



ERM and Board Risk Oversight – A Tale of Two Surveys from COSO

January 26, 2011

Audio Information

US/Canada Dial-In#: (877) 293-7094

Int'l/Local Dial-In#: (706) 902-0817

Conference ID#: 31812394

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Presenters



Moderator - Bob Hirth is the Executive Vice President and Global Managing Director of Internal Audit and Financial Controls at Protiviti, and is based in San Francisco. He has more than 25 years of professional services experience working with a broad range of global, public and local private organizations in a variety of industries, helping them deal with their most significant business risks and issues as well as providing advice on Corporate Governance. His experience includes external auditing, business and operational consulting as well as internal audit and business risk management.

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Presenter - David Landsittel was elected Chairman of COSO on June 1, 2009. He is currently a consultant to accounting firms and others on auditing, financial reporting, corporate governance, and quality control matters. David also serves on the boards of directors and as chair of the audit committees for Molex Incorporated and Burnham Investors Trust for the Burnham Family of Funds. Moreover, he is an Executive-In-Residence at DePaul University in Chicago. He began his career and spent 34 years with Arthur Andersen & Co. David was previously chair of the Illinois CPA Society and more recently chair of the CPA Endowment Fund of Illinois – a not-for-profit group that provides scholarships and encourages qualified students to pursue careers in public accounting. He holds an MBA from the University of Chicago Graduate School of Business and an undergraduate degree from DePauw University.

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Presenters (Continued)



Presenter - Mark Beasley, Ph.D., CPA represents the AAA on the COSO Board and is the Deloitte Professor of Enterprise Risk Management and Professor of Accounting in the College of Management at North Carolina State University. He is the founding director of NC State's ERM Initiative (www.erm.ncsu.edu), which is a thought leader in ERM with an emphasis on the integration of ERM with strategy and governance. Mark's research focuses on issues related to corporate governance, risk, and controls. He is a past President of the American Accounting Association's Auditing Section and has served on several national task forces and working groups, including the Auditing Standards Board SAS No. 99 Fraud Task Force and the advisory board for The Conference Board's research about board of director responsibility for ERM.

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Presenter - Jim DeLoach is a Managing Director in Protiviti's Houston office. Jim is Protiviti's global leader in the governance services space, which includes SOX compliance and enterprise risk management services. This widely published writer and author also has served on the COSO Advisory Board. Jim is the author of Protiviti's popular *Guide to Sarbanes-Oxley* and *Guide to Enterprise Risk Management*, among many other publications. He is frequently sought after to advise and counsel executives and directors regarding governance, risk management and Sarbanes-Oxley compliance matters.

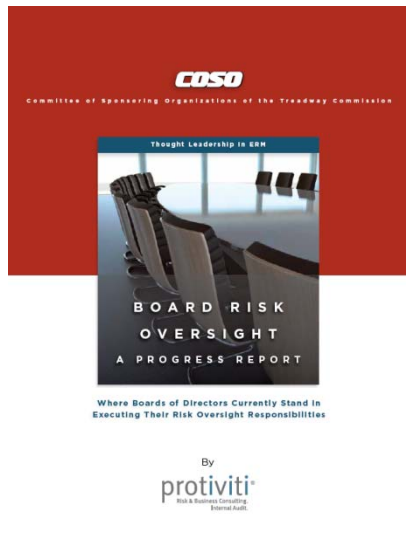
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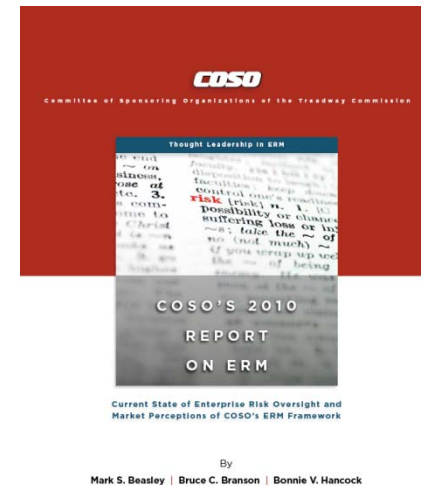
Agenda

- COSO and its perspective on the need for two surveys
- Overview of survey results
 - *Board Risk Oversight – A Progress Report: Where Boards of Directors Currently Stand in Executing their Risk Oversight Responsibilities*
 - *COSO's 2010 Report on ERM: Current State of Enterprise Risk Oversight and Market Perceptions of COSO's ERM Framework*
- COSO response to survey results
- Initial steps organizations should consider taking to achieve improvements
- Discussion of questions

Publications



*Board Risk Oversight – A Progress Report:
Where Boards of Directors Currently Stand in
Executing their Risk Oversight Responsibilities*



*COSO's 2010 Report on ERM: Current State
of Enterprise Risk Oversight and Market
Perceptions of COSO's ERM Framework*



Some Background about COSO

- A voluntary private sector organization
- A joint initiative of the following sponsors:
 - American Accounting Association (AAA)
 - American Institute of Certified Public Accountants (AICPA)
 - Financial Executives International (FEI)
 - Institute of Management Accountants (IMA)
 - The Institute of Internal Auditors (IIA)
- COSO's mission:

*“to provide **thought leadership** through the development of comprehensive frameworks and guidance on **enterprise risk management**, **internal control** and **fraud deterrence** designed to improve organizational performance and governance and to reduce the extent of fraud in organizations.”*



COSO's Perspective on the Need for Two Surveys

- COSO's ongoing desire to obtain input from interested parties on all three of the subjects of its mission
- An understanding of the ERM environment is particularly important
 - Because of the external interest in risk management arising from the economic downturn
 - Because of our perception that the extent of ERM implementation is uneven
 - The ERM Integrated Framework provides that board risk oversight is an important element of the internal environment when implementing ERM
- A conclusion that separate perspectives were needed regarding:
 - An understanding of the maturity and robustness of ERM process from a management perspective, and how our ERM framework is viewed by management
 - A separate understanding about how directors view the current and future state of their risk oversight processes
- Survey results provide a basis for COSO's conclusions about the need for future thought leadership efforts



Board Risk Oversight – Overall Survey Results

- Major findings:
 - Strong majority reports boards not executing mature/robust risk oversight processes
 - Overall dissatisfaction in the way risk is considered in context of enterprise's strategy
 - Generally agreed that, in the absence of routine risk appetite dialogue, risk appetite may not always get driven down into the business to set risk tolerances
 - Processes for monitoring and reporting of risks should be enhanced
 - Public companies report better processes
 - Risk oversight assessment should be incorporated within the board's existing periodic self-assessment process
- There are one or more obstacles inhibiting improvements in the risk oversight process
- Six areas for improving board risk oversight noted



(1) Improve Robustness of Risk Oversight Process

- Should be more structured processes for monitoring key risks and reporting them to the board
- Boards are not fully satisfied with processes that monitor the impact of changes in the environment on the business strategy
- Risk oversight responsibility generally resides with the board



(2) Enhance Risk Reporting to the Board

- Reports not received annually by most boards are generally received on an as-needed/ad-hoc basis or not at all
- Reporting most commonly cited as received at least annually
 - High-level summary of the top risks for enterprise and operating units (71 percent)
 - Periodic overview of management’s approach to assess, prioritize and measure risk (65 percent)
 - Risk reports, such as trends in key risk indicators (58 percent)
- Reporting most commonly cited as not received or received in an ad-hoc manner (e.g., as requested)
 - Scenario analyses evaluating the impact of key external variables on the organization (47 percent)
 - Summary of exceptions to management’s established policies or limits for key risks (46 percent)
 - Summary of significant gaps in capabilities for managing key risks and status of initiatives to address those gaps (43 percent)
- Directors from public companies reported more favorable results in terms of receiving the reports at least once a year



(3) Improve Risk Appetite Dialogue

- Many organizations are seeking to better understand their risk appetite
- Only four in ten responses indicate that organizations routinely express risk appetite in either quantitative or qualitative terms
- Majority of responses noted dissatisfaction with discussions regarding risks acceptable to the organization and subsequent framing of strategy
- Action plans to address deviations from risk tolerance parameters require improvement



(4) Improve Monitoring of Risk Management Process

- Nearly two-thirds indicate that monitoring of the organization's risk management process isn't done at all or is executed ad hoc
- About half of respondents agree that there is a periodic assessment of the resources supporting the risk management process
- Overwhelming majority noted that processes to monitor the impact of the changing environment on the business strategy can be improved



(5) Keep Board Informed of Most Significant Risk Matters

- Many companies have a process to apprise the board of the most significant risks and how those risks are managed
- However, in relatively few organizations is the process well-defined and rigorous
- Directors of U.S.-based organizations responded more favorably to how significant risks are being managed and where specific limits are exceeded



(6) Implement Board Self-Evaluation of Risk Oversight Process

- Almost one-third of the respondents stated that the board does not self evaluate its risk oversight processes
- Also, one-third of the respondents claim that self evaluation of the risk oversight process is done on an ad-hoc basis
- Less than one-tenth of the respondents agree:
 - The self evaluation is a robust and mature activity
 - The board is satisfied with the supporting self-assessment process



2010 Report on ERM – Overall Survey Results

Two Main Objectives: Obtain management perspectives on

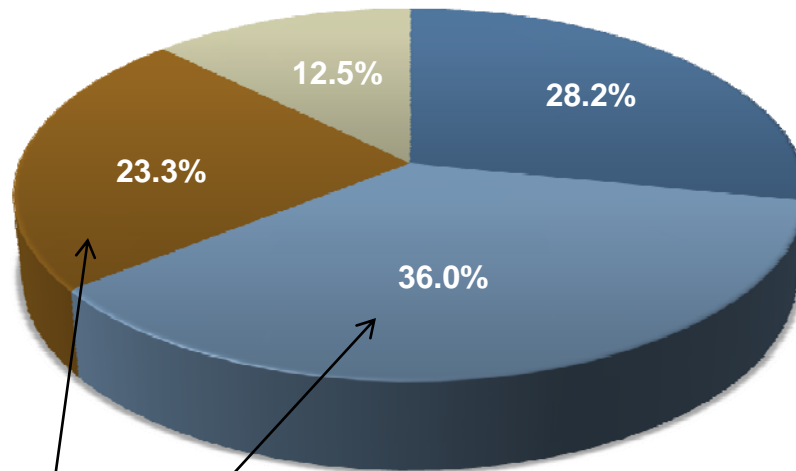
1. Current state of enterprise risk management
2. Usefulness of COSO's *Enterprise Risk Management – Integrated Framework*

Responses from 460 executives

- Mix of executive types responding – CROs, CFOs, Internal Auditors, Controllers
- Over 75% represent “for-profit” entities with 41% publicly traded companies
- Variety of industries represented

Major Finding: Relatively Immature Risk Management Processes

Current Stage of ERM



- Systematic, robust and repeatable process with regular reporting of aggregate top risk exposures to board.
- Mostly informal and unstructured, with ad hoc reporting of aggregate top risk exposures to the board.
- Mostly track risks by individual silos of risks, with minimal reporting of aggregate top risk exposures to board.
- There is no structured process for identifying and reporting top risk exposures to the board.

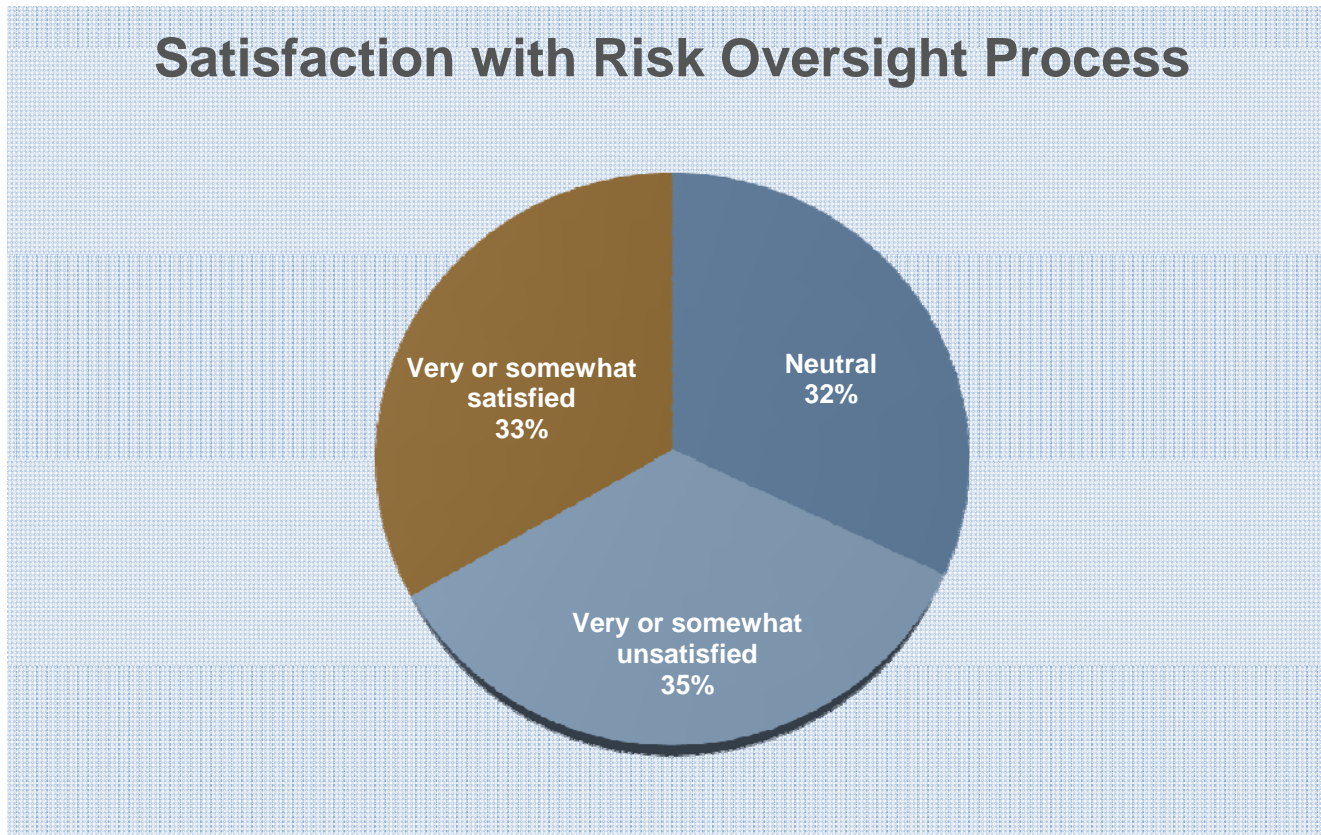
Almost 60% say informal, ad hoc, or silo-based risk oversight

Major Finding: Underdeveloped Elements of Risk Oversight

	Not at All 1	2	3	4	A Great Deal 5
Formally report top risk exposures to board	20.3%	17.0%	17.9%	24.5%	20.3%
Structured processes for identifying and monitoring emerging strategic risk exposures	21.1%	23.3%	25.5%	18.1%	12.0%
Mgt and Board monitor robust set of key risk indicators for emerging risks	26.0%	24.3%	24.8%	16.9%	8.0%

42.4%
**Self-describe sophistication of risk oversight
as immature or minimally mature**

Major Finding: General Dissatisfaction with Existing Risk Oversight





Insight 1: Lack of Perceived Value from ERM

- Lack of robustness in risk infrastructure may be due to
 - Failure to see interconnectivity of risk oversight and strategy execution
 - Disconnect with the relationship between “risk and return”
 - Unfortunate positioning of ERM as “compliance” or “bureaucratic”
 - Lack of C-Level and Board of Directors endorsement
 - Perception that ERM is too costly or difficult
- Helpful resources:
 - *COSO’s Effective Enterprise Risk Management: The Role of the Board of Directors*
 - *COSO’s Strengthening Enterprise Risk Oversight for Strategic Advantage*



Insight 2: Lack of Maturity Attributable to Overconfidence

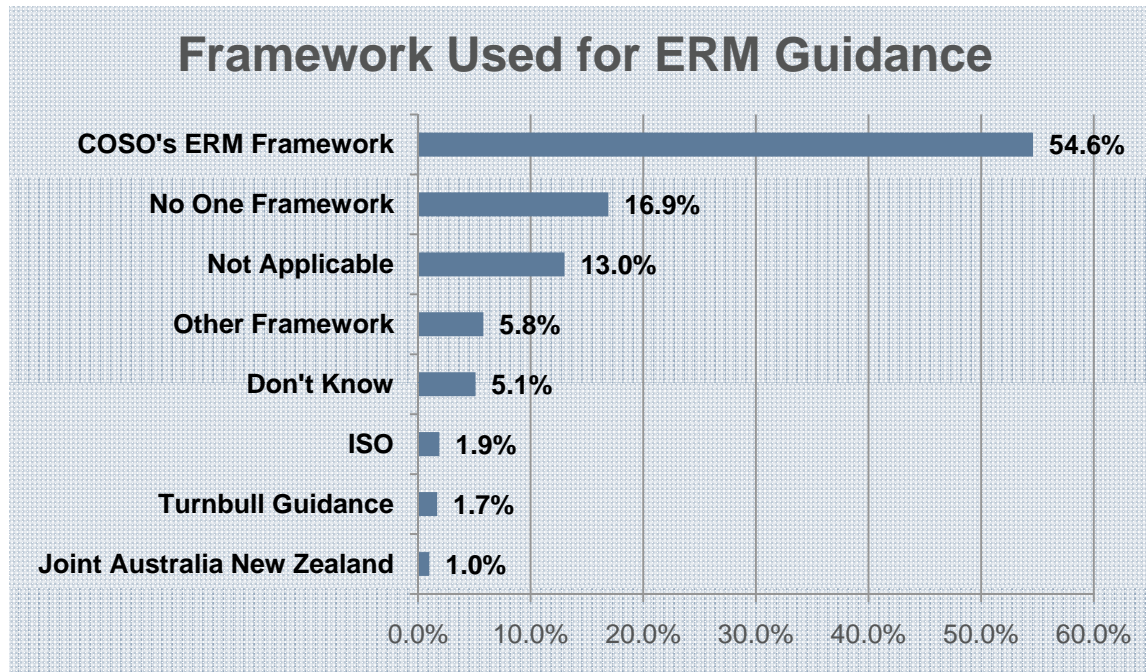
- Lack of robustness in risk infrastructure may be due to
 - Overconfidence on part of management in current approaches
 - Belief that ad hoc and informal nature is adequate and appropriate despite increasingly complex risk environment and velocity of change
 - Paralysis as to how to start
 - Ignorance that won't be unveiled until significant crisis occurs
 - Need for training and “level-setting” about purpose and benefits of ERM
- Helpful resources:
 - *COSO's Embracing Enterprise Risk Management: Practical Approaches for Getting Started*
 - *COSO's Developing Key Risk Indicators to Strengthen Enterprise Risk Management*



Insight 3: Change On Horizon

- Growing calls for improved risk oversight
 - 59% of boards extending moderate to extensive calls for strengthened risk oversight
 - Much of board's interest is being driven by audit committee
 - CEO is calling for increased senior executive involvement in risk oversight
 - For those with an internal audit function, 65% making moderate to extensive requests for management involvement in risk oversight
 - Some additional pressure coming from external sources, including regulators and key stakeholder groups

Insight 4: COSO ERM Framework Helpful Resource



- Perceptions About COSO ERM Framework

- 66.6% strongly believe it provides theoretical and sound principles for ERM
- 45.8% strongly believe it clearly describes key elements of robust ERM process
- But, there are strong indications of a need for more templates and examples of up-to-date ERM implementations



COSO Response to Survey Results

- The overall strategy: providing “thought papers” aimed at moving ERM implementation up the “maturity curve” – all available free at www.coso.org
- Two thought papers issued in late 2009:
 - *Strengthening Enterprise Risk Management for Strategic Advantage*
 - *Effective Enterprise Risk Oversight: The Role of the Board of Directors*
- Two additional thought papers issued January 2011:
 - *Developing Key Risk Indicators to Strengthen Enterprise Risk Management: How Key Risk Indicators Can Sharpen Focus on Emerging Risks*
 - *Embracing Enterprise Risk Management: Practical Approaches for Getting Started*
- Another thought paper aimed at helping organizations better articulate and implement “risk appetite” is expected to be issued next spring
- Additional thought paper projects may be undertaken



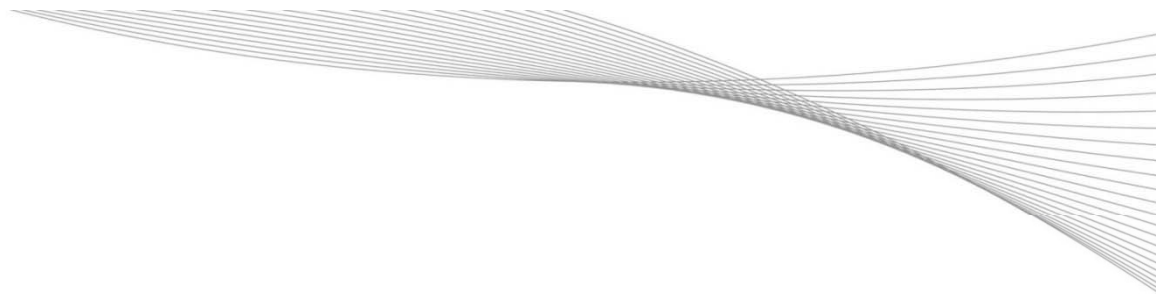
Recommendations for Improving Board Risk Oversight

- Implement a more structured process for monitoring and reporting critical enterprise risks and emerging risks
- Look for opportunities to enhance the risk reporting process to make it more effective and efficient and increase the regularity of reporting
- Come to an agreement with management on risk-related matters that need to be escalated to the board, addressing the what, when and why
- Encourage out-of-box, big-picture thinking focused on the critical assumptions underlying the corporate strategy to assess strategic risks
- Focus on whether developments in the business environment result in changes in critical assumptions underlying the organization's strategy
- Implement a more defined and rigorous process supporting the risk appetite dialogue between the board and management
- Incorporate appropriate questions relating to risk oversight in the board's periodic evaluation of board performance effectiveness



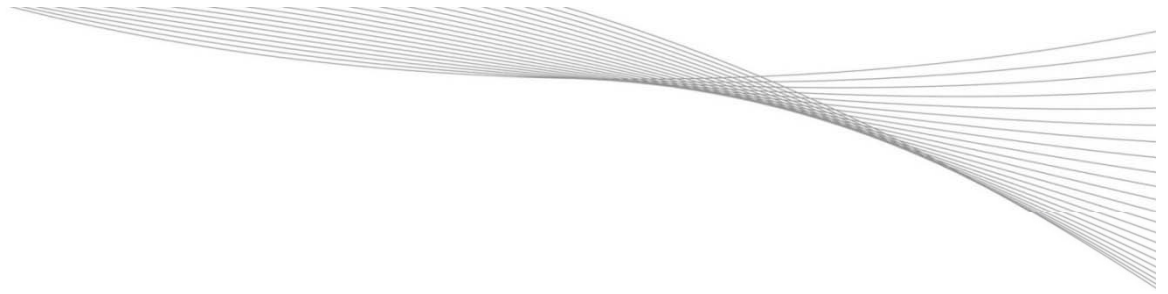
Recommendations for Management

- Start by focusing on risks to core business drivers and new strategies
 - Identify risks that are most likely to derail business drivers
 - Emphasis on emerging risks
 - Seek benefits of being proactive vs. reactive to emerging risks
- Keep it simple and let it evolve
 - A conversation among senior management about biggest risks may be easiest start
- Ensure CEO and Board support
 - Culture is king
 - Communicate that support immediately and frequently
- Start!!
 - Avoid paralysis of where to begin
- Don't re-invent the wheel
 - Take advantage of numerous existing resources



Q & A

Thank You



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