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PERSPECTIVES

RISK MANAGEMENT OVERSIGHT: A DEBATE CONTINUES AND AUDIT COMMITTEES GET BUSIER

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The debate over board oversight of risk management continues. And the central issue is the same. How is risk most effectively overseen by the board of directors? Should there be a board-level 'risk committee'? Should risk oversight be spread among a number of committees? Should risk management oversight reside with the full board?

Some board members are dead set against a separate risk committee. They point out that risk oversight is a full board responsibility. And they observe that risk is inseparable from strategy and that a board-level risk committee might operate to unduly constrain those able to participate in key discussions.

Others argue that a board-level risk committee is critical. They point to perceived risk management failures during the financial crisis and the particular expertise needed to interact with the risk management professionals. They also contend that some sort of board-level risk committee needs to exist, if for no other reason so that there is some place for enterprise risk management to go.

Audit committees have a lot of skin in this game. In the absence of a board-level risk committee, audit committees can find themselves with responsibility for oversight of all sorts of risks. They may include credit risk, liquidity risk, operational risk, cyber security, environmental risk and 'overall legal compliance'. That is a lot to ask of a committee whose expertise resides in financial statement presentation and disclosure.

But the problem is not just one of expertise. Another problem is time. As audit committees get drawn further and further into collateral areas of risk management, they stand to be increasingly distracted from their core responsibility: financial reporting. Sarbanes-Oxley places squarely within a US audit committee responsibility for the oversight of financial reporting. And the statute contains no exception for audit committees that are too busy with other things.

Nor does the US SEC appear to be in a particularly forgiving mood. The SEC recently brought charges against an audit committee chair who, as the SEC perceived it, was not properly fulfilling his financial reporting 'gatekeeper' function. At the same time, the SEC's chief accountant has been encouraging audit committees to get 'back to basics'. A particular peeve of the SEC is audit committees too busy or distracted to pay enough attention to the audit fee and delegating that task to management.

How did audit committees get into this fix? Recent history helps explain. In the wake of a number of high-profile financial reporting failures, audit committees were often perceived to be the most independent and active of the board's committees. As the need for additional board oversight increased, the logical place to put the responsibility seemed to be the audit committee. That is certainly how the New York Stock Exchange (NYSE) seemed to approach it. The NYSE wrote rules taking the audit committees of listed companies well beyond the boundaries of financial reporting into, essentially, all risks a company may face.

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But now, some audit committee advocates are pushing back. One audit committee adviser has cautioned that audit committees in substance have become the 'default committee' – the committee that gets responsibilities that don't seem to fit anywhere else. A committee of the New York City Bar Association recently wrote to the NYSE urging revision of the NYSE rule mandating broad audit committee risk oversight. An international group, the Society of Corporate Secretaries & Governance Professionals, has been agitating with increasing vigour for change.

What's an audit committee to do? The first thing is to recognise there simply may not be a one-size-fits-all solution. For some boards, a separate risk committee may make sense; for others, not. But the key thing is for an audit committee to ensure that it has the time and resources to fulfill its legally mandated financial reporting responsibility. If it does not, that is not just a problem for the audit committee. The entire board has an interest in seeing that the audit committee gets it right.

And if the audit committee is too busy? One possibility would be to look at the risks given to an overly burdened audit committee and divide them into two groups. One group, quite obviously, would be those risks associated with financial reporting. The second group might be thought of as 'other'.

As to the first group, those risks should obviously stay with the audit committee. As to the second, if they are to be placed within a committee, another committee or committees need be found. In the absence of anything better, perhaps the second committee should be called the 'risk committee'. R&C

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