**WHAT DOES COSO STAND FOR?**

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***Grumpy Old Accountants, April 2012***

On March 1 COSO issued a “thought paper” entitled, “[Enhancing Board Oversight: Avoiding Judgment Traps and Biases](http://www.coso.org/documents/COSO-EnhancingBoardOversight_r8_Web-ready%20(2).pdf).” The presumed contribution of this publication is a five-step decision-making algorithm that boards of directors can use to enhance professional judgment. Our problem with this work is that COSO is wasting its time, as well as yours and mine, by repackaging well-known decision-making paradigms when it should be providing real thought leadership that can prevent future banking crises, audit failures, and the like. Despite attempts by KPMG (Sam Ranzilla and George Herman) and its academic partners (BYU professors Steven Glover and Douglas Prawitt) to pass this paper off as something insightful and new, it is neither!

The stated purpose of this collaboration is to promote high-quality judgments by board members. The paper begins with the observation that directors have “fiduciary responsibilities of corporate governance and oversight,” but face challenges to meeting those duties and obligations. Directors need to have wisdom and understanding to exercise “high-quality judgment and oversight.” Who could disagree with this? Certainly, we don’t.

But then we learn the true purpose of the document. The paper goes on to state that the business judgment rule assists this process by granting directors legal immunity as long as they act “in good faith with reasonable skill and prudence.” Aha! So, the purpose of the “thought piece” is really to discuss a tool to minimize director legal liability.

The COSO authors attempt to carry out this purpose by “incorporating insights from academic research and reflecting KPMG’s commitment to consistent and incisive professional judgment in all aspects of its work.” To achieve this goal, they assert that directors should observe the following model for high-quality judgment processes:

1. Define the problem and identify fundamental objectives,
2. Consider alternatives,
3. Gather and evaluate information,
4. Reach a conclusion, and
5. Articulate and document the rationale.

However, haven’t most all of us seen this model before? Yes, if you don’t believe us, just check out [Wikipedia](http://en.wikipedia.org/wiki/Decision_making#Decision-Making_Stages) for the complete model!

So presumably, by following this time-worn process, directors can avoid traps and biases and improve their decision-making, thereby avoiding legal liability. The authors go on to discuss various snares, such as groupthink, framing, and anchoring, but the story remains simple—follow the five-step yellow brick road and you will find Oz. If only it were that simple!

The main problem with this suggestion is that it fits everything. It is too general. One could advocate this approach to a student’s choosing which college to attend, whom to marry, which firm’s offer to accept, how to audit, and what television shows to watch. The model offers few specifics to assist directors in their decision making.

Another issue is that the model is too mechanical, as it frames decision-making as a linear process. In reality, one might get to step 4 and make a decision, only to learn of a new alternative. Or one might make a decision only to find out that it is not feasible. It is even possible to reach the last step only to discover that the board is solving the wrong problem! Clearly, feedback loops are part and parcel of real-world decision-making.

Additionally, COSO’s model does not introduce learning into the process. The board of directors might use this model to address several issues, and learn later whether the decisions were the best decisions for the investors in the business enterprise. The directors could then learn from these past decisions, and this knowledge could help them make better decisions in the future. In short, they could learn from their mistakes.

Clearly, the model is grounded in the psychology of learning, but real-world decision-making involves a number of sociological issues. The model ignores the fact that board decisions are group decisions, not individual ones. Consequently, the model also ignores the strengths and weaknesses of individual board members, the social relationships among board members, the relationships between board members and managers, as well as dynamics of group decision-making including corporate culture and power relations among the various actors. Social psychology might have provided a better theoretical template than psychology.

Tellingly, the model omits ethical considerations, and we wonder why. After all, most of the accounting, audit, and financial implosions of the last quarter century have centered on ethical problems, not traps and biases or difficulties in decision-making. We would have explicitly included ethical concerns somewhere within the model. But then again, we aren’t focused exclusively on the mitigation of legal liability.

We also think the model should embed fiduciary responsibilities within the process. There should be a step that instructs board members to exercise professional skepticism. Boards do not exist to pat managers on the back; the need for “yes men” ended a long time ago. Directors need to ask hard questions, and at times challenge managers. As representatives of shareholders, directors need to examine the motives of managers and understand that managers’ interests at times diverge with the interests of capital providers. Only by exercising professional skepticism can board members truly discharge their responsibilities.

Finally, we think the courts have extended the business judgment rule far beyond what is socially good. Director decision-making will not likely be enhanced by this “new” COSO model. However, it could come from our court systems if they did not give directors carte blanche for virtually everything that happens. Greater legal consequences for poor director oversight (fines, penalties, jail time, etc.) would get the attention of directors—and improve their decision making.

If this is the best that COSO can do, maybe it’s time for the organization to close shop. Or at least change its name to the ***Committee On Stating the Obvious***!

*This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.*