



 **ERNST & YOUNG**
Quality In Everything We Do

**Companies on risk.
The benefits of alignment.**

Including Australia/New Zealand Supplement

Risk. Let's talk.

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Australia/New Zealand Supplement

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Foreword

Globalisation is creating tremendous opportunities for business today: borders are coming down, new markets are opening up, and developments in technology are driving growth. However, new opportunities also create more risks. While risk has always been an inherent part of business, it is clear that the focus on risk and risk management is growing, both in response to the new risks created by globalisation and also because the consequences of risk in our increasingly interconnected world have become more significant.

Corporations continue to look for more effective and efficient ways to deal with risk, in order to obtain the value they have worked so hard to build. Responding to the worldwide increase in regulation and corporate governance requirements in recent years, companies have instituted risk management procedures that go well beyond financial controls. The challenge they face now is to align their people, functions, controls and reporting lines, to design an approach to risk that provides them with the best balance of threat and opportunity.

To gain insight and contribute to the current debate around risk, Ernst & Young is conducting a series of research surveys in which we explore attitudes to risk and risk management, comparing viewpoints across key stakeholder groups including investors, senior executives, audit committees and other independent board members.

This second report in the series presents the views of over 400 corporate leaders, including CEOs, CFOs and Chief Risk Officers, representing some of the world's major organisations. The opinions and ideas they have expressed provide an assessment of current challenges, together with a sense of how the increasing demands of risk management have affected their wider roles. Their insight into how to be more effective in risk management will help companies act confidently to gain competitive advantage, achieve real growth and create value.

We would like to acknowledge and thank all respondents for their time and their insights.



Thomas McGrath

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This report is the second installment in a series of surveys Ernst & Young is running on the subject of risk in 2005 and 2006. If you would like to contribute to this debate, please visit our dedicated risk website at www.ey.com/risk/letstalk

Executive summary

Global businesses continue to invest in broad-ranging risk management initiatives, and leading organisations are realising value from these efforts. In meeting the challenge of balancing threat and opportunity, they are assessing whether their risk management approach meets the particular demands of the business, whether it is connected with business strategy, and whether it is aligned across the organisation.

Companies that align their goals, risks and risk management activities, including controls, are able to focus on the risks that matter and manage them effectively; they are better able to act on opportunities to gain competitive advantage, achieve real growth and create value. Alignment also means less waste in terms of time, money and effort.

In our previous survey, Investors on Risk. The need for transparency, we saw that the world's largest investors are clearly not 'risk-averse'.

On the contrary, they know that a company's profits stem directly from the risks that it takes. For them, the objective of risk management is not a categorical elimination of all risk. They simply need to know and understand that the company has a framework and approach that will let them make an accurate assessment of the risk/reward ratio. Investors are certainly 'surprise-averse', and told us clearly that companies need to be more transparent

about their risk profile and about their risk management systems. Investors also want company leaders to engage in an ongoing dialogue on these issues, if possible on a one-to-one basis.

'Risk' is a very broad term; we know that any discussion with shareholders will include aspects of risk. But are companies ready to have discussions that explicitly concern risk and risk management? Do company leaders have the right systems, people and information in place to provide the range of external stakeholders with the assurance that their risk management not only reduces exposures but allows them to realise value?

In this second survey, we asked respondents for their views on the state of risk management in their organisations, and the impact of risk management on them as individual leaders. We have quoted our respondents' replies extensively, to illustrate how they personally view the risk challenge.

Ernst & Young defines risk management as:

“A systematic and structured way of aligning an organisation's approach to risk and its strategy, helping the business to manage uncertainty more effectively, minimise threats and maximise opportunity”

Senior management told us that:

- **Risk levels are rising.** Two-thirds of respondents perceive a rise in risk levels over the last two to three years. This finding is also evidence that companies have a lower tolerance for risk now than in the past.
- **The roles of the CEO, CFO and the Board have been changed** by risk management issues, in terms of greater responsibility and accountability for risk and risk management.
- There is definite **room for improvement** in risk coverage and formalisation. Forty-two percent of our respondents say that there are gaps in their risk coverage, and companies do not yet seem to have formalised an approach which encompasses the full range of risks.
- Nearly four in ten companies **do not have formal processes to align risk management with corporate strategy.** This finding, more than any other emerging from our survey, suggests that companies still have some distance to go to gain full value from their risk management approach.
- **Investment in risk management** will rise. Sixty-six percent of companies plan to increase their investment over the next three years. A number plan to invest further in a dedicated risk management function. The challenge is to ensure that these dedicated teams promote excellent standards, facilitate processes and bring stability to the whole risk framework.
- **Further alignment is needed** between risk management functions and line management, as well as across individual functions. Our findings suggest that general managers do not always have a full understanding of the risk challenges in functional areas (e.g. tax and technology), and that more communication is required between senior executives and functional leaders.
- Risk management **challenges over the next three to five years** include developing a more integrated and systematic approach, clarifying ownership of risk and embedding a risk culture throughout the organisation.

Companies don't need to add complexity to their existing processes. Good risk management is based on knowing what the key risks are, what needs to be done about them, and who is responsible

Our findings

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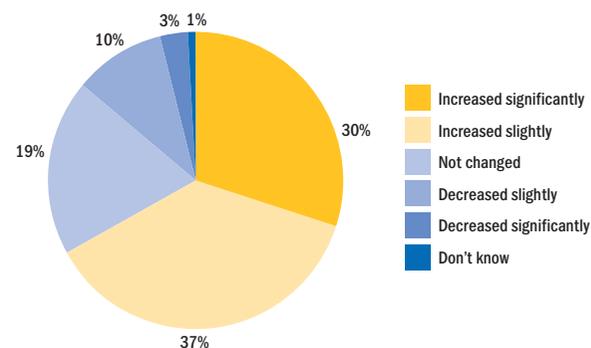
The world today: an increased focus on risk

Almost one-third of our respondents believe that the overall levels of risk they face have increased significantly over the last two to three years, with a further third saying that there has been a slight increase.

We believe that these findings illustrate both an increased perception of risk levels and a lower tolerance of risk. The well-known corporate failures of recent years, coupled with the increase in regulations and new corporate governance laws around the world, have heightened levels of sensitivity to risk and its implications. These findings are also a recognition that the implications of risk are much greater in our increasingly globalised and connected world.

As an illustration of this increasingly shared experience, we found remarkably similar perceptions and consistency in the responses to this question, across markets, types and size of organisation.

Figure 1 Companies report increasing risk levels



Q: Has the overall level of risk faced by companies changed over the last 2-3 years?

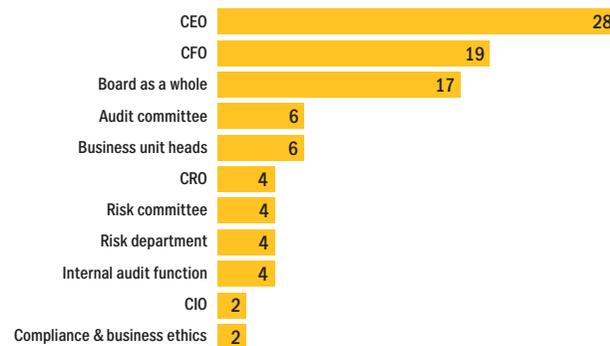
Percentage of all respondents (441)

The CEO, CFO and Board have increased awareness and accountability

Beyond the impact on organisations as a whole, risk management issues have significantly affected corporate leaders as individuals. Our respondents told us that the role of the CEO has changed most in response to risk management issues, followed by those of the CFO and the Board as a whole. Respondents don't see a significant change for groups already charged with risk management, including the risk committee, risk department and CRO.

The CEO, CFO and Board are now perceived to have greater accountability, involvement and focus on risk. The impact has two aspects: expectations placed on them by the organisation and external stakeholders, and how they experience risk themselves, as individuals.

Figure 2 Risk management issues have fundamentally changed the roles of CEO, CFO and the Board

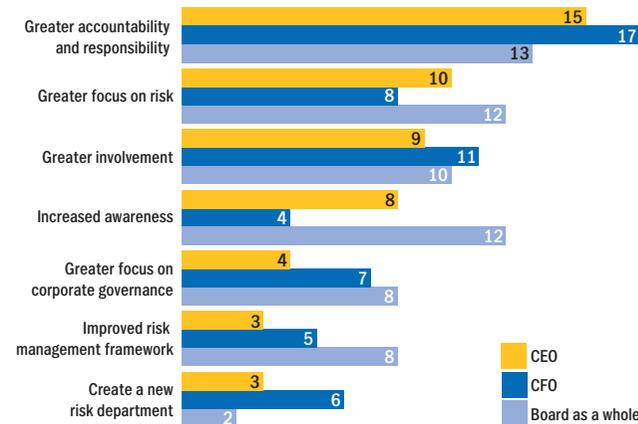


Q: Who has seen their role change most significantly in response to risk management issues?
 Percentage of all respondents (441)
 This chart represents first responses with one selection per respondent.

There are some differences in emphasis; respondents say that the CFO has a relatively higher level of responsibility than in the past, while the CEO and Board are now more likely to be aware of, and focus on, risk than previously.

Our view of these findings is that these groups have always had the ultimate accountability and responsibility for risk. We may be seeing an increase in awareness of their own responsibility, an explicit expression of responsibilities that were already in place. Our findings may also suggest that in some organisations, risk is a broadly accepted responsibility and has been driven deeper into the business.

Figure 3 The primary effect of risk on roles: The CEO, CFO and Board now have increased accountability and responsibility for risk



Q: How have roles of the CEO, CFO and the Board as a whole changed?
 Percentage of respondents saying role of CEO has changed (163); role of CFO has changed (219) and role of Board has changed (153)
 This chart represents the first responses to an open-ended question. For questions of this type, the percentage of responses is substantial.

How is risk changing key management roles?

	The CEO	The CFO	The Board
More accountability	<p>"He is now explicitly responsible for the internal risks, and has to make an action plan which the CFO has to execute." – CFO, Italy</p> <p>"There is a totally different exposure from outside, so he must have a clearer idea about risk management. He is the one, apart from the Board, who is supposed to stand up and give directions." – CEO, Russia</p>	<p>"More stewardship of the other people involved in risk and corporate governance." – CFO, Australia</p> <p>"The CEO blames him if something goes wrong!" – Head of Risk, US</p> <p>"It is now very similar to the role of the CEO: far more focus on regulatory requirements and scrutiny from analysts and investors." – CFO, UK</p>	<p>"They are required to report more frequently, to increase their responsibility, to enhance their role in risk management." – FD, Hong Kong</p> <p>"They are now more accountable for their actions and decisions. Understanding of risks and exposures as part of their decision-making and ensuring that appropriate mitigating action is taken for resolution of those risks." – Group FD, UK</p> <p>"The whole issue of Board liability as it relates to the management of the company has become much more of a concern to them, including the personal liability that they might face." – VP of Operations, US</p>
Focus on risk	<p>"There is simply a greater focus on risk. He must identify and address the concerns of the Board... demonstrate to the Board how he intends to approach risk." – CEO, Canada</p> <p>"He is more risk-aware, and because of that makes better, more supported decisions." – FD, Poland</p>	<p>"His role has changed in response to increasing legal responsibilities. There is a stronger central responsibility, and an increasing need for analysis and information in risk areas. The CFO has taken a deeper dive into the risk spectrum." – Head of Risk, Germany</p> <p>"A 180-degree change in strategic risk, major operations and customer risk." – FD, China</p>	<p>"They have changed in terms of their recognition of the need for cooperation between risk management, strategy and long-term company success." – CFO, Switzerland</p> <p>"The dynamics have changed, with a focus on how to improve stakeholders' value. Globalisation has moved them to being more open-minded." – CFO, India</p>
Greater involvement	<p>"He has more responsibility for the details, and at the same time has to be more strategic on risk." – CFO, Sweden</p> <p>"His role has become a lot more active and operational. He has become the focal point of the company and is responsible for dealing with communication and information." – CFO, China</p>	<p>"It is no longer just about preparing financial statements. It's about formulation and execution of strategy and risk-based investment decisions." – Risk Director, Australia</p> <p>"The CFO has moved towards a more communications-based role on the overall levels of risk in the company." – CFO, UK</p>	<p>"They are more involved – before it was operational, now it is strategic." – CFO, Brazil</p> <p>"They are now much more active and demanding, asking questions of management on the process and the details." – CFO, Canada</p> <p>"They have a more effective policy of intervention, with more effective involvement than in past years." – CFO, Italy</p> <p>"The Board now has explicit control of risk management. In the past this was only implicit control." – Head of Internal Audit, The Netherlands</p>

We asked respondents to comment in depth on the impact that risk has had on them. We have included a broad selection of their comments here, because they serve to illustrate real changes in organisational priorities, and at the same time how responsibilities that were implicit before are now being expressed in an explicit way.

How has managing risk affected working relationships?

We also asked senior management how their more formalised role in managing risk had affected their working relationships with colleagues on the management team and Board. We were struck by how much consistency there seemed to be across markets in the spirit of the remarks we read. CEOs and CFOs around the world seemed to share largely similar thoughts and concerns. Their comments tell us quite clearly that the overall effect has been beneficial to their working relationships; positive statements outnumbered negative ones by a ratio of six to one.

The key benefits for working relationships are increased effectiveness of decision-making and communications, together with better alignment of efforts, leading to a positive impact on the business as a whole. Negative effects have been a perceived loss of control; friction with others on how to handle risk; and frustration with bureaucracy.

Role in risk management has positively affected working relationships	Risk management also presents challenges to working relationships
<p>Better decision-making</p> <p>“ It helps us to take decisions in the right manner without conflict.” – <i>CEO, Hong Kong</i></p> <p>“ It’s resulted in better decision-making.” – <i>CFO, Australia</i></p> <p>“ Risks are well managed, correctly mitigated and the company has a return on what they are spending on it.” – <i>CEO, Brazil</i></p> <p>“ It has created a clearer exchange of information.” – <i>CFO, Netherlands</i></p>	<p>“ I have to put procedures into place that people might not be happy with. They are concerned with making the most profit, but I need to be aware of the risks.” – <i>Head of Quality, Security and Environment, France</i></p> <p>“ Taking away responsibilities from business heads and relinquishing it to the Board.” – <i>CRO, Canada</i></p> <p>“ If you try to improve your internal control and risk compliance profile within a group, you will at times create friction with senior colleagues.” – <i>CFO, India</i></p>
<p>Increased alignment</p> <p>“ We have the same vision and mission of the company. We are working in a harmonious way.” – <i>Group Finance Director, Germany</i></p> <p>“ Better understanding of the need to see risk in a wider context.” – <i>CEO, Poland</i></p> <p>“ There is a dialogue on this subject between board members which results in a positive approach.” – <i>CRO, Italy</i></p> <p>“ Ideas are shared, things are learned; we come out with ways and means to improve when there are issues.” – <i>CFO, Russia</i></p> <p>“ The overlap of processes in different sectors is now more transparent.” – <i>CRO, Switzerland</i></p>	<p>“ Some of our colleagues are trying to force others to take ownership.” – <i>CFO, Australia</i></p> <p>“ It necessitates steps which the management finds hard to accept; we have a different point of view about risks.” – <i>CFO, Sweden</i></p>

Key factors for successful risk management

Company leaders considered a set of factors that are important in risk management, and identified those which contribute most to the successful management of risk. Their responses are highly consistent with those of the institutional investors we interviewed earlier in 2005; the common view is that successful risk management rests on clear ownership, understanding throughout the organisation, and internal communications.

Companies as a whole and investors give a relatively low priority to the need for a dedicated risk function (recognising that this is the norm for particular industries). Both groups also give a relatively lower rating for a centralised approach to risk management. We believe that there is an important distinction to be made between

Figure 4 Key factors for corporates: CEOs, CFOs and CROs



Q: How important are the following aspects to the success of a company's approach to risk management?
(High rating - % respondents giving 8, 9 or 10 rating on a 1-10 scale)
Percentage of all respondents (441)

taking a centralised approach to risk management, as against an approach that is integrated and aligned – that is, where the leaders of the organisation ensure that different controls and processes are working towards a consistent set of objectives.

One particular corporate finding stands out: just 42% identified having a policy for communicating to major investors as an important part of risk management. Our previous survey with investors documented the need for clear and effective communications. This does not happen in an unmanaged way, but as a result of a considered strategy for communications content and approaches. Our view on this issue is covered more fully on page 15 of this report.

Figure 5 Key factors for Institutional investors



Q: How important are the following to the success of a company's approach to risk management?
(High rating - % respondents giving 8, 9 or 10 rating on 1 -10 scale)
Percentage of all respondents (137)

Room for improvement in the current approach to risk management

We presented respondents with a range of risk types, and asked them to tell us whether or not specific types were included in their formal risk assessment process. Overall, we see the full spectrum covered by the majority of companies, to a greater or lesser degree.

We looked at how different types of companies answered this question. We found that, overall, there was a higher degree of formalisation in ‘developed’ market countries vs emerging markets, in public companies vs private, and in larger companies vs smaller. However, the difference was consistently one of degree (ranging up to 20%), rather than differences across individual areas. The overall distribution remained the same.

Based on our perception of risk management in global organisations, a number of the individual responses are somewhat surprising. For example, only two-thirds of the senior level respondents we spoke to say that tax, technology, competitive and pricing risk are included in this process. We may be seeing a lack of understanding at the line management level about what is going on in some of the functions across the organisation. This lack of understanding and communication may in turn be contributing to a level of independence and over-engineering in separate parts of the business.

Figure 6 Areas included in formal risk assessment process

Operational risk	87
Compliance (laws and regulations) risk	86
Financial reporting risk	85
Strategic risk	79
Security risk	78
Fraud	76
Currency or treasury risk	75
Trade credit or customer insolvency risk	75
Transactional risk	74
Reputational risk	73
Business ethics	72
Tax risk	69
Technology risk	66
Competitive risk	63
Pricing risk	61

Q: Which areas are included in your company's formal risk assessment process?
Percentage of all respondents (441)

On a scale of 1-10, our respondents gave their organisations a mean score of 7.0 in terms of how well they judge risk is currently managed

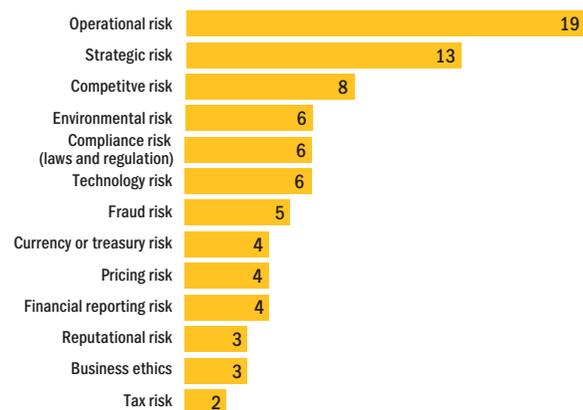
Companies are not formally managing all their key risks

On a global basis, 42% of the organisations we surveyed believe they have key risks that are not being formally managed. Here, we see some regional variations: 53% of Asian companies reported gaps in coverage of key risks, 44% in Europe and only 29% in the Americas. Looking at these groupings from another perspective, companies in emerging markets were somewhat more likely to report gaps (53%) than those from developed countries (38%).

The gap correlates fairly consistently with company size. Twenty-seven percent of the largest companies in our sample – with >\$5bn in revenues – told us that they had gaps in their coverage, compared with 43% of companies with a revenue of \$500m.

We then asked those people who believed there were gaps in risk management to indicate specific risk types. Across all areas, the risks most likely not to be managed in a formal way are operational, strategic and competitive. It is not surprising that CROs were more likely to identify gaps overall than anyone else in the management team. CEOs and CFOs were more likely to feel that gaps existed in areas outside their own control: the primary concern to CEOs was financial reporting risk; CFOs were most likely to indicate gaps in operations, strategy and pricing risk.

Figure 7 Gaps where key risks are not formally managed



Q: Are there currently any gaps where you believe key risks are not being formally managed?
 Percentage of respondents saying that there are key risks not being formally managed (180)

42% of companies globally say key risks are not being actively managed

We did not survey the full range of functional decision-makers. If we had, the perceptions would have been very different. For example, a very low proportion identified tax risk and technology risk as a gap (2% for tax risk and 6% for technology risk). These figures are clearly open to question; following implementation of Sarbanes-Oxley, the highest level of material weaknesses have related to tax reporting and technology. Tax Directors would have provided us with a very different viewpoint: indeed, every survey among Tax Directors since 2002 has identified tax risk as a major issue for tax departments. This is equally true for CIOs – our global surveys with this group demonstrate that technology risk continues to be an important issue.

Although recognition of the significance of these areas of the business has increased, awareness has probably not grown enough. These results are evidence of the ‘black box’ phenomenon, where general managers may have a limited understanding of complex areas like tax and technology, and possibly make mistaken assumptions that the key risks in these areas are well known and managed properly by ‘those responsible’. There may be a disconnect – a critical lack of communication between line management and the individual functions. We believe that executives need to strip away these assumptions and work closely with each function to ensure that risks are understood and reported, that controls are in place and are working as intended.

These results are evidence of the ‘black box’ phenomenon, where general managers may have a limited understanding of complex areas and possibly make mistaken assumptions that key risks are well known and managed properly by ‘those responsible’

Risk management needs to be more aligned with business objectives

Alignment is identified as critical to the success of a company's risk management approach (Figure 4, p10); however, nearly four in ten companies told us that they do not have a formal process which aligns risk management with corporate strategy.

This finding, more than any other emerging from our survey, suggests that companies still have some distance to go to gain full value from their risk management approach. On the surface, we find this surprising, and it challenges our experience of the market. We did deliberately ask if there was a formal process of alignment, which may have lowered the overall response. This is a demanding question, but one we feel needs to be answered in the light of constantly changing processes and activities around risk.

Public companies are more likely than private ones to have formalised the linkage (66% vs 44%); the largest companies are significantly more likely than the smallest to have done so (76% >\$5bn vs 49% <\$500m).

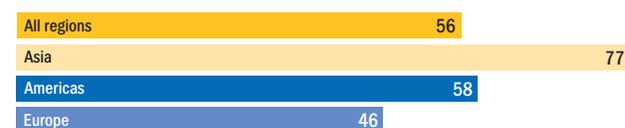
We see an important distinction in the responses from companies in a number of emerging markets and those from more developed markets. The remarkably high responses from Asia result largely from companies in China (78%), Singapore (75%), and India (64%) reporting that they have connected

risk management with corporate objectives. Australian companies, included in the Asian region, also had high ratings (83%), but did not independently drive the Asian results. Responses from companies in Brazil were also significantly higher, at 73%.

Our interpretation of this difference is that companies operating in developed capital markets, with more of a risk/return mentality, may be making a connection between risk management and strategic objectives that is more implicit than explicit. In contrast, emerging market companies may be looking at risk management from a different starting point. They are in a state of evolution, many becoming privatised and more 'westernised'. As a part of this process, they are choosing to adopt a more formalised approach from the start.

The linkage of risk management and corporate strategy, although important, is just one aspect of the wider integration discussion. In addition to aligning risk functions so that they work well together, it is critical for companies to ensure that management processes and risk processes are adequately connected in a formalised manner to obtain the benefits of alignment.

Figure 8 Are companies aligning risk management with corporate objectives?



Q: Does your company have a formal process to align risk management with corporate objectives?
 Percentage of all respondents (441), Americas (129), Asia (139), Europe (173)

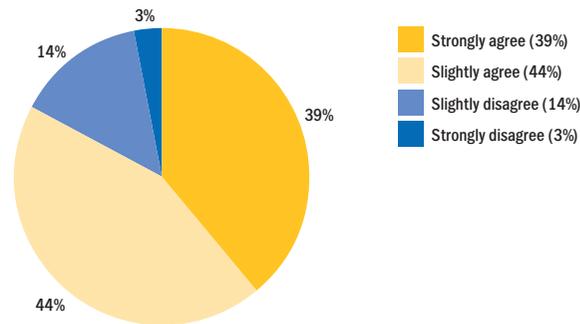
Ernst & Young defines an aligned organisation as:

“An organisation whose structure, cultural preparedness and stakeholder dialogue converge to achieve strategic goals, while still maintaining strategic options open. It embeds risk information in its decision-making and business processes, and ensures an adequate level of formalisation and integration around risk”

There is a growing understanding of risk management within organisations

Companies need to be building awareness among individuals of the risk impact of their actions and decisions – as well as the opportunities risk offers and how to take advantage of them. The overall adequacy and effectiveness of risk management is the ultimate responsibility of the Board. However, the business units themselves clearly need to take ownership of risk. Our survey shows some progress in this direction: 39% of respondents strongly agree that they have a risk culture embedded throughout their organisation, and a further 44% say that they ‘slightly’ agree.

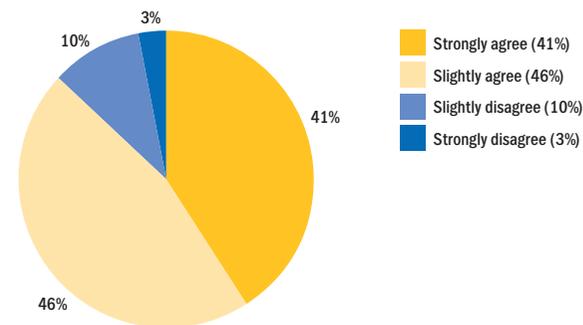
Figure 9 Do companies have a ‘risk culture’?



Q: Does your organisation have a risk culture that is embedded throughout the organisation?
Percentage of all respondents (441)

Companies are also moving forward in terms of internal education on risk. Forty-one percent agree strongly that people at their organisation are educated about the importance of managing risk, and another 46% slightly agree. This is encouraging: ongoing education is critical to maintaining awareness of risk in decision-making.

Figure 10 Do companies educate their people about the importance of managing risk?



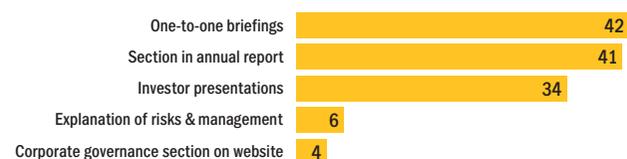
Q: Are people are educated about the importance of managing risk?
Percentage of all respondents (441)

“Our challenge? Increasing awareness and communication across the business – improving understanding of high-risk activities” CFO, Australia

Companies need to push their external communications on risk further

Our survey of investor attitudes to risk showed that they value good communication highly, particularly in a one-to-one format (Figure 11). Investors want the opportunity to ask questions and raise individual concerns. In contrast, companies primarily use the annual report, and to a lesser extent, investor presentations. While a great deal of effort goes into setting out the company's approach to risk in the annual report, in practice the content tends to be very high level. The report itself is quickly outdated, and may not meet analysts' needs. Organisations that rely on the annual report run the risk of providing less than adequate information.

Figure 11 Investors read the annual report, but also want one-to-one briefings



Q: What are the most appropriate methods for companies to communicate their approach to risk management to investors?
Percentage of all respondents (137)

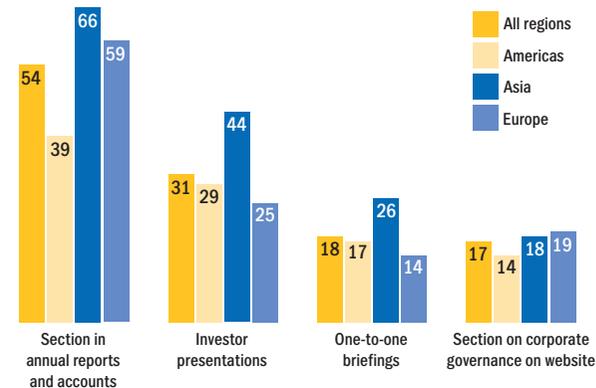
Communication with external stakeholders on risk should:

- Come from the top levels of the organisation
- Be part of a two-way dialogue
- Be relevant and specific to the company
- Cover both the risks faced and how they are being managed
- Not be defensive or overly engineered
- Not be detrimental to the company
- Allow a fair assessment of the company's expected risk/reward ratio

Overall, companies are making less use of one-to-one briefings explicitly on the subject of risk than investors would wish, although larger companies are more likely to do so than smaller ones (33% in companies >\$5bn vs 18% <\$500m). The challenge now is to meet this expectation for timely information and personal two-way dialogue (in countries where it is permitted), while at the same time adhering to corporate governance requirements which prohibit selective disclosure. We must also acknowledge that any discussions about 'uncertainties' are, in effect, risk discussions. It is impossible to talk with stakeholders without discussing risks. There is likely to be a great deal of implicit discussion about risk which is not recognised or labelled as such: 'risk' is a very broad term.

This finding has implications for communications with the wider range of key external stakeholders, including investors. Company leaders need to have an ongoing dialogue with the groups in order to better understand and respond to the environment which is affecting the future of their organisation, as well as to demonstrate in a positive way what the company is doing.

Figure 12 Companies are communicating primarily through the annual report



Q: What methods does your company use to communicate its approach to risk management to investors?

Publicly quoted companies: all regions (266), Americas (84), Asia (94), Europe (88)

Companies intend to do more in terms of risk management

When respondents were asked to consider current and future investment levels, an interesting set of assumptions emerged.

First, over three-quarters of companies described their current risk management resources and investment as adequate. However, companies also still believe that there is more to be done. The majority (66%) plan to increase their investment in risk management over the next three years. Even the very largest companies are planning to spend more, at 44%. The challenge they now face is deciding what the focus of this investment should be.

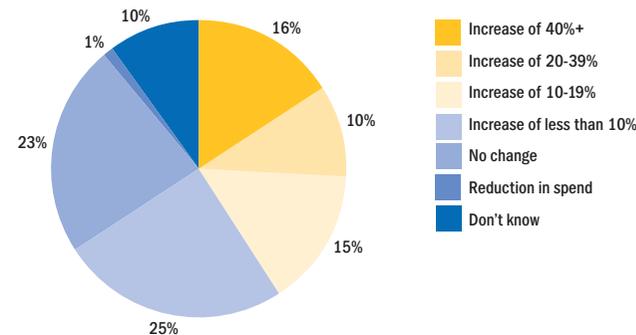
One in five of the organisations who are currently under-investing in risk management identify a dedicated risk management department as the top priority for increased investment, followed by operational risk and strategic risk (a risk management department is the main priority for CFOs as well as CROs).

Those companies who are considering the creation of a new risk management department have the opportunity to set it up in the right way from the very beginning. The best risk management functions allow businesses to be more informed, to make quicker and better decisions.

We do not advocate a bureaucratic or over-engineered approach that could potentially marginalise the issue by pushing it into its own silo. The risk management function does not imply the centralised control of risk: the business needs to own it. Instead, the risk management function provides the frameworks, the analysis and aggregation of data that allows alignment across the organisation.

Through consistent assessment and communication, the risk management function ensures that the right amount and quality of information flows between senior management and functional leaders. It continuously challenges people at all levels of the organisation to build risk management into business management.

Figure 13 Two-thirds of companies are planning increased investment in risk management



Q: By what percentage would you say your company's investment in the following areas will change in the next three years?
Percentage of all respondents (441)

Risk needs line management involvement: it cannot be shouldered by the risk management function alone

Challenges for the future

We asked participants to comment on what they see as the key challenges in risk over the next three to five years. In addition to revisiting the key survey themes (awareness, culture, alignment), they talked about the importance of a practical approach, and the balancing of risk and reward.

Risk management challenges in the next three to five years	
Aligning risk with the business	<p>"Integration of risk with the holistic goals of the company." – <i>Head of Risk, France</i></p> <p>"Above all, a coherent and consolidated management of risk." – <i>CFO, Italy</i></p> <p>"The biggest goal is to create an integrated system of risk management." – <i>CFO, Switzerland</i></p> <p>"Linking risk to value addition and more strategic objectives." – <i>Group Risk Director, Australia</i></p> <p>"To put together the growth of risk management with the growth of the whole company." – <i>CRO, Germany</i></p>
Awareness and culture	<p>"Ensuring that risk management remains top of mind for all individuals in the company." – <i>Head of Risk, US</i></p> <p>"To ensure the different sectors of the company have an overall understanding of risk as it relates to the company, not just their department." – <i>Head of Risk, France</i></p> <p>"The most important thing is that the most junior employee should be aware of the risks." – <i>Executive Director, India</i></p> <p>"Increased awareness by all the employees of difficulties connected to risk management and the importance of this issue." – <i>FD, Poland</i></p>
Staying practical	<p>"Maintaining management interest, including the Board; keeping regulatory overheads to a minimum; and keeping documents up to date." – <i>FD, UK</i></p> <p>"Making it bullet-proof, making it more efficient and effective." – <i>FD, Hong Kong</i></p> <p>"We deal with 140 companies around the world, so the key challenges are geographic and cultural diversity." – <i>Head of Risk, US</i></p>
Balancing risk and reward	<p>"Getting the risk/reward balance right and consistent across all areas of risk." – <i>Head of Risk, UK</i></p> <p>"The balance between risk avoidance and effectively using risk to competitive advantage." – <i>CFO, Canada</i></p> <p>"The challenge for us is to be able to satisfy customers' demand for risk-taking without jeopardising the company's financial results." – <i>Head of Risk, Sweden</i></p>

"Our challenge? To bring risk back to the general management instead of having it under a different job title: to make managers hands-on again, more doing instead of talking – and more control from the Board" FD, Netherlands

Our conclusions

The benefits of alignment

Our survey results have confirmed what we know from our work with clients: that companies see rising risk levels, that they see room for improvement in their approach to risk management, and that they plan to spend more in this area. We believe that, overall, they have the building blocks of good risk management in place. However, despite making significant investments of both time and resources, they may not be realising as much value as they could.

How can they make more efficient use of their time and money? Some are responding to increased pressures and expectations by creating new risk management infrastructures and functions. The challenge will be to push (and allow) these functions to play their full role in providing the standards and processes for more effective risk management.

Benefits of alignment...

Accountability: clarified roles

Efficiency: clear triage between 'must-haves' and 'nice-to-haves' in treating risk; risk management on the right level

Consistency: common approaches, tools and language

Flexibility: learning from others in the company; sharing views makes for quick reaction

Consciousness: risk and risk management awareness on all levels

Effectiveness: no foreseeable surprises

Compatibility: proper embedding of functional risk management into existing management processes

Communications: coordinated messages from Board and management in stakeholder dialogue

...to strengthen risk management competency

Through consistent frameworks, analysis and communications, they can ensure that the right amount and quality of information reaches the CEO, executive management and the Board.

The best risk management functions will allow companies to avoid duplication of effort, increase efficiency and ultimately use risk management to benefit the business. Company leaders can then focus on leveraging what they have in place already, and respond to the following challenges:

- Re-evaluating the current risk management approach. What are the key risks? What risks are being covered? Who is managing what?
- Challenging whether there is adequate formalisation of risk management activities already in place.
- Assessing whether there is alignment between goals, risks and controls, helping management to focus on the risks that matter.
- Maintaining and building dialogue with the various functions across the organisation, to avoid overlaps, gaps and inconsistencies.

Survey approach

From October through December 2005, our researchers¹ interviewed 441 C-suite members and other senior decision-makers in large organisations across major industry sectors. We talked to people in 16 countries, with emphasis on the larger financial centers.

Overall, we found a high degree of consistency in senior management responses across markets, types and size of organisation.

We did see some differences in the level of formalisation in the risk management approach, with the largest public companies in developed market countries tending (but not always) to report a formalised process. Meaningful differences have been highlighted in our commentary.

Research sample

Job title		Revenue	
CFO/CEO	180	\$5 billion plus	51
Group Finance Director/FD	48	\$2 billion - \$5 billion	51
CRO	59	\$1 billion - \$2 billion	55
Head of Risk Management	96	\$501 million - \$999 million	66
Head of Internal Audit	15	Up to \$500 million	153
Financial Controller	9	Finance/Government	27
Head of External Audit	6	Revenue not reported	38
Head of Corporate Development	5	Total	441
Non-Executive Director	4		
COO	2		
CIO	1		
Other senior management	16		
Total	441		

¹ The telephone-based survey was conducted by Taylor Nelson Sofres, London, identifying Ernst & Young as the sponsor.

Research sample

Region/country	
Americas	64
Brazil	13
Canada	65*
USA	51
Asia	35
Australia & New Zealand	54*
China & Hong Kong	27
India	50*
Singapore	8
Europe	173
France	21
Germany	12
Italy	22
Netherlands	23
Poland	13
Russia	13
Sweden	22
Switzerland	21
UK	26
Total	441

Industry group	Total
Energy, Chemicals & Utilities	85
Financial Services	66
Government, Public Sector & Not For Profit	3
Health Sciences	17
Industrial Products	86
Real Estate, Hospitality & Construction	18
Retail & Consumer Products	60
Services	27
Technology, Communications & Entertainment	59
Transportation	20
Total	441

* For the purposes of this report, the findings for Australia, Canada and India have been weighted down to achieve consistent representation with comparable markets.

Appendix

Risk definitions

We asked respondents how important it is for companies to have clear strategies to manage a range of types of risk. In most cases, the risk types were immediately apparent to them, and they were able to comment easily; in a small number of cases, individual respondents asked us what we meant by the risk type. Below are the descriptions we then gave them for the purposes of this study.

Compliance: the risk relating to a company's non-compliance with applicable laws and regulations.

Trade credit/customer insolvency: the risk and cash flow implications of bad debt or slow payment of trade debt.

Competitive: the risk that actions of competitors or new entrants to the market could hurt an organisation's competitive position and its capacity to conduct business efficiently.

Reputational: the risk that negative public opinion may impact earnings and capital.

Security: the risk that failure to restrict access to information adequately may result in unauthorised knowledge and use of confidential information.

Technology: the risk that information technologies are compromising the integrity and reliability of data and information, or are threatening the organisation's ability to sustain the operation of critical processes.

Currency/treasury: the risk that volatility in foreign exchange rates exposes the organisation to economic and accounting losses.

Pricing: the risk that prices of key resources and services are higher than their expected levels, resulting in increased costs or lower margins.

Transactional: the risk that strategic transactions (eg M&A) will fail.

Operational: the risk that operations are inefficient and ineffective in executing the business model, satisfying customers and achieving quality, cost and time-performance objectives.

Taxation: the risk that failure to accumulate and consider relevant tax information may result in non-compliance with tax regulations or adverse tax consequences that could have been avoided.



**Companies on risk in Australia
and New Zealand.**

**Perspectives from local corporate
risk owners.**

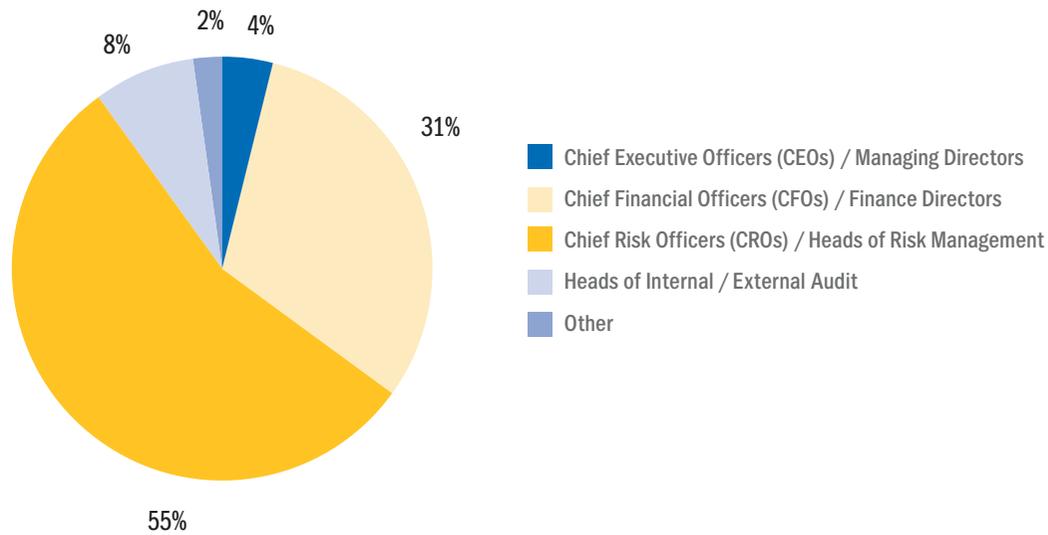
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Introduction

As part of its 2006 global survey of corporate attitudes to risk and risk management, Ernst & Young interviewed 54 senior executives across Australia and New Zealand. This supplement contrasts their responses with those of the core global sample base of 441 executives in the accompanying main report.

The breakdown of the local sample is as follows:



Executive summary

The standout finding from the local survey is that companies in Australia and New Zealand are more progressed in their approach to risk than their global counterparts, with the majority having employed Chief Risk Officers (CROs) and taking a long-term and enterprise-wide view of risk. This said, the CRO role is an evolving one, with no industry-wide definition of seniority or responsibilities.

The survey found that local companies take the responsibility for risk oversight right down to the operational level and are more likely to align risk management with corporate strategy. This advanced approach affords local companies the insight to identify gaps where key risks are still not being addressed and recognise where work still needs to be done. As such, most respondents plan to increase their investment in risk over the next three years, primarily with the aim of embedding a risk culture and improving their ability to manage operational risk.

Advanced management of risk

Local organisations in the response group have a more strategic and considered approach to risk management than their global peers. This is evidenced by the high priority they place on risk, their higher tolerance of risk, their focus on long-term risk assessment and the dedicated roles and mechanisms they resource to manage risk. Both local and global companies take an enterprise-wide view of risk as opposed to managing it on an issue by issue basis.

Commentary

At the country level, risk management maturity is driven by political factors and the nature of local industries.

For example, if we examine the regulatory environment, it is not surprising that companies in Australia and New Zealand are less risk averse than those in other countries and are more familiar and engaged with the risk management process. Our business communities have been highly risk aware since 1995 when the

Australian/New Zealand Standard, AS/NZS:4360-Risk Management, was one of the first risk standards to be published anywhere in the world. Subsequent corporate governance requirements such as CLERP 9, Australian Stock Exchange (ASX) Principles 4 and 7, Australian Prudential Regulatory Authority (APRA) regulations, New Zealand Stock Exchange (NZX) and New Zealand Securities Commission initiatives have only served to sharpen this local focus.

At the same time, some of the largest industry groups, particularly in Australia, have traditionally been primary industries, including mining, energy, utilities and resources, in which risk management has always been a priority. Equally, the dynamic financial services market has created a focus on Basel II and the resulting processes surrounding operational risks, which ensure internal control reporting is linked to risk management.

Issue	Australia/NZ	Global
Risk as a priority	53% believe risk is extremely important, 47% fairly important	35% believe risk is extremely important, 57% fairly important
Attitude to risk	83% 'tolerant of risk' or 'embrace risk'	69% 'tolerant of risk' or 'embrace risk'
Strategic versus tactical approach	Companies spend less time reviewing short term risks (next 12 months), and more on longer term risks (5 years plus)	Trend is to focus on the short term (next 12 months) and less on the longer term (5 years plus)
Dedicated risk management function	76%	61%
Have a Chief Risk Officer	70%	55%
Internal control reporting linked to risk management	79%	69%

Tighter operational risk responsibilities

Local organisations take a more strategic and practical approach to monitoring risk and overseeing risk management. Globally, the CFO is regarded as being responsible for both these areas. Locally, companies place oversight at board level, and split the responsibility for monitoring risk between the CRO and, at an operational level, business unit heads. However, despite local companies believing the board receives appropriate risk information, confidence in the board's capacity to use this information is not strong.

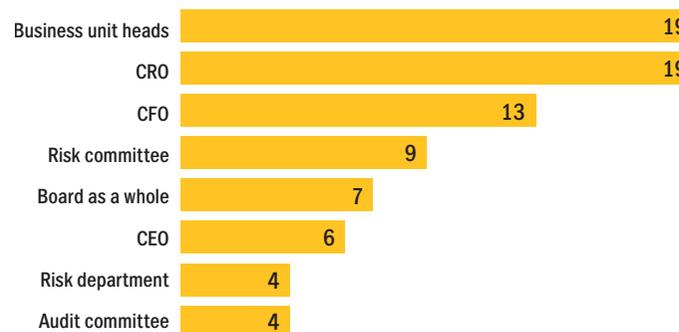
It should also be noted here that the role of the CRO in the local market is still an evolving one. As yet, there is no industry-wide definition of responsibilities and many organisations are still experimenting with risk management structures to best suit their requirements.

Commentary

Splitting the responsibility for monitoring risk is a more practical and effective approach as it ensures those closest to the risks are responsible for managing them. It means that risk management can take place at the point where risk occurs. This approach also helps to embed risk management into an organisation's day to day operations.

Given the role of the board in strategy setting and oversight, it is also highly appropriate to place risk oversight responsibilities at this level. At board level, a dedicated risk committee can consolidate risk information from across the organisation and analyse it in the context of the big picture. However if, as the survey suggests, the board does not always use the risk information provided, then it is losing out on vital strategic information required for effective corporate governance.

Figure 1 Business unit heads and CROs are primarily responsible for monitoring risk



Q: Who is responsible for monitoring risk?

Percentage of all Australian and New Zealand respondents (54)

Issue	Australia/NZ	Global
Who is responsible for monitoring risk?	Business Unit Heads and the CRO	CFO
Who has primary oversight for risk?	The board	CFO
Does the board receive sufficiently regular, transparent and robust information on risk?	Yes 87%	Yes 85%
Does the board regularly use this information?	Yes 43%	Yes 55%

“We focus on a broad spectrum of risks, from compliance to operational, marketplace and strategic”

Head of Risk Management, New Zealand

“Our business units are developing a greater appreciation of how risk management can support their objectives as well as how their appetite for risk can frame strategy”

CRO, Australia

Greater alignment with corporate strategy

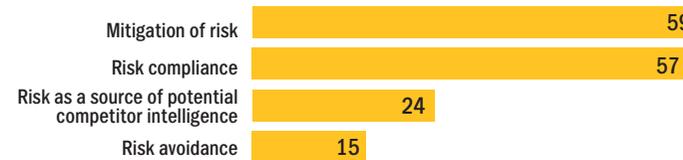
Both local and global respondents understand the need to establish a risk framework and to communicate the importance of risk throughout the organisation. However, only local companies are taking practical steps to move beyond this starting point by aligning risk assessments with corporate strategy. Neither group see risk information as being primarily relevant to assisting organisations in developing competitive advantage.

Commentary

Despite local companies aligning risk assessment with corporate strategy, risk information is still not being used as a primary generator to deliver competitive advantage. Reasons for this may include a lack of direction from senior management, failure to make sufficient use of risk information by the board and/or a failure to understand how the information can be used to gain a competitive advantage.

Issue	Australia/NZ	Global
Most important success factor in risk management?	Clear ownership of risk and cascading an understanding of the importance of risk management throughout the organisation	Clear ownership of risk and cascading an understanding of the importance of risk management throughout the organisation
Formal process to align risk assessment with corporate strategy	83%	56%
Use of risk information	Risk mitigation and compliance scored much higher than competitive advantage	Risk mitigation and compliance scored much higher than competitive advantage

Figure 2 Risk mitigation and compliance are the core activities



Q: What emphasis does your company's approach to risk management place on the following?

Percentage of all Australian and New Zealand respondents providing a score of 8, 9 or 10 on a 1-10 scale (54)

"We need to develop and maintain appropriate risk oversight and management without becoming risk averse"
Head of Risk Management, Australia

"I think it's about getting the risk/reward balance right - taking the right amount of risk in a given situation and getting an appropriate return" *CRO, Australia*

Awareness of key risks not being addressed

Four in ten participants from both local and global groups believe their organisations have key risks that are not being addressed. Primarily, these risks are seen as being operational. As part of their self-appraisal, two thirds of local organisations do not believe they have a strongly embedded risk culture, a response later reiterated when participants were asked about the future challenges they face. This lack of a risk culture is also evidenced by the number of companies effectively educating individuals about the importance of risk: less than 40% of local companies strongly agreed that this was taking place.

The fact that only one third of local companies are very confident they have sufficient resources to deliver the company's risk management objectives, and even fewer believe that they receive sufficient support from key personnel in the business units, also supports the claim that risk management is not fully embedded. However, as the results from both the local and global survey show that two thirds of participants are planning on increasing investment in risk management over the next three years, it would be hoped that much of this investment would go into addressing these weak points around resourcing and support.

Issue	Australia/NZ	Global
Decision-makers rating the overall quality of their risk management 8, 9 or 10 on a scale of 1-10	19%	36%
Active risk management	More than four in ten decision-makers believe there are key risks that are not being actively managed in their organisation	More than four in ten decision-makers believe there are key risks that are not being actively managed in their organisation
Top two areas in which risk is not being actively addressed	<ol style="list-style-type: none"> Operational risk Technology risk 	<ol style="list-style-type: none"> Operational risk Strategic risk
Areas requiring increased investment	Operational risk and building a dedicated risk management department	Operational risk and building a dedicated risk management department
Strongly embedded risk culture?	33%	39%
Strong education about the importance of managing risk	39%	41%
People are measured on managing risk versus reward	54%	62%
Very confident of sufficient resources to deliver risk management objectives	35%	30%
Very confident of sufficient support from key personnel in business units to deliver risk management objectives	20%	35%
Increasing investment in risk management	Two thirds of respondents believe they will increase investment in risk	Two thirds of respondents believe they will increase investment in risk

“Our risk assessment is not comprehensive in some business units due to disjointed rollout of risk policies and the diversity of our operations”
Head of Risk Management, New Zealand

Commentary

These results, about the effectiveness of and commitment to risk management strategies, are particularly interesting when viewed in the context of the earlier results that show Australian and New Zealand companies as being fairly advanced in risk management when compared with global organisations. Despite taking a strategic approach to risk management, two thirds of the local organisations taking part in the survey do not rate their overall risk management very highly. In fact, there is an overall desire to develop and enhance the risk process, particularly around improving operational risk management.

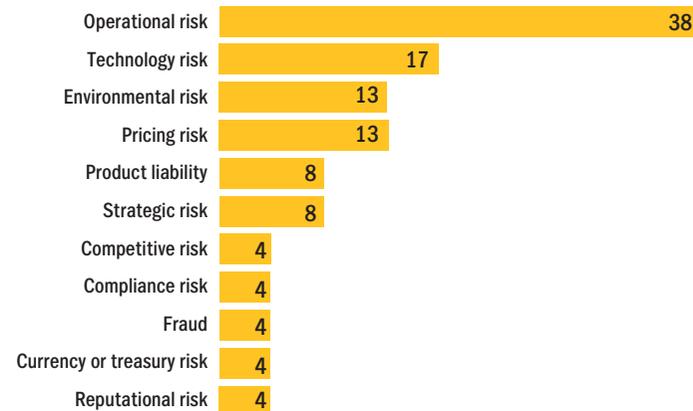
One reason for this critical view of apparently mature risk processes may be that these respondents operate in the mature framework provided by AS/NZS 4360. In such an environment, those people involved with risk seek to continuously improve the supporting processes and procedures by comparing themselves against this standard. In other words, their greater understanding of risk management best practice makes them more critical of their own performance.

Additionally, a number of organisations taking part in the survey are likely to have participated in risk management audit or review exercises that would have raised suggestions and recommendations for risk management improvements and, in turn, made them more aware of areas that need to be addressed. Certainly in financial services, the work done to comply with Basel II regulations has increased focus on operational risks and made organisations more critical of risk processes in this area.

These reasons aside, work clearly still needs to be done on becoming risk mature as an organisation by, for example, embedding risk awareness and linking risk and reward at the personnel level. Until risk becomes part of the daily workings of the company, accepted and led from the top, it is unlikely that resources in terms of people, time and money will be readily available to help embed and support the risk process.

Another area for improvement is for companies to look more closely at intangible risks. Reputation risk was not identified as an issue at all locally, and was ranked bottom globally. Failure to address intangible risks is common across many organisations, mainly due to the difficulty of quantifying the risk and being able to put in place effective strategies and plans to manage it. Unfortunately, however, an intangible risk such as a threat to reputation can still tangibly impact the bottom line and damage long term profitability. It is therefore vital that such intangible risks are not overshadowed by other more obvious risk areas, such as those covered by corporate governance requirements, and that mitigation plans and strategies are developed to protect an organisation's entire risk profile.

Figure 3 Operational risk represents the biggest opportunity



Q: Are there currently any gaps where you believe risks are not being actively managed? Yes. What are these gaps?
Percentage of the 24 Australian and New Zealand respondents that responded in the affirmative

Future challenges

The survey results confirm the Ernst & Young experience with our own clients: companies see rising levels of risk; they see room for improvement in their approach to risk management; and they plan to spend more in this area. They recognise that, although they have solid foundations in place for good risk management and have made significant investments of time and resources, they may not be realising as much value as they could.

Over the next three to five years, both local and global companies believe the key issue facing them is the continued management of risk. Important challenges will include:

- developing a more integrated and systematic approach;
- clarifying ownership of risk;
- using risk information to develop competitive advantage; and
- embedding a risk culture throughout the organisation.

By comparison, foreign exchange and technology risks are perceived to be the least significant challenges facing organisations over the next few years, despite the fact that technology risks were identified locally as being the second biggest concern in terms of gaps in addressing key risks. This means either that organisations believe they can address the gap easily, or that they are not overly concerned with the impact these risks may have if they do occur.

The priority placed by local organisations on operational risk may have arisen as a result of the recent focus on this area by corporate governance requirements. Although it is clearly important to address these operational areas and implement a robust framework, failure to address all areas of risk facing an organisation, particularly those specifically identified as areas where risk is not being well managed, will lead to deficiencies in the process and poor risk management.

The future challenge will be to provide the framework and processes needed for more effective risk management, together with appropriate analysis and communication to ensure that the right amount and quality of information reaches the CEO, executive management and the board. The best risk management functions will allow companies to avoid duplication of effort, increase efficiency and ultimately use risk management to benefit the business.

This, perhaps, is the ultimate measure of effective risk management. If the function is providing the board with information it already knows then the risk process is not 'paying its way'.

Figure 4 Embedding risk is the key challenge going forward



Q: What do you see as the key challenge in terms of risk for your company over the next three to five years?
 Percentage of all Australian and New Zealand respondents (54)

Integration will be one of the key risk challenges in the next 3 to 5 years:

“We are trying to manage our internal changes to ensure that risk management just happens in the business as part of our standard operating procedures”

CFO, New Zealand

“Our aim is to move from just having a framework... to embedding it into business processes”

CRO, Australia

“A risk culture within the business is important, as is avoiding blame so that we don't suffer from the 'bad news travels slowly' syndrome”

CRO, Australia

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