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Ignoring risk can be biggest risk of all

Premium content from Charlotte Business Journal - by Jim McLoughlin Jr. and John Fagg Jr.
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Google the word "risk" and you will receive about 543 million results (in 0.23 seconds, no less), the first page of which will consist primarily of links pertaining to Hasbro's board game. But corporate risk is certainly no game.

The recent global financial crisis has shown many companies weren't prepared to manage significant risk. Other events have demonstrated that enterprise risk — an executive's financial misconduct, commercial bribery by a corporation's sales force or the failure of key engineering or safety systems — can come from any direction and is frequently unexpected and unforeseen. As a result, boards and audit committees are more aware of the need to assess and manage corporate risk. While managing risk isn't new, it has never been more important than it is today.

In years past, risk-management responsibility was largely delegated to the chief executive, chief financial officer, general counsel or internal-audit team. However, to adequately assess and manage risk and to fulfill responsibility to shareholders, companies should establish an enterprise-risk function led by a chief risk officer.

In a nutshell, enterprise-risk management is the application of management policies to all aspects of a company to identify and prioritize its risks. A chief risk officer's full-time job is to ask, "What if the worst happens?" and to plan accordingly. The function of this post is invaluable.

Whether a company is a risk-taker or risk-averse, it needs to clearly define the amount of risk it is comfortable taking. After the risk appetite is defined, the CRO should ensure the company stays within proscribed limits.

Companies with effective plans not only reduce enterprise-wide risk and enjoy greater peace of mind, but they also fare better when their business practices come under scrutiny. An independent auditor reviewing the strength of a company's internal controls regarding financial reporting will look favorably upon the existence of a CRO tasked with critically examining the company's profit and loss statement and financial reporting. Similarly, the U.S. Department of Justice guidelines instruct prosecutors to assess a company's compliance function when deciding whether to prosecute. Having a CRO who reports to the board would go a long way toward sending a message that risk is given proper attention.

The Securities and Exchange Commission identifies lack of corporate risk management as a contributing factor in America's economic crisis. As a result, the SEC has been working to strengthen its influence over risk management. In 2010, the agency began requiring companies to disclose their risk oversight, assessment and reporting lines, including communications between management and the board on risk-management issues.

A best practice is to have the CRO report dually to the board and chief executive or chief operating officer. A CRO helps to establish a clear line of communication between the board and management about risks. The creation of a CRO position that reports to the board sends a strong message that risk management is an essential part of board oversight. Having access to the board also ensures the CRO has the clout to convey a clear directive about the company's risk appetite, tolerance and understanding.

Many companies see risk management as costly and cumbersome. Such a view can jeopardize a company's survival. Risk management should start at the top. If a company does not have strong leadership on risk management, it should not expect others to appreciate the need for it. Further, risk management should be an integrated component of a company's strategy. A company should structure enterprise-risk management so it's an essential element of developing and executing its strategies and objectives.

The need for coordinated and strategic risk management continues to rise. While Hasbro's game may encourage impulsive or capricious decision-making, corporate risk is certainly no game. Unmanaged corporate risk is, ironically, the biggest risk of all.

Jim McLoughlin Jr. and John Fagg Jr. are members at Moore & Van Allen and can be reached at jimmcloughlin@mvalaw.com or (704) 331-1054 and johnfagg@mvalaw.com or (704) 331-3622, respectively.