Ashurst Risk Advisory

Ashurst Risk Advisory LLP
London Fruit & Wool
Exchange
1 Duval Square
London E1 6PW

Tel +44 (0)20 7859 1200

www.ashurst.com

Our ref:
FRC Consultation - UK
Corporate Governance Code

[redacted]

[redacted]

13 September 2023

By email

codereview@frc.org.uk

Ashurst Risk Advisory LLP's response to the FRC's consultation on proposed changes to the UK Corporate Governance Code

Introduction

Ashurst Risk Advisory LLP (Ashurst Risk) is the consulting division of Ashurst proving risk consulting services to complement Ashurst LLP's core legal services. With dedicated teams working side by side, Ashurst offers truly integrated end-to-end legal and consulting capabilities across various risk domains including enterprise risk, governance, resilience and regulatory risk.

Nisha Sanghani and Chris Thackray lead the Regulatory, Governance, Operational Risk & Resilience team at Ashurst Risk and are both well-known for their thought leadership and practical approach to enterprise risk management, regulation, corporate governance, and board accountability.

Ashurst Risk welcomes the opportunity to participate in this consultation on the UK Corporate Governance Code (the Code).

Summary

We recognise that the UK Government and the FRC have a collective aim to increase stakeholder confidence in UK businesses and therefore the main proposed changes concern those parts of the Code which deal with the need for a more robust framework of prudent and effective risk management and internal controls. They are aimed at providing a stronger basis for reporting on, and evidencing the effectiveness of, the framework during the reporting period. These are very credible outcomes.

Overall, we support the proposed Code changes but do recognise certain elements of the changes, which are intended to increase board accountability and standards of risk management, are likely to require substantial efforts by organisations to achieve Code compliance and meet the new standards. In the following section, we provide our views in respect of specific consultation questions that relate to this point specifically.

Responses to consultation questions 13 to 18

Question 13 - Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?

Overall, we agree the proposed amendments to the Code are likely to lead to a strengthening of risk management and internal control systems however, whilst necessary, the effort required to implement these changes will be substantial.

Given the scope covers operational, compliance and reporting controls and not just internal controls related to financial statement reporting this will be a significant undertaking for most organisations, especially those without a board Risk Committee already overseeing enterprise-wide risk.

On the basis that organisations are likely to have different approaches to meeting the Code, as well as a differing levels risk tolerance and base understanding in terms of what will be required going forward, we consider the FRC's forthcoming proposals on "Guidance on Risk Management, Internal Control and Related Financial and Business Reporting" to be of critical importance.

To this extent, and notwithstanding that the Code is not intended to be prescriptive, we believe that it would be beneficial for the guidance to set out examples of methodologies and frameworks that would support the board in its oversight and ongoing review of the effectiveness of risk management and internal controls systems.

We highlight the following points for the FRC's consideration in relation to both the proposed changes to the Code and the final guidance:

- Organisations should be explicitly guided to establish which controls are material (notwithstanding that how they do this will be down to each individual organisation).

- Prudent board's will likely see the value of developing a risk-based testing approach across relevant operational, compliance and reporting controls. The boards will also likely have a well-established enterprise risk framework with inherent risks documented and residual risk regularly assessed. Helpful guidance, or examples of good practice on these approaches might achieve more consistency across organisations (and assist with the right market-wide outcomes in relation to better risk management and resilience).

- It would be helpful for all organisations to understand that the maintenance of a risk framework and ongoing evaluation of internal controls and risk is not the same as developing a risk-based testing approach. The latter must be performed independently to achieve robust oversight.

- It may be useful to include guidance on minimum standards for the setting of and disclosure of material risks, including financial and non-financial impacts, the board's prior awareness of such risks, any delayed or outstanding audit or other management actions (e.g., given by the board) prior to the materialisation of the risk, any internal whistleblowing or other confidential employee complaints relating to the risk, etc.

- It might be useful to clarify the scope of risk management and in particular to specify that internal controls are relevant for the mitigation of both internal and external risks.

- The proposal requiring board's to provide an explanation of their declaration pertaining to the effectiveness of its risk management and internal controls framework will result in company's giving vague statements that are reused annually. Emphasis should be put on the board having to explain how financial and non-financial losses incurred as a result of material and non-material events has been used by the board to determine the effectiveness of the company's risk management and internal control framework. Additionally, there should be a requirement for board's to articulate the progress in mitigating principal or emerging risks.

- The proposals put the emphasis on the scope and responsibilities of audit to identify weaknesses in the firm's risk management and internal controls however, there should also be consideration to the board's assessment of the skills and competencies of the audit function to adequately carry out their duties.

- It would be useful for the proposals to include a requirement for the board chairperson to assess the adequacy of board skills and expertise to challenge and govern senior management's business plans for the strengthening of risk management and internal control systems relative to material risks.

- The proposals place an emphasis on the board having at least one member with "relevant financial experience" but make no mention of the board soliciting relevant experience to adequately challenge the company's management and mitigation of other material risks (e.g., operational risk, market risk, reputational risk, etc.), which would also be useful to include.

- It might be useful to require companies to disclose their risk management framework or risk management policies for material risks (as disclosed) allowing investors and other company stakeholders to assess the adequacy of such policies in safeguarding their interests (monetary or not).

- As an extension of the going concern assessment it would be useful to require the board to explain (or at least consider) how the board's requirements of senior management to address principal risks are adequate to mitigate stakeholder losses or causing undue harm to other company stakeholders.

- It would be useful for the board to at least consider, or give an assessment of the strategic risks to the firm taking account of internal and external risks facing the firm (e.g., geopolitical risk, market risk, etc.) and to articulate how the board intends to oversee the mitigation of these risks to mitigate disruption to the business strategy and plan.

Q14: Should the board’s declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?

We agree that the board's declaration should be based on continuous monitoring, reflecting the fact risk oversight and evaluation is a continuous process rather than an annual exercise.

Q15: Where controls are referenced in the Code, should ‘financial’ be changed to ‘reporting’ to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?

We agree that reporting should be captured in a broader sense than purely financial reporting on the basis narrative is a key element of the annual report.

Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

We believe that examples of risk management frameworks and good governance would be extremely useful to include in the final guidance. Also see our response to question 13 for further elaboration.

Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?

Ashurst Risk has developed its own risk management and internal controls framework based on many years-experience in both financial services and non-financial services sectors. As well as capturing financial and non-financial risks our model allows for the pro-active oversight and measurement of internal and external risks that may impact an organisations customers, operations and / or resilience.

We would welcome the opportunity to discuss this further with the FRC if requested to do so.

Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

Please see our response to question 13.

We would be delighted to discuss any of our suggestions with the FRC in due course. We would also welcome the opportunity to discuss our views in relation to the additional consultation questions not covered in our response to date.

Yours sincerely

[redacted]