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TONE at the TOP

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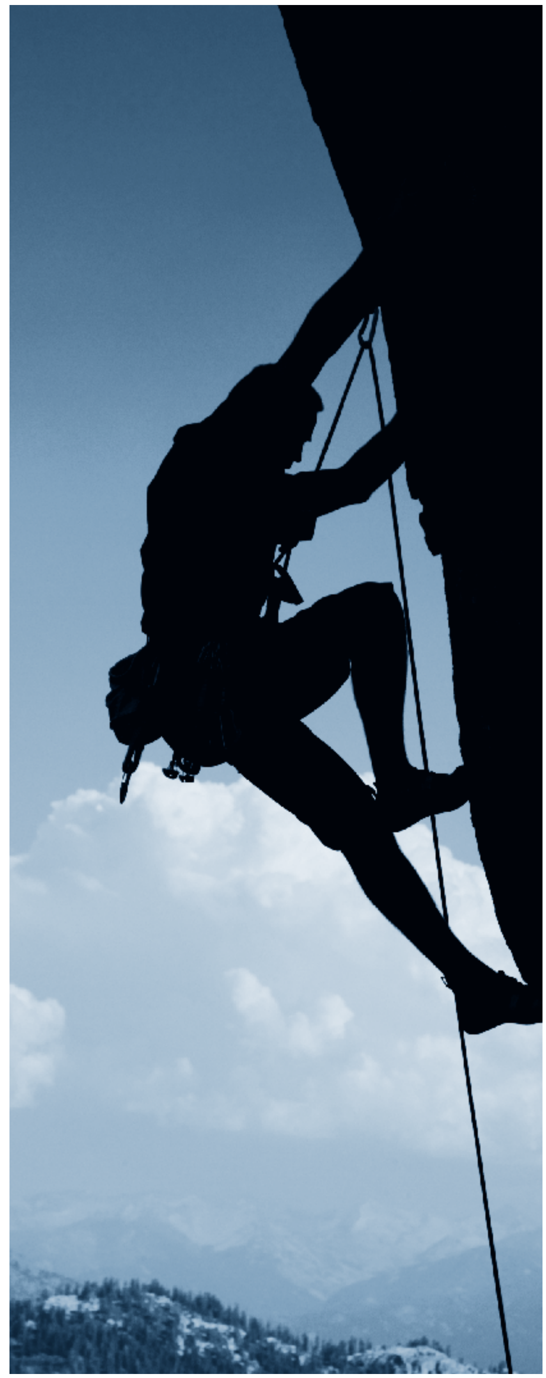
EXCLUSIVELY FOR SENIOR MANAGEMENT, BOARDS OF DIRECTORS, AND AUDIT COMMITTEES

A Culture of Risk



Although risk is inherent in growth, the proliferation of corporate failures has demonstrated the downside of engaging in too much risky business behavior. The problem is that too many organizations set their risk tolerance level too high in order to accommodate their drive for "more," and in some cases, to satisfy their appetite for profit.

When this happens, the corporate culture becomes skewed with an unbalanced emphasis on taking chances and engaging in questionable practices for the sake of growth, or – for the appearance thereof. In essence, it becomes a culture of risk. . . But at what cost?

Even the most casual observer of the business environment over recent years has witnessed the painful price of such a culture. Rather than being a rare occurrence in only a few isolated cases, this has been the case with numerous organizations around the world that have embraced and advanced a culture of risk. And unfortunately, the repercussions have proved to be devastating.

A NEW WORLD OF BUSINESS

"Things just aren't the way they used to be." Could there be a greater understatement than this? Is any part of today's business like it was 15 or even 10 years ago? Hardly! It is, indeed, a new world of business, and change continues to occur at a high rate of speed, even before the ink is dry on the latest contract or ground is broken on the next venture.

Several factors feed into this new dynamic business environment. Technological advances that make old systems virtually obsolete within a blink of an eye, business transactions with the complexity that rivals the most delicate of surgeries, business deals with unseen partners and customers many thousands of miles away, and unprecedented changes in corporations at a rapid pace are contributing to a scenario that certainly is not for those who are highly risk averse. Given all of these factors — not to mention the global financial crisis and aftermath — what can those responsible for organizational governance do to deal with their increasingly challenging roles, short of giving up and pulling the covers over their heads?

HELP IS ON THE WAY

Thanks to public and regulatory demands for better governance and corporate accountability, the pendulum appears to have begun swinging away from unchecked growth and risk-taking. But how can boards (and their organizations) move forward? Where do they find stability?

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines ERM as "a process, effected by an entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives." Based on this definition, COSO recently released "Effective Enterprise Risk Management Oversight: The Role of the Board of Directors." This new paper was developed to help organizations succeed in finding solid ground and shifting their culture to one of greater accountability supported by more effective entity-wide corporate governance.

STEPPING UP TO ACCOUNTABILITY

According to COSO, there are critical steps the full board of directors and its committees (audit committee, nominating/governance committee, compensation committee, etc.) should take to shift an organization's tone at the top and business culture to an enterprise-wide mindset of accountability and effective risk management. When those responsible for corporate governance fully answer and proactively respond to the following questions, they will have taken the essential first steps toward earning the trust of their stakeholders:

1. ***What is your understanding of the entity's risk philosophy? Do you concur with the risk appetite as demonstrated by the corporate decisions and actions being made?***

   Risk appetite is the amount of risk (or potential for detrimental occurrences) that an organization is willing to accept in pursuit of its objectives. To effectively fulfill their role, board members must have a comfort level with the balance stuck between achieving organizational goals and protecting stakeholder interests. Boards must fully understand and reach agreement with management in regard to the entity's overall tolerance of and appetite for risk.

ABOUT COSO / www.coso.org

Originally formed in 1985 to sponsor the National Commission on Fraudulent Financial Reporting, COSO is a voluntary private-sector organization dedicated to improving the quality of financial reporting through better integration of business ethics, strategy, risk management, internal control, and corporate governance. COSO provides frameworks and other guidance that are based on identified best practices that help organizations to meet their objectives. COSO comprises the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), the Institute of Management Accountants (IMA), and The Institute of Internal Auditors (IIA).

2. ***To what extent is effective enterprise risk management in place throughout the organization?***

   Today's boards must step forward and challenge management to ensure and demonstrate that the risk management processes in place throughout the enterprise are effective. They must hold management responsible for identifying and then assessing and managing exposure to the most significant risks that could get in the way of the agreed-upon objectives or make the organization vulnerable to fraud.

3. ***How does the organization's portfolio of risk relate to its risk appetite?***

   To be effective in carrying out its oversight role, the board must understand and proactively review not only operational risks, but also those risks related to the organization's strategies. To ensure the interests of stakeholders are guarded and risk exposures are consistent with the overall appetite for risk, the board should take an integrated approach to assessing and discussing the risks of both strategic and operational initiatives.

4. ***What are the most significant risks to the organization? Is management responding appropriately to those risks?***

   As discussed earlier, change is constant in today's business environment. Inherent in that change are new and evolving risks, of which the board must be aware. In order to stay alert to potential devastating occurrences, the board requires regular updating of critical and accurate information from management and the internal auditors. This practice will help ensure effective board oversight of key risk exposures for the preservation and enhancement of stakeholder value.

HEALTHY DEPENDENCY ON INTERNAL AUDITING

It might be obvious that the board of directors should rely on management for pertinent information about the organization that it serves. However, through its audit committee, the full board has access to the internal auditors' assessment of risks throughout the enterprise, and to their opinions on how well the internal controls that are in place are working.

THE INTERNAL AUDITORS AND RISK

According to The Institute of Internal Auditors (IIA), the chief audit executive (CAE) is responsible for developing a risk-based plan that takes into account the organization's risk management framework and uses risk tolerance levels set by management.

To ensure coverage of risks, the internal audit plan usually addresses:

- Unacceptable risks with insufficient controls that senior management wants audited immediately.
- Control systems on which the organization is most reliant.
- Areas where the differential is great between inherent risk and residual risk.
- Areas in which inherent risk is very high.

Because objectivity and independence help define their role in the organization, the internal auditors are in a position to provide to the audit committee and the board valuable insights on both strategic and operational risks. Based on their extensive training and experience in risk assessment, proficient and professional internal auditors can bring immeasurable value and support to the board by ensuring it has a realistic picture of the state of the organization's risks. And this can achieve a great deal of progress toward helping shift the entity's environment away from a culture of risk.

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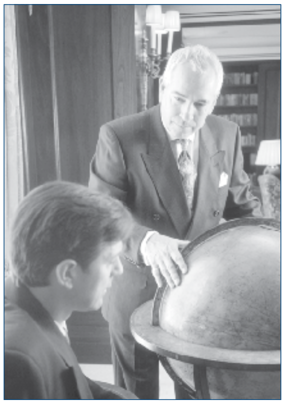

Mission

To provide executive management, boards of directors, and audit committees with concise, leading-edge information on such issues as ethics, internal control, governance, and the changing role of internal auditing; and guidance relative to their roles in, and responsibilities for, the internal audit activity.

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The Institute of Internal Auditors (www.theiia.org) is dedicated to the global promotion and development of internal auditing.

Established in 1941, The IIA is an international professional association with global headquarters in Altamonte Springs, Fla. The IIA has more than 170,000 members in internal auditing, risk management, governance, internal control, IT auditing, education, and security.

The IIA is the global voice, recognized authority, chief advocate, principal educator, and acknowledged leader in certification, research, and technological guidance for the internal audit profession worldwide. The IIA enhances the professionalism of internal auditors and is internationally recognized as a trustworthy guidance-setting body. It fosters professional development, certifies qualified audit professionals, provides benchmarking, and through The IIA Research Foundation, conducts research projects and produces educational products.

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