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Face the Future with Confidence

ENTERPRISE RISK MANAGEMENT – ALIGNING RISK WITH STRATEGY AND PERFORMANCE

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COSO: THOUGHT LEADERSHIP TO IMPROVE YOUR ORGANIZATION

Orthofix paying $14 million to settle SEC charges

JANUARY 18, 2017

- Orthofix International, a medical device maker, has agreed to pay over $14 million to settle charges that it improperly booked revenue and made improper payments to doctors at government-owned hospitals in Brazil to increase sales.
- The SEC also announced Wednesday, Orthofix agreed to admit wrongdoing
- Four former Orthofix executives also agreed to pay penalties to settle the charges related to the accounting failures

Orthofix, continued

- Improperly recorded revenue as soon as a product was shipped even though contingencies required certain events to occur in order to receive payment in the transaction. In other cases, Orthofix immediately recorded revenue when it had provided customers with significant extensions of time to make payments.
- The SEC's order also found Orthofix violated the Foreign Corrupt Practices Act when its subsidiary in Brazil used high discounts and improper payments through third-party commercial representatives and distributors to entice government-employed doctors to use Orthofix's products. The company also resorted to fake invoices for the purported services.
- "Orthofix did not have adequate internal controls across all its subsidiaries and failed to detect and prevent the improper payments in Brazil that were intended to boost sales"

INTEGRITY AND ETHICAL VALUES ARE EVERYTHING

- Consistent with most organizational values
- Fundamental to our Culture, interactions
- Integral to Professionalism as a person
- Integral to Accounting profession as a core behavior – expected
- Provides confidence in you by others
- Foundational to COSO – makes COSO work and effective
- Accountability is a consequence
- **Not Easy**
- **You Will Experience And Observe Ethical Dilemmas**

L3 Technologies Settles $1.6M Revenue Recognition Case…

JANUARY 12, 2017

One of the largest U.S. defense contractors has agreed to pay more than $1.6 million to settle charges of booking millions of dollars in improper revenue that allowed some executives to “barely satisfy” targets for incentive bonuses, the SEC said on Wednesday.

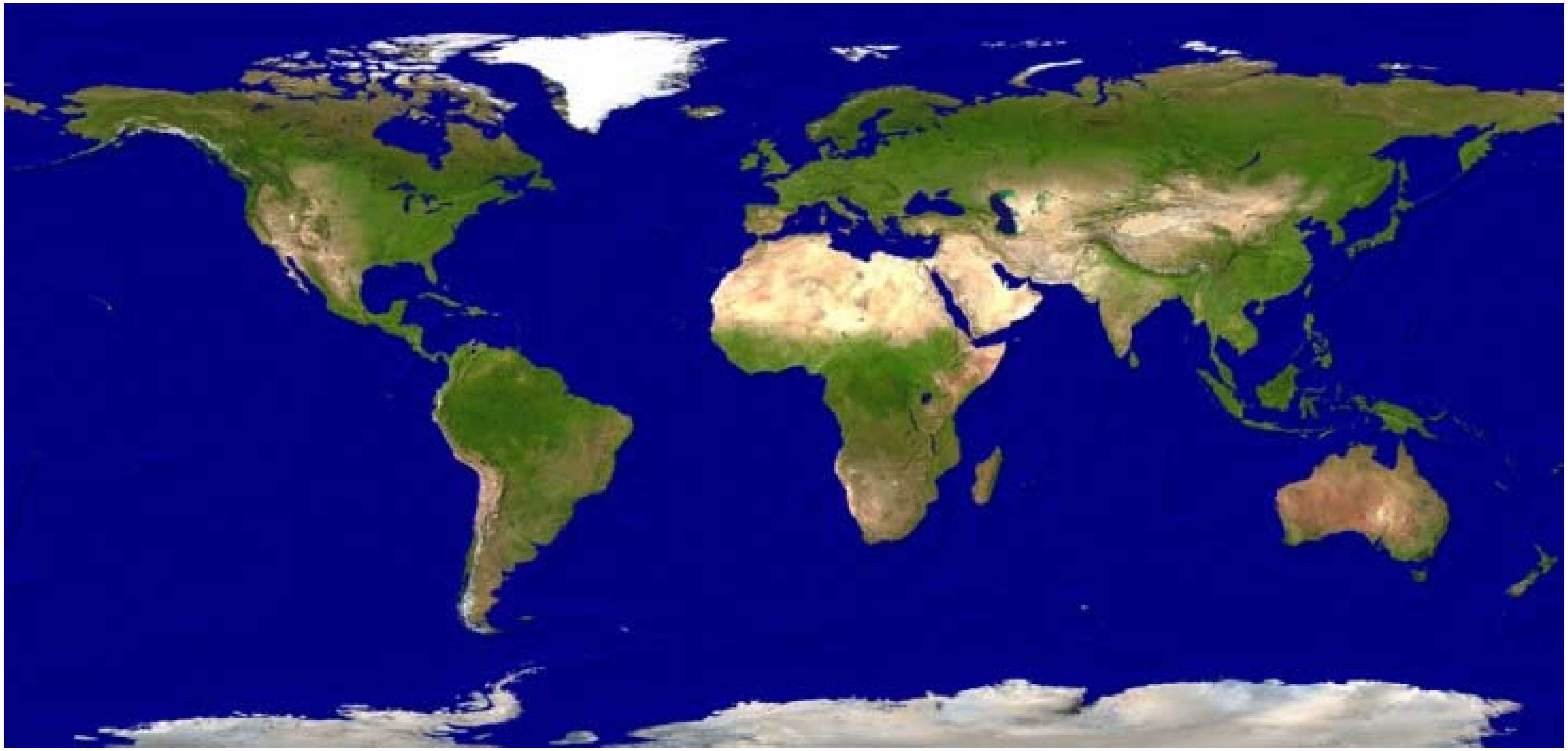
A senior finance official ordered 69 invoices be generated, even though there was never any agreement with the Army on payment for the work, the SEC said. The invoices were never delivered, but L3 recorded the revenue anyway.

CONTROL ENVIRONMENT COMPONENTS

According to the COSO Framework, the control environment comprises the:

- Organization’s commitment to integrity and ethical values.
- Oversight provided by the board of directors in carrying out its governance responsibilities.
- Organizational structure and assignment of authority/responsibility.
- Process for attracting, developing and retaining competent people.
- Rigor around the performance measures, incentives and rewards to drive accountability for performance.

GLOBAL INTEREST AND APPLICATION HAS INCREASED SIGNIFICANTLY !



SEC PROXY REQUIREMENT…

Provide Information About Board Leadership Structure and the Board's Role in Risk Oversight:

- The SEC approved rules relating to board leadership structure and **the board's role in risk oversight.** The rules require disclosure about:
- A **company's board leadership structure**, including whether the company has combined or separated the chief executive officer and chairman position, and why the company believes its structure is the most appropriate for the company at the time of the filing.
- In certain circumstances, whether and why a company has a **lead independent director** and the specific role of such director.
- **The extent of the board's role in the risk oversight of the company.**

Tone is Critical…

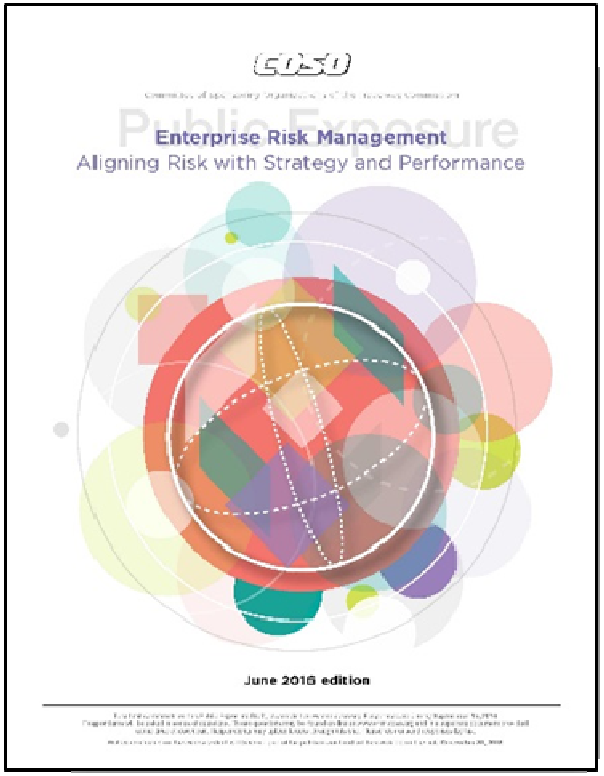
…internal control over financial reporting and disclosure controls and procedures will not be effective at December 31, 2015.

The improper conduct of the company's former Chief Financial Officer and former Corporate Controller, which resulted in the provision of incorrect information to the Committee and the company's auditors, contributed to the misstatement of results. In addition, as part of this assessment of internal control over financial reporting, the company has determined that the tone at the top of the organization and the performance-based environment at the company, where challenging targets were set and achieving those targets was a key performance expectation, may have been contributing factors resulting in the company's improper revenue recognition.

TEN PRINCIPLES OF RISK OVERSIGHT

1. Understanding the company's key drivers of success
2. Assess the risk inherent in the strategy
3. Define the role of the full board and its standing committees with regard to risk oversight
4. Consider whether the risk management system is appropriate and sufficiently resourced
5. Understand and agree with management the types and format of risk information required
6. Encourage dynamic, constructive risk dialogue between management and the board
7. Closely monitor the potential risks in the company's culture and its incentive structure
8. Monitor critical alignments – of strategy, risk, controls compliance incentives and people
9. Consider emerging and interrelated risks: What's around the next corner?
10. Periodically assess the risk oversight process in view of the board's oversight objectives

COVER STORY…


Enterprise Risk Management
Aligning Risk with Strategy and Performance
June 2016 edition

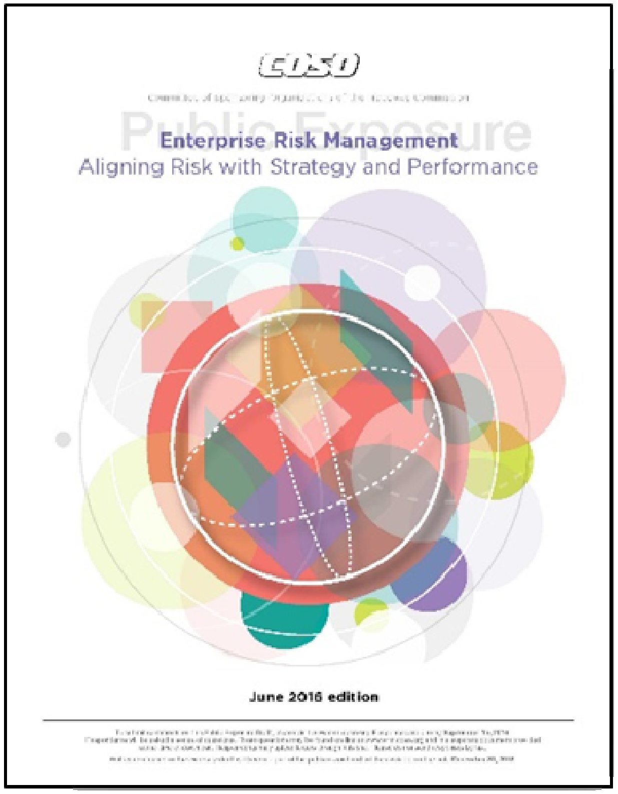
WHY CHANGE THE TITLE OF THE FRAMEWORK?

Retitles the framework as **Enterprise Risk Management—Aligning Risk with Strategy and Performance**

Recognizes the importance of strategy and entity performance

Delineates between internal control and enterprise risk management

Integrates enterprise risk management with decision making



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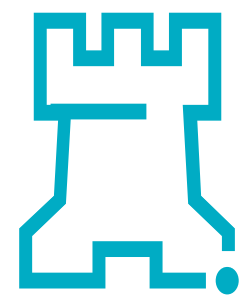
THE STRATEGIC VALUE OF ENTERPRISE RISK MANAGEMENT

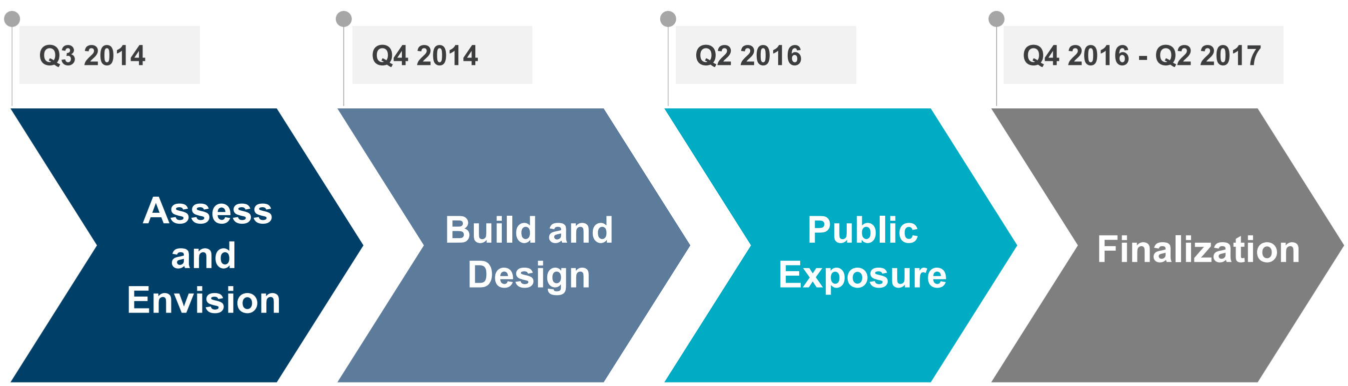
- Increases the range of opportunities
- Identifies and manages entity-wide risks
- Reduces surprises and losses
- Reduces performance variability
- Improves resource deployment
- Anticipates, identifies, adapts, and responds to change



A KEY INTRODUCTION…

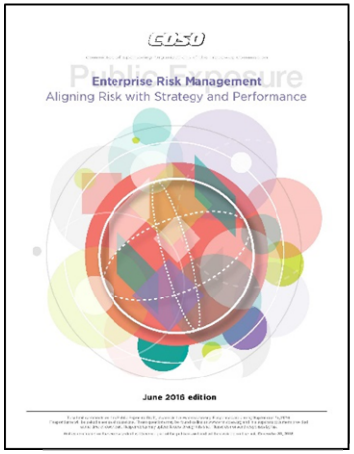
- Our understanding of the nature of risk, **the art and science of choice** lies at the core of our modern market economy.
- Every choice we make in the pursuit of objectives has its risks. From day-to-day operational decisions to the fundamental trade-offs in the boardroom, **dealing with uncertainty in these choices is a part of our organizational lives.**

ERM UPDATE APPROACH AND TIMING



WHAT’S AVAILABLE NOW…

- Executive Summary
- FAQ document
- Draft Framework
- Numerous articles
- Accounting/Consulting Firm publications



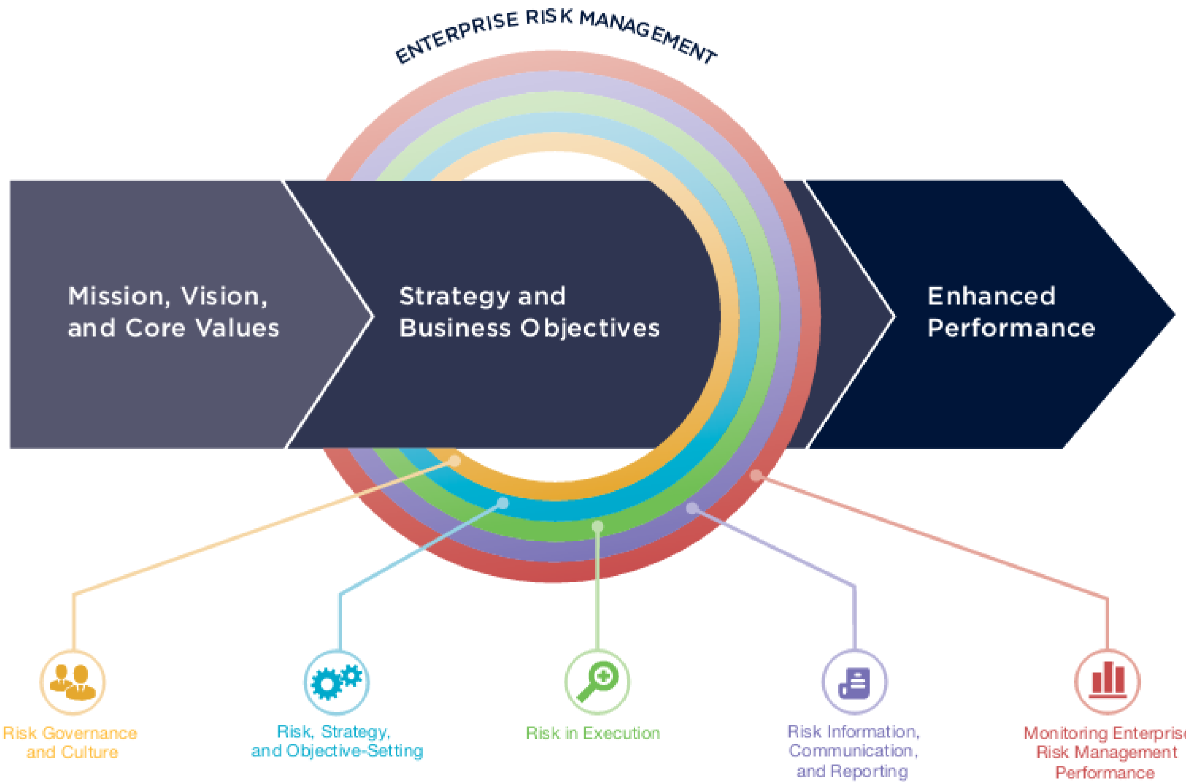
TOP CHANGES TO THE FRAMEWORK

- **Updates** components and **adopts** principles
- **Simplifies** definitions
- **Emphasizes** value
- **Renews** the focus on integration
- **Examines** role of culture

TOP CHANGES TO THE FRAMEWORK (CONTINUED)

- **Elevates** discussion of strategy
- **Enhances** alignment with performance
- **Links** with decision making
- **Delineates** enterprise risk management from internal control
- **Refines** risk appetite and acceptable variation in performance

1. UPDATES COMPONENTS AND ADOPTS PRINCIPLES



1. UPDATES COMPONENTS AND ADOPTS PRINCIPLES

Risk Governance and Culture

1. Exercises Board Risk Oversight
2. Establishes Governance and Operating Model
3. Defines Desired Organizational Behaviors
4. Demonstrates Commitment to Integrity and Ethics
5. Enforces Accountability
6. Attracts, Develops, and Retains Talented Individuals

Risk, Strategy, and Objective-Setting

7. Considers Risk and Business Context
8. Defines Risk Appetite
9. Evaluates Alternative Strategies
10. Considers Risk while Establishing Business Objectives
11. Defines Acceptable Variation in Performance

Risk in Execution

12. Identifies Risk in Execution
13. Assesses Severity of Risk
14. Prioritizes Risks
15. Identifies and Selects Risk Responses
16. Assesses Risk in Execution
17. Develops Portfolio View

Risk Information, Communication, and Reporting

18. Uses Relevant Information
19. Leverages Information Systems
20. Communicates Risk Information
21. Reports on Risk, Culture, and Performance

Monitoring Enterprise Risk Management Performance

22. Monitors Substantial Change
23. Monitors Enterprise Risk Management

2. SIMPLIFIES DEFINITIONS

Risk	The possibility that events will occur and affect the achievement of strategy and business objectives (or will not occur)
Enterprise Risk Management	The culture, capabilities, and practices, integrated with strategy and execution, that organizations rely on to manage risk in creating, preserving, and realizing value

3. EMPHASIZES VALUE

- Enhances the focus on value – how entities create, preserve, and realize value
- Embeds value throughout the framework, as evidenced by its:
  – Prominence in the core definition of enterprise risk management
  – Extensive discussion in principles
  – Linkage to risk appetite
  – Focus on the ability to manage risk to acceptable levels

4. RENEWS THE FOCUS ON INTEGRATION

- Integrates enterprise risk management with other business processes:

Governance Processes	Strategy Setting	Objectives Setting	Performance Management

- Focuses on applying enterprise risk management at various levels of the organization (e.g. entity level, business unit, division)

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5. EXAMINES THE ROLE OF CULTURE

- Addresses the growing focus, attention and importance of culture within enterprise risk management
- Influences all aspects of enterprise risk management
- Explores the relationship with culture in the context of:
  - Risk governance
  - Oversight of the entity
  - Connection between framework Components
- Depicts the behavior within a risk spectrum from risk averse to risk aggressive
- Affects the entity's decision making
- Explores the alignment of culture between individual and entity behavior

Impact on Value…

LendingClub

May 9 (Reuters) - Online lending platform operator Lending Club Corp said its Chief Executive and Chairman Renaud Laplanche has resigned following an internal review, which revealed a violation of the company's business practices.

- Shares of the company were down 15.6 percent at $5.99 in premarket trading.
- The review revealed that loans extended to a single investor did not conform to instructions, with certain employees being aware that the sale did not meet the investor's requirements, the company said on Monday.

6. ELEVATES DISCUSSION OF STRATEGY

- Explores enterprise risk management and strategy from three different perspectives:
  - The **possibility of** strategy and business objectives not aligning with mission, vision and values
  - The **implications from** the strategy chosen
  - **Risk to** executing the strategy

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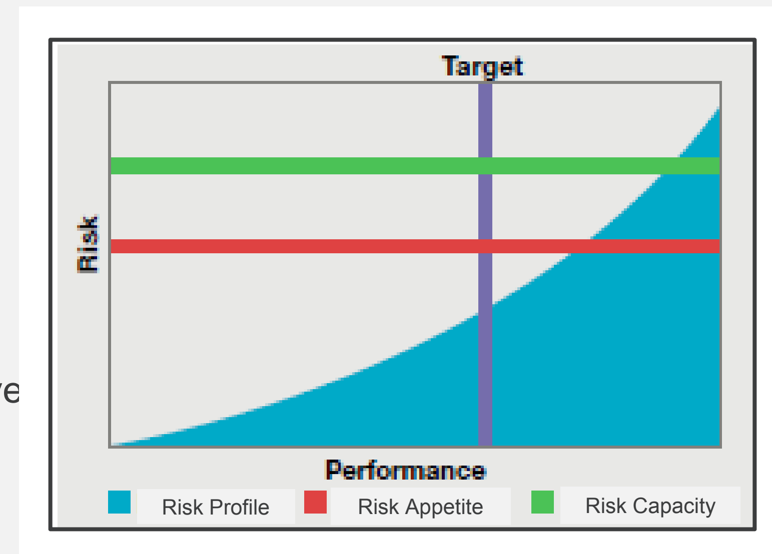
7. ENHANCES ALIGNMENT WITH PERFORMANCE

- Enables the achievement of business objectives by actively managing risk and performance
- Focuses on how risk is integral to performance by:
  – Exploring how enterprise risk management practices support the identification and assessment of risks that impact performance
  – Discussing acceptable variations in performance
- Manages risk in the context of achieving business objectives not as individual risks
- Seeks to enhance the integrated reporting on risk and performance

7. ENHANCES ALIGNMENT WITH PERFORMANCE, CONTINUED

- Introduces a new depiction referred to as a risk profile
- Incorporates:
  - Risk
  - Performance
  - Risk appetite
  - Risk capacity
- Offers a dynamic and comprehensive view of risk and enables more risk-aware decision making
- The framework provides a complete depiction of how to build a risk profile

Illustrative Risk Profile



8. LINKS INTO DECISION MAKING

- Explores how enterprise risk management drives risk aware decision making
- Highlights how risk awareness optimizes and aligns decisions impacting performance
- Explores how risk aware decisions affect the risk profile

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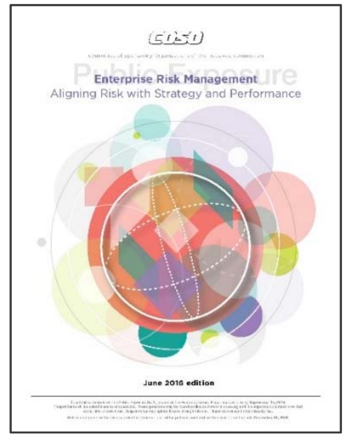
HAIN TUMBLES AFTER DELAYING RESULTS OVER ACCOUNTING CONCERNS

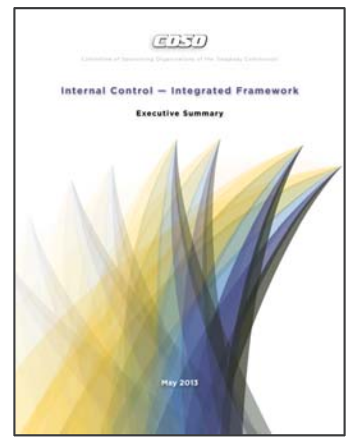
New York (August 16, 2016)

- (Bloomberg) Hain Celestial Group Inc., a supplier of organic and natural products to Whole Foods Market Inc. and other grocers, plunged the most in more than 15 years **after delaying financial results on accounting concerns** and abandoning its full-year targets. It's **also evaluating its internal control over financial reporting, and the board's audit committee is conducting an independent review** of the situation.
- The remarks jarred investors, **sending the shares down as much as 30 percent** to $37.25, the biggest intraday drop since November 2000. Before the plunge, Hain shares had been up 32 percent this year.
- The accounting issue centers on Hain's transactions with distributors.
- "Previously, the company has **recognized revenue pertaining to the sale of its products to certain distributors at the time the products are shipped to such distributors,**" Hain said in Monday's statement. "The company is evaluating whether the revenue associated with the concessions granted to certain distributors **should instead have been recognized at the time the products sell through its distributors** to the end customers."

9. DELINEATES BETWEEN ENTERPRISE RISK MANAGEMENT AND INTERNAL CONTROL

- The document does not replace the 2013 **Internal Control – Integrated Framework**
- The two frameworks are distinct and complementary
- Both use a components and principles structure
- Aspects of internal control common to enterprise risk management are not repeated
- Some aspects of internal control are developed further in this framework





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Internal Control Does Matter…

FEBRUARY 25, 2016

Tupperware Brands (NYSE:TUP) slides nearly 5.5% after the company said in a SEC filing it said it's still assessing deficiencies related to the information technology systems used in its financial reporting and won't file its 10k annual report on time. Instead, it expects to file its report within the 15-day extension period. "Although the Company has not concluded its assessment of the effectiveness of its internal control over financial reporting, the Company believes that these deficiencies could represent a material weakness in its internal control over financial reporting," the company said.

10. REFINES RISK APPETITE AND ACCEPTABLE VARIATION IN PERFORMANCE

Risk Appetite	The amount of risk, on a broad level, an organization is willing to accept in pursuit of value
Acceptable Variation in Performance	The boundaries of acceptable outcomes related to achieving business objectives

A SUITABLE MODEL EVERYWHERE…

INCREMENTALISM…

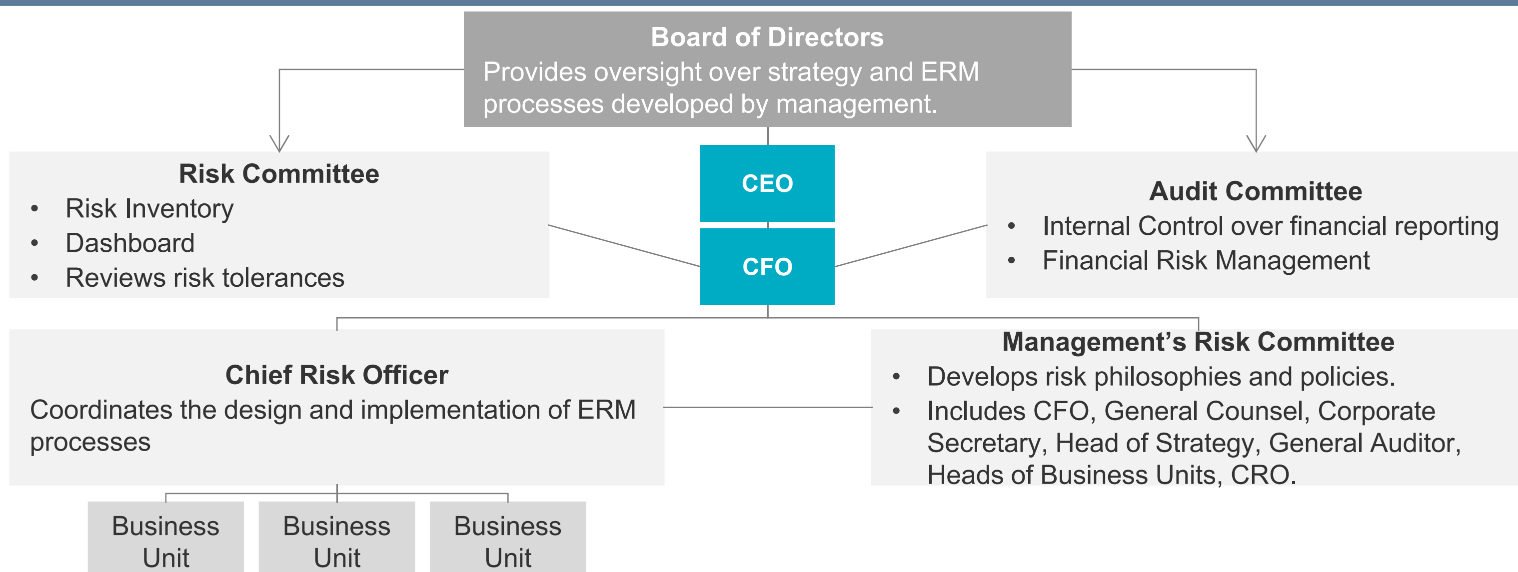
“How would you like to meet more of your objectives more of the time? “

TRENDS IN ENTERPRISE RISK MANAGEMENT (ERM)

CONCEPT OF ENTERPRISE RISK MANAGEMENT

Enterprise Risk Management (ERM) is the process of planning, organizing, leading and controlling the activities of an organization in order to minimize the effects of risk on an organization's capital and earnings. It provides a framework for management to deal with uncertainty and associated risk and opportunity, thereby enhancing the company's capacity to build value.

ERM Framework



Source: www.ucop.edu

ERM JOURNEY

Program Development

Set Foundation

Establish framework and vision

- Board established **vision**
- ERM sponsorship
- **Common risk language**
- Set context for understanding risk
- Enterprise **risk assessment process**
- Communication protocols/**'tone at top'**
- Process to manage risk management gaps
- Current state analysis; future state defined

Build Capabilities

Develop capabilities, methods, and tools

- **Establish risk appetite**
- Define roles and responsibilities
- **Risk tolerance levels set**
- Best practices and knowledge sharing
- Improve management of individual risks
- **Scenario analysis/modeling** capabilities enhanced
- **Risk reporting** and key metrics

Enhance Capabilities

Integration, ongoing evaluation, and monitoring

- **Integrate risk management** into key processes
- Link performance and risk management
- **More quantification**; risk currency
- Ongoing monitoring and evaluation of **emerging risks**

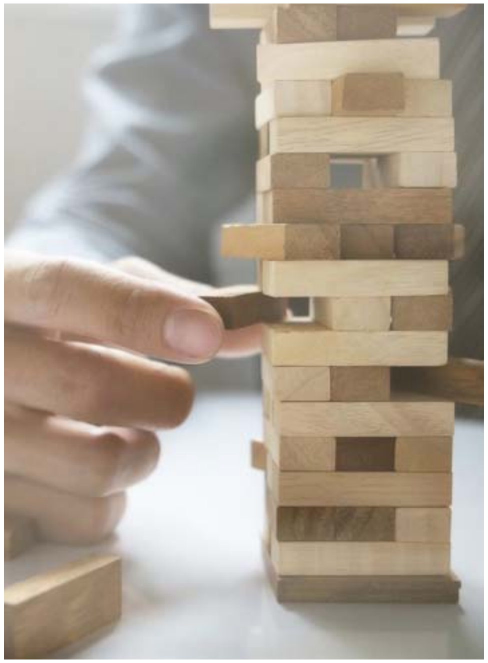
RISK APPETITE STATEMENT – A KEY ELEMENT TO CREATING A ROBUST ERM FRAMEWORK

Risk appetite is a widely accepted concept that remains difficult to apply in practice. It is important for firms to implement an effective, enterprise-wide risk appetite framework (RAF) due to the difficulty of translating broad, high-level risk objectives into clear, understandable guidelines and metrics for business units and operations personnel.

It is essential that organizations evaluate critically the **current landscape** to identify relevant areas of risk and ensure that mitigating controls have been implemented as needed.

Organizations should pay careful attention to the **Key Risk Indicators** (KRIs) that are developed to ensure they cover all relevant business risks. The data to support these KRIs needs to be captured, aggregated, and reported efficiently throughout the enterprise.

Organizations need to be consistent in promoting a good **risk culture** with ongoing education and dialogue. Front-line units cannot support the enterprise's goals in addressing risk without knowing what these goals are. A well-operating risk management framework can enable an ongoing, enterprise-wide conversation about risk, while maintaining focus on how risk management objectives are achieved.



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KEY COMPONENTS OF A RISK APPETITE FRAMEWORK (RAF)

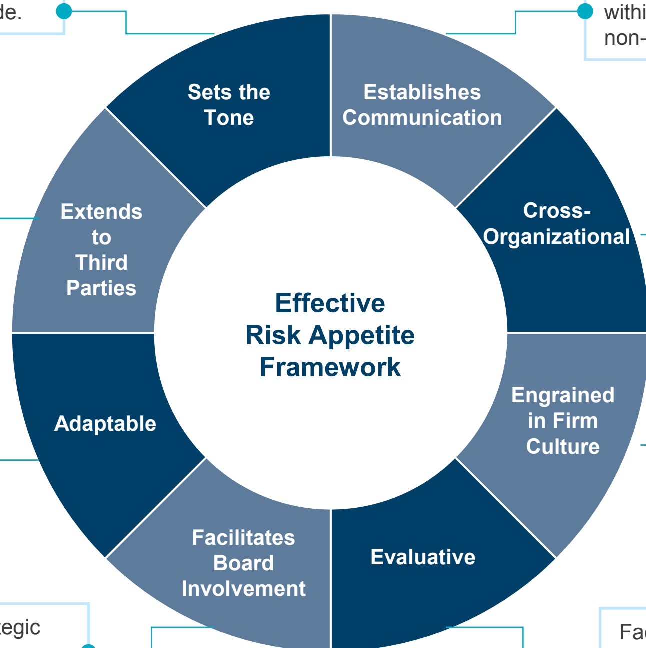
A risk appetite statement (RAS) is just one component of a broader, more comprehensive RAF. Below outlines the key components of an effective RAF.

The RAS sets the tone for desired behaviors firm-wide.

Establishes a process for communicating RAF across and within the organization as well as protocols for sharing non-confidential information with external stakeholders.

The RAF should cover activities. operations and systems of the organization that fill within its risk landscape but may not be in its direct control (i.e. Subsidiaries, third party outsourcing suppliers, etc.)

The RAS is owned by the board and developed by senior management with active involvement across all key areas of the institution.



The RAF should be easily adaptable to changing business and market conditions.

The RAS is supported by a strong culture which constantly asks whether risks have been identified and/or whether limits are still appropriate.

The RAS is a catalyst for discussion and strategic decision-making at the board and senior management levels.

Facilitates the evaluation of opportunities for appropriate risk taking and acts as a defense against unknown or excessive risk taking.

RISK APPETITE METRICS

- Risk appetite metrics are first-level enterprise measures that are most directly correlated with the enterprise's risk appetite.
- They are to be reported to the board of directors, specifically the risk committee, as well as any adherence to defined risk boundaries

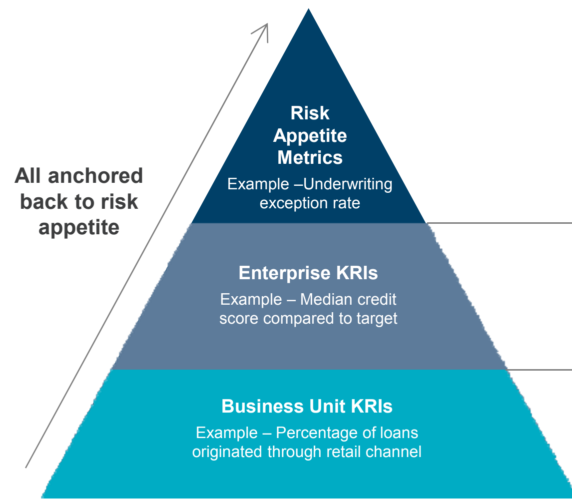
Risk Appetite Process

- The process of reporting on the established metrics is executed by the Line of Business (LOBs) with oversight by the office of the CRO
- It is important that LOBs and independent risk management are highly involved during the strategy-setting, budgeting, and risk appetite creation/review processes.
- The annual strategy planning provides an opportunity for LOBs to communicate their goals and the associated risk thresholds to corporate executives and risk management.

Measuring Risk Appetite

The establishment of risk appetite metrics generally coincides with strategic planning. The metrics are refined based on a dynamic risk environment. Many institutions apply a top-down and bottom-up approach to metrics, as represented in the pyramid below.

Level | **Example**



- Enterprise measures reported directly to board of directors
- Directly tied to risk appetite statement
- Designed to measure risk across the entire organization

- Supplemental or additional metrics
- Factor into risk-based decisions made at the enterprise level
- Measured across all lines of business

- Developed by business lines with support from enterprise risk management
- Specific to each line of business
- Provide business leaders with measures to manage risk in addition to risk appetite metrics and enterprise KRIs

BUSINESS LINE LEADERSHIP RESPONSIBILITIES

An effective risk appetite framework (RAF) encompasses all lines of business and their various support functions. The RAF should be applied to each individual LOB, while ensuring consistency with the board's strategy.

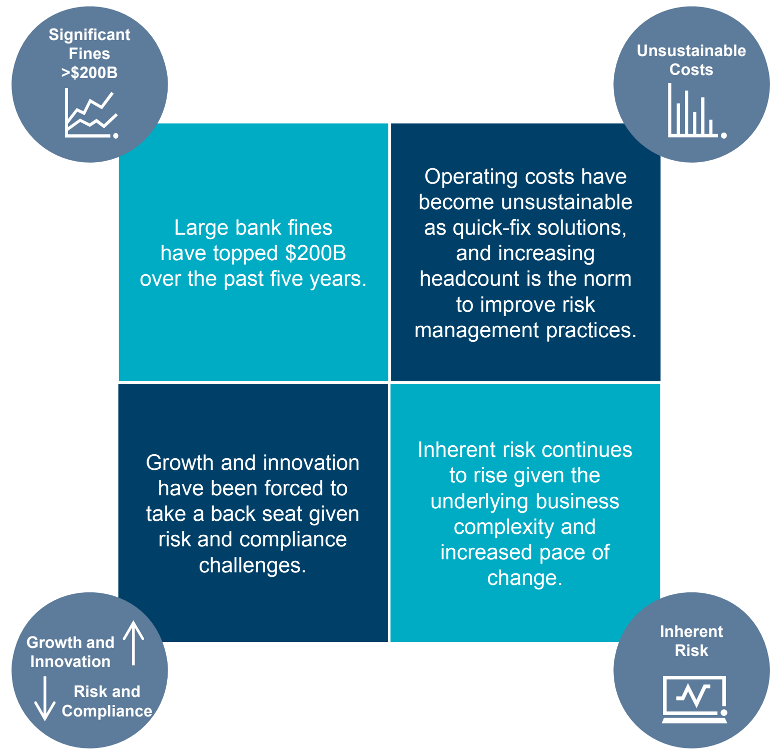
Responsibilities of business line leadership:

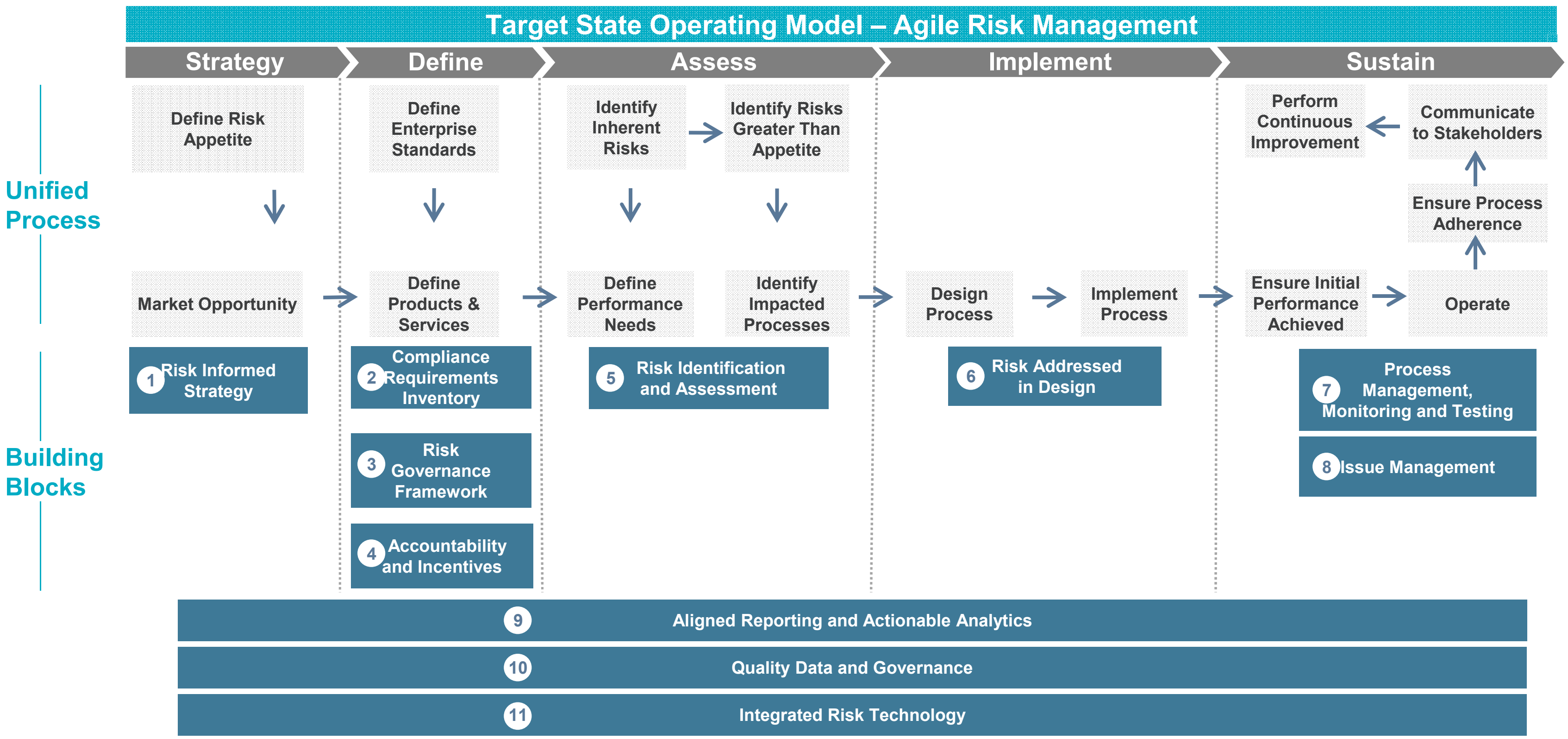
- Accountability for effective risk management within their specific business units;
- Ensure alignment between the approved risk appetite and planning, compensation, and decision-making processes of the business unit and legal entity;
- Embed the risk appetite statement and risk limits into their activities so as to embed prudent risk taking into the institution's risk culture and day to day management of risk;
- Establish and actively monitor adherence to approved risk limits;
- Cooperate with the CRO and risk management function and not interfere with its independent duties;
- Implement controls and processes to be able to effectively identify, monitor, and report against allocated risk limits;
- Act in a timely manner to ensure effective management, and where necessary, mitigation of material risk exposures, in particular those that exceed or have the potential to exceed the approved risk appetite and/or risk limits; and
- Escalate promptly breaches in risk limits and material risk exposures to the CRO and senior management in a timely manner.

AGILE RISK MANAGEMENT

CHALLENGES FACED TODAY

- Emerging from the global financial crisis, **organizations have failed to keep pace** with changing trends in risk and compliance.
- “Firefighting" projects has **diverted funds** from areas such as customer-facing upgrades and critical investment in creaky legacy systems and, as a result, has increased the overall cost structure for risk and compliance, **restricting business growth**.
- The increase in spending on risk and compliance initiatives since the crisis has taken place in a period marked by sustained **organizational cost-cutting initiatives.**
- Additionally, firms are losing sight of the real benefit of risk management: **looking ahead to identify threats and opportunities.**
- Some organizations that have imposed cuts for several consecutive years are now realizing they will soon maximize the savings they can derive from straight cost-cutting and that they will need to **shift their focus to growth and innovation.**




Target State Operating Model – Agile Risk Management
Strategy
Define
Assess
Implement
Sustain
Unified Process
Building Blocks
Define Risk Appetite
Define Enterprise Standards
Identify Inherent Risks
Identify Risks Greater Than Appetite
Perform Continuous Improvement
Communicate to Stakeholders
Ensure Process Adherence
Market Opportunity
Define Products & Services
Define Performance Needs
Identify Impacted Processes
Design Process
Implement Process
Ensure Initial Performance Achieved
Operate
1 Risk Informed Strategy
2 Compliance Requirements Inventory
3 Risk Governance Framework
4 Accountability and Incentives
5 Risk Identification and Assessment
6 Risk Addressed in Design
7 Process Management, Monitoring and Testing
8 Issue Management
9 Aligned Reporting and Actionable Analytics
10 Quality Data and Governance
11 Integrated Risk Technology

BENEFITS OF AGILE

Optimized Performance

- Faster business processes that create competitive advantages
- Optimized resource utilization
- Risk designed products and services
- Simplified reporting and analysis focused on achieving business objectives within risk appetite limits
- Technology enabled processes and controls that are continuously improved

Consistent Experiences

- Increased loyalty when customers know what to expect; reduction in “surprises”
- Simplified servicing allows for ease of doing business for the customer and employees
- Faster developed products that meet customers’ demands

Focus on Growth

- Tailored product and service solutions that fit the customer’s profile and drive profitability
- Ability to move faster when introducing products or changes to processes
- Lowered stress on business stakeholders

Face the Future with Confidence

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