

Risk management / Compliance and ethics

Introduction

On April 20, 2006, members of the Audit Committee Leadership Network (ACLN) met for the network's twelfth meeting. Members considered two related topics:

- **Risk management: responding to the challenges**
- **Compliance and ethics: a deep dive into one area of risk**

Members first considered risk management, a subject they had previously discussed in December 2003.¹ Members then explored in depth one particular risk area: compliance and ethics. Members were also asked for the top issues they are facing. The answers included the need for more effective financial reporting systems, revamping the internal audit function, compensation of audit committee members and the chair, and whether the audit committee should have independent legal counsel on retainer.

Audit chairs participating in the meeting included:

- John Clendenin, Audit Committee Chair, The Home Depot
- Gene Fife, Audit Committee Chair, Caterpillar
- Roland Hernandez, Audit Committee Chair, Wal-Mart
- Chuck Noski, Audit Committee Chair, Microsoft and Morgan Stanley
- Judith Richards Hope, Audit Committee Chair, Union Pacific
- Steve West, Audit Committee Chair, Cisco Systems
- Doug Yearley, Audit Committee Chair, Lockheed Martin

Audit chairs who participated in individual discussions before the meeting were:

- Jim Adams, Audit Committee Chair, Texas Instruments
- Sandy Warner, Audit Committee Chair, General Electric Company

These members of the network, who participated in the meeting or in individual discussions beforehand, sit on the boards of over 30 large-, mid-, and small-cap public companies between them.

Other members participating in the meeting included:

- John Ferraro, Vice Chairman, Ernst & Young
- Tom Flannery, Partner and Director, Audit Committee Communications, Ernst & Young

ViewPoints reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations.

¹ For more information, see Audit Committee Leadership Network, "Enterprise Risk Management and the audit committee," *ViewPoints*, December 22, 2003. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Dec03_View3.pdf.

Executive summary

Risk management: responding to the challenges

Rather than dwell on the oft-debated acronyms of risk management (ERM, COSO, etc.), members focused on three of the biggest risk-related challenges they confront as audit committee chairs: identifying the key risks facing the company, dealing with those risks, and determining the governance of risk management.

- **Challenge 1: Identifying and prioritizing the risks to the business** *(Page 3)*

Members make a distinction between strategic risks, which are dynamic, and operational and compliance risks, which are static and easier to deal with. They recommend improving identification of strategic risks by obtaining in-depth input from the external auditor, the internal auditor, and management. They also recommend embedding risk management in existing processes for managing the business, using any available framework to get the conversation started at board level, and ensuring that the company learns from extreme events to identify new risks. Members want their companies to think the unthinkable regarding risks to the business, and some members have brought in outside experts to help.

- **Challenge 2: Dealing with risks once they have been identified** *(Page 5)*

Members are concerned with finding actionable solutions to identified risks. They focused on self-insurance (fiscal responsibility coupled with adequate capital reserves) and crisis planning to support risk mitigation. [Examples of actions audit chairs take to plan for extreme-event risks can be found on page 6.](#)

- **Challenge 3: Determining the governance of risk management** *(Page 6)*

Most members report that the board is the main venue for risk discussions. Board committees may prepare the board for the discussion or undertake much of the oversight work. For some members, the major challenge is dealing with strategic risk. For others, it is focusing on practical risk considerations. Members agree that executive sessions have added a new dimension to the board's ability to deal with risk. Audit committees that have oversight of risk management face such challenges as determining what areas of risk belong in the audit committee, keeping the company focused on risk management, and deciding what to take to the full board for discussion.

Compliance and ethics: a deep dive into one area of risk

- **The role of the audit committee** *(Page 8)*

Members described two alternative approaches to oversight of compliance and ethics: (1) the audit committee provides oversight, or (2) a separate ethics committee of the board provides oversight. [Elements of audit committee oversight of compliance and ethics can be found on page 9.](#)

- **Tone at the top: the first internal control** *(Page 10)*

Members agree that the CEO is the company's chief ethics officer and that tone at the top underpins all compliance efforts. Members discussed several red flags when auditing tone at the top and agreed that consistently applied discipline is a key support for the ethics program.

- **Globalization and ethics** (Page 10)

Audit committees are paying particular attention to ethical issues in emerging-market countries. They identified the practices they use to ensure that the tone at the top is reflected in the emerging markets, including regularly reviewing operations, conducting due diligence on partners and agents, and ensuring a strong internal audit focus. [Tips for audit committee oversight of ethics issues in emerging markets can be found on page 11.](#)

Risk management: responding to the challenges

Many audit chairs have reported that audit committees have entered a new, post-Sarbanes-Oxley era. The initial implementation of Section 404 is complete, processes are now being automated and embedded in companies, and audit chairs report they have more time to devote to other matters – in particular, risk management. Senior management is encouraging audit committees to focus on risk management. Last December, *InSights* interviewed nine CFOs and reported, “As the amount of time spent on Section 404 compliance subsides, CFOs are seeking to involve the audit committee in broader initiatives, including enterprise-wide risk management.”²

Increasing interest in risk management has not been accompanied by increased satisfaction with risk frameworks or processes that identify risk. Members were asked to rate how satisfied they were getting a comprehensive enough view of risk. One member cautioned, “*You can’t get a 10. The factors affecting risk keep changing. If you get a 10, new issues come up, and you are back to 8 again. The role for the audit committee is to be at the forefront of discussion, evaluation, and getting experts involved. We have to keep harping on, keep preaching, and keep asking questions.*”

Members addressed the biggest risk management challenges facing audit committee chairs:

- Challenge 1: Identifying and prioritizing the risks to the business
- Challenge 2: Dealing with risks once they have been identified
- Challenge 3: Determining the governance of risk management

Challenge 1: Identifying and prioritizing the risks to the business

The first step for most companies implementing a risk management process is to identify the priority risks to the business. Discussions with audit committee chairs in a number of networks and recent business literature suggest that companies, boards, and audit committees rely to different degrees on a combination of tools and frameworks and a robust strategic planning process to surface risks.

The business case for a formal risk management process often stems from failure. A recent Booz Allen Hamilton study of companies whose stock price significantly underperformed over a six-year period

² Tapestry Networks and Ernst & Young, “The CFO’s perspective,” *InSights*, December 22, 2005, 5. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Dec05_InSights.pdf.

determined that “13% of the value destroyed by these companies resulted from compliance failures; the other 87% was attributable to strategic and operational blunders.”³

Finding a framework that can be applied to strategic, operational, and compliance risks

For many companies, the risk-mapping phase of risk management is as far as they get. Even risk mapping can present challenges for the board and the audit committee. Members are careful to make a distinction between strategic risk on the one hand and operational and compliance risk on the other.

Members indicated that discussion about the identification of strategic risks is the preserve of the board, while the downstream monitoring of the risks (together with identification of financial, operational, and compliance risks) is the role of the audit committee. For instance, several members said their audit committee “review[s] the track record on deals to enforce accountability by the finance committee or the full board.” However, some audit committees are also involved in discussions of strategic risk (see “Emerging best practice: bring in the experts” on page 5 for an example).

One member said, “*The issue is the framework to address risk. Strategic-risk discussion is very different from compliance risk, and we tend to get them mixed up. Compliance is static; strategic risk is dynamic and involves the board. Finding a framework to address both is a challenge.*” Another member agreed: “*We have an infrastructure to deal with operational and compliance risk. On the strategic side, that is less explicit.*” Members offered several suggestions for dealing with this challenge:

- **Obtain multiple in-depth inputs on risk.** Several members try to get a 360-degree view of risk: “*We get three views: external auditor, internal auditor, and management – that helps.*”
- **Embed risk management in existing processes for managing the business.** “*Management [is] trying to embed risk management in the strategic planning process to drive managers to think about it explicitly. A separate antiseptic activity won’t work.*”
- **Use any framework to get the conversation started.** “*The board is creating a matrix of different areas of risk, how responsibility is allocated organizationally, how this is communicated to the rest of the company, which part of the board has oversight of it. This has been effective in giving us something to talk about.*”
- **Focus on lessons learned from extreme events to identify new risks.** Extreme events become opportunities to review and refresh the company’s risk management process: “*We all support just-in-time manufacturing, but post-Katrina, companies found if they had a major supplier in the area, they had no inventory.*”

The difficulty in thinking the unthinkable

A consistent message from members was the difficulty in getting their companies to be truly imaginative in identifying risk. One member said, “*It is hard to get people to think outside the box in the risk area. We look at what caused risk in the past, rather than what will cause problems in the future.*”

³ Paul Kocourek and Jim Newfrock, “Are Boards Worrying About The Wrong Risks?” *The Corporate Board*, March-April 2006, 2. Available at http://www.boozallen.com/media/file/worrying_about_the_wrong_risks.pdf.

Another member talked of the reluctance of executives to have negative conversations: *“It is hard to say to management, ‘You have to focus on this.’ They don’t like nightmares, so you have to keep bringing it up.”* Even so, there is a balance to maintain: *“Companies get into trouble when they are not thinking the unthinkable, but we don’t want them to be so risk averse that they don’t take opportunities.”*

Emerging best practice: bring in the experts. One member outlined the solution he pioneered in one company: *“With a given set of players on the board and audit committee, we only have so much expertise, and this constrains our thinking. We go out and get the best experts on the issue under discussion. They come in and motivate the [company’s] thinking. We get the world’s best thinkers to tell us what is likely to happen in 10 years’ time. This is done at the audit committee and reported to the full board. There is resistance [as] this challenges management’s own expertise, but you hear things you don’t hear from management. Now [the company] has had enough value [from the process] that management no longer challenges the fees.”*

Another member described a similar process: *“We hired a crisis consulting firm to ask questions about thinking the unthinkable. There was good implementation following this.”* However, a third audit chair who had tried a similar approach cautioned, *“You do get push back from management; they do not believe there are any angles they haven’t thought through.”*

Challenges posed by the chief risk officer

While many companies outside the financial services and energy utilities sectors do not have a chief risk officer (CRO) role in their company, those that do recognized several challenges inherent in the role. One member opposed rolling risk up into a single office or officer because it is just too large and pervasive: *“I want everyone to worry about [risk], not just those people ‘tasked’ with it.”* In our December 2003 meeting, members felt strongly that an enterprise-wide view of risk has to be both embraced and driven by the CEO.⁴ Prior to the current meeting, several members reported in the words of one audit chair: *“The CEO and the president really are the chief risk officers.”*

Another member talked about the difficulty inherent in the CRO’s having an enterprise-wide view of risk. This audit chair is aware of a company that is experimenting with a CRO role: *“[The CRO] ... reports to the general counsel ... The CRO will deal with all risks, but [the role] is in the legal department, and this may impact the result.”*

Challenge 2: Dealing with risks once they have been identified

The second major risk management challenge facing audit chairs is how the company should respond to the risks that have been identified. One member said, *“My concern is translating good risk identification into executable operations – being able to do something about it. We track a good number of risks; management has tried to respond, but it is difficult to find good solutions.”* Another member agreed: *“There is certainly more we can do ... The biggest challenge is that many of the risks we face cannot be controlled – weather, terrorism, prices of raw materials.”*

⁴ Audit Committee Leadership Network, “Enterprise Risk Management and the audit committee,” *ViewPoints*, December 22, 2003, 6. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Dec03_View3.pdf.

Companies have four approaches available to manage a particular risk once it has been identified. These approaches can be used separately or in combination. The four approaches are: (1) avoidance of the risk; (2) transference of the risk to a third party (typically through an insurance contract); (3) assumption of the risk by the company, including through self-insurance or the formation of an insurance subsidiary; and (4) mitigation of the impact of the risk through the implementation of certain controls or management actions.

Members focused on self-insurance and crisis planning to support risk mitigation:

- **Self-insurance.** One member suggested the best way to deal with identified risks was to develop deep pockets. *“You can’t look five years out ... but you can ensure [the company has] the economic horsepower to withstand any hits. That is more important. We need fiscal responsibility, and more than adequate capital reserves.”*
- **Crisis planning to support risk mitigation.** Should companies have a crisis plan ready to cover top-priority, high-impact risks? One member said, *“Event risks are difficult to predict – 9/11, Hurricane Katrina, Bhopal. These are the toughest of all risks. You need systems to deal with [them] when [they] happen.”*

Audit chairs whose companies plan for extreme-event risks:

- **Encourage management to put a plan in place in advance.** *“Crisis management is a constant issue ... You can’t wait until the crisis is happening.”*
- **Brainstorm potential scenarios.** *“We ran tabletop scenarios with a crisis group. How do you deal with the process? You have to plan for it. Dealing with the press and protecting the company’s reputation is a top-of-mind issue.”*
- **Ensure that crisis plans are specific, not generic.** *“The company may have plans in place, but they are very generic. They set out the PR firms and lawyers [we would use]. I requested a detailed plan for the avian flu pandemic. It was a good exercise, and we have a plan in place.”*
- **Take a good look at tone at the top.** *“Tone at the top is the most critical thing that the audit committee has to think about. Is the CEO in the right area of ethical behavior? Can we rely on the CEO and his or her team in a crisis?”*

Challenge 3: Determining the governance of risk management

The third risk management challenge audit chairs identified is ensuring good oversight of risk management. Most members report that their board is the main venue for discussions on risk. Board committees play various roles; some prepare the board for the discussion, while others undertake much of the oversight work. Many financial institutions have a dedicated risk committee of the board.

Challenges for the board

Some members are concerned about how well the board deals with strategic risk. *“We have strategic discussions, but we don’t spend enough time on the competition and strategic threats to the company.”*

There is a lot of pull from management to ask members what they think. Most board discussions are around risk and how much [we are] going to take. I feel we're not taking enough risk."

Members also agree that risks evolve at such a pace that the regular board and audit committee meeting cycle cannot easily accommodate them. *"This is a fast-changing environment. You can identify the risks now, and in six months' time they would have changed significantly."*

Another concern is the flipside of lack of breadth in discussions of strategic risk – the board's ability to focus more deeply on practical risk considerations. One member said, *"We have a strategic planning session every year, but we look down from 80,000 feet, and the challenge is, how do we make it practical?"*

Members offered several solutions to help the board better manage strategic risk:

- **Address risk at each board meeting.** *"The entire business is [about] risk assessment. We do some risk assessment at every meeting, especially planning meetings."*
- **Link risk management to strategic planning.** *"We link risk into the strategic planning process through a dashboard. Risks are labeled red, yellow, and green, and indicate change. The dashboard is tailored to the particular business at hand. We decide what is on the dashboard through a consensus discussion led by management [and] added to by the board."*
- **Take advantage of executive sessions.** *"The executive sessions have been a real benefit of Sarbanes-Oxley. Things come up every time. There is a candor in the executive session you don't get in full board meetings. Private meetings with the CEO are also very useful. Mostly, the CEOs appreciate it – they don't reach out for it, but they are grateful when they get it."* Another member added, *"The board must be informed of major hot buttons. We use the executive session to raise sensitive issues around people."*

Challenges for the audit committee

What is the role of the audit committee with respect to risk oversight? The New York Stock Exchange (NYSE) listing rules states, "While it is the job of the CEO and senior management to assess and manage the company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled. The audit committee should discuss the company's major financial risk exposures and the steps management has taken to monitor and control such exposures."⁵

The challenges faced by those audit committees that have oversight of risk management, beyond the obvious challenge of finding time on already crowded audit committee agendas, include:

- **Determining what areas of risk belong in the audit committee.** One member recommended that even if the audit committee took on oversight of financial risks, it *"should stay away from strategic risk – that is management's job and then the board's. The audit committee should look at operational and compliance risk. The audit committee is downstream in the decision-making process."*
- **Keeping management focused on risk management.** *"The audit committee says, 'What are you worried about? What would blow up the company? What are you doing about it? Is that enough;*

⁵ Commentary from the *Final NYSE Corporate Governance Rules* 303A.07(c)(iii)(D), <http://www.nyse.com/pdfs/finalcorpgovrules.pdf>.

should you be doing these other things?’ The audit committee has to be a pain in the neck. We ask questions to the CEO when he attends audit committee meetings.”

- **Deciding what to take to the full board for discussion.** Even when the audit committee has taken on the full risk oversight role, *“it is the responsibility of the total board to look at the audit committee’s ‘big worry’ items, to understand them and the implications of what can go wrong.”* One audit chair said, *“This is where the audit committee chair has one of the most important roles. You have to evaluate how important [an issue is] and how to take action on it. It comes down to the experience of the audit committee chair and the nose test: does it smell right or not?”* Another audit chair said, *“I don’t want to be preemptive: any audit committee member can take any issue to the board. There is no category and no checklist [of the types of risk that can be discussed].”*

While audit chairs may differ about the audit committee’s role in the oversight of risk management, the one thing they agree on is not to confuse overseeing risk processes or specific risks with the managerial responsibility for managing risk.

Compliance and ethics: a deep dive into one area of risk

In addition to focusing on risk management in general, ACLN members held a deep-dive discussion on the specific risk topic of compliance and ethics. During the discussion, attention focused on:

- The role of the audit committee
- Tone at the top: the first internal control
- Globalization and ethics

Several factors have put compliance and ethics on the agenda of boards and audit committees, including Sarbanes-Oxley and the NYSE listing requirements,⁶ the Federal Sentencing Guidelines for Organizations,⁷ and the duty of oversight set out in the Delaware Chancery Court’s 1996 *Caremark* decision.⁸

The role of the audit committee

In their 2004 study of ethics programs, The Conference Board revealed that “in the U.S., more than three-quarters of the participating companies delegate [ethics] program oversight to the audit committee ... The second choice ... is the governance committee.”⁹

⁶ The final governance rules were approved by the Securities and Exchange Commission on November 4, 2003. They state that audit committees should oversee whistleblower processes and procedures that allow employees to make allegations of fraud, questionable accounting or auditing matters, or ethical violations in safety and anonymity. The rules are available for review at <http://www.ecgi.org/codes/documents/finalcorpgovrules.pdf>.

⁷ The guidelines adopted in 1991 and amended in 2004 “now emphasize that significant board involvement in corporate compliance and ethics programs is required to mitigate potential criminal penalties.” (Quotation from Weil, Gotshal & Manges LLP, letter to clients and friends, July 14, 2004.)

⁸ The *Caremark* decision held that the full board is protected by the business judgment rule as long as board members take reasonable steps to assure themselves that the corporation has in place a system of financial and legal compliance controls designed to provide accurate financial reports and prevent serious violations of law.

⁹ The Conference Board, *Ethics Programs - The Role of the Board: A Global Study, Report R-1344* (New York: The Conference Board, 2004), quoted on the website of the Ethics and Compliance Officer Association in “Boards of Directors Getting More Involved In Companies’ Ethics Programs,” <http://www.theecoa.org/newsletter/Archive.asp?ID=66>.

It is the NYSE listing standards that effectively delegate the duty of compliance oversight to the audit committee. The standards introduced for implementation during 2004 require the audit committee's charter to specify the committee's purpose, which must include a provision to assist with board oversight of the company's compliance with legal and regulatory requirements.

Elements of audit committee oversight of compliance and ethics

Members broadly agree that audit committee **oversight of compliance** includes:

- Receiving reports from the chief compliance officer or equivalent
- Considering regulatory filings for each jurisdiction
- Reviewing adherence to internal company policies
- Assessing accountability for warrants made during acquisitions
- Examining conflicts of interest and how they are reported

Audit committee **oversight of ethics** includes:

- Receiving reports of whistleblower complaints and from the chief ethics officer or equivalent
- Assessing the effectiveness of codes of conduct
- Evaluating and even participating in global ethics training

In September 2004, the ACLN discussed non-financial compliance. *ViewPoints* reported, "Members agreed that the audit committee, and not another board committee, should oversee non-financial compliance. They argue that the audit committee's role is to ensure that management has put the processes and accountabilities in place and is enforcing them: the audit committee should not manage non-financial compliance itself."¹⁰

During the current meeting, members described two approaches to oversight of compliance and ethics:

- **Audit committee provides oversight.** One member reported that compliance and ethics had moved from the governance committee to the audit committee. Another member said, "*The compliance and ethics program is in the audit committee. I would like to give it up, but that's not going to happen. We also have the investigations group via the corporate audit function. HR manages the employee sign-off on the ethics code, but the audit committee follows up.*"
- **Ethics committee created to provide oversight.** In a company in which the audit and ethics committees had been combined but have now been separated, the audit chair commented, "*The ethics committee looks at business practices, training, environment and safety issues, and non-financial compliance. We couldn't handle this in the audit committee and do it well. We worked [out] the line between the ethics and audit committees, and crossover membership is helpful.* This audit chair observed that because the separation of duties was easily blurred, the two committees need to be in continuous communication.

¹⁰ Audit Committee Leadership Network, "Comply, Audit, Disclose! New thinking about the role of the audit committee," *ViewPoints*, October 8, 2005, 2. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Oct04_View6.pdf.

Tone at the top: the first internal control

In the words of one ACLN member, *“The CEO is the chief ethics officer. Ethics has to be deeply transmitted authentically by the CEO.”* In effect, tone at the top underpins all compliance efforts. In this company, the board oversees the CEO’s goal setting each January and reviews progress at midyear and end of year. *“We establish the tone at the top and how it is communicated and followed through for everyone else. [The CEO then] sits down with the VPs and blends their goals with his.”* Another member agreed, saying, *“There are not enough board meetings ... [to] compensate for a bad CEO.”*

The Institute of Internal Auditors points out that a strong system of internal control includes a big-picture view of risk and an enterprise-wide set of controls, enacted through an internal set of reporting processes and emanating from a “well seasoned and ethical tone at the top.”¹¹

However, one member asked, *‘How do you audit tone at the top as a control, and what should the audit committee do?’* This member said that red flags included inappropriate management compensation, *“how sensitive management is to tracking the analysts’ consensus, and how much time they spend on it.”* Another member said the audit committee should ask about complex transactions, look at management motivation, and ask the external auditor for its risk assessment of the company: *“Where are the negatives?”*

ViewPoints previously reported ACLN members’ view that “tone at the top is so important that the audit committee should insist that perpetrators of fraud are always fired.”¹² Members feel equally strongly that those who violate codes of conduct must be effectively disciplined.

Speaking about the audit committee, one member reported, *“We engage with management on the consistent application of discipline. We don’t get involved in particular cases, but the ethics program needs to be supported by appropriate discipline. It is a management responsibility, but effective operation of the system is a safeguard, and the audit committee needs to see it is happening.”* Another member agreed, saying, *“There is a clear disciplinary code, and management has to come to the audit committee if they want to deviate from it.”*

Globalization and ethics

Audit committees are paying particular attention to ethical issues in emerging market countries. One member observed, *“There are cultural differences from one country to another – they do not all have the same standard of ethics. You have to focus on [ethics] and make it a high priority to embed it in the organization.”* However, members are equally aware that imposing U.S. standards on countries outside the United States is problematic: *“This is a big issue in China – we fire people who break the code ... Are we imposing U.S. views of ethics on other countries?”* Members identified the practices they use for ensuring that the tone at the top is reflected in the emerging markets (see box overleaf).

¹¹ Institute of Internal Auditors, “Is Your Sense of Security...FALSE?” *Tone at the Top* 29 (March 2006), 1. Available for download at http://www.theiia.org/?doc_id=739.

¹² Audit Committee Leadership Network, “Preventing, detecting and investigating fraud,” *ViewPoints*, March 24, 2004, 4. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Mar05_View8.pdf.

Tips for audit committee oversight of ethics issues in emerging markets

- **Review operations regularly.** *"We get stats on discipline every year by geography and see the firings. [We ask,] 'Is the spike up or down, and what does it mean?'"*
- **Conduct due diligence on partners and agents.** *"A lot goes through agents for distribution and selling. You need to look at them, check their credentials, and ensure there is complete transparency on finances."*
- **Ensure strong internal audit focus.** Corporate internal audit should focus on high-risk emerging markets as part of its annual plan. *"We select a set of countries with problems and dedicate internal audit resources to audit them every year, not on the three-yearly audit cycle." "We sent our internal audit staff to be trained as certified fraud examiners; about half of them have it, and we use them as a SWAT team."*
- **Ensure a code of conduct is rolled out.** The rollout needs to be backed up with a training program. *"We are all going global, and it is difficult to manage compliance with the Foreign Corrupt Practices Act (FCPA). Ethics training is relevant for any multinational." "You need an occasional public hanging or [the code] loses its teeth."*

Conclusion

Increasing interest in risk management has not necessarily led to increased clarity. Audit chairs feel most risk management frameworks do not recognize the difference between strategic risks, which are dynamic, and operational and compliance risks, which are static. These two types of risks require different types of conversations, with different parts of the business, and with different frequency. Much of the work on the risk management process, as well as on specific risks such as compliance and ethics, falls to the audit committee. Now that Section 404 is receding as a time-consuming agenda item, confronting the challenges of identifying key risks and then ensuring there are plans in place to deal with them is, in the words of one audit chair, "the next frontier for audit committees."

About this document

The Audit Committee Leadership Network is a group of audit committee chairs drawn from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit environment.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues.

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