Audit Committee Leadership Summit

October 2020

ACLS

VIEWPOINTS

Risk oversight in the wake of the pandemic

The COVID-19 pandemic and its economic impact are once again raising questions about the state of enterprise risk management (ERM) in large global companies and the options for improving it. Like previous crises, this one is forcing companies and their boards to consider whether they could have done more to anticipate and prepare, and whether their responses could have been more effective. Many of the questions that directors raise are specific to COVID-19, but others take up the issue of ERM more generally: In what ways could corporate risk management be better at identifying risks and assessing how they might play out? How can companies build more resiliency toward unknown risks, including the ability to rapidly restore business operations?

On September 18, 2020, members of the North American and European Audit Committee Leadership Networks (ACLN and EACLN, respectively) met virtually to discuss these questions. They were joined by Amy Brachio, global business consulting leader at EY, and Panu Haapaniemi, director of risk management at UPM, a forest industries company based in Finland. *For biographies of the guests, see Appendix 1, on page 8, and for a list of network members and other participants, see Appendix 2, on page 10.*

Executive summary

Several themes emerged regarding how companies and boards can improve risk management.

- **Go deeper on risks and their interdependencies** *(page 2)*

  Members and guests agreed that companies and boards should do more to identify risks and to understand how risks can amplify and interact with one other. They mentioned several approaches to uncovering more risks and understanding their dynamics: expanding scenario planning to include more variables; tapping the insights of more stakeholders, including younger employees and others deeper down in the organization; using sophisticated data analytics to reveal relationships between risks; and implementing online collaboration tools to improve communication about risk and risk mitigation across the organization.

- **Build resiliency for responding to unexpected risks** *(page 4)*

  Even the best efforts to identify risks and predict their impact will sometimes fail to anticipate major events, so members and guests underscored the importance of resiliency. Diversify the supply chain and be ready to identify and address its vulnerabilities, they urged, and build more flexibility into operations so production can be shifted among business units and geographies as necessary. Also critical for an effective and sustained response to a major crisis is the health and well-being of the workforce; companies should create a corporate culture that supports open communication from employees about their needs. Improving resiliency will entail additional costs, creating tension at a time when pressures to cut costs are strong, but as an audit chair noted, the returns may be worth it many times over.

- **Enhance the role of the board** *(page 6)*

  The board can play an important role in ensuring that risk management is comprehensive and integrated into the business and its strategy. Separate committees for risk and even for specific risks, such as cyber, can be helpful to achieve focus and depth. At the same time, the board's collective experience can be invaluable in identifying emerging risks. Moreover, the board can fruitfully take the lead on integrating risk and strategy, ensuring that risk management becomes less a bureaucracy and more a tool for running the business.

For a list of discussion questions for audit committees, see Appendix 3, on page 12.

Go deeper on risks and their interdependencies

The speed and impact of the COVID-19 pandemic clearly took the world by surprise, and the first question many observers are asking as they explore its implications for ERM is, Why did we fail to anticipate this risk and its potential to disrupt our businesses? For many companies, the pandemic was a "black swan," a risk that did not even appear on their risk maps. For others, it was a "gray rhino," a risk they identified but did not analyze sufficiently to understand its full implications.[1]

Members and guests agreed that companies could do more to identify risks and to understand how risks amplify and interact with each other. Commenting on the impact of the pandemic, a member said, *"We were looking at the pandemic as a risk in isolation. It's the first time we've gone through this, so we can't take all the blame—and we'll get better as time passes—but this is not the only example of a risk that we studied in isolation without assessing the overall impact on other activities, not solely our activities but all those that impact our business."*[2] Another member agreed: *"The adjacencies to the pandemic were much broader than anyone had on their radar screens."*

Members and guests mentioned several approaches to uncovering more risks and understanding the dynamics among them:

- **Expand scenario planning.** While scenario planning is an established element of risk management, companies are working to improve their techniques. Ms. Brachio noted that companies are trying harder to incorporate all the important variables and interacting effects: *"Organizations are looking at what will truly stress the organization—items that will* *expand the topic—and injecting more into the scenario. They are playing it out—an outage, a hurricane—and analyzing what would happen if you added something else."*

- **Tap the insights of more stakeholders.** Members discussed broadening the sources of information on risks. One member noted the value of going beyond the usual routine in compiling risks: *"We talk to the same people every year, and we get the same list."* Supplement the process with other input, the member urged: *"Talk to the 20-somethings and ask what they're seeing. Add their voice as part of the ERM process, because otherwise, you'll get the same answers. Talk to third parties and vendors, and open different doors."* Another member made a similar point about the challenge of uncovering certain hidden risks: *"That level of detail can only be found deep in the organization."*
- **Use sophisticated data analytics.** New tools for analyzing data can reveal relationships between risks that might not be apparent otherwise. One member described an effort at their company: *"It started with internal audit doing an in-depth risk analysis and creating a data analytics program to show the true interrelationships. One risk moved, then another moved. It was very sophisticated, and they transferred the analysis to other busines units. It was a big success story."*
- **Implement online collaboration tools.** Collaboration tools improve communication across the organization, including communications about risk and risk mitigation. As Ms. Brachio explained, such tools can reveal at least two important things: *"First, they uncover risks you wouldn't normally see, and second, they identify when people don't know how to mitigate risks."*

A richer understanding of the risks that could emerge and the interactions among risks would enable more effective mitigation efforts. Scenario planning can include more detailed desktop exercises that clarify potential responses. EY's Tonny Dekker suggests that such exercises can go as far as actually practicing the response to potential scenarios: "Going one step further, resilience war games can test and hone the organization's response to these situations, just like a fire drill."[3]

In pre-meeting conversations, several audit chairs confirmed the importance of enhanced scenario planning and desktop exercises. One member said, *"Scenario planning should be institutionalized more than it is. In the context of ERM, we don't quantify effects as much as in other areas. Quantification would make people think about it more."* Another saw advance training as very important: *"The way you respond to a disaster has to be trained. Think about firefighters; they know what to do because they've thought through it all and have extensive training."*

Members and guests acknowledged the challenge that companies and boards face when a large number of additional risks begin to emerge and compete for attention. Focus may be challenged. A member suggested, *"It's easy to get overwhelmed by all the risks out there, and as a board it's been helpful to get management focused on risks that can take the company* *down or destroy large amounts of value."* The member mentioned systems thinking and the "Five Whys" approach as valuable tools: *"Look five layers deep about how this or that would happen. It opens your eyes about what needs to be mitigated."*

Participants touched on some of the emerging risks that companies might now be facing, illustrating adjacencies that are easily missed. One member highlighted the plight of smaller businesses and how that could ultimately impact larger companies and the economy as a whole: *"Most of our companies are dependent on small business at some point in our value chain. It comes down to who's consuming, who's delivering products … I don't think we understand the destruction in our economies."* Another member brought up the political turmoil surrounding the upcoming presidential election: *"Are people factoring in disruption due to civil disorder around the election? I've thought about it, and I've seen chatter from think tanks and universities."*

Ms. Brachio agreed that outside risks need more attention, but urged boards to consider *"upside risks that organizations have to take to realize opportunities that could help them thrive over time."* Mr. Haapaniemi also noted that the positive side of some major events should not be forgotten, as the manifold effects of a complex event such as the pandemic are likely to include some that benefit the company.

Build resiliency for responding to unexpected risks

Recognizing that even the best efforts to identify risks and predict their impact will sometimes fail to anticipate major events, members and guests underscored the importance of resiliency. One member was determined to seize the lessons of the current crisis: *"I have pushed hard to use this concrete example of complex, stacked risks to see what mitigation plans we could have had and document that in flight. We could have something again in three years, and we don't want to reinvent the wheel."*

To prepare for completely unexpected risks, companies will need to seek a more general kind of resiliency, one that can support a range of mitigation efforts and is therefore useful in the face of many different kinds of threats. Members and guests highlighted several strategies that are important for maintaining and improving general resiliency:

- **Strengthen support for supply chains.** *"Improving resiliency throughout the supply chain is really key,"* Mr. Haapaniemi noted. Supply chains are critical for operations and at the same time vulnerable to a broad range of risks. Diversify supply chains and be ready to identify and address their vulnerabilities, members urged. Ms. Brachio noted, for example, that in the current crisis, some companies are helping their smaller, less sophisticated vendors obtain government aid to survive the pandemic.

- **Enable more flexible operations.** Business units should be able to continue operations in the face of diverse challenges, and their leaders should understand how other units operate. A member said, *"Resiliency comes from being able to replace one operation with* *another, on the fly. If you have a management structure with deep silos, you will not be resilient."* Mr. Haapaniemi mentioned the value of harmonized product platforms in a global manufacturing network of factories: if the platforms are harmonized, it is possible to shift and balance production volumes and to source key components from different geographies as necessary. *"We already had in place a program to further harmonize our product platforms and adapt our manufacturing to be able to shift production around the world, but we accelerated the program when the pandemic hit,"* he noted.

- **Support the workforce.** A healthy workforce is critical for an effective and sustained response to a major crisis. A member noted the prevalence of mental health issues during the current crisis and underscored the importance of tracking this issue and addressing it proactively. The member advocated building a company culture in which employees feel comfortable communicating about their struggles and needs.

  The strategy is linked to long-term success as well as crisis survival: *"It's about having a culture that says it's ok to talk and ask the company for help … It links with reputation longer term, and companies will get the reputation for being good on this and attract talent going forward."* Ms. Brachio brought up culture more generally, highlighting the challenge of the remote working environment: *"This is something boards and management have to focus on: what are tools and techniques to ensure the culture remains intact?"*

Members also touched on resiliency in pre-meeting conversations. One member pointed out that resiliency is nothing new: *"Great companies think through this routinely. So I would not think the idea is to go down some new path relative to how we think of resiliency, but instead sharpen and perhaps broaden current business continuity exercises."* Members noted that companies might also want to sharpen their attention to financial resiliency, including their capital structure and access to liquidity. One member highlighted the strains that result when revenue collapses: *"The financial issue is, How do you plan in a crisis; when do you think it will end; when will the new normal be; what will your costs be, and can you access capital today to see you through? You need to be able to access as many tranches of liquidity as you can."*

There is also an important strategic aspect to resiliency: a crisis may present new opportunities that companies should be ready to exploit before their competitors do. A member highlighted the use of technology to help a company pivot strategically: *"Those who don't keep their ear to the ground to understand the needs of the market and then use technology to meet those needs will lose. Have you invested in technology at speed? Do you understand where your marketplace and customers are? Now is a time when that can get away from you if you're not moving quickly."*

Improving resiliency will often entail additional costs, creating tension at a time when pressures to cut costs are strong. Measures like increasing operational redundancy and building up cash balances can reduce short-term returns.[4] Some members were skeptical that investors would welcome investments in resiliency, though the current crisis might neutralize some resistance. But an audit chair stressed, *"The cost of not doing it is a multiplier on the investment of five times."*

Enhance the role of the board

As companies adjust their ERM functions in response to the crisis, boards are also discussing how to adjust their own structures and processes to provide better oversight. ACLN and EACLN members mentioned several measures that boards might consider:

- **Assessing committee responsibilities.** Some companies assign risk oversight to the audit committee, while others have a separate risk committee. An ACLN member suggested that the appropriate arrangement depends on management's approach to risk: *"It has to happen collaboratively between the CEO and chairman, the senior leadership team, and the board itself. If you think a separate risk committee fits, given your evolution and progress, I recommend it. If not, and you're behind, then you need to do other things."* However, the member also noted that multiple committees still need to be involved: *"We make sure the finance chair and audit chair are automatically assigned to the risk and cyber committee."* One member said their board was considering an entirely new committee, which would focus on technology and take on related aspects of risk and risk mitigation: *"We're also talking about setting up an innovation and digitization committee; that's where the focus on resiliency would be."*

- **Contributing its own perspectives on risks.** The board's collective experience can be invaluable in identifying emerging risks. As Ms. Brachio noted, *"The board and directors are well positioned to help management think broadly enough, particularly board members who sit on multiple boards."* In a pre-meeting conversation, a member suggested that the board should try to go beyond the analysis presented by management: *"I'd ask all of us if we are stepping back and preparing to ask the stupid or obvious questions, or the curveball questions, and not focusing on what's on the papers in front of us. If management is good, then that stuff will be good."*

- **Sharpening the metrics brought to the board.** Some aspects of ERM can be hard to gauge, so boards need to be sure that the information they receive is as helpful as possible. Measuring resiliency might be particularly difficult for the board, some members acknowledged. A member said, *"You have to have metrics that are specific to the business and managers who tell you what they need and how long they can live under certain circumstances. And that leads to questions of inventory levels, redundancy of facilities, information security, the depth of the management team, liquidity, etc. It's very specific to the company in question."*

- **Integrating risk and strategy.** A member described their board's experience integrating risk and strategy: *"Risk used to be looked at separately in an audit committee meeting, but then we merged it into strategy and long-term planning. We managed to present the* *strategic plan with the potential volatility of certain elements based on risks. You could see how prudent or aggressive the plan was."*

Conclusion

Serious crises often reveal opportunities for improvements in key corporate functions, even in companies that already respond to crises with agility. The COVID-19 pandemic has put a spotlight on risk management. Companies recognize that they need to be better at identifying risks and understanding the dynamics among them, which means improving scenario planning, drawing on more sources of information, and harnessing better analytical tools. Companies also want to improve their resilience to crises, which may mean strengthening supply chains, enabling more flexible operations, and supporting the workforce. For boards, the time may be right to review committee responsibilities for risk oversight and the role that the board can play in assisting management. Both companies and boards might want to revisit a key question raised by a member: *"Is ERM a tool for running the business, or just a bureaucracy?"*

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 organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

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. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

Appendix 1: Guest biographies

Amy Brachio leads EY's Global Business Consulting practice. Ms. Brachio is a frequent speaker on topics relevant to boards and the C suite, including resilience, cybersecurity, megatrends driving transformation, evolving approaches to enterprise risk management, and the impact of disruptive technologies.

Ms. Brachio has more than 20 years of experience helping large, diversified organizations manage risk. She advises clients on topics that are top-of-mind to boards and C-suite executives, including leading practices in risk management and enterprise transformation. Ms. Brachio is leading work with EY clients to drive confidence in achieving strategic objectives and maintaining stakeholder trust.

In Ms. Brachio's capacity as a member of EY's Global Consulting Executive team, she has been a key part of the business's response to COVID-19, including as a key contributor to EY's Resilient Enterprise framework and in actions being taken by EY to respond to the business impact of the pandemic.

She was selected as one of *Profiles in Diversity Journal*'s 2017 Women Worth Watching and spotlighted by Source Global Research as part of their Women in Professional Services series. She was also a recipient of *Consulting* magazine's Global Leaders in Consulting award for 2019. She has served on the board of directors and in multiple officer positions for the ALS Association MN/ND/SD chapter and works with organizations including Girls Who Code to advance women in technology. Ms. Brachio is a member of C200, an organization devoted to advancing women in business.

Panu Haapaniemi is director of risk management, UPM-Kymmene Corporation. Mr. Haapaniemi has more than 15 years of background in risk and insurance management in a global business environment.

He began his career as a claim specialist at one of the largest Finnish insurance companies, Pohjola, where he managed corporate claims in global insurance programs. He held leadership positions in claims and underwriting departments before deciding to focus on enterprise risk management, which took him to the global risk function at KONE Corporation, a global leader in elevators, escalators, and automatic doors.

At KONE, Mr. Haapaniemi focused on strategic development programs within risk management. He developed business continuity and crisis management plans and capabilities for the global supply organization and shared service centers and various leadership teams around the world. He was a key member in driving enterprise risk management forward throughout the global organization and was instrumental in developing tools and frameworks for project risk and opportunity management, business impact analysis, incident and claim management, global business risk assessment, cyber risk management, and natural catastrophe risk management in the global supply chain.

Mr. Haapaniemi became director of risk management at UPM-Kymmene Corporation in June 2020. UPM is leading the forest-based bioindustry into a sustainable, innovation-driven, and exciting future across six business areas. UPM creates renewable and responsible solutions that replace fossil-based materials by making the most of residues and side streams. In 2019, UPM had 54 production plants in 12 countries, delivered products to 12,500 customers in 120 countries, and had €10.238 billion in sales. Within UPM, Mr. Haapaniemi is responsible for the enterprise risk management function, global insurance programs, and developing risk frameworks and reporting tools. He is a member of the assurance committee and is responsible for enterprise risk management reporting and updates to the audit committee of the board of directors.

Mr. Haapaniemi has a master's degree in law from Helsinki University and an MBA from Aalto University.

Appendix 2: Participants

The following EACLN and ACLN members participated in all or part of the ACLS meeting:

- Mike Ashley, Barclays
- Julie Brown, Roche
- Barbara Byrne, ViacomCBS
- Pam Craig, Merck
- Pam Daley, BlackRock
- Dan Dickinson, Caterpillar
- Sam Di Piazza, AT&T
- Dave Dillon, 3M and Union Pacific
- Carolyn Dittmeier, Assicurazioni Generali
- Liz Doherty, Novartis and Philips
- Bill Easter, Delta Air Lines
- Lynn Elsenhans, Saudi Aramco
- Eric Elzvik, Ericsson
- Tim Flynn, JP Morgan and Walmart
- Sheila Fraser, Manulife
- Byron Grote, Tesco, Akzo Nobel, and Anglo American
- Margarete Haase, ING
- Marion Helmes, Heineken
- Fritz Henderson, Marriott
- David Herzog, MetLife and DXC Technology
- Liz Hewitt, National Grid
- Charles Holley, Amgen and Carrier Global
- René Hooft Graafland, Ahold Delhaize
- Michele Hooper, United Airlines
- Suzanne Nora Johnson, Pfizer
- Hugh Johnston, Microsoft
- Arne Karlsson, Mærsk
- Dagmar Kollmann, Deutsche Telekom
- Mike Losh, Aon
- Edward Ludwig, CVS
- Benoît Maes, Bouygues
- Brad Martin, FedEx
- René Médori, Vinci
- David Meline, ABB
- Hanne de Mora, Volvo Group
- Marie-José Nadeau, ENGIE
- Chuck Noski, Wells Fargo
- Louise Parent, FIS
- John Rishton, Unilever
- Mariella Röhm-Kottmann, Zalando
- Sarah Russell, Nordea Bank
- Guylaine Saucier, Wendel
- Erhard Schipporeit, RWE
- Tom Schoewe, General Motors
- Leslie Seidman, GE
- Gerald Smith, Eaton
- Alan Stewart, Diageo
- Tracey Travis, Facebook
- Jim Turley, Citigroup and Emerson Electric
- John Veihmeyer, Ford
- Robin Washington, Salesforce.com
- David Weinberg, The Coca-Cola Company

EY was represented in all or part of the ACLS meeting by the following:

- Marie-Laure Delarue, EY Global Vice Chair, Assurance
- Jean-Yves Jégourel, EY Global Vice Chair, Professional Practice
- John King, EY Americas Vice Chair of Assurance Services
- Steve Klemash, EY Americas Leader, Center for Board Matters
- Julie Teigland, EY EMEIA Area Managing Partner

Appendix 3: Discussion questions for audit committees

- ? Is it possible to reduce the number of black-swan events a company encounters, and if so, how? What approaches will flag risks that might otherwise go undetected?
- ? How can the potential impact of a risk be fully understood? What techniques can help companies understand all the potential effects?
- ? What are the practical challenges of identifying and assessing risks? How can they be addressed?
- ? In what ways might companies better prepare for known risks? How can mitigation plans be fine-tuned and implemented more effectively?
- ? How can companies be more resilient when unanticipated risks strike?
- ? Should risk appetite be reassessed in the wake of the pandemic?
- ? What organizational aspects of the ERM function could be improved?
- ? Have the responsibilities of board committees been adjusted in any way as a result of the pandemic? If so, how?
- ? What new metrics or other information is the board requesting from management in response to the pandemic?
- ? How can the board help management identify and assess risks?

Endnotes

[1] Marcus Baram, "Why the Coronavirus Crisis Is a 'Gray Rhino' and Not a 'Black Swan,'" *Fast Company,* March 10, 2020.

[2] This document 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 are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

[3] Tonny Dekker, "COVID-19: How CROs Can Lead by Building Stakeholder Trust," EY, June 18, 2020.

[4] Jonathan Guthrie, Andrew Whiffin, and Pan Kwan Yuk, "Lex In-Depth: Why Rescue Finance Will Slow Recovery for Businesses," *Financial Times,* August 26, 2020.