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Board Risk Reporting in Disruptive Times[1]

Risk reporting to the board may not be fit for purpose in these uncertain times. Directors are trending toward expecting more dialogue, engagement and forward-looking insights based on relevant data and information. A principled approach would help.

Boards and their companies face a constant and seemingly unending state of flux in the marketplace. Emergence of the unexpected is the norm. Directors face uncertainty in not knowing what they don't know. The half-life of corporate strategies is shrinking. Innovations in process workflows, products and services are constantly changing the way people live, work and play. Smart decision-making places a premium on staying in close touch with relevant stakeholders. The volatile geopolitical landscape, regional conflicts, national elections driving policy shifts, government fiscal deficits and central bank monetary policy decisions are forcing fresh assessments of long-held assumptions. These and other interrelated factors are driving opportunity, risk and the pace of change, making it clear that the past has little relevance in predicting the future.

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[1] This issue is a companion piece to Issue 169 of *Board Perspectives*, "Board Risk Oversight in the Age of Disruption," November 2023: www.protiviti.com/us-en/newsletter/bp169-board-risk-oversight-disruption.

For boards, this highlights the importance of considering broadly unforeseen developments — both internationally and domestically — that could significantly impact a company's risk profile and strategy-setting and execution. Directors need help in defining, understanding and converging on risk.

Given this state of play, we offer 10 interrelated principles underlying board risk reporting and engagement.[2]

1. **Link risk reports to key business objectives.** Depending on the nature of the business, the relevance of risk reporting should be assured by coupling it to business plans and the critical objectives and initiatives management has communicated to the board. Some risks may affect multiple objectives, whereas others may require specific actions to address changing internal and external conditions to ensure achievement of objectives — which, in turn, increases the robustness of the strategy itself. In effect, risk reporting should be integrated with strategy, business plans and performance management. It is less effective when it is an afterthought to strategy and an appendage to performance management. Failure to define risks in the context of the organization's objectives leads to inevitable "so what" questions.

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2. **Feed board reporting off of management reporting.** If the two are aligned in substance with the only difference being depth of content, the reporting process is more elegant, and things get easier. If management devotes significant time to prepare risk information solely for the purpose of reporting to the board, a red flag emerges for directors. For the process strongly suggests that the reports the board receives are not intended to facilitate the organization's strategic management of risk. The process is most effective when (1) the primary risk owners assume responsibility for managing the critical risks, including emerging risks, created by the activities for which they are accountable, (2) the risk management discipline is integrated with performance management, and (3) focused, concise and insightful board reporting is derived from relevant information used in the business.

[2] In February 2016, Protiviti released a *Board Perspectives* issue (www.protiviti.com/sites/default/files/2023-02/board-perspectives-risk-oversight-issue77-principles-for-improving-board-risk-reporting-protiviti.pdf) summarizing six board risk reporting principles intended to focus directors on the risks that matter. Later that year, Richard M. Steinberg added four more principles to Protiviti's six in his article "Risk Reporting to the Board," published in 2016 in *Compliance Week* (www.complianceweek.com/risk-reporting-to-the-board/10727.article). His four principles addressed additional matters boards should consider when evaluating the quality of risk communications. This collaboration by the author with Steinberg (who was the lead author of the original COSO internal control and enterprise risk management frameworks and is a sought-after board adviser) provided the starting point for refreshing this discussion in this issue of *Board Perspectives* in view of today's market optics.

3. **Focus risk reporting on critical enterprise risks and emerging risks.** Critical enterprise risks represent the risks that can threaten the viability of the company's strategy, business model or reputation. If agreed upon with the board, they warrant the most attention when considering the strategy-setting process in boardroom discussions. Also, directors need to be mindful of emerging risks triggered by unanticipated and potentially disruptive events of varying velocity, including catastrophic events (e.g., a pandemic, major cyberattack or hurricane) and existing risks accelerated by external and/or internal factors in unexpected ways (e.g., significant supply chain disruptions, regional conflicts or disruptive industry innovations). These two risk categories provide a context for the full board and specific board committees to consider when evaluating whether the scope of risk reporting is sufficiently comprehensive, forward-looking and focused on the right risks. High-level updates on company initiatives in these risk areas allow the board to understand progress, or lack thereof, toward improving and sustaining organizational agility and preparedness and to engage management in focused follow-up discussions.

4. **Address day-to-day risks on an outlier basis and when reporting on different areas of the business.** Every business has myriad operational, financial and compliance risks. If any of these risks are critical enterprise risks, they warrant the attention of either the full board or a designated board committee. The remaining risks represent a separate category of risks that should be communicated to the board as part of periodic status reports on line-of-business, product, geography, functional or program performance. However, unusual significant and unexpected matters related to these day-to-day risks should be escalated timely according to established protocols. For example, if there are exceptions against established limits (i.e., limit breaches) or a significant breakdown, error, incident, loss (or lost opportunity), close call or near miss in a critical area, this would warrant escalation to the board.

Critical enterprise risks and emerging risks provide a context to consider when evaluating whether the scope of risk reporting is sufficiently comprehensive, forward-looking and focused.

5. **Define and communicate who is responsible for risk management.** Directors want to know that someone owns the risks that matter. Risk ownership responsibility rests with the CEO, their direct reports and so on, cascading downward and across the organization so that everyone with significant responsibilities is accountable for the risks sourced from their respective activities. To this end, the chief risk officer (CRO) may serve as a catalyst in designing, implementing and providing needed support to risk owners in implementing the organization's risk management framework. The board needs assurance that responsibility for managing risk is where it should be — at the source of risk so that unforeseen developments can be acted on timely.

6. **Require risk owners to engage directly with the board on relevant risks.** When owners of corporate, line-of-business, product, geography, functional or program objectives and performance goals report to the board, they should also disclose the most important risks they face within the context of a common framework and language. This linkage of opportunity and risk is important, as it enables each stakeholder reporting to the board to engage in a dialogue with directors on (a) the underlying risks and assumptions inherent in executing the strategy and achieving performance targets, (b) the "hard spots" and "soft spots" inherent in the business plan, and (c) the implications of changes in the external environment on the core assumptions and desired risk levels underlying the strategy. Integrating risk with performance reporting engages the collective experience of the board in addressing potential market developments and elevates confidence in management's risk awareness and ownership.

7. **Report on whether changes in the external environment are affecting critical strategic assumptions.** To help address emerging risks, board reporting should offer insights regarding management's assumptions about markets, customers, competition, technology, regulations, commodity availability and other external factors and, more important, whether those assumptions remain valid. Reporting should focus on whether changes in these external factors have occurred or are occurring and, if so, whether such changes alter fundamentals underlying the business model.

   To illustrate, national elections all over the world have begun tilting the direction of policy preferences from one end of the political spectrum to the other. What impact will these elections have on long-standing alliances, societal civility, and trade, immigration, fiscal and monetary policies? Who will be the inevitable winners and losers by industry and how will company strategies and messaging be affected? Risk reporting should include insights from both external and internal sources as well as from geopolitical and scenario analyses to offer an "early warning" red-flag capability. Proactive "reality testing" that drives timely, actionable follow-up engenders forward-looking confidence in the boardroom.

8. **Provide insights on how management ensures an effective risk management process.** In addition to understanding who is responsible for risk, directors should have at least a high-level understanding of the risk management process itself — for example, how the process is designed, the way in which it is implemented, the extent of buy-in and ownership across the organization, how the board's role is delineated from management's, and how effectively the process is functioning — giving them confidence that management is effective in identifying, sourcing, measuring, managing and monitoring the company's risks.

   The overriding theme of considering the potential for and impact of significant unforeseen developments should be emphasized when discussing who is responsible, who is accountable, who should be consulted and when, and who should be informed in an open, "speak up"

and transparent culture. If the CRO (or an equivalent executive) and internal audit provide assurance on the effectiveness of risk management processes — including the related tabletop and scenario-planning exercises, market intelligence–gathering processes, risk metrics and internal controls — the board's confidence is further enhanced.

9. **Pay attention to directors' preferences.** This self-evident principle suggests the importance of listening to directors to align risk reporting more closely with their preferences. Our discussions with directors indicate that many want:

    - **Plain language reporting —** This is an imperative for boardroom success.
    - **Crisp presentations —** Keep presentations short and to the point. Addressing specific questions in the boardroom (rather than preparing a comprehensive presentation that purports to anticipate every possible question) leads to focused discussions and zeroes in on directors' real concerns.
    - **More insights and less detail —** Overwhelming directors with data mires them in the weeds and does not contribute to strategic conversations. Instead, focus on the message and the real issues facing the company and end with key takeaways and actionable conclusions. Sharing data is productive if the dots are connected with intention to support takeaways that educate the board on management's thinking. If a deep dive is needed in a particular area, take it offline, if possible.

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- **More engagement and dialogue —** Directors value productive risk discussions. For example, risk assessments that are linked to the company's strategic objectives and performance goals could be integrated into strategic boardroom discussions. Risks related to the most formidable obstacles to achieving the company's objectives and goals can surface useful insights that require follow-up.
- **Better understanding of the uncertainty the company faces —** Many directors want to know what management is doing to improve organizational resilience, agility and preparedness.
- **An opportunity to look forward, not backward —** Boards want more forward-looking insights (i.e., management not only tends to the knitting of executing the strategy but also monitors the vital signs in the marketplace that evidence continued relevance of the strategy

and business model). For example, analysis of plausible and extreme scenarios can contribute insights that lead to meaningful response plans, action triggers and decision prompts that will give the board confidence in the company's resilience in facing the unexpected.

- **Learnings from post-mortems —** When things that weren't anticipated go wrong — either in the company or in another organization — an objective post-mortem can provide valuable insights for both the board and CEO.

10. **Continuously improve board risk reporting through an iterative process.** Apply the above interrelated principles with the intention of asking the board to provide feedback. While it is true that directors often don't know what they want specifically in the way of reporting, continuous improvement is a two-way street. Start with an approach and improve it continuously with iterative feedback from directors and the CEO.

Directors want an ongoing review of progress, a focus on practical and actionable takeaways, and timely forward-looking insights on what matters as markets evolve and unforeseen developments occur.

The above interrelated principles are not intended to prescribe specific reporting practices but rather to offer sound directional guidance for the board and management to improve board risk reports and conversations that are grounded in a strategic context. There is no one-size-fits-all approach to board risk reporting. What works for one board may not for another. Every organization is different from a strategic, operational, cultural and organizational structure standpoint, which, in turn, drives different reporting to the board. But in the end, directors want an ongoing review of progress, a focus on practical and actionable takeaways, and timely forward-looking insights on what matters as markets evolve and unforeseen developments occur.

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Protiviti, Broadridge, and BoardProspects are pleased to launch our second annual Global Board Governance Survey designed to gain the perspective of board members, CEOs and other C-level executives on the topic of disruption. Your participation will help us better understand and contrast the perspectives of active directors and C-suite leaders on this important issue of our times. Take the survey today.

How Protiviti Can Help

Protiviti assists boards and executive management with assessing the enterprise's risks, either across the organization or at various operating units, and its capabilities for managing those risks. We help organizations identify and prioritize their critical risks, including emerging and disruptive risks that can impair their reputation, brand image and enterprise value.

We assist companies in integrating their risk assessment process with their core business processes, including strategy-setting. We work with boards and board committees in reviewing their governance practices and facilitating board and C-suite retreats. We also help organizations improve their risk reporting, including reporting to better inform the board's risk oversight process.

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