



The Institute of Internal Auditors
New York Chapter

How to Gain Insight and Respond to Unpredictable Risk

“Learning from and Responding to Uncertainty”

IIA Workshop
January 11, 2008

The Futures ▲
STRATEGY GROUP LLC

Collective Intelligence

BAS
BOARD ADVISORY SERVICES, INC.

*"Everything has changed but the
way we think."*

ALBERT EINSTEIN

Introduction

Five years ago the Sarbanes-Oxley act set in motion a string of unintended consequences for public companies. Among them: internal auditors are acquiring extraordinary opportunities to participate in the strategic direction of their organizations. And it is now evident to auditors that conventional risk and compliance models will be insufficient for the job of managing nontraditional business risks guaranteed to characterize the next 15 years.

The Futures Strategy Group (www.futurestrat.com), **Collective Intelligence** (www.collectintel.com) and **Board Advisory Services** (www.boardadvisors.com) are partnering to conduct a one-day scenario planning seminar hosted by the Institute for Internal Auditors in New York. Attendees will receive a hands-on introduction to managing future risk and uncertainty, while learning to cultivate a clear line of sight on the cross-impacts of multiple kinds of risk from anywhere in their organizations. The intense one-day event will be framed by an adaptation of FSG's alternative-futures planning method. Collective Intelligence, a frequent partner of FSG, will help lead participants through the scenario planning work and provide them with the practical tools of capturing organizational knowledge and putting it to work. Throughout the day, Board Advisory Services, which has built its reputation on a horizontal view of risk management, will keep the expert audience on track toward an integrated view of governance, risk, and compliance.

The participants should expect to experience a scenario planning exercise that is very different focusing on plausibility versus probability. At the end of the day, the participants will understand what is different and why it is valuable. This is not a predictive scenario model; however, it does facilitate the creation of predictive risk assessments.

During the workshop, the audience will be asked to look into the future, ask key strategic questions, and analyze the implications against a number of plausible futures. We will not model the past into the future.

Institute for Internal Auditors

January 2008 Conference on “Managing Future Uncertainty”

Presented by the Futures Strategy Group, Collective Intelligence and Board Advisory Services, Inc.

Workshop Agenda

9:00	Introduction and Welcome	Kevin McDermott, Collective Intelligence
9:15	Re-Imagining	Jay Simmons, Board Advisory Services
	Responding to Strategic Risks	
9:45	Scenario Analysis at a Glance	Peter Kennedy, The Futures Strategy Group
10:15	Scenario Team Breakouts	Facilitation Team:
	“Markets Rule”	Anne Simmons, Board Advisory Services
	“Asia’s Century”	Peter Kennedy, The Futures Strategy Group
	“Storm Clouds”	Charles Perrottet, The Futures Strategy Group
	“Terror Uncontained”	Kevin McDermott, Collective Intelligence
12:00	Lunch	
	IIA Board Meeting	Location to be announced
	Speaker	Joe Reo, VP MetLife
1:30	Resume Scenario Breakouts	
3:00	Presentations & Discussion	Plenary
4:00	Wrap Up	

Re-Imagining...How we Respond to Strategic Risks

Jay Simmons, Board Advisory Services, Inc.

Managing Business Risk Has Always Been A Strategic Necessity, But Today The World Is Changing At Unprecedented Rates

The Top 10 Risks for Business¹

- ▶ Regulatory and Compliance Risk
- ▶ Global Financial Shocks
- ▶ Aging Consumers and Workforce
- ▶ Emerging Markets
- ▶ Industry Consolidation/Transition
- ▶ Energy Shocks
- ▶ Execution of Strategic Transactions
- ▶ Cost Inflation
- ▶ Radical Greening
- ▶ Consumer Demand Shifts

The Next 5

- ▶ War for Talent
- ▶ Pandemic
- ▶ Private Equity's Rise
- ▶ Inability to Innovate
- ▶ China Setback

¹ E & Y and Oxford Analytical Survey: Strategic Business Risk - 2008

What Must Companies Do To Respond To These Risks?

Corporate Leadership with an Enterprise Risk focus must: ¹

- ▶ Conduct an annual risk assessment to define key risks and their impact on business drivers
- ▶ Go beyond financial and regulatory risk to consider the wider environment
- ▶ Conduct scenario planning for risks that you identify and develop operational responses
- ▶ Evaluate your organization's ability to manage the risk that you identify
- ▶ Monitoring and control processes to give earlier warning and improve ability to respond
- ▶ Keep an open mind about where risks can originate

¹ E & Y and Oxford Analytical Survey: Strategic Business Risk - 2008

How Have Companies Been Doing?

Business Risk:

NEW YORK (CNN) -- Mattel, announced a recall of 844,000 toys that contain excessive levels of lead paint - the third such recall of Chinese-manufactured toys by Mattel this summer.

(CBS) Mattel recalled 9 million Chinese-made toys Tuesday.

Mattel said Wednesday it was recalling 1.5 million Chinese-made toys worldwide.



Business Response:

BETHESDA, Maryland (CNN) -- The CEO of Mattel Inc. ... apologized as the company was forced to recall millions of toys for the second time in two weeks.

"We are concerned," Mattel Chief Executive Officer Bob Eckert told CNN. "With respect to the specifics of this recall, Mattel was investigating the earlier recall, and discovered this one as well."

But Mattel's safety checks — which include independent audits of facilities ... did not prevent the chain of events that led to today's recall.

How Have Companies Been Doing?

Business Risk:

(Fortune Magazine) "What Were They Smoking?" Wall Street's money machine breaks down. The sub-prime mortgage crisis keeps getting worse-and claiming more victims. -- shocking and utterly predictable.

Shocking, because a pack of the highest-paid executives on the planet, lauded as the best minds in business and backed by cadres of math whizzes and computer geeks, managed to lose tens of billions of dollars.

Predictable because whether it's junk bonds or tech stocks or emerging-market debt, Wall Street always rides a wave until it crashes.

The list of losers, including Citigroup, Bank of America, J.P. Morgan Chase, Credit Suisse, and Merrill Lynch - have lost more than \$240 billion in market value.



Merrill Lynch CEO Stanley O'Neal and Citigroup CEO Charles Prince lost their jobs. Bear Stearns CEO James Cayne may resign.

Morgan Stanley and Bear Stearns CEOs said they'd forego their annual bonuses because of the poor performances.

How Have Companies Been Doing?

Business Risk:

Write-downs on structured products

Citigroup	\$9.8 b	This is the low estimate; Citi says the figure could be \$3 b higher.
Merrill Lynch	\$7.9 b	Analysts project that the broker will have to write down billions more this quarter.
UBS	\$4.4 b	UBS still has nearly \$40 b in CDOs and mortgage-backed securities on its books.
Morgan Stanley	\$3.7 b	Morgan's total subprime exposure after write-downs stands at \$6 b
Wachovia	\$2.1 b	Wachovia was among the top issuers of subprime mortgage CDO debt this year.
Credit Suisse	\$948 m	Credit Suisse lost nearly another \$1 b on leverage loans.
Lehman Brothers	\$700 m	Total includes leveraged loans; Lehman does not provide more detail.
Bank of America	\$3.527 b	CEO Ken Lewis is cutting back the company's investment-banking operations.
Bear Stearns*	\$1.65 b	Big hedge fund losses in June kicked off the subprime follies.
J.P. Morgan Chase	\$339 m	CEO Jamie Dimon is credited with losing less than his peers.

How Have Companies Been Doing?

Business Response:

Market players have realized they don't understand the financial system they created. ²

Financial markets accepted crazy home prices as the new normal. Investments that were labeled AAA turned out to be junk. ²

Nobody knows where the financial toxic waste is buried. Citigroup wasn't supposed to have tens of billions of dollars in sub-prime exposure. Florida's Local Government Investment Pool was supposed to be risk-free. ²

How did things get so opaque? The answer is "financial innovation" — two words that should, from now on, strike fear into investors' hearts. ²

Unlike Enron, the problem here is not unethical or compromised auditors; it's accounting rules and rule makers that have not kept pace with the sophistication of the markets. ³

² Innovating Our Way to Financial Crisis By Paul Krugman NY Times

³ "Strengthening the Gatekeepers: The importance of independence and accountability to the capital markets", Arthur Levitt, Jr.

What Does The Future Hold?

Five key trends, which are all likely to reshape internal audit by 2012 ⁴

- ▶ Globalization
- ▶ Talent and organizational issues
- ▶ Technological advancement
- ▶ Changes in risk management
- ▶ Changing internal audit roles

⁴ PricewaterhouseCoopers LLP Survey Internal audit 2012

How Do You As Auditors Respond?

- ▶ Are you speaking the same language as your management and business partners?
- ▶ Are you assessing risks to the companies growth (business value) or are you solely focused on control processes?
- ▶ Are you assessing risks in an integrated fashion with an end to end perspective?
- ▶ Is there a coordinated framework to align the various risk and control functions regarding governance, risk, and compliance assessments.
- ▶ Do existing risk judgments assess the business risk exposures that the company faces in the markets it serves, fully and adequately?
- ▶ Do you participate in discussions on strategic business initiatives as it relates to identifying risks and risk mitigation strategies?
- ▶ The future for auditing will require independence as it has for the last 50 years, but it will also require that you sit at the executive table as a partner ensuring independent validation of strategic directions about to be undertaken. This will be a risk based perspective with business implications and choices.
- ▶ What do you need to do that? We'll give you a taste in the next few hours.

Scenario Analysis at a Glance

Peter Kennedy, The Futures Strategy Group

What This Day Is All About

A hands-on introduction to Scenario Analysis

Four break-out groups, working in different scenarios, based on real scenarios originally developed for NASA

A real deliverable -- each group will have to evaluate a hypothetical business proposal based on the requirements contained in that group's scenario

A plenary comparison of group results -- looking for common themes, points of divergence, and lessons learned

Hard work, some fun, and useful insights -- a window into a different way of doing risk analysis

What Do We Mean By “Scenario Analysis?”

Scenario Analysis is a powerful way to think expansively and critically about future risks and uncertainties in the business environment. It is:

- ▶ A risk management and planning process that explicitly factors in a range of plausible alternative future operating conditions
- ▶ A tool by which users are forced to consider un-forecastable disruptions and design appropriate control and remediation measures
- ▶ A unique window into future enterprise requirements and issues

A way of managing the uncertainty that surrounds the future

Simple “Scenarios” Versus Scenario Analysis

What’s the difference?

Simple Scenarios	Scenarios Analysis
Tend to be short-term, one to three years out	Longer-term, five to 25 years out
Alternative forecasts, predictive	Not forecasts (but can help inform forecasts)
Focus on a single or a very small set of trends and issues	Looks aggressively at the full range of factors that affect the enterprise
Do not capture cross-impacts	Assumes cross impacts and non-intended consequences
One-off applications	An ongoing knowledge and learning tool

What's The Value Of Scenario Analysis In A Risk Management And Control Context?

Horizon: Scenario Analysis looks well out beyond normal business planning -- 18 to 24 months, to five, ten, even 25 years out

Rigor: Scenario Analysis contemplates not just THE ISSUE but all potentially relevant factors surrounding THE ISSUE

Comprehensiveness: Scenario Analysis is not about best and worst cases. Considers all plausible characteristics of the future, even extreme ones.

Utility: Scenario Analysis is rooted in action, a focus on what do you begin doing TODAY to be prepared for future challenges and opportunities?

Alignment: Scenario Analysis lends itself to collaboration across business units, and between audit/control and strategy & operations functions.

Knowledge: it is a powerful learning and training tool

Examples Of Scenario Analysis Applications

USAF explored the implications of the Cold War ending in the early 1980s; eyes opened to lower budgets, more competition for resources

Merrill Lynch used an expansive set of scenarios to develop business continuity plans after 9-11

Volkswagen anticipated financial and market disruptions during hyperinflationary periods in the 1990s in Brazil and Argentina

Panama Canal reluctantly considered an environmental crisis in their scenario set. They were prepared when a once-a-century drought hit

IBM used scenarios to develop business unit strategies. It has extended that application to its Enterprise Risk Management program, creating an integrated, and collaborative planning/risk management function.

The Drill Today

A simulated, abbreviated Scenario Analysis

Four breakout groups working simultaneously, each in a different scenario:

- Markets Rule
- Asia's Century
- Storm Clouds
- Terror Uncontained

Scenario documents will be distributed when the groups begin

Facilitators will lead the discussion, following a common guide

- ▶ “Explore” the scenario--“What is it like to live in ‘Markets Rule’ of 2020?”
- ▶ Identify general business risks and opportunities
- ▶ Evaluate a business proposal (details forthcoming) in scenario context

Compare results and identify common solutions in plenary

Essential Rules Of The Road

Accept the scenario as-is; stay true to your scenario world.

Stay in the year 2020! Use the past tense when speaking of years pre-2020.

“Share the air” Listen well. Exchange ideas. There are no “correct” answers.

Be prompt for sessions -- time is extremely limited and it will fly by!

Turn off all cell phones and PDAs during sessions.

Work hard, have some fun!

Scenario Team Breakouts

“Markets Rule”

“Asia’s Century”

“Storm Clouds”

“Terror Uncontained”

Facilitation Team:

Anne Simmons, Board Advisory Services

Peter Kennedy, The Futures Strategy Group

Charles Perrottet, The Futures Strategy Group

Kevin McDermott, Collective Intelligence

Appendix

Anne M Simmons

Principal, Board Advisory Services, Inc

anne.simmons@boardadvisors.com

Anne believes that control and compliance lead to confidence in business strategy and execution. Optimized business performance must be a balance of risk and reward. Her perspective focuses on creating that balance through rigorous governance, business planning, and monitored performance. Creating lasting value emanates from designing sustainable, repeatable and compliant solutions to business opportunities.

As a highly qualified senior executive and enterprise program manager, Ms. Simmons offers dynamic, focused, and decisive leadership. A record of developing and executing business strategies within emerging, mature, global, and extremely competitive business markets. Demonstrative expertise in team building and achieving significant business results with an emphasis on compliance and risk management.

Ms. Simmons has functioned as an executive in number capacities delivering business value through line of business leadership for mission critical transaction businesses, development of de novo consulting organizations within fortune 500 firms, establishing professional services capabilities in a turnaround situation, and business evaluation and implementation of emerging technology based business propositions seeking venture capital.

Ms. Simmons is a frequent author and speaker on business strategy and management related topics.

Charles M. Perrottet **Principal, The Futures Strategy Group LLC** **cperrottet@futurestrat.com**

Charles Perrottet is a founding principal of the Futures Strategy Group, LLC (FSG), which was established in 2002 to support long-term planning and strategic decisions of large corporate and governmental organizations. FSG is the successor organization to Deloitte Consulting's Scenario Practice, which Mr. Perrottet led as a Firm Director, and The Futures Group, where Mr. Perrottet led the Strategy Practice for over ten years.

Prior, Mr. Perrottet served as VP of Corporate Development for Hasbro. He had corporate responsibility for strategic planning, mergers and acquisitions, and investor relations. In this capacity, he acted as principal advisor to the CEO on issues concerning corporate strategy, new business opportunities, technological developments, and the competitive environment. During his tenure, his company was the largest and most successful company in its field and enjoyed the highest 10-year return to investors of any Fortune 500 firm.

Mr. Perrottet has been an advisor to top executives for most of his 30 years. He has helped them construct strategies that have capitalized on changes in the makeup of the customer base "pulling" their markets and technological, regulatory, and competitive developments "pushing" the markets. Mr. Perrottet has led strategy projects for some of the world's largest and most successful companies. Mr. Perrottet holds a degree (Magna Cum Laude) in marketing from Lehigh University, an MBA in finance from the University of Chicago, and an MSc in economics from the London School of Economics.

He has written extensively on planning, strategy and the forces for change for such publications as Management Review, Bests, Planning Review, Airline Business, Journal of Business Strategy, Chemical Management Review, and other publications.

Jay Thomas Simmons **Principal, Board Advisory Services, Inc** **jay.simmons@boardadvisors.com**

Jay is an outspoken proponent of horizontally and vertically integrating business, compliance and risk strategies with the need to execute new business and organizational models to ensure leverage across channels, business units, and core functions for an optimized return on investment that increases shareholder value and creates a sustainable competitive advantage.

He is an industry recognized expert on all aspects of global high value and small value payment systems and settlement systems, fraud, technology, and regulatory policy implementation as acknowledged by the Association of Financial Professionals, the Office of the Comptroller of the Currency, the Federal Reserve Bank, the OECD, and others. He is a retained payments system expert for intellectual property and patent litigation.

He has been a regular speaker for the Association of Financial Professionals, NACHA, BAI, SWIFT and many others; he is frequently published by the Journal of Capital Management, Journal of Cash Management, Banking Technology News, American Banker and others.

Jay held senior management positions in global cash management, trade finance and corporate finance with **J.P. Morgan, Chase Manhattan Bank, CoreStates Financial, Bank of America and Citigroup.**

Jay has also held executive and board positions with **LogicaCMG, Board Advisory Services, Inc., LockStar, Inc. and CertCo, Inc.**

Educated in the U.S. and Asia, Jay graduated with a BA in Behavioral Science and Organizational Dynamics from Pennsylvania Military College. He was selected for and completed J.P. Morgan's credit and management training program. He became a Certified Cash Manager in 1993 by the Association for Financial Professionals.

Kevin McDermott **Principal, Collective Intelligence** **KevinMcDermott@collectintel.com**

Kevin McDermott launched Collective Intelligence in 1996. His first major client, an international strategy consultancy, asked him to map the firm's inaugural intranet. Central to that work was McDermott's invention of an innovative methodology capturing the insights of the firm's consultants soon after completion of engagements—short, narrative "after action" reports applying the lessons of experience while they were fresh. The success of this invention brought an invitation to address the first forum on "Groupware & Electronic Communities" at the Massachusetts Institute of Technology. Since then CI's client list has grown to include financial-services firms, the US Department of State, a leading international recruiter and one of the world's largest international aid organizations.

In 2006 McDermott was a major contributor to Project Horizon, a groundbreaking strategic-planning exercise sponsored by global affairs agencies of the U.S.

McDermott previously worked as a journalist, reporting from France for *The Washington Post* and *Saveur*, from England for *The New York Times*, and from Haiti for *The Atlantic Monthly*. He earned a masters in American Studies from the University of Nottingham in Great Britain. He holds a double degree in Political Science and English from the University of Rochester in the United States.

Peter J. Kennedy, Jr. **Principal, The Futures Strategy Group LLC** **pkennedy@futurestrat.com**

Peter Kennedy is a founding principal of the Futures Strategy Group (FSG) and an accomplished strategy consultant specializing in long-term market assessment and scenario-based strategic planning. Prior to the founding of FSG and for nearly four years, Mr. Kennedy was a senior manager in the Strategy practice of Deloitte Consulting. Before that, Mr. Kennedy was director of the Emerging Markets practice of The Futures Group, Inc., based in Glastonbury, Conn.

In all, Mr. Kennedy has nearly 20 years experience helping client organizations make effective plans in the face of future uncertainty and change. He has provided analytical, forecasting and decision support services to numerous corporate and governmental organizations in the U.S., Europe, and Latin America. Mr. Kennedy has previously delivered scenario-planning services to clients in the automotive, air transportation, healthcare, financial services, telecommunications, and consumer products industries. His government clients include the U.S. Coast Guard, NASA Aeronautics, and the U.S. Department of State.

Prior to joining The Futures Group, Mr. Kennedy spent six years with The Economist Group, where he served as a country analyst, editor, and manager of proprietary research for the Americas region.

Mr. Kennedy holds an MA in Latin American Studies from the University of Texas at Austin and a BA in History from Le Moyne College. He has written extensively on planning, strategy, and emerging markets issues for such publications as *Journal of Business Strategy*, *Directors and Boards*, and *Business Latin America*. Mr. Kennedy has appeared on national news programs, including CNN's Money Line and Bloomberg's Financial News.

Mr. Kennedy speaks regularly on scenario planning and has extensive experience running scenario-based strategy workshops, including at Stanford University's graduate business school, Northwestern University's Kellogg School of Business, the University of Texas's Institute of Latin American Studies, and the U.S. Coast Guard Academy.

Mr. Kennedy speaks Spanish. He holds U.S. and Irish citizenship.