

Enterprise risk: recurring challenges and new considerations for the audit committee

Introduction

On 30 September and 1 October 2008, members of the European and North American Audit Committee Leadership Networks met to discuss a range of issues,¹ including enterprise risk. For further information on the networks, see "About this document," on page 10.² For a full list of participants, see Appendix 1 on page 11.

Executive summary

The financial crisis continues to grip global capital markets. Financial media, shareholders and regulators have zeroed in on failures in enterprise-wide risk management as one of the key drivers of the crisis. Board directors of financial institutions have been pressed to pinpoint where the breakdown in risk management occurred. Naturally, the concern has extended to other industries, and boards and audit committees in all sectors are reconsidering their companies' approaches to managing enterprise risk. Rating agencies are increasing their attention to risk as well, as evidenced by the recent Standard & Poor's announcement that it may downgrade companies that display weak risk management even if problems have not yet become apparent.

During discussions on the subject of enterprise risk, audit chairs³ focused on the following topics:

- **Why companies are continually blindsided by risk** (*Page 2*)

At the summit, audit chairs focused on three reasons for companies' persistent problems in managing risk: management's limited views on possible sources of risk, market pressures for a short-term performance orientation, and the link between remuneration and risk taking. Audit chairs said that the board as a whole should be responsible for taking a holistic view of risk.

- **The role of the board and the audit committee in risk oversight** (*Page 5*)

Audit chairs agreed that in light of the current crisis, their boards are spending increasing amounts of time on risk oversight. Some had speculated in pre-summit discussions that this may be blurring the lines between the board and management. At the summit, audit chairs sought to distinguish the role of the audit committee from that of management and the full board. Most summit participants agreed that strategic risk is the responsibility of the full board, whereas the role of the audit committee is highly dependent upon industry, location and whether the board has other committees that address aspects of risk. However, common focal points for audit committees are operational and financial risk. Given these

¹ Other summit discussions included "Finding a balanced approach to global regulation" and "IFRS in Europe and the US: lessons learned and challenges ahead." *ViewPoints* on both of these discussions can be found at http://www.tapestrynetworks.com/networks/net_audit_summit3.html.

² *ViewPoints* reflects the use of a modified version of the Chatham House Rule whereby names of members, guests and company affiliations are a matter of public record, but comments made by members before and during meetings are not attributed to individuals or corporations. Comments made by participants at the summit are shown in italics.

³ This document uses the term "audit chair" to include all summit participants who are members of audit committees.

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



focal points, audit chairs recommended actions for audit committees to take during the current financial crisis.

- **Enhancing risk oversight: considerations for the audit committee** (Page 8)

As boards are pressurised to respond to shareholder concerns about the effectiveness of their oversight of risk, audit committees can become catalysts for improvements. Audit chairs suggested several ways the audit committee can help improve management's approach to risk and catalyse enhanced board oversight of risk, such as by asking "out-of-the-box" questions to help identify risks and testing whether company culture runs counter to risk management efforts.

Why companies are continually blindsided by risk

Enterprise risk has been a factor not only in the current financial meltdown, but also in past crises, such as the US savings and loan crisis of 1987 and in European corporate scandals such as Parmalat in the early years of this decade. Audit chairs discussed the following issues at the summit:

- The most devastating risks often come from where no one is looking
- Pressure to perform in the short term obstructs companies' ability to manage risk
- There is a link between risk appetite and remuneration

The most devastating risks often come from where no one is looking

In a recent *Economist* article, a risk manager of a global bank explained, "At the beginning of the year [2007], I gathered my team for an off-site meeting to identify our top five risks for the coming 12 months. We were paid to think about the downsides but it was hard to see where the problems would come from ... 'Where is the liquidity crisis supposed to come from?' someone asked in the meeting. No one could give a good answer."⁴ For all sectors, the financial crisis is the most recent example of how seemingly rigorous approaches to risk management can leave blind spots.

Trying to think of and prepare for the unexpected is a challenge for management and boards alike. In a pre-summit conversation, one audit chair put it this way: "I have come to the conclusion that nine out of ten risks you can map, but the one lurking in the dark will bring you to your knees." Audit chairs at the summit voiced several concerns about management's approach to thinking about risks, including a tendency to take a retrospective view of the possible sources of risk. One participant said, "*If management cannot link the question to a real issue [they've seen], they think it is theoretical and [remote], that it will never happen, and so they tend to forget it. This mind-set needs to change.*"

In addition, several audit chairs were concerned that management may take a narrow, business-unit view of risk, without the benefit of a company-wide view: "*Silos [are problematic] – some people are experts in areas and see only the risks in their own areas ... but aren't good at looking at the interconnections across business lines and*

⁴ "Confessions of a Risk Manager," *Economist*, 7 August 2008. Available at http://www.economist.com/finance/displayStory.cfm?source=hptextfeature&story_id=11897037.

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



how they affect one another.” Another stated, “People look at [risk] in isolation, and no one imagines the perfect storm.”

Audit chairs at the summit agreed that the board and the audit committee have a role in challenging management’s retrospective view and pointing out the issue of siloed risk analysis. One European audit chair said, *“Non-executives can be more holistic in their view of the risks. They can look at the external environmental issues and probe for what is relevant to the company itself.”* Another said, *“The audit committee is responsible for making sure there are processes in place that enable more rigorous communication between [business] units and [that examine] how [risks] will affect the business as a whole.”*

Both before and during the summit, audit chairs were quick to stress that “no one is smart enough to know [all the risks] that can take a company down,” but several highlighted the importance of the board’s role in looking for “red flags.” One European audit chair said, *“You need to use common sense. If you don’t understand it, don’t build it or buy it.”* A US audit chair stated, *“You can’t know all the risks, but there are things [we can do]: understand the liquidity risk of every business and how it rolls up to the holding company; have a strong balance sheet to withstand any risk, especially when we know major risks are coming, even though we don’t know where the risk is coming from.”* This audit chair went on to outline a key red flag: *“Each business has ... an historical pattern of return on equity. If it gets too high compared to the historical norm, look at it. You’d be amazed at what this turns up.”*

Pressure to perform in the short term may obstruct companies’ ability to manage risk

Speaking at the summit, audit chairs questioned whether the pressure to consistently communicate positive information to shareholders impacts a company’s ability to adequately address risk. One US audit chair said, *“The psychology in the US is, as directors and managers, we don’t want to see or plan for bad news. At least a year ago, [the US] saw [the financial crisis coming,] but it was too painful to think about.”*

Others highlighted the pressure the market exerts on companies that are more conservative in their approach to risk than their industry peers. One European audit chair asked, *“Is being too risk averse a risk factor?”* Another European said, *“The cost of ... safety nets is [high.] If you are the only one in the sector doing it, the market won’t accept it.”* With respect to risks that the current financial crisis has revealed, an audit chair said, *“We have to reinvent the idea that you need extra solvency and liquidity. Don’t give the extra cash back to shareholders. This was highly unpopular a while ago. To me, this is a lesson learned.”*

There is a link between risk appetite and remuneration

The financial crisis has brought to the fore the question of how executive remuneration is determined and the implications for management’s risk appetite. Many market observers believe that the problem in financial institutions was not faulty risk management practices; rather, it was management’s risk appetite, which ran ahead of the board’s risk appetite, often fuelled by compensation approaches that encouraged greater risk taking. At the summit, audit chairs questioned how their boards could address this complex issue.

Regulators and investors in Europe and the United States have suggested that excessive executive remuneration contributed to increased risk taking and the current crisis. A March 2008 report by the Senior Supervisors

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



Group, which consists of regulators from France, Germany, Switzerland, the UK and the United States, pointed to an imbalance between risk appetite and controls in the financial firms it analysed: “Senior management at nearly all firms surveyed had allowed the businesses to increase their exposure to market risk, but some firms’ senior management was far more assertive than others’ in encouraging the increased risk taking. For example, firms that experienced material unexpected losses in relevant business lines typically appeared to have been under pressure over the short term either to expand the business aggressively, to a point beyond the capacity of the relevant [risk] control infrastructure, or to defend a market leadership position.”⁵

The report also indicated that executive remuneration may have contributed to this increase in risk appetite: “An issue for a number of firms is whether compensation and other incentives have been sufficiently well designed to achieve an appropriate balance between risk appetite and risk controls, between short-run and longer run performance, and between individual or local business unit goals and firm-wide objectives. Many firms are assessing their overall financial performance for 2007 and, in light of their results, re-evaluating their approaches to performance-driven compensation and other incentives going forward.”⁶ In an initial move to limit the remuneration of those executives who are seen as directly responsible for the current crisis, the US Congress included a provision in the recent Emergency Economic Stabilization Act that provides for limits on certain aspects of executive remuneration for some companies participating in the programme.⁷

Summit participants highlighted the difficulties boards have in setting executive pay. Stock programmes that were intended to align management’s motivations with the needs of shareholders have not proven sufficient. An audit chair stated, “*The use of stock as a large part of compensation – particularly restricted stock – didn’t change the behaviour of Wall Street.*” One pointed to the importance of balancing risk taking and remuneration: “*I strongly believe there is no growth without some risk [taking]. Compensation is the major incentive to take some risk. The question is where is the limit? We need some reasonable caps on compensation [for] everybody from the CEO down to the trader.*”

Some audit chairs suggested including provisions in remuneration packages that would allow the company to reclaim remuneration or rewards in cases of subsequent poor performance and instituting risk-adjusted pay for performance, so that senior executives’ pay would reflect the amount of risk taken in reaching specified performance targets. One stated, “*We can take back some of the bonus, if there are problems. We use a three-year rolling period, which aligns the compensation programme with the shareholder. At [my company] we are linking senior management [compensation] with the top 10 risks.*”

US corporate governance experts Stephen Davis and Jon Lukomnik recently wrote, “How does a board encourage appropriate risk-taking? What we propose is that boards ‘risk-adjust’ the familiar pay-for-performance paradigm ... This type of risk-adjustment is well known and understood in the investing world, where returns are normalized for volatility or for leverage. And make no mistake about it; putting the balance

⁵ Senior Supervisors Group, *Observations on Risk Management Practices during Recent Market Turbulence* (Senior Supervisors Group, 2008), 7. Available at http://www.newyorkfed.org/newsevents/news/banking/2008/ssg_risk_mgt_doc_final.pdf.

⁶ Ibid.

⁷ The complete text of the Emergency Economic Stabilization Act of 2008 is available at <http://financialservices.house.gov/essa>. The provisions referred to here are from pp. 29–32, Section 111, “Executive Compensation and Corporate Governance.”

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



sheet at risk is economic leverage. So why not adjust executive compensation performance targets to take risk into account?”⁸ In its April interim report, the Institute of International Finance, a representative body for banks, stated:

There is strong support for the view that the incentive compensation model should be closely related by deferrals or other means to shareholders’ interests and long-term, firm-wide profitability. Focus on the longer term implies that compensation programs ought as a general matter to take better into account cost of capital, not just revenues. Consideration should be given to ways through which the financial targets against which compensation is assessed can be measured on a risk-adjusted basis.⁹

A July 2008 European issue of *InSights*, which examined the audit committee’s involvement in remuneration, quoted a leading institutional investor representative, who said, “Audit committees need to be [more] aware of what impact remuneration plans can have on risk management.”¹⁰ An expert from the auditing profession added, “Audit committees should understand clearly how executives are paid and the key drivers of the overall remuneration programme so that they can evaluate the potential effect on the company’s overall risk profile.”¹¹ While the audit chairs interviewed for the report acknowledged that remuneration could be linked to risky decisions, they disagreed on whether the audit committee should be involved in target setting or the selection of performance metrics. However, with pay a recurring theme in financial and other crises, it may not be possible to avoid more audit committee involvement in the pay-setting process.

The role of the board and the audit committee in risk oversight

Effective board oversight of risk is crucial to a company’s success in managing and mitigating risk. In most countries, the audit committee plays an important role, whether overseeing the overall risk management process, overseeing specific financial risks or all material risks. In Europe, the 8th Company Law Directive has increased the similarities between European and US boards’ approach to risk. At the summit, participants discussed:

- The board’s role in overseeing strategic risk
- The audit committee’s role in overseeing financial and operational risks

The board’s role in overseeing strategic risk

Most audit chairs at the summit agreed that strategic risk – which Ernst & Young defines as “risk that could cause severe financial loss or fundamentally undermine the competitive position of a company”¹² – is the responsibility of the full board. One European audit chair put it this way: “*We have to integrate risk management more fully into the main responsibility of the board through strategy discussions.*” Many audit

⁸ Stephen Davis and Jon Lukomnik, “Risk-Based Strategic Analysis Critical to Long-Term Success,” *Compliance Week*, 14 October 2008. Available at <http://www.complianceweek.com/article/5090/risk-based-strategic-analysis-critical-to-long-term-success>.

⁹ Institute of International Finance, *Interim Report of the IIF Committee on Market Best Practices* (Washington, DC: Institute of International Finance, 2008), 12. Available at <http://www.iif.com/download.php?id=SDzcEc8juCI=>.

¹⁰ Ernst & Young and Tapestry Networks, “An increased role for audit committees in remuneration,” *InSights*, 27 June 2008, 7.

¹¹ Ibid.

¹² Ernst & Young, *Strategic business risk 2008: The top 10 risks for business* (EYGM, 2008), 2. Available at [http://www.ey.com/Global/assets.nsf/International/EY_Strategic_Business_Risk_2008/\\$file/EY_Strategic_Business_Risk_2008.pdf](http://www.ey.com/Global/assets.nsf/International/EY_Strategic_Business_Risk_2008/$file/EY_Strategic_Business_Risk_2008.pdf).

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



chairs agree that consideration of strategic risk should be embedded in the company's strategic planning process, which should include a way to bring risk to the board for evaluation and approval. An audit chair said, *"In strategic [planning], management will need to consider [the financial implications of the business model]. Then [management can] explain it to the board and audit committee, who can apply their own judgment."*

One audit chair suggested that the board should spend more time focused on strategy and risks: *"In my experience, you need a two-to-three-day off-site with the board to understand where the company is going and to talk about the risk balance."* In response, another audit chair stated, *"Risk is dynamic, and strategic risk can't wait [to be discussed] within the time frame of our strategic planning."* Other audit chairs reported that they talk about strategy and risk *"at every board meeting."*

Audit chairs point to the importance of healthy dialogue between management and the board on risk and strategy. One stated, *"We have improved the quality of the conversation between the board and line management [on risk] and have [improved] their reports."* Several members who have experience serving on two-tier boards commented before the summit that this structure constrains the free flow of important information about risk to the supervisory board level. However, some European audit chairs noted recent efforts to increase the depth and frequency of communication from the management board to the supervisory board on "every risk."

The audit committee's role in overseeing financial and operational risks

Given the increased attention on enterprise risk, audit chairs are again asking themselves – and their boards – where the audit committee should focus. At a minimum, audit committees in Europe and the United States are charged, along with internal auditors, with ensuring their companies have a rigorous approach to risk management. Any additional specific areas of focus depend on many factors, such as the company's business sector, the extent to which it is regulated, its location and the composition of the board. The scope is often broader in the US and in some European countries, where national corporate governance codes may recommend a specific role for the audit committee in risk management.¹³

The audit committee's role is also influenced by the existence of other board committees that have a risk focus. One audit chair stated, *"Our corporate governance and sustainability committee looks at non-financial risks such as reputational [risk]. Our health, safety and environment [committee] looks at [other non-financial risks], and together, these [committees] take the burden off the audit committee."* Several audit chairs attending the summit have a separate risk committee on their boards. One European audit chair said, *"More risk committees are being adopted in [my country] because the audit committee can't get into operational risk."* However, another audit chair stated, *"Rather than a separate risk committee, our audit committee has invited three board directors and three external experts ... to join our audit committee and to cover more ground on risk."*

¹³ This is true in Belgium, Germany, The Netherlands, Sweden, and Switzerland. For more information on audit committee purpose and membership requirements, as outlined in select national corporate governance codes, the 8th Directive and NYSE listing requirements, see European Audit Committee Leadership Network, "Increasing audit committee effectiveness," *ViewPoints*, 21 April 2008. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_Euro_ACLN_Apr08_View14.pdf.

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



Several audit chairs highlighted the need for more coordination between the audit committee and other committees that review elements of risk, such as the risk, finance and remuneration (or compensation) committees. The governance committee may play a part in mapping board- and committee-level risk oversight, evaluating the effectiveness of that oversight and determining whether any changes are required. It must also ensure that each committee is staffed with members who, collectively, are well suited to oversee risk-related issues.

When audit committees take a broader role in risk oversight, some audit chairs may become more actively engaged with management on the subject. This may raise concerns about overstepping the line between oversight and management. In a pre-summit conversation, one audit chair described talks with group presidents, internal audit, external audit and the CFO to discuss the company's risk portfolio and to understand the risks: "This gives me a good view ... [but] it takes a lot of work, and some of my fellow audit committee chairs would say, 'You are crazy to do that; you don't get paid to do that; it's not your job.'" Audit chairs at the summit did not voice concern about their boards' oversight of risk management trespassing into the domain of management.

At the summit, audit chairs were interested in discussing the role of the audit committee in addressing financial and operational risks associated with the current financial crisis. Both the European and North American Audit Committee Leadership Networks met earlier this year (in March and June, respectively) and discussed the consequences of the credit crisis and the role of the audit committee, which resulted in several practical suggestions for audit committees. Suggestions compiled from those meetings and from the summit are provided in the box below.

How audit committees should address risks associated with the financial crisis:

- **Conduct a "going concern" analysis.** Audit chairs at the summit said they are focused on understanding and addressing any concerns about the company's liquidity, access to credit, ability to refinance, concentration risks and counterparty risk, including deep in the supply chain and through joint ventures. One audit chair reported that for the last two quarters, the audit committee has reviewed counterparties, including insurers (such as issuers of directors and officers liability insurance) and customers (especially troubled companies with high receivables).
- **Review investments, investment policy and the treasury function.** At the summit, two audit chairs said they receive weekly e-mail updates from the CFO on key topics such as investments, which often lead to a phone call and more engagement. Another audit chair's company had done scenario planning for a situation in which the commercial paper market dried up for an extended time period. This audit chair told management to "think the unthinkable."

(continued overleaf)

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



How audit committees should address risks associated with the financial crisis (*continued*):

- **Review company-defined-benefit pension funds.** Audit chairs at the summit discussed pension risk, particularly of deficits. One audit chair said, *“Companies will have to fund pension funds, and [this] will depress the price of the stock.”*
- **Talk to the external auditor.** Audit chairs said they would talk to their lead audit partner ahead of time to discuss the audit firm’s likely year-end opinions on issues such as pension funds and the impairment of intangibles and goodwill.
- **Address increased disclosure requirements.** Audit firms are stressing that once companies have identified how various financial instruments expose them to risk and are able to accurately value those instruments, disclosure is a must – even if the disclosure will negatively impact the company’s stock.
- **Reserve for litigation risk.** Lawyers are reporting that the number of suits filed against organisations involved in the sub-prime crisis has risen dramatically, and they expect the trend to continue. Audit committees must review management’s assessment of the need to reserve for and disclose these new litigation risks.

Enhancing risk oversight: considerations for the audit committee

Both at the summit and in pre-meeting conversations, after discussing the division of responsibilities between the full board and audit committee, audit chairs suggested several ways in which audit committees can enhance management’s mitigation of enterprise risk and improve the board’s oversight of risk:

- **Continuing to ask out-of-the-box questions to identify risks.** As a result of the current financial crisis, regulators will likely focus more attention going forward on risk identification. Hector Sants, the CEO of the UK’s Financial Services Authority, explained, *“We remain convinced that one of our main priorities must be ensuring that boards and senior management focus clearly on a variety of stress scenarios that could develop and properly satisfy themselves that they can deal with those scenarios. A good, simple test is for [the] Board to ensure they understand the circumstances under which their firm would fail and that they are comfortable that the risk is acceptable.”*¹⁴ One audit chair said at the summit, *“I try to ask the unthinkable, look at what could be catastrophic. For example, what if our business model didn’t work? What would threaten the enterprise’s survival?”*
- **Finding a balanced approach to bottom-up and top-down risk identification.** According to several members, both bottom-up approaches to risk, which typically focus on incremental, operational risks and then are aggregated, and top-down approaches, which are typically strategic and handled by senior executives and the board, are necessary for comprehensive risk management. Prior to the summit,

¹⁴ Hector Sants, “Principles-Based Regulation – Lessons from the Sub-Prime Crisis.” Speech at the Securities and Investments Institute Annual Conference, 15 May 2008. Available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2008/0515_hs.shtml.

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



an audit chair said, “The only way one can be effective in having a strategic understanding of the broad risks is by knowing what the sum of all the small risks is.”

- **Ensuring risk is owned by executives throughout the business.** One audit committee chair remarked before the summit, “I want everyone to worry about [risk], not just the people ‘tasked’ with it.” Yet members recognise an explicit decision needs to be taken about who owns risk. Several members feel strongly that, ultimately, the CEO is responsible for risk. Those who have experience working both with and without a formally designated chief risk officer (CRO) say that the presence of a CRO does not make a qualitative difference in risk oversight. One audit chair said in a pre-meeting conversation, “I’ve struggled with the concept of a CRO. By the time you have a CEO, CFO, head of compliance, head of internal audit, you get crowded. For more industrial organisations, I wonder how [a CRO would fit in] ... if others are doing their jobs. The ultimate CRO is the CEO, and on financial risk, it is the CFO.”
- **Ensuring that an integrated picture of risk drives audit and compliance.** Internal and external audit play a major role in assuring a company has a rigorous approach to risk management, as do compliance and legal professionals. Audit chairs articulated their role as a “*third line of defence*” and noted that each group plays a part in ensuring the company has a comprehensive picture of risk. Members said internal audit takes the lead in ensuring all risks are identified; as a US audit chair put it before the summit, “They are talking to each business and setting up a matrix to see if there are any gaps. Then [they] have the board see the matrix and discuss their comfort level with [what has been identified.]” Some audit chairs, however, raise concerns about having the appropriate skills set within internal audit to do so.

At the summit, audit chairs agreed they rely on their external auditors for expertise on risk. External audit reviews and supplements internal audit’s risk assessments, particularly during the creation of the annual internal audit plan. External audit brings objectivity and industry-wide perspectives that are critical. Several audit chairs said their external auditors join the general session of the audit committee when risk is discussed. One network member suggested this trend is increasing in Europe. In addition, several audit committees invite internal and external audit to a joint discussion and analysis of the company’s major risks. A member stated prior to the summit, “I do a pre-meeting with internal audit and external audit and invite them to the board conversation ... [I ask them] ... ‘Would you change the order [of priority of the risks], or is there something we are missing?’ When you do that, you get lots of expertise and a lot of insights.” When asked what they would like most from their external auditors in terms of risk expertise, audit chairs at the summit seemed to agree with their colleague who said, “*Commitment. To be clear. To have an opinion about [the] risk[s].*”

- **Testing that company culture does not run counter to risk management efforts.** The tone at the top plays a critical role in ensuring that company culture supports risk management efforts. At the summit, an audit chair said, “*How you change behaviour is [via] the culture of the organisation: you need to fire people when they’re doing bad things. It starts at the top. It’s hands-on management, and it needs to be at every level.*”

ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



Conclusion

With the financial crisis and the global economic slowdown dominating headlines, boards of directors, audit committees, investors and regulators will all be keeping a close eye on enterprise risk. Audit committees can be catalysts for improving their companies' approach to managing risk by encouraging management to take a broader view of risk and to address the recurring problems that typically inhibit effective risk management, such as the linkages between short-termism, remuneration and management's risk appetite. Additionally, audit committees should spur their boards to maximize risk oversight by clarifying the responsibilities of the full board, board committees and the audit committee. And, with economic woes impacting planning for 2009, this is a critical time for audit committees to take a lead in helping their companies understand and address financial, audit and compliance risks, and the associated implications for their company's strategy.

About this document

The European Audit Committee Leadership Network (EACLN) and Audit Committee Leadership Network (ACLN) are groups of audit committee chairs drawn from leading European and North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The networks are convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit committee 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 endeavour to fulfil 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. Anyone who receives *ViewPoints* may share it with those in their own network. The more board members, members of management and advisers who become systematically engaged in this dialogue, the more value will be created for all.

The views expressed in this document represent those of the European or North American Audit Committee Leadership Networks. They do not reflect the views nor constitute the advice of network members, their companies, Ernst & Young, or Tapestry Networks. Please consult your counsellors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organisation.

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ViewPoints

FOR THE AUDIT COMMITTEE
LEADERSHIP SUMMIT



Appendix 1: Participants at the Audit Committee Leadership Summit

European and North American Audit Committee Leadership Network members participating in all or part of the summit, who sit on the boards of over 44 large-, mid- and small-cap public companies between them, included:

- Dr Werner Brandt, Audit Committee Member, Lufthansa
- Mr Phil Hodgkinson, Audit Committee Chair, BT
- Mrs Judy Richards Hope, Audit Committee Chair, Union Pacific
- Mr Laban Jackson, Audit Committee Chair, JPMorgan Chase
- Dr DeAnne Julius, Audit Committee Chair, Roche Holding
- Ms Marie Knowles, Audit Committee Chair, McKesson
- Mr Wim Kok, Audit Committee Chair, ING
- Mr Daniel Lebègue, Audit Committee Chair, SCOR
- Mr Oscar Munoz, Audit Committee Chair, Continental Airlines
- Mr Chuck Noski, Audit Committee Chair, Microsoft and Morgan Stanley
- Ms Pam Patsley, Audit Committee Chair, Texas Instruments
- Pierre Rodocanachi, Audit Committee Member, Vivendi
- Ms Guylaine Saucier, Audit Committee Chair, Areva
- Mr Kees Storm, Audit Committee Chair, Unilever and InBev
- Dr Bernd Voss, Audit Committee Chair, ABB
- Steve West, Audit Committee Chair, Cisco Systems
- Chris Williams, Audit Committee Chair, Wal-Mart

Ernst & Young partners participating in all or part of the meeting included:

- Mr Steve Almassy, Americas Assurance Leader
- Mr Steve Howe, Americas Managing Partner
- Mr Tom McGrath, Managing Partner, EMEIA Financial Services
- Mr Christian Mouillon, Deputy Area Managing Partner EMEIA



Appendix 2: Questions audit committees should be asking themselves and their boards about enterprise risk

- ? How can management get a better sense of external risks? How can management be more creative about the possible risks facing the business?
- ? How often is management's appetite for risk discussed by the full board or audit committee? How comfortable are you that the board or audit committee sufficiently addresses management's risk appetite in the context of remuneration? How can the audit and remuneration committees co-ordinate effectively, with each other and with the full board, to ensure these issues garner sufficient director input?
- ? What is being done to ensure directors are sufficiently educated regarding the complexities of the risks facing the business?
- ? How effective is the board's oversight of risk? Does the process by which risk is discussed, and the division of responsibilities between the necessary board committees, adequately allow for issues to be surfaced? What are your concerns about gaps in risk coverage?
- ? Have you felt the line between board oversight and management has blurred as a result of the need to address risk? How much risk oversight is enough?
- ? How satisfied are you that risk assessment is sufficiently embedded in the business strategy and planning processes? Does the organisation's culture support its efforts to assess risk, or do you see challenges in this area? What can the audit committee do to influence this?
- ? How can the audit committee serve as a catalyst for more effective oversight of risk?