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Submitted by email: riskreview@frc.org.uk

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Dear Catherine

ICSA response to Draft Guidance on Risk Management, Internal Control and the Going Concern basis of accounting, and associated changes to the Code

We welcome the opportunity to comment on your draft Guidance on Risk Management, Internal Control and the Going Concern Basis of Accounting, and associated changes to the UK Corporate Governance Code.

In preparing our response we have consulted, amongst others, with members of the ICSA Company Secretaries Forum, which includes company secretaries from more than 30 large UK listed companies from the FTSE100 and FTSE250. However, the views expressed in this response are not necessarily those of any individual members of the ICSA Company Secretaries Forum nor of the companies they represent.

Overall we support the draft Guidance and associated changes to the Code. It is a well structured, clearly written document, which should be easily understood by boards. We think it is sensible to bring together the guidance on internal control and the guidance on going concern and liquidity risk. We think the draft Guidance has largely achieved the aims of making a clearer distinction between going concern in the broader context and the specific going concern assessment in relation to financial statements.

We have set out below some general points, and some more detailed comments, in relation to specific sections of the draft Guidance. Our most important comments relate to Appendices D and E.

1. General comments

One observation that we would like to make relates to the assessment of 'fitness for purpose' of any risk management and internal control system within an organisation. The work of risk professionals and internal audit professionals is invaluable to ensuring a robust system; however, we are concerned that professionals who are involved in the detail of risk management are not necessarily well equipped to carry out a company-wide, top-level assessment. We think it might be helpful if companies considered carrying out periodic reviews of 'fitness for purpose' by a group of individuals and we suggest the group best placed to do this might comprise the Chief Risk Officer (or head of risk), the Chairman of the audit committee or risk committee (as appropriate) and the Company Secretary, who has an overview of all functions and is likely to be removed from the detailed day to day running of risk management and internal control functions.

With regard to the document structure we would suggest that numbered paragraphs throughout (ie 1.1, 1.2, 1.3 etc) are preferable to the use of bullet points, as this ensures easy reference to specific points in the Guidance.

2. Specific comments

2.1 Section 1: Introduction

We support the introduction in Section 1 and think the high level conclusions of the two reports, set out under paragraph 5, are helpful. We also think that paragraph 11 is particularly helpful in focusing attention on the wider factors to be taken into account when considering overall risk, including the structure and hierarchy of risk within organisations.

2.2 Section 2: Responsibilities

We would highlight paragraph 21 and, in particular the providing of timely information to the Board. We think that further emphasis could be given to the need for the board to satisfy itself that it has received all relevant information and the board has a full understanding of the risks being taken. In a number of recent incidents where risk management failures have occurred, it has become clear that the board was blind to the areas of risk where failure occurred and was not in control of the situation.

We would also highlight the last sentence of paragraph 21 and emphasise the importance of ensuring that appropriate accountability, as well as responsibility, is clearly established at all levels of the organisation.

2.3 Section 3: Exercising Responsibilities Effectively

Section 3 is helpful in setting out the exercising of responsibility and we note that this is aligned to the requirements of the Companies Act 2006. However, we think there should be specific reference to the important responsibilities of the audit or risk committee and, in particular, the crucial importance of the audit or risk committee reporting fully to the board. It is our members' experience that committee reporting to board meetings is not always given sufficient time and consideration, particularly when board agendas are very full.

2.4 Section 4: Identifying and Assessing Principal Risks

In our view, Section 4 is well-written and particularly useful in assisting boards, who are not risk specialists, identify and assess risk. However, we note that paragraph 26 makes no specific references to reputational risk, or broader political, regulatory or market risks. In our view it is essential that boards continually evaluate reputational risk as failure can lead to serious value destruction.

2.5 Section 5: Establishing the Risk Management and Internal Control System

We think Section 5 has been well written, is appropriate guidance for boards and is about the right length. We have two comments on this section as set out below:

2.5.1 We would highlight the second bullet point under paragraph 31 as the key issue and suggest that this issue be given additional emphasis in the Guidance.

2.5.2 We also think that a risk management and internal control system should include effective 'whistleblowing' procedures.

2.6 Section 6: Reviewing the Risk Management and Internal Control System

We have no comments under this section. We think it is well-written and appropriate for boards. We think the length of this section is also about right and should not be expanded further.

2.7 Section 7: Communication

We think section 7 provides a helpful summary of the disclosure and reporting requirements. However, we think it might be useful for the Guidance to include some initial comments from the FRC to explain the important differences between current guidance and what is now being proposed, so that readers can understand how the changes, once implemented, will:

a) increase the capability and resilience of companies;

b) reduce 'board blindness' by ensuring important risks are elevated to the board and boards are able to evaluate the information they need to receive and where to direct their enquiries; and

c) help boards identify areas of risk for their focus and further enquiry, and understand what more is needed by boards and their risk management functions, to help them identify the types of risk they have missed previously.

2.8 Appendix A: Amendments to the UK Corporate Governance Code

We agree with the proposed changes to the UK Corporate Governance Code. However, please see our comments under Appendix D below.

2.9 Appendix B: Assessing solvency and liquidity risks

We think this Appendix is helpful, in particular the section on stress testing and sensitivity analysis. However, we note that, again, there is no mention of reputational risk.

2.10 Appendix C: Determining and reporting on the going concern basis of accounting

We think this is a helpful section and have no specific comments.

2.11 Appendices D and E: Questions for boards to consider and warning signs

As indicated at the beginning of our response, our most important comments relate to the example questions set out in Appendix D and suggested warning signs set out in Appendix E. Whilst we think Appendix D contains some good questions, our main concern is the way in which they are likely to be used. Although these are quite specifically examples and suggestions, by setting out precise questions, it may lead boards to focus on those questions rather than prompting wider consideration of the issues. A worst-case scenario would be that these questions could be used as a 'checklist', which would narrow the focus of the board to cover only those questions.

We also consider the warning signs set out in Appendix E to be too detailed and are concerned that they could also limit the board's thinking. In addition, we think the points set out under the heading 'effectiveness of risk management and internal control system' are quite confused. The items listed either fall clearly within considerations of governance arrangements, or relate to specific risks or questions over the business model.

When reading these Appendices, it would appear that they do not provide any guidance that would be more helpful to boards than the FRC Guidance on Board Effectiveness produced in 2011 (Appended to the Code) and, in many ways, the Guidance on Board Effectiveness would be more helpful. We therefore suggest that Appendices D and E be replaced by having the FRC Guidance on Board Effectiveness Appended to the Guidance. This would have the added benefit of ensuring there is consistent guidance for boards on their effectiveness in relation to all areas of their work and it also avoids the risk of inconsistent or conflicting guidance. This may also be an appropriate time to consider a revision of the 2011 Guidance on Board Effectiveness to reflect all changes over the past three years.

However, if sections D and E are to be retained, we suggest it would be preferable if Appendix D set out a list of broader areas for boards to consider. There may be a number of questions boards wish to ask regarding each topic but it would be for boards to decide their own questions, relevant to the specific circumstances of their individual companies. We set out below areas for boards to consider under each of the headings in Appendix D.

Risk Appetite and Culture

1. Risk appetite and limits
2. Risk management
3. Board and committee members' suitability and capability
4. Board risk oversight
5. Alignment of culture, code of conduct, HR policies and performance rewards
6. Desired culture and its promotion
7. Employee risk communication, expectations and discretion
8. Employees' suitability and capability
9. Whistleblowing arrangements and reporting
10. What is (un)acceptable behaviour

Risk Assessment

1. Strategy and business model
2. Execution dependencies
3. Method and frequency
4. Emerging risks and opportunities
5. Escalation process and triggers
6. Material strategic, transactional, project and product risks etc.
7. Scenario modelling
8. Risk correlation and contagion
9. Third party risks (eg JVs, outsourcing and supply chain)

Risk Management and Control System

1. Clarity and co-ordination of authority, responsibility and accountability
2. Senior management monitoring of policies, systems and activities
3. Holistic approach to risk management
4. Adaptation of processes/controls to reflect deficiencies/new risks
5. Assurance sources and effectiveness
6. Adequacy and timeliness of board information
7. Adaptation of board information to changes in risk profile
8. Assessment of delegation to committees
9. Response to control weaknesses/failures
10. Crisis management responsibilities and testing

Public reporting

1. Adequacy of shareholder information to assess performance, business model and strategy
2. Links and alignment of principal risks and uncertainties reporting with going concern assessment

We hope our comments are useful and if you would like to discuss any comment in more details, please contact me.

Yours faithfully

Peter Swabey
Policy & Research Director