a common ERM language, and provides clear direction and guidance for enterprise risk management. In 2016 COSO has published the COSO ERM Integrated Framework. The framework further expands on internalcontrol by paying particular attention to the broader subject of ERM. This research aims to find out how the implementation of COSO in risk management in the banking sector. This research was conducted using data collection methods using library research, namely by browsing the literature containing theories from scientific works, both published and unpublished in the form of hard copies or soft copies in books, papers, and online journals. The results of this study are the integration of the five components of internal control with ERM provides assurance for management that organizational goals will be achieved effectively and efficiently including preventing fraud in banking sector.

Keywords: Enterprise Risk Management, institutionalize risk, banking sector,

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1. INTRODUCTION

The rapid changes in technology, globalization, and the development of transactions have led to higher challenges faced by companies in managing the risks they must face (Beasley et al, 2021). Risk management or Enterprise Risk Management (ERM) is a strategy used to evaluate and manage all risks in the company. This approach to managing organizational risk is often referred to as risk management.

In the midst of an economic situation full of uncertainty in business competition and the complexity of business risks that must be faced by the company, the risk management system is one of the main tools to reduce and handle any risks that may arise.

According to Khoirunnisa (2018), COSO (Committee of Sponsoring Organization of the Treadway Commission) is a private organization consisting of the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), the Institute of Internal Auditor

(IIA), the Institute of Management Accountants (IMA) and the Financial Executives Institute (FEI). This organization in 1992 issued the results of a study toproduce a definition of internal control, known as the internal control model (Internal ControlModel). This COSO product was soon widely accepted as an internal control authority by management, accountants, auditors and users of financial statements.

This study focuses on the application of ERM and its effect on the financial performance of banks around the world. Banks of course play a very important role in the economy because of their core products: loans for businesses and for home purchases.
The banking sector was ranked seventh in the economy among 82 sectors by size of contribution to Indonesia's Gross Domestic Product (GDP) in 2011. The recent global economic downturn caused by the subprime mortgage crisis in the US in July 2007 and its negative effects on Financial markets and participants in the financial industry around the world have triggered a capital management crisis in most financial institutions, especially banks (Alkubaisi, 2021).
The cause of the crisis and it was found that one of the main causes was the failure to implement risk management. By implementing risk management, organizations can reduce unexpected and expensive surprises, and the effective allocation of resources can be more effective. This improves communication and provides senior management with a summary ofthe threats, which can be faced by the organization, thereby ultimately assisting them in betterdecision making.
Risk management and performance measurement should be linked together to enable the company to define and guide its overall risk profile, as well as to shape its strategic direction. Given the size of the contribution of banks in the world economy, as well as the importance of risk management in ensuring the achievement of strategic objectives, this study discusses the extent of the implementation of Enterprise Risk Management (ERM) in the world's commercial banks and the obstacles to its implementation (Uysal, 2021).

2. LITERATURE REVIEW

2.1. Stewardship Theory

Theory *stewardship* based on the behavior of individuals who are motivated to fulfill shared needs rather than their individual needs with the aim of achieving agreed organizational goals. This theory is 4. to provide services for the common good. Therefore, this theory is closely related to individual psychology and organizational sociology. Satisfied individuals will contribute to organizational success (Davis et al., 1997). In the application of this theory in the company, managers or executives are motivated to give their best efforts to their principals. The best efforts are made by improving the company's performance both in terms of operational and financial, not vice versa by practicing earnings management, so that the company's success can be achieved.
Donaldson and Davis (1991) focus on the structure of the manager's position at the level of the company's organization, meaning that with a higher position of responsibility and authority it encourages managers to be pro to the company by providing loyalty and all their abilities.
Davis and Donaldson (1997) further elaborates on psychological factors and situational (sociological) factors as follows:
1) Individual Psychological Factors

In the psychological view that humans are the center of the role (model of man) which will continue to develop beyond the current state until it reaches the highest level but is still limited by its ability to reach its full potential.
a) Motivation
Motivation is based on full rewards that can be achieved (intrinsic rewards) that cannot be changed easily, so that they can encourage individuals to work with full capacity for the achievement of the company's organizational goals. This award canbe in the form of opportunities given by the organization to individuals to grow, improve their achievements and actualize themselves. In line with this motivational basis, Hackman and Oldham (1980) suggest that there are psychological

characteristics of positions, namely individual experience in understanding work, individual experience in accountability for results, and individual understanding of a real relationship. Therefore,

b) Identification

Identification is based on the individual's view of being an inseparable part of an organization for the achievement of the mission and vision of the organization. Individuals identify with imagining the rewards they will receive for the success ofthe organizations they support and also the frustration they will receive if the organization fails. From the view of social identification, a manager is seen as havinga personal concept and image because it is closely related to the attributes of the organization and the success of the organization. This is in line with the views of Mowday et al. (1982) which states that every individual in the organization is cooperative in cooperation and behaves as an inseparable part of the organization without demanding too much in return.

c) Use of Power

Power is an important aspect and becomes a bridge between managers and their principals. Managers are motivated by the power entrusted by the principal, so that it becomes a psychological driving force in supporting the achievement of organizational goals. This is what distinguishes one individual from another in an organization on the basis of expertise and individual strengths in the organization. To achieve this, it is necessary to have a reward and an acknowledgment of the power received by the individual as a provision in carrying out supervision (Abeyrathna and Lakhsan, 2021).

2) Situational Factors

Situational factors are closely related to sociology in organizations. The success of theorganization has a direct impact on the maximization of the principal's wealth, thus bringing the maximizing effect on the group in management, and in a small scope willmaximize the interests of individuals in the organization.

a) Management Philosophy

Management philosophy is oriented towards the visible aspect of the relationship between individual organizations and their principals, namely the existence of a form of involvement from the economic aspect that creates consistent self- fulfillment (Argyris, 1973). This means that the management philosophy is able to encourage individual organizations to behave and behave as expected by management.

b) Culture

Culture emphasizes other things to achieve goals other than group goals which are collective in nature, meaning that it is inherently inherent in individual organizations, namely the tendency of individuals to develop harmoniousrelationships with their principals which are not based on individual culture. In this individual culture, it is short-term oriented from the economic aspect, but can be used to evaluate the organization's business activities.

c) Power Range

The span of power is an extension of the power of individuals in the organization, and there are differences between these levels of power where individuals who have great power can support leadership relationships with levels of power below them. Although there are differences in the level of power in the organization, there

is acceptance and tolerance from the individual organizations involved in it.

d) Connection

In relationships, organizational individuals prefer a form of self-development for responsibilities within the organization as well as in self-actualization based ontrust and participation in the organization.

2.2. Enterprise Risk Management (COSO)

In the Executive Summary issued by COSO (2004), what is meant by Enterprise risk management (ERM) is a process that is influenced by the board of directors, management, and other personnel that is applied in setting strategy and covers the company as a whole, designed to identify potential events. that can affect the company and manage risks within its limits to provide reasonable assurance regarding the achievement of the company's objectives.

In strategic views, ERM is intended to reduce the degree of failure in achieving organizational strategic goals over a period of time (Febrianti, et al., 2021). ERM is an approach to managing the risks of a modern dynamic business enterprise irrespective of the nature of the risks and sources of the risks. However, the varying adaption of approaches is vital in implementing a particular business to achieve its business goals within the constraintsof available resource, culture, regulatory, market, and social environments. Furthermore, Thomas, et al. (2018) have concluded that size was not related to the extent of ERM development and concluded that financial institutions tend to adopt ERM because of regulators' requirements.

COSO states that Enterprise risk management includes the following six things:

1. Aligning risk appetite and strategy

Management considers the magnitude of the entity's risk in evaluating alternative strategies, setting related objectives, and developing mechanisms to manage the associated risks.

2. Enchancing risk response decisions

ERM provides the power to identify and choose among alternative risk responses – avoid, reduce, share, and accept risk.

3. Reducing operational surprises and losses

An entity's advantage increases its capability to identify potential events and establish responses, reduce surprises, and relate costs or losses.

4. Identifying and managing multiple and cross-enterprise risks

Every company faces multiple risks that affect different parts of the organization and Enterprise risk management facilitates an effective response to interconnected impactsand integrates responses to multiple risks.

5. Seizing opportunities

Taking into account potential events, management is positioned to identify and proactively realize opportunities.

6. Improving deployment of capital

Obtaining robust risk information enables management to effectively assess overall capital requirements and improve capital allocation.

From these six things, it can be seen that Enterprise risk management (ERM) overcomes risk through identification, evaluation, minimizing costs caused by risks, and looking at potential events that can cause losses. The Committee of Sponsoring Organizationsof the Trade way Commission (COSO) defined (ERM) as a process, effected by an entity's board of directors, management and other personnel, applied in a 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 (Lubis and Erlina, 2018 and Salifou, 2020).

COSO (2004), explains that the effectiveness of an organization's ERM must be assessed from the following four ERM objectives:

(1) Strategy, which is a high-level goal, in line with and supporting the organization'smission.
(2) Operation, which is related to the effective and efficient use of resources
(3) Reporting, which focuses on the reliability of financial reporting
(4) Compliance, including complying with applicable laws and regulations.

3. RESEARCH METHOD

This research is a basic research because it aims to gain more knowledge and understanding about something that is happening. The method of data collection uses literature study, namely by

browsing the literature that contains theories from scientific works, both published and unpublished in the form of hard copies or soft copies in books, papers, and online journals.

4. RESULTS AND DISCUSSION

Internal control is a process that must be carried out by a business organization entity to protect assets and can encourage compliance with established company policies, for that every business entity must test the internal control system in order to determine the effectiveness of the internal control system implemented in the organizational entity. to reduce uncertainty in the future, namely the risk of bad loans that can cause losses to banks, and to assess the suitability of the design and application of the internal control system with the established criteria.

4.1. Result

In the banking sector, Enterprise Risk Management (ERM) is used in the process to determine and identify suitable corporate strategies to be implemented by taking into account various risk factors, then the identified risks are managed and mitigated so that the company'sgoals can be guaranteed to be achieved.

The mission and vision set by the banking company provides an overview of the type and amount of risk that can be accepted by the company. Both can help banking organizations to establish boundaries and focus on how a decision that is taken affects the company's strategy. A banking company that understands well its mission and vision will be able to determine a strategy that will produce the expected risk profile, in the sense that the risks that occur are risks that can be predicted and mitigated.

It must be underlined that this ERM does not create a banking company strategy but only informs about the risks associated with the strategy that is considered with the adoption of the strategy. The organization must evaluate how the chosen strategy can affect thecompany's risk profile, especially on the profile of the type and amount of organizational risk that can be exposed.

When evaluating the potential risks arising from the strategy, the Management also needs to consider the critical assumptions that have been made from the strategic choices it has set. In addition, the organization can also consider various risks arising from the chosen strategy. ERM give view which valuable how sensitive changes to assumptions have little or even a major effect on the achievement of company goals (Wahyuni and Novita, 2021).

Therefore, with the implementation of Integrated Framework-based ERM, banking companies can align company policies and strategies with the acceptable risk level (risk appetite) that has been set by Management, so as to improve the quality of decision makingon various risks faced by the company. In addition, it can be used to identify various risksand minimize losses caused by these risks. The implementation of ERM is not a goal to be achieved by the company, but is a process in supporting the implementation of good corporate governance.

Enterprise risk management is not strictly a serial process, where one component affects only the next. It is a multidirectional, iterative process in which almost any componentcan and does influence another. There is a direct relationship between objectives, which an entity strives to achieve, and enterprise risk management components, representing what is needed to achieve them. The association is depicted in a three-dimensional matrix, in the form of a cube. The four objectives categories – strategic, operations, reporting, and compliance – are represented by the vertical columns, the eight components by horizontal rows, and an entity‟s units by the third dimension. This depiction portrays the ability to focuson the entirety of an entity‟s enterprise risk management, or by objectives category, component, entity unit, or any subset thereof. Many studies have evaluated the COSO ERM framework as a whole/ components of COSO ERM framework

4.2. Discussion

In relation to the risk management process, the COSO ERM Integrated Framework provides guidance for companies to determine their targets to be achieved. There are 4 main targets to be

achieved in the implementation of the COSO ERM Integrated Framework, namely:

1) Strategic (Strategic)

The strategic objectives are set to provide support in the implementation and achievement of the company's mission, so that the goals set are in line with the operations carried out by the company.

2) Operations

Operational targets are needed in utilizing all the resources owned by the company effectively and efficiently, so that these resources can be more efficient.

3) Reporting (Reporting)

The target of reporting is the reliability of reports issued by the company, especially for reporting purposes with external parties (stakeholders, shareholders).

4) Compliance

The target of compliance is the fulfillment of the provisions and requirements of applicable laws and regulations, both the provisions and requirements of the Government and the Regions.

There are several elements of the ERM Integrated Framework in this 2016 public exposure which is an integration between the five components of internal control with ERM, namely:

1) Internal Environment

Risk management carried out by the company is a form of risk management that occurs within the company's internal environment. There are various elements that affect the internal environment, including the value system adopted by the company, management leadership style, decision-making patterns, and patterns of determining management authority and responsibility. This has an impact on the form of an acceptable level of risk (risk appetite), tolerance level, risk culture and ERM implementation.

2) Goal setting

Goals must be set earlier before the company's management decides to identify existing risks, so that it is hoped that these risks can be further mitigated, so that company goals can be achieved. The company's objectives can be identified into strategic, operational, fulfillment, and reporting objectives. This can enable centralized management of all four aspects of the company's objectives in the ERM process.

3) Risk identification

All events, both from within the company (internal) and from outside the company (external) that have the potential to have an influence on the targets to be achieved, must be identified various risks that can arise. Identification of this risk can be done invarious ways, including looking at trend analysis, analysis of past events (historical), or by analyzing future projections.

4) Risk assessment

In risk assessment, the company assesses the various levels and magnitude of risks that can affect the achievement of company goals. These risks can be determined based on the likelihood of occurrence (likelihood) and the impact it causes so that mitigation can be calculated, starting from the level and magnitude of the risk fromthe highest to the lowest.

5) Risk treatment

Stage then carry out appropriate risk treatment for each risk that occurs, determine thelevel of risk tolerance, and determine various alternative solutions for the identified risks. There are several risk treatments that arise, namely avoiding, accepting, reducing, and sharing risks to various parties.

6) Control activities

In control activities, the implementation of policies and procedures that have beendetermined by the company is intended to ensure that risks have been met treated by effective, so that the mitigation process is carried out properly. The next stage iscompiling and developing an integrated company development system.

7) Information and communication (Information and communication)

Information relating to the achievement of company goals is identified whether ithas a direct

impact or not, grouped into various types, and distributed or communicated through the right communication media at the right time so that each individual company can carry out their duties and responsibilities better.

8) Monitoring

The last is to monitor all risk control activities that have been carried out to ensure thatthe risks have been properly mitigated. In addition, it also considers the data obtained in the form of historical data, current data, and data in the form of future forecasting. Historical data is intended to track past performance in relation to achieving itstargets, plans and expectations. The current data provides additional information and future data for the refinement of information analysis. From the monitoring results, it is then re-evaluated for further refinement and then developed to produce a better implementation of the organizational system.

5. CONCLUSION

There are several elements of this ERM Integrated Framework which is an integrationbetween the five components of internal control with ERM, so that if the components of internal control are integrated with ERM and implemented within the organization, it will provide assurance for management that organizational goals will be achieved effectively and efficiently including preventing risks from occurring. fraud. The elements of internal control and their integration with ERM are:

1) Internal Environment

Risk management carried out by the company is a form of risk management that occurs within the company's internal environment.

2) Goal Setting

Goals are set earlier before the organization's management decides to identify existingrisks, so it is hoped that these risks can be further mitigated, so that company goalscan be achieved.

3) Risk Identification

All events, both coming from within the organization (internal) and from outside the organization (external) that have the potential to have an influence on the goals to be achieved, must be identified various risks that can arise.

4) Risk Assessment

In risk assessment, the organization assesses the various levels and magnitude of risksthat can affect the achievement of organizational goals.

5) Risk Treatment

Stage then carry out appropriate risk treatment for each risk that occurs, determine thelevel of risk tolerance, and determine various alternative solutions for the identified risks.

6) Control Activities

In control activities, the implementation of policies and procedures that have been determined by the organization is intended to ensure that risks have been treated effectively.

7) Information and Communication

Information relating to the achievement of organizational goals is identified whether ithas a direct impact or not.

8) Monitoring

Stage the last is to monitor all risk control activities that have been carried out to ensure that the risks have been properly mitigated.

9) Organizations must exercise oversight

Supervision can be carried out by internal organizations or external parties, under the supervision of the audit committee.

10) Internal auditors

Internal auditors help prevent fraud by examining and evaluating the adequacy and effectiveness of the internal control system, in line with the potential risks inherent in various operating segments.

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