U.S. RISK BAROMETER

Survey of C-Level Executives with the Nation's Largest Companies

protiviti®
Independent Risk Consulting

Business Risk | Technology Risk | Internal Audit

TABLE OF CONTENTS

EXECUTIVE SUMMARY

In September 2005, Protiviti Inc., a leading business and technology risk consulting and internal audit firm, commissioned a study to better understand the risk profiles of senior executives with the 1,000 largest companies in the United States. Specifically, the objectives of the study were to (1) identify the nature of the risks undertaken by these corporations, (2) understand the appetite for risk and concerns with regard to risk of senior executives, and (3) understand the current state of these corporations' risk management capabilities, including changes in and ownership of those capabilities. Protiviti plans to commission this study periodically to identify and understand ongoing trends in risk and risk management.

The study was conducted by an independent research firm through a survey of 76 senior executives at Fortune 1000 companies who both report to the board and have a strategic role with respect to identifying and managing risk. Of the 76 executives interviewed, three were chief executive officers (CEOs), 41 were chief financial officers (CFOs), 15 were chief risk officers (CROs), two were treasurers, and 15 were EVPs or directors of risk management. (Please see the Survey Methodology section for further details.)

The study results are summarized in three categories – changes in risk profile, risk management capabilities and current state of risk.

CHANGES IN RISK PROFILE

Key conclusions:

- Corporate America's largest companies are taking more risks.
- Risk levels as well as appetite for risk have changed significantly over the past two years.
- Primary catalysts for change include the regulatory environment, strategic decisions, and current and potential litigation.

Without question, the overall level of risk is increasing for many companies. More than four in 10 top executives surveyed at Fortune 1000 companies say their organizations take a moderate number of risks, while an additional 30 percent indicate their organization takes many risks. Nearly five in 10 senior executives believe their organization's risk profile has become more risky, attributing the change most often to strategic decisions, such as the introduction of new products.

More than half of those surveyed – 51 percent – said that the overall level of risk their organizations face has changed significantly during the past two years, with legislative and regulatory issues as well as current and potential litigation cited as the most common reasons. In addition, almost half of the respondents – 49 percent – say the level of risk in their industry has changed significantly over the past two years. The change in the level of industry risk is largely due to regulatory issues as well as a general point of view that the business climate is much riskier today. For example, many among the half who perceived a change believe the industry in which they operate is getting more competitive and the pace of change is increasing.

Although half of the executives report their organization's level of risk has increased, they are split over whether their organizations have become more aggressive or more risk averse. While 40 percent say they have become more risk averse, 42 percent claim to have become more aggressive. Both of these groups attribute strategic decisions and changes in management as primary reasons for the change. Those reporting to have become more risk averse also cite changes in the regulatory environment, financial condition and litigation as key reasons why, while those indicating they have become more aggressive cite as motivating factors better management, future outlook, and a desire to improve and grow.

These findings suggest that as the operating environment changes and the pace of change escalates, organizations must become more forward-looking. As the environment changes, new risks emerge and should be escalated timely so that assumptions underlying the existing business model, and the effectiveness of the strategies around executing that model, can be evaluated.

RISK MANAGEMENT CAPABILITIES

Key conclusions:

- Most senior executives lack a high degree of confidence that their organization's risk management capabilities identify and manage all potentially significant business risks.
- Few companies are effective at balancing growth and control.
- Not enough companies are employing best risk management practices.
- Most companies are taking steps to improve their risk management capabilities.
- CFOs "own" risk management in most organizations.
- The most significant benefits of risk management are viewed to be lower costs of insuring risk and more timely identification of critical risks.

Seven in 10 executives report their organizations have changed risk management capabilities over the past two years. Nevertheless, there clearly is more work to be done, as is evident in a number of the survey findings:

- Only 38 percent believe their organizations are "very effective" at identifying and managing all potentially significant business risks.

This finding suggests there is a significant opportunity to improve risk management capabilities, and in particular with integrating risk management with strategy-setting.

- Just 32 percent of executives believe their companies are very effective at balancing protection of the business with efforts to undertake new sources of growth and increase returns. Companies appear to place a greater emphasis on growth versus control, but the margin is small. More than half – 53 percent – say the higher priority is encouraging new initiatives and entrepreneurialism, while 43 percent report controlling the business and protecting enterprise value take precedence.

Based on our experience, this is an important issue. An oversight process must be in place to provide assurance to the board and senior management that the entrepreneurial activities and the control activities of the organization are in balance so that neither one is disproportionately strong relative to the other.

- More than half – 58 percent – report their organizations quantify risk in just a few areas, and 54 percent agree there is more they can do to identify and manage the risks they face and quantify their organization's risk profile.

Of note, most financial organizations report that they quantify their risks to the fullest extent possible, which is predictable given the regulatory environment in which they operate. The Basel Accords, for example, require quantification to determine the level of regulatory capital international banks must hold to offset unforeseen risks. In addition, certain risks (e.g., market and credit risks) faced by financial institutions may lend themselves more to quantification than risks in other industries.

Fortune 1000 companies have multiple processes and systems deployed to help manage the risks they face, but here again, the participating executives report there is substantial room for improvement. To identify and prioritize risk, the only practice used frequently is incident reporting and loss measurement. Just 28 percent use risk mapping, 30 percent have risk-based metrics in place and 32 percent employ risk modeling. In addition, less than half of large companies currently deploy proven risk management practices enterprisewide, including an enterprisewide risk assessment process (38 percent), oversight by a risk management executive committee (38 percent), and a common risk language along with uniform risk management standards (39 percent). The most common risk management practice, according to 80 percent of major companies, is the deployment of an internal audit department. All of these practices are important because, as our experience indicates, they are essential elements of beginning an enterprise risk management program.

Sixty-five percent of the participating executives report their organizations plan to make changes in risk management capabilities during the next two years. In particular, these executives hope to improve their organization's ability to identify potential risks through implementing better technology, hiring more qualified staff and improving their planning processes to stay ahead of significant issues that arise over time. Primary reasons for making changes include new legislation, plans to expand and changes in organizational culture.

Based on the survey results, the overall responsibility of managing risk in a Fortune 1000 company is most likely to fall on the shoulders of the CFO. CFOs are most likely to have primary responsibility for risk management policy and reporting. CROs also play a significant role in risk management policy, reporting and execution. Operating unit managers, meanwhile, are most likely to have primary responsibility for risk management execution. Other individuals with risk management responsibilities include internal auditors, in-house legal counsel and chief operating officers, all of whom typically play a role in monitoring and identifying processes.

Organizations most often evaluate the benefits of risk management from a tactical perspective. For example, benefits cited include a lower cost of insuring risk (46 percent) and more timely identification of risk (43 percent), followed by improvements in process performance (39 percent), and increased internal awareness of risk (38 percent) and monitoring changes in the organization's risk profile (33 percent). Other benefits include improved quality in internal risk reporting and metrics (26 percent), enhancements in share or enterprise value (22 percent) and more robust business plans (20 percent).

Interestingly, just one in five noted enhancements to share or enterprise value to be a benefit, which may indicate difficulty in attributing such enhancements to improved risk management. Clearly, risk management has more to prove to gain favor as a source of competitive advantage with senior executives of large companies.

Notwithstanding the need for improvement, the study found that there are some risk management practices a majority of the companies were deploying. For example:

- Six of ten of the participating executives indicated their companies integrate responses to manage key risks with the strategic management and business-planning process. It is not surprising that executives integrate responses around the risks of which they are knowledgeable with strategy-setting and planning processes, because that is what successful companies do. However, the more significant question is whether companies are keeping their business strategies and plans current as circumstances change. As noted earlier, only 38 percent of companies assess risk periodically, enterprisewide.
- Likewise, almost six of ten (57 percent) executives report their companies designate a dedicated risk manager supported by a risk management staff. Based on our experience, these designated risk managers have varying responsibilities, ranging from the broad responsibilities of a chief risk officer to the more focused responsibilities of managing insurable or treasury risks.
- In addition, 59 percent of the participating executives report their organizations clarify roles, responsibilities and accountabilities for managing critical risks, 55 percent note that their companies articulate a statement of risk management goals and objectives, and 50 percent report there is risk oversight by a board subcommittee of independent directors.

With respect to the risk oversight statistic: As we do not see many boards setting up a separate risk management or compliance committee, this finding suggests that boards are considering selected risks through the existing committee structure, e.g., through the finance committee and audit committee. In addition, while all effectively functioning audit committees primarily provide oversight of financial reporting risks, this finding suggests that senior executives of large companies see some expansion taking place in that committee's role to address additional risks, such as IT security and business continuity.

In summary, while risk management may be a higher priority for today's largest companies and while they are taking steps to improve their risk management capabilities, there is still a substantial amount of work to be done.

CURRENT STATE OF RISK

Key conclusions:

- Companies do not have just one predominant risk today – rather, they face a range of risks.
- Customer satisfaction, IT security, competition and the current regulatory environment top the list of most significant risks

Executives in the survey did not identify one dominant risk; rather, their organizations face a range of risks they deem to be significant. This finding is not surprising based on the risk assessments we have facilitated for our clients in which we see a wide range of risks driven by external and internal forces. Current events also impact executives' assessment of risk. For example, ever-mounting regulatory pressures are driving the volume of requests for help with anti-money laundering, Basel II and new accounting standard releases. Increasing competition is driving the need for improving quality, time and cost performance.

To better understand the risks that are top of mind for senior executives of large companies, the Protiviti Risk Model[SM] was used to organize the survey and our commentary. That model breaks down the sources of uncertainty in a business into three broad groups – environment, process and information for decision-making.

With respect to external environment risks, executives deem the competition to be the most significant risk facing organizations today. Organizations also show concern over the regulatory environment, technology innovation and the state of financial markets. In addition, external threats such as weather, floods and terrorist attacks are becoming a concern. This last point is consistent with the increasing demand Protiviti is seeing from companies nationwide for business continuity services in the wake of the recent hurricane season. The political climate of high-risk countries is considered a less significant risk.

The most significant internal process risks facing organizations today in terms of processes, systems and the internal environment appear to be risks relating to information systems and security. Interestingly, while many executives cited IT security as a significant concern, a review of first-year results for SOA compliance indicates it is an area that continues to be cited often as a significant control deficiency. Apparently, it is not receiving appropriate attention despite the concern of senior executives. In addition to IT matters, critical process risks include customer satisfaction, as well as concerns around employee integrity, ethical behavior and fraud.

In terms of information for decision-making risks, executives deem Sarbanes-Oxley Section 404 compliance and other legal and regulatory compliance issues as their most significant risks around the reliability of information. It is logical to infer that the criminal penalties and personal reputation issues make this a greater current priority for senior executives, whose personal success is inextricably tied to the success of their respective organizations. As Year Two of SOA compliance begins to close for accelerated filers, more companies are turning their attention to improving the financial reporting process and transitioning their compliance from an ad hoc project to an ongoing process. This "project to process" transition is likely in response to expectations for more value-add and increased cost-effectiveness as well as the potential for the SEC-mandated phase-in of more stringent annual filing requirements for the nation's largest companies.

SURVEY RESULTS AND ANALYSIS

CHANGES IN RISK PROFILE

Significant changes have been taking place among the largest U.S. companies in terms of their risk profiles, which are a combination of their overall appetite for risk and the level of risk they face in the operating environment.

Organizational Risk

More than half of those surveyed – 51 percent – said that the overall level of risk their organizations face has changed significantly during the past two years. These respondents also were asked to identify why this risk level had changed during that period. Factors they cited included legislative and regulatory issues such as Sarbanes-Oxley (13 percent).

> **General Industry Observations**
>
> Directionally, the overall level of risk seems to have changed the most for organizations in the consumer products, financial services and utility industries.

Each survey respondent was asked to rank, on a scale of 1 to 10, the organization's risk appetite (i.e., the company's willingness to take risk) and the overall level of risk of the organization's operating environment.* The average response for each is shown in Figure 1. Eighty-four percent of respondents said that currently their organizations face either a medium or high level of risk. In addition, 72 percent described their organizational risk appetite as one that accommodates either a moderate or substantial number of risks.

Respondents also were asked how their organization's risk appetite has changed since 2003. Forty-eight percent reported it to be much or somewhat more aggressive (i.e., management is willing to take on more risk). Just 20 percent said the organization's risk profile was less aggressive, (i.e., management desires to take less risk) and 32 percent reported no change.

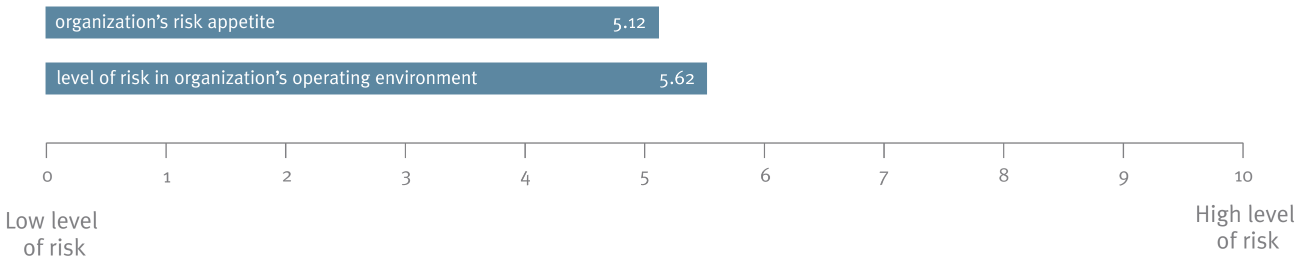

Figure 1

*Protiviti will track these risk rankings over time to monitor trends in organization risk profiles and the management of risks.

When asked to note reasons why their organizational risk profiles had become more risky, the most common responses included management decisions to introduce new products, enter new markets or engage in mergers and acquisitions (22 percent); changes in the competition (22 percent); changes in regulation (17 percent); and board oversight (11 percent). Executives also mentioned a number of other strategic decisions as reasons underscoring changes to their organization's risk profiles, including selling off riskier ventures or pulling out of riskier markets.

Interestingly, one in three respondents (33 percent) who said their organizational profiles were either much or somewhat less risky attributed this to changes in their company's systems and processes, and 27 percent cited as a reason management decisions to introduce new products, enter new markets or engage in mergers and acquisitions. These comments suggest a point of view by these executives that taking no action in a dynamic marketplace is often a riskier alternative. Another 13 percent indicated board oversight.

Today's Fortune 1000 companies are split as to whether they are risk averse or risk aggressive. Among executives polled, 40 percent said their organizations had become either more or somewhat more risk averse over the past two years, while 42 percent had become more aggressive in taking risk.

Among those who reported becoming more risk averse, one in three (32 percent) referred to a variety of related factors such as the existing financial condition, existing market conditions, the current business climate, the desire to avoid losses and the nature of the times.

In addition, one in four (27 percent) cited Sarbanes-Oxley as a key factor, while 17 percent noted changes in management or leadership and better management. Finally, 13 percent cited concerns with respect to litigation matters.

Executives who reported their organizations were more risk aggressive attributed more favorable market conditions and competitive environment (15 percent) and favorable changes in management or leadership (13 percent) as important factors, along with future outlook and long-term growth strategies (13 percent).

In addition, 15 percent of the participating executives referred to a variety of related factors such as improved financial condition and a more favorable business climate.

SELECTED COMMENTS FROM RESPONDENTS – WHY HAS THE ORGANIZATION'S RISK PROFILE CHANGED OVER THE PAST TWO YEARS?

Management/better management/change in leadership

"Alignment of management and new strategy."

"Hiring and change in top management."

"Management decisions concerning entering new markets."

"Greater competence in management, ability to react to external conditions quickly."

Change in regulatory environment/ Sarbanes-Oxley

"Just the legal environment, such as the Sarbanes-Oxley 404 compliance."

Change in financial conditions/balance sheet

"Better financial conditions, the direction management has taken."

"The improvement of financial conditions has allowed us a chance to take more risk."

Our future outlook/our desire to improve/grow

"Looking at where we want to be in the future."

"The drive to continue to grow the business."

Litigation/lawsuits

"Currently have a class action lawsuit filed against us."

Changing market conditions

"Evolving marketplace."

Our ability to understand/manage risks

"Better understanding of risk and how it relates to the business."

We are more conservative/cautious/we are trying to avoid more losses

"The aggressive investigation of U.S. government and state governments for financial matters and fraud."

"Profitability has declined and we are more cautious in making economic decisions."

Industry Sector Risk

Almost half – 49 percent – of respondents reported that the overall level of risk within their respective industry sector had changed significantly over the past two years. When asked how this risk level has changed, 19 percent cited the industry in general, including competition, the faster pace of business as well as uncertainties in the marketplace, while another 19 percent cited legislative and regulatory issues such as Sarbanes-Oxley.

Perhaps more significantly, 91 percent of executives rate the overall level of risk in their respective industry sector to be at either a medium or high level (respondents ranked the overall level of risk in their industry sectors on a scale of 1 to 10 (see Figure 2).*

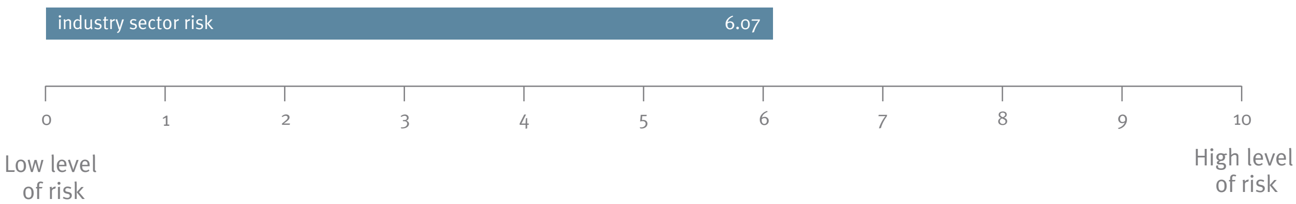

Figure 2

Note the participating executives also rated the level of risk in their organization's operating environment using the same 10-point scale as above (see page 6). A comparison of these two indexes generally indicates that the respondents view the level of risk in their respective industries as slightly higher than the level of risk encountered by their respective organizations.

General Industry Observations

- Directionally, the technology industry is the most aggressive – more than half said their organization has become more aggressive in the past two years.
- Not surprisingly, management in the financial services sector believe they work in a high-risk industry, as do executives with basic materials manufacturers, healthcare organizations, consumer products companies and utilities.
- Consumer products, industrial products and utility companies report significant changes in industry sector risk over the past two years.

*Protiviti will track this risk ranking over time to monitor trends in organization risk profiles and the management of risks.

RISK MANAGEMENT CAPABILITIES

Changes in Risk Management Capabilities

Without question, events over the past two years have compelled Fortune 1000 companies to address their risk management capabilities. The results of the survey indicate that seven out of 10 organizations have made moderate or significant changes to these capabilities over the past two years, while only 9 percent have made no changes (see Figure 3).

In addition, during the next two years 65 percent are planning either significant changes or moderate continuous improvement to their risk management capabilities. These executives were asked to name the areas in which improvements were planned. Their responses (multiple answers were permitted):

Within this report, "risk management" is defined using the COSO definition of enterprise risk management: "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 risks to be within its risk appetite, to provide reasonable assurance regarding achievement of entity objectives."

"Risk management capabilities" include the policies, processes, competencies, reporting and technology required to execute a risk response.

- Improvements in identifying, managing and monitoring risks related to internal processes: 41 percent
- Improvements in identifying, managing and monitoring external environment risks: 37 percent
- Improving management of information for decision-making risk: 35 percent

Interestingly, two-thirds of executives said there was not a single event that either prompted or is causing these changes. Those that are making changes due to a specific event cited new legislation and heightened regulatory scrutiny, expansion, merger and acquisition activity, and changes in organizational culture, such as moving to a centralized structure.

How much has your organization changed its risk management capabilities over the past two years?

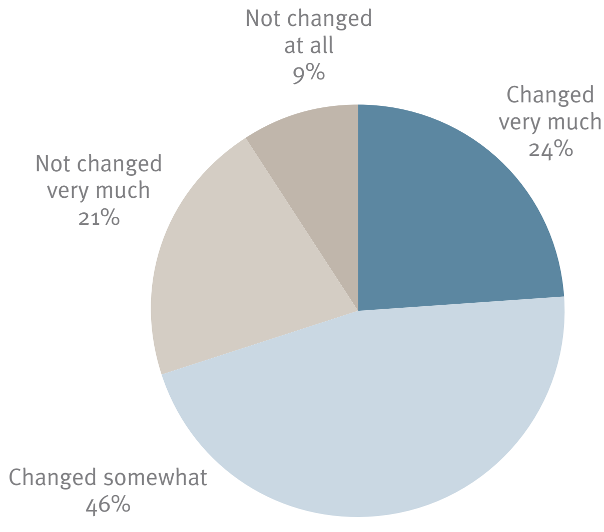

Figure 3

When respondents were asked (in an open-ended question) what changes did they or their organizations have in mind, their responses included:

- **Process-related changes:** Adopting or improving processes for risk management and developing more formalized plans (12 percent)
- **Organization-related changes:** Addressing human resources, hiring qualified people, segregating duties, replacing managers (12 percent); continued focus on and oversight of enterprise risk (8 percent); increased centralization (4 percent); more formal risk committee (4 percent)
- **Reporting-related changes:** Better and/or more reporting (4 percent) and internal audits (4 percent)
- **Technology-related changes:** Incorporating new technology, reengineering the organization technology infrastructure and new databases (12 percent); implementing enterprise risk management frameworks, models and systems (6 percent)

General Industry Observations

- Financial institutions and utilities have led the way in making significant changes in risk management capabilities during the past two years.
- Financial organizations are generally more satisfied with their risk management capabilities and do not plan to make significant changes during the next two years.
- Most companies in the technology, utilities and consumer products sectors will be making significant changes or moderate continuous improvements to their risk management capabilities during the next two years.

Current State of Risk Management Capabilities

Most Fortune 1000 companies report there is substantial room for improvement in how they identify and manage risks. In fact, just 38 percent report they are "very effective" at identifying and managing all potentially significant risks, while 57 percent say they are "somewhat effective" (see Figure 4). In addition, more than half of the survey respondents – 54 percent – acknowledged there is more they can do to identify and manage the risks they face and stay ahead of issues over time.

General Industry Observations

- Companies in the financial services industry are more confident than others that they are effective in identifying and managing all potentially significant risks.
- Organizations in the financial services and basic materials industries claim more than companies in other sectors to quantify risks to the fullest extent possible, most likely due to the inherent risks their industries have long faced and the emphasis on managing market risk and commodity price risk.
- Financial services, healthcare and utilities executives are more confident that their organizations are on track with respect to quantifying their risk profile.

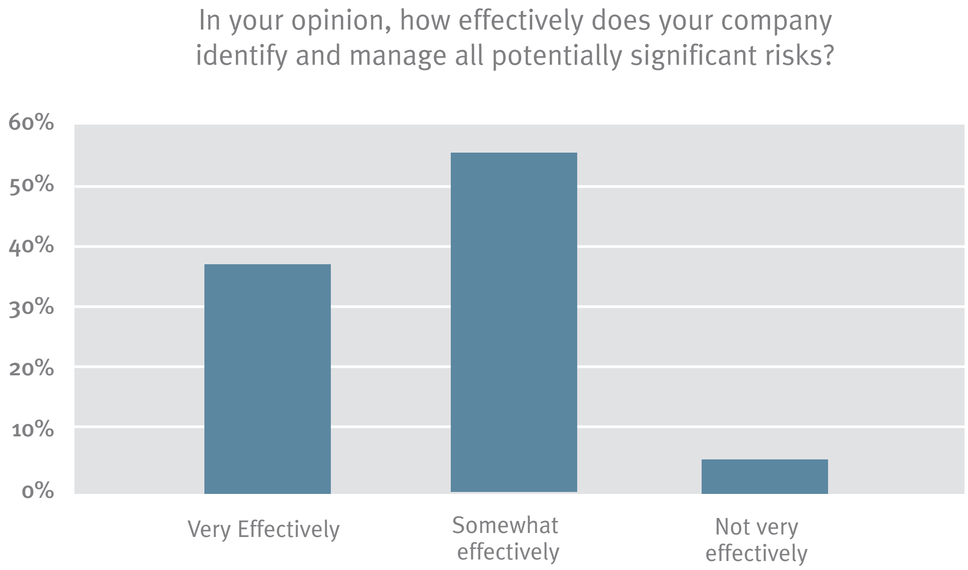

Figure 4

Quantifying and Deploying Risk

When asked to what extent their organizations quantify risk, 41 percent answered "to the fullest extent possible," while 58 percent do so "for a few risks only" (see Figure 5).

Generally speaking, to what extent does your organization quantify risk?

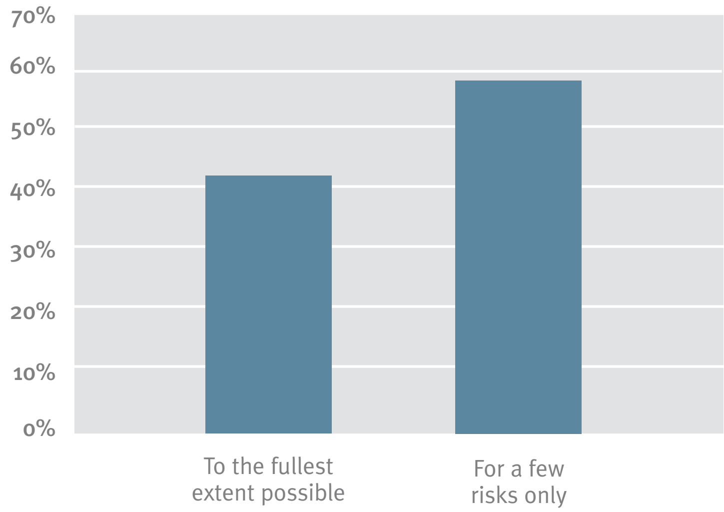

Figure 5

Executives were also asked to rate the deployment of risk management practices within the company. As noted below, an internal audit function is the most frequently deployed risk management process enterprisewide among Fortune 1000 companies.

Among the notable findings:

- A majority of Fortune 1000 companies have risk management practices that are "rigorously deployed enterprisewide" with regard to the following:
  - – An internal audit department (80 percent)
  - – Responses to address key risks are integrated with strategic management and business planning (61 percent)
  - – Clarity as to roles, responsibilities and accountabilities for managing critical risks (59 percent)
  - – A dedicated risk manager supported by a risk management staff function (57 percent)
  - – Risk management goals and objectives (55 percent)
- For 24 percent of companies surveyed, risk oversight by a board subcommittee of independent directors is deployed only in specific areas, and 26 percent do not deploy this practice at all. Similarly, more than one in three firms (36 percent) say they do not have risk oversight by and direction from a risk management executive committee, while 26 percent have this in place in specific areas only.
- Half of Fortune 1000 companies only deploy a risk assessment process in specific areas, while just four in 10 (38 percent) do so rigorously enterprisewide.
- While 46 percent rigorously deploy a risk monitoring process enterprisewide, 41 percent deploy this process only in specific areas.
- One in four companies – 25 percent – do not deploy a common language and uniform standards for managing risk. Another 36 percent only deploy it in specific areas.

Incident reporting and loss measurement is the most common system or process companies are utilizing to identify and prioritize risk, according to 59 percent of respondents. Other systems and processes cited include risk assessment workshops with management and/or the board of directors (39 percent), risk modeling (32 percent), risk-based metrics (30 percent) and risk mapping (28 percent).

What systems/process have you utilized to identify and prioritize risk?

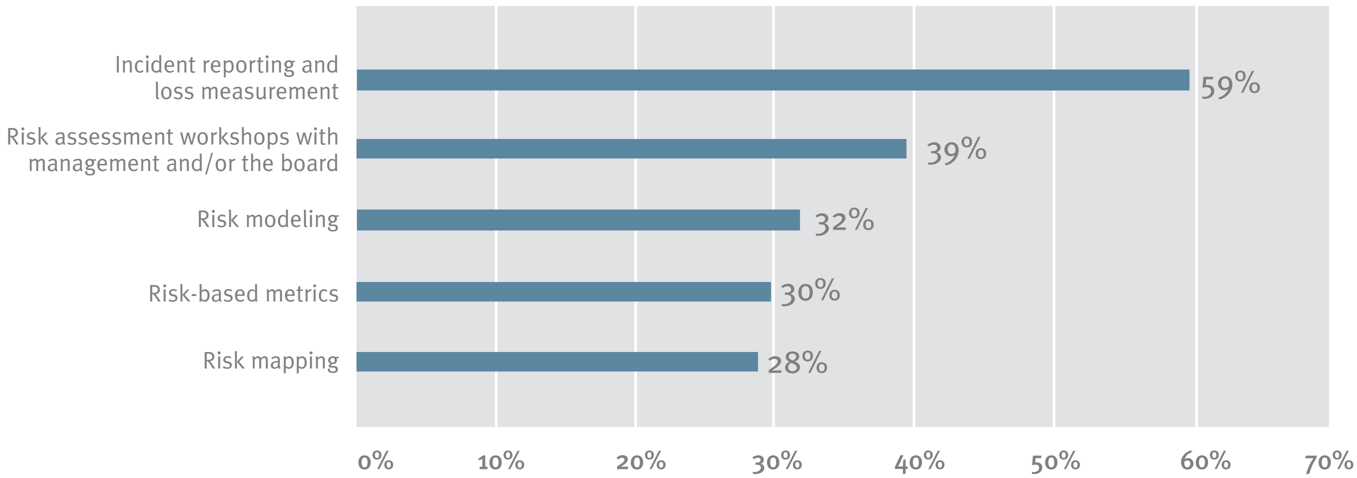

Figure 6

When executives were asked how they evaluate the benefits of the company's risk management capabilities, nearly half – 46 percent – noted the reduced costs of insuring risk. Forty-three percent cited more timely identification of risk, while 39 percent noted improvements in process performance and 38 percent cited increased internal awareness of risks. One in three respondents evaluate the benefits through managing changes in the organization's risk profile. Other benefits included improved quality in internal risk reporting and metrics (26 percent), enhancements in share or enterprise value (22 percent) and more robust business plans (20 percent).

Balancing Business Control and Growth Initiatives

When asked to rate the effectiveness of their organization's balance between business control (protecting enterprise value) and growth initiatives (encouraging entrepreneurial behavior to enhance enterprise value), 62 percent of executives indicated their companies were "somewhat effective" in defining and maintaining the appropriate balance, with only 32 percent responding "very effective" (see Figure 7).

How effective is your organization in defining and maintaining the "appropriate balance" between the need to control the business (to protect enterprise value) and the need to encourage new initiatives and entrepreneurial behavior to grow the business and increase returns (to enhance enterprise value)?

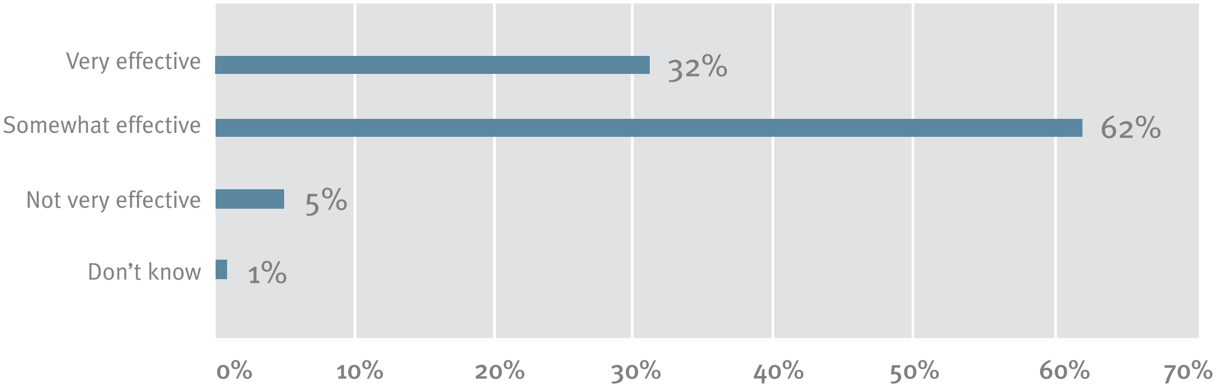

Figure 7

General Industry Observations

- Organizations in the financial services sector generally place greater value on control and protection of enterprise value.
- Basic materials companies appear to place higher priority on growth and other initiatives to enhance enterprise value.
- Most industry responses were split in their choices between the two objectives.

The results of the survey also suggest that Fortune 1000 companies place a greater emphasis on growth versus control, but the margin is small. Executives were asked, if they had to make a choice, which of these would be the higher priority. More than half – 53 percent – believe the higher priority is encouraging new initiatives and entrepreneurial behavior to increase returns and enhance enterprise value, while 43 percent say the need to control the current business and protect enterprise value takes precedence.

Ownership of Risk Management Capabilities

Without question, CFOs with Fortune 1000 companies are relied upon more than any other executive or committee to oversee risk management policy, execution and reporting.*

> **Risk owners and responsibilities**
>
> *A risk "owner" is an individual or group within an organization who, when one or more risks are identified, is charged with the responsibility to decide, design and monitor a risk management response and the appropriate policies, processes, competencies, reports and systems to effectively implement that response. The risk owner is identified as having the appropriate knowledge and expertise to meet these responsibilities.*

Risk Management Policy

Within 32 percent of these organizations, the CFO has primary responsibility for risk management policy, while in another 28 percent CFOs have secondary responsibility. The CEO has primary responsibility in 16 percent of Fortune 1000 companies and secondary responsibility in 9 percent. Sixteen percent of companies have assigned the primary role to the chief risk officer (CRO) and 12 percent of companies rely on operating unit managers for this responsibility (see Figure 8).

Figure 8

*Results were comparable with respect to CFO and non-CFO respondents.

Risk Management Execution

Here again, the CFO is the leader, assuming primary or secondary responsibility in nearly half (46 percent) of Fortune 1000 companies. Interestingly, 39 percent of these firms assign either primary or secondary responsibility to operating unit managers. In nearly one out of five companies (18 percent), CROs assume primary responsibility (see Figure 9).

Figure 9

Risk Management Reporting

In six out of 10 Fortune 1000 companies, primary responsibility falls to either the CFO (36 percent) or CRO (24 percent). CFOs have the role of secondary responsibility in 18 percent of these companies, while 14 percent assign this role to internal audit. CEOs have either primary or secondary responsibility in 18 percent of Fortune 1000 companies (see Figure 10).

Figure 10

CURRENT STATE OF RISK

Overview

As noted earlier, companies definitely view their markets and industry sector as moderately to significantly risky (see indexes on pages 4 and 6). Yet executives do not attribute this climate to one dominant risk; rather, they cite a broad range of external environment risks, internal process risks, and information for decision-making risks.

The C-level executives who participated in this study were asked to do two things with respect to articulating the current state of their company's risks. First, they were asked with an open-ended question to describe the most significant risk their company faces. Second, the executives were asked to rate a variety of external environment risks; internal risks relating to processes, systems and internal environment; and information for decision-making risks, each according to the following risk rating scale:

1. The risk is insignificant to our company.
2. The risk is currently not significant to our company, but we monitor it.
3. The risk is significant to one or more operating units but not to the company overall.
4. The risk is very significant to the company overall.

The following charts illustrate the results of this portion of the study by assigning each risk an index number indicating the average response from all survey participants. The higher the index number, the more significant this risk is considered to be by today's Fortune 1000 companies.

External Environment Risks

Almost six of 10 executives (58 percent) indicated that the biggest risk their companies faced were external environment risks in nature. To understand these risks, we asked the executives to rank a number of external environment risks with regard to the impact on their organizations. These risks and corresponding index ratings from the survey, according to the risk ratings scale, were:

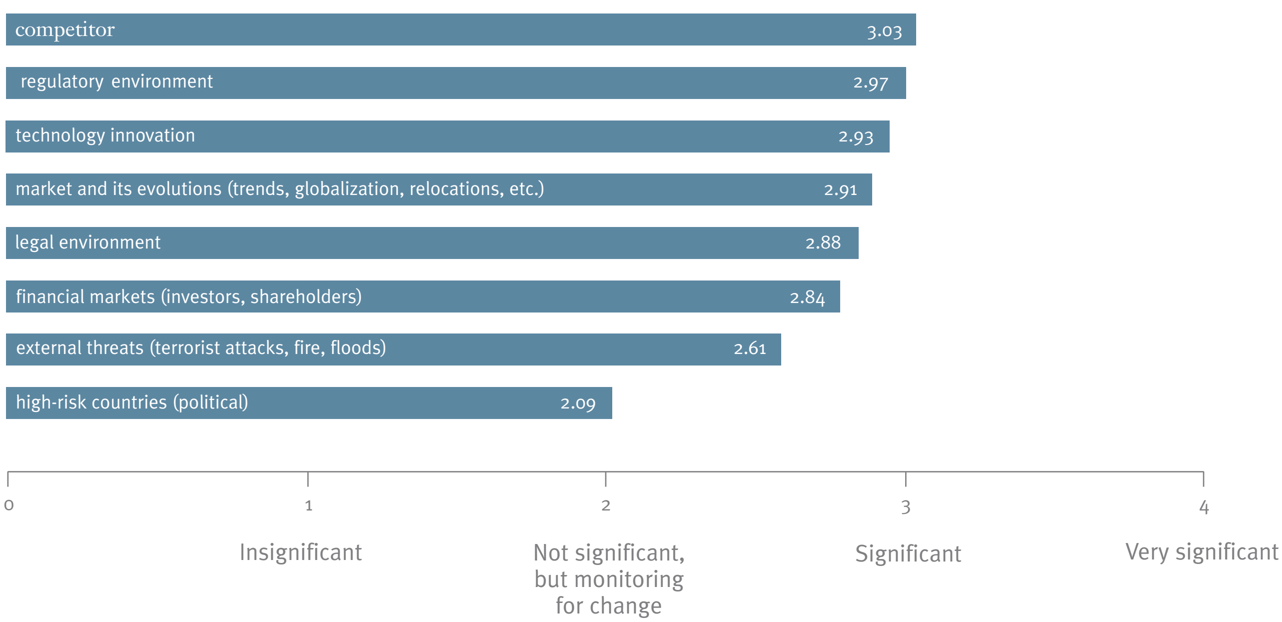

Figure 11

Among the key findings:

- Competition is deemed to be the most significant risk to Fortune 1000 companies today – 42 percent of respondents ranked it as a "very significant risk" to the company overall.
- The current regulatory environment ranks as a very significant risk among 39 percent of the companies, while technology innovation and financial markets each was noted as such among 37 percent of executives. The marketplace, with the uncertainty of its evolutions and trends, is seen as a critical risk among 36 percent of Fortune 1000 companies.
- One out of three companies – 33 percent – say the legal environment poses very significant risks to the company overall.
- A number of external environment risks are seen as significant to one or more operating units but not to the company overall. The most frequently cited include:
  - External threats (36 percent)
  - Legal environment (32 percent)
  - The marketplace and its evolutions (32 percent)
- Interestingly, 41 percent of respondents report that high-risk countries are insignificant to their companies, suggesting their operations are more concentrated in such countries. No other risk was rated as insignificant by more than 14 percent of respondents.

General Industry Observations

- Executives from technology companies noted numerous external environment risks that they considered significant to the organization overall, including competitors, technology innovation and the regulatory environment.
- Industrial goods manufacturers view competitors and overall market trends as very significant risks.

Internal Risks Relating to Processes, Systems and Internal Environment

Almost four of 10 executives (37 percent) indicated that the biggest risk their companies faced was related to the internal environment, processes and systems. To better understand these internal risks, we asked the executives to rate these risks. The risks and corresponding index ratings from the survey, according to the scale used, were:

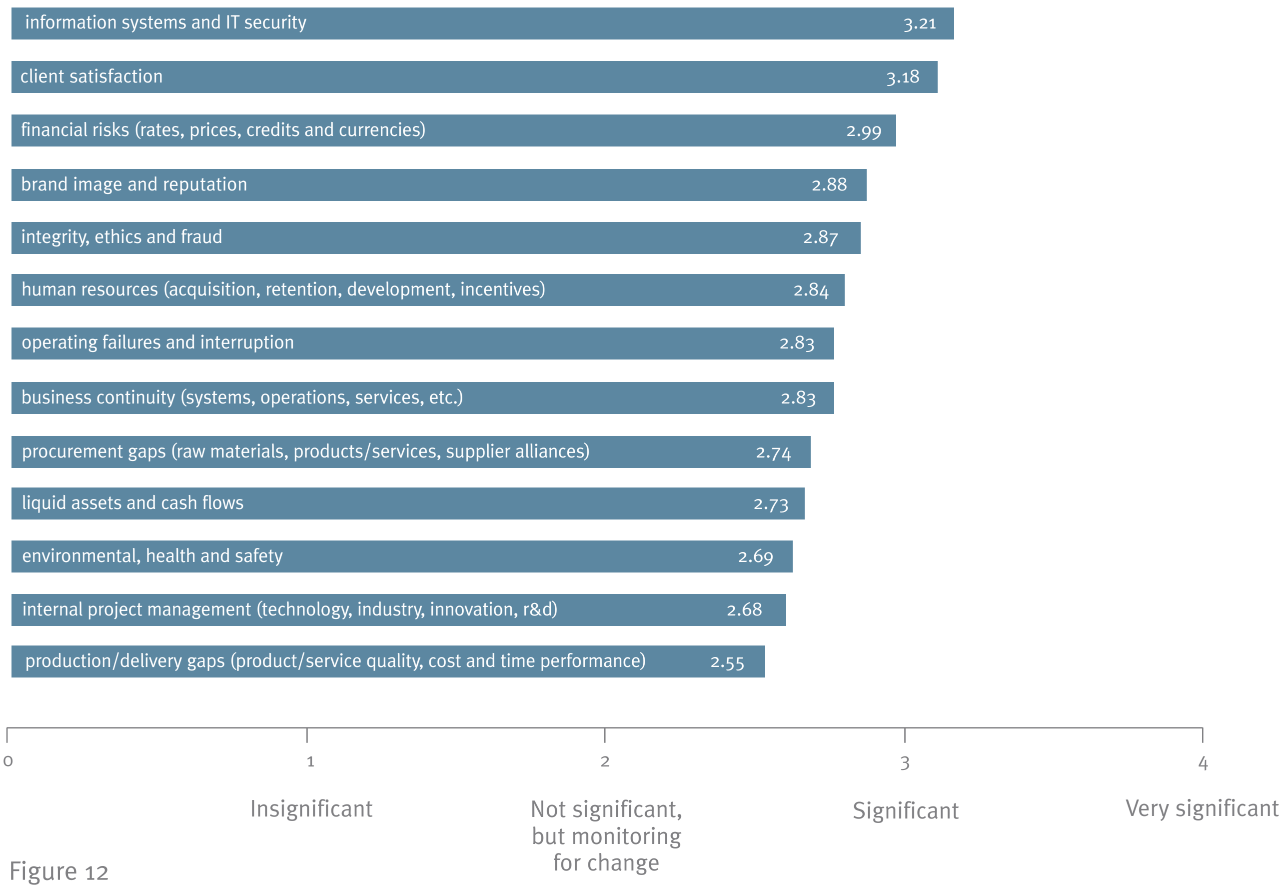

Figure 12

Among the key findings:

- The survey results suggest the most significant internal process risks Fortune 1000 companies must address today are information systems and IT security, followed closely by client satisfaction, which was ranked as a very "significant risk" by 49 percent of respondents.
- Other risks noted to be "very significant" to the company overall include integrity, ethics and fraud (46 percent), and brand image and reputation (43 percent).
- Interestingly, one in five Fortune 1000 companies believes that the areas of integrity, ethics and fraud are internal risks that are insignificant to the organization. Nearly this ratio of respondents (18 percent) also noted that brand image and reputation is an insignificant risk for their companies.

- A number of internal risks were rated to be significant to one or more operating units but not to the company overall. The most frequently cited include:
  - Operating failures and interruption (39 percent)
  - Human resources (34 percent)
  - Information systems and IT security; financial risks (rates, prices, credits and currencies); and internal project management (technology, industry, innovation, research and development) – 32 percent for each.

General Industry Observations

- Utility companies tend to view liquid assets, cash flows and financial-related issues (rates, prices and credit) as very significant risks to their entire organizations, while viewing information systems and IT security, as well as operating failures and interruptions, as significant to one or more operating units.
- Companies in the service industry sector see information systems and IT security as organizationwide risks. Financial risks are viewed as significant to one or more operating units within these companies.
- Companies in the financial services sector generally rank brand image and reputation and client satisfaction as very significant risks.

Information for Decision-Making Risks

Finally, when asked to identify the most significant risk they faced, five percent of the executives indicated that the biggest risk their companies faced was related to information for decision-making. Although such issues may not be as top of mind as external environment risks or internal risks relating to processes, systems and the internal environment, they are nevertheless important. We asked the executives to rank risks with regard to the integrity and reliability of information for decision-making within their organizations. These risks and the corresponding index ratings from the survey, according to the risk ratings scale, were:

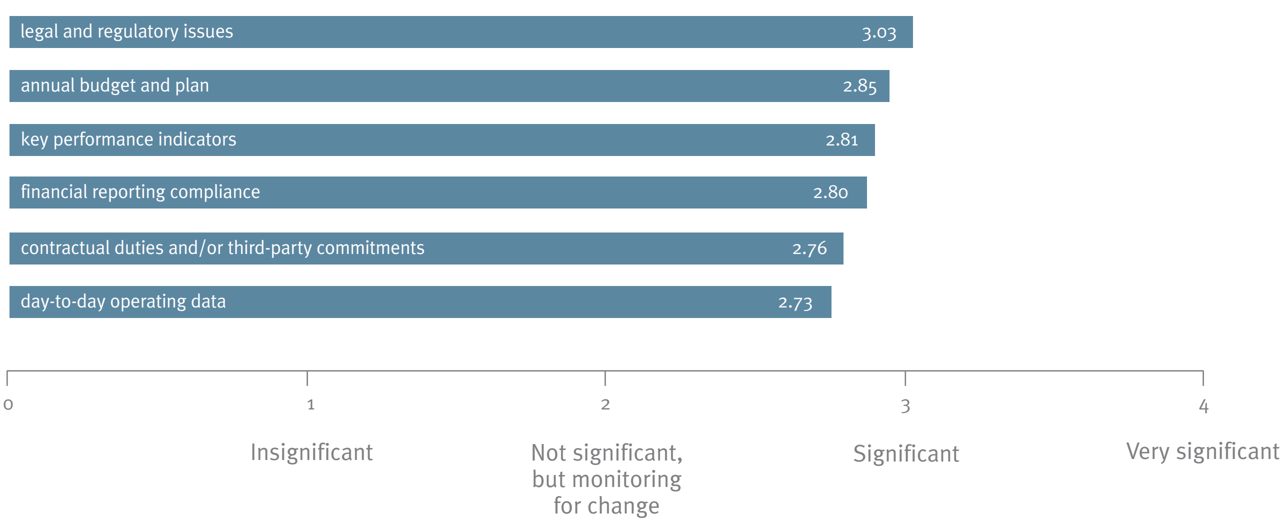

Figure 13

Among the key findings:

- Financial reporting and Section 404 compliance is viewed as the top information for decision-making risk among Fortune 1000 companies, receiving 43 percent of the responses. Another 16 percent of executives said this risk was significant to one or more operating units but not to the entire company. However, 24 percent said this risk was insignificant to the organization, and 16 percent noted this risk is not significant to the company, but they are monitoring it over time. Because Fortune 1000 companies were targeted by this survey, substantially all of the companies included in the sample are expected to be subject to Section 404 compliance requirements in the future.
- Other risks seen as very significant to the company overall include legal and regulatory issues (38 percent), annual budget and plan (33 percent), and contractual duties and/or third-party commitments (25 percent).
- A number of information for decision-making risks were rated as significant to one or more operating units but not to the company overall. The most frequently cited include:
  - Key performance indicators (41 percent)
  - Contractual duties and/or third-party commitments (38 percent)
  - Day-to-day operating data (36 percent)

General Industry Observations

- Organizations in the basic materials industry sector see legal and regulatory issues as a "very significant" risk.
- Financial reporting and Section 404 compliance are viewed as significant organizationwide risks by companies in the utilities, consumer products and technology sectors.
- Utility companies tend to view day-to-day operating data, legal and regulatory issues, and contractual duties and commitments to third parties as significant risks to one or more operating units, but not the company overall.
- Companies in the technology sector believe key performance indicators and contractual duties are significant risks to one or more operating units.

SURVEY METHODOLOGY

Protiviti's U.S. Risk Barometer Survey was conducted in September 2005 by an independent research firm. The survey includes responses from 76 C-class executives with Fortune 1000 companies, specifically CEOs, CFOs, and other executives who have a strategic role in their organization's risk management decisions and report on a regular basis to the board of directors. The margin of error is 9 percent

These executives received assurance from the survey firm that their names and individual responses would be kept confidential. Protiviti did not obtain this information as part of its Risk Barometer study.

Responses also were tabulated by the industry in which each respondent's company operates. Categories used for purposes of summarizing the survey results by industry include:

- Basic materials
- Consumer products
- Financial services
- Healthcare
- Industrial products
- Services
- Technology
- Utilities

Given the number of respondents surveyed for this study, the industry findings and trends included in the report are directional.

Protiviti's U.S. Risk Barometer Survey was conducted by the Corporate Research Group of Penn, Schoen & Berland, a research-based communications firm that conducts quantitative and qualitative research nationwide.

HOW PROTIVITI CAN HELP YOU

Protiviti is a leading provider of independent risk consulting and internal audit services. The firm helps clients identify, assess and manage operational and technology-related risks encountered in their industries, and assists in the implementation of the processes and controls to enable their continued monitoring. Protiviti also offers a full spectrum of internal audit services to assist management and directors with their internal audit functions, including full outsourcing, co-sourcing, technology and tool implementation, and quality assessment and readiness reviews.

Protiviti recently was named a leader in enterprise risk management and compliance by Forrester Research. "The Forrester Wave™: Enterprise Risk Management Consultants, Q4 2005" places Protiviti as one of only four companies in the "leader" category. Protiviti's offerings help companies address many of the issues raised in this study. For example:

- **With respect to strategic risks,** Protiviti assists senior management with assessing the risks associated with executing their business strategy and identifying gaps around managing the priority risks so that appropriate action steps can be added to the business plan to close those gaps. Our forward-looking approach helps companies improve their strategic management process by evaluating and managing the likelihood of potential future events over a pre-defined time horizon and the related impact of those events on the business model. We further support our strategic risk services with subject-matter expertise in specific risk areas, including technology, financial, operational, compliance and event-related risks. These subject-matter experts understand the best practices around sourcing, measuring, managing and monitoring risks, and apply their knowledge to assist companies depending on the current maturity of their existing risk management capabilities. They address specific risks around credit, market, operational, compliance and other risks, and apply specialized knowledge with respect to compliance and operational controls.
- **With respect to IT security risks,** Protiviti's technology security team has developed reliable and effective tools and processes to help companies improve the effectiveness and efficiency of their security administration processes, while also lowering security risks. Our national team conducts external penetration testing and vulnerability assessments in a comprehensive and cost-effective manner. All of our security tools have undergone an internal certification process that ensures they are safe and reliable and will operate as intended.
- **With respect to business continuity risks,** business recovery, IT disaster recovery and crisis management planning are all mature services that Protiviti was providing clients long before the recent hurricane season occurred. We assist companies with their business continuity and disaster preparedness to reduce the impact of catastrophic events.
- **With respect to compliance with Sarbanes-Oxley,** we assist companies with annual Section 404 compliance and with their "project to process" transition. Our methodology provides a process-based solution to help companies get organized, set the foundation, document their processes and controls, and evaluate the design effectiveness and operating effectiveness of those processes and controls. Our thought leadership, methodologies and suite of technology solutions, combined with our competencies in processes, risks and controls, have helped hundreds of companies comply successfully. In addition, our "project to process" methodology helps companies improve the sustainability of their internal control structure and increase the cost-effectiveness and value-add of their compliance process.

- **With respect to compliance with other regulations,** our offerings include anti-money laundering, HIPAA compliance, Basel II services and regulatory compliance. Many of our other product offerings address aspects of compliance and operational controls, including capital projects and construction, revenue optimization, spend risk solutions and supply chain risk consulting.
- **With respect to operational risks,** Protiviti's offerings focus on the quality of operational risk management leading to cost and time savings for the organization in the following areas: capital projects and construction, financial process effectiveness, revenue optimization, spend risk solutions and supply chain risk consulting. In the financial services sector, we also offer Basel II services, including Basel II implementation, Basel II and Sarbanes-Oxley integration, and other operational risk management solutions.
- **With respect to financial risks,** our services address both price risk and credit risk. Our services with respect to price risk include the following offerings: energy commodity risk (commodity risk infrastructure, CCRO diagnostics, energy asset optimization, risk modeling and analytics and risk systems) and treasury risk management (which includes FX and interest rate management). Our core offerings with respect to credit risk management include customer acquisition, risk management infrastructure, portfolio management, collections, customer service and call center, and acquisition due diligence.
- **With respect to internal audit,** Protiviti provides a full spectrum of services, technologies and skills to management, directors and the internal audit community. We provide world-class professionals and state-of-the-art methodologies and tools. Our network allows us to offer the right resources at the right time and in the right place to meet your needs, and we offer a creative and flexible approach to quality assurance reviews, from a standard compliance report to a full transformation of your capabilities. We also provide ongoing assistance for your internal staff and systems.

More information about our services is available at **www.protiviti.com.** Interested parties may select either "Solutions" or "Industries" to better understand our service offerings, what we offer and how we go to market.

Protiviti, which has more than 45 locations in North America, Latin America, Europe, Asia and Australia, is a wholly owned subsidiary of Robert Half International Inc. (NYSE symbol: RHI). Founded in 1948, Robert Half International is a member of the S&P 500 index.

NOTES

NOTES

Protiviti is a leading provider of independent internal audit and business and technology risk consulting services. We help clients identify, assess and manage operational and technology-related risks encountered in their industries, and assist in the implementation of the processes and controls to enable their continued monitoring. We also offer a full spectrum of internal audit services to assist management and directors with their internal audit functions, including full outsourcing, co-sourcing, technology and tool implementation, and quality assessment and readiness reviews.

Protiviti has more than 45 locations in North America, Latin America, Europe, Asia and Australia. The firm is a wholly owned subsidiary of Robert Half International Inc. (NYSE symbol: RHI). Founded in 1948, Robert Half International is a member of the S&P 500 index.

protiviti.com

1.888.556.7420