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By email to: riskreview@frc.org.uk

Dear Catherine

RISK MANAGEMENT, INTERNAL CONTROL AND THE GOING CONCERN BASIS OF ACCOUNTING – consultation on Draft Guidance to the Directors of Companies applying the UK Corporate Governance Code and associated changes to the Code.

Airmic and CIMA are pleased to submit a joint response to the above consultation. This follows our joint letter to Stephen Haddrill, dated 5 February 2013 and an initial response in relation to the proposed integration of the Turnbull and Sharman guidance, dated August 2013.

General comments

We remain supportive of the approach of combining the internal control with the going concern and liquidity risk guidance documents as we believe that the assessment of solvency and liquidity risks for narrative reporting purposes as well as the going concern assessment required for financial reporting purposes should be part of a broad ongoing risk management process. We welcome the importance given to the cultural and behavioural aspects of risk management.

While the high-level **structure** of the guidance is sensible in terms of the flow of the section headings and the removal of detail to appendices, we are concerned that it has lost some of the clarity, focus and accessibility that is so welcome in the current 'Turnbull' guidance. In a number of places, we found that the terminology remained confusing and that the guidance was not as clear as it could be in terms of emphasising that both the assessment of solvency and liquidity risks and the going concern assessment are subsets of the larger risk management process. The link between the main sections and the appendices could also be strengthened in places. We address these concerns in more detail below, but as a first step, it may be useful to consider including simple diagrams or tables in the guidance to help readability and to make it clear what boards need to do. For a board member without a financial background, it may be worth bearing in mind that some of the terminology is quite technical in places and needs to be explained clearly in 'layman's language'.

In terms of high-level **content,** we believe that the guidance needs to make explicit reference to **reputation** as this is such an important aspect of the board's risk management responsibility. Although the guidance also makes reference to risks relating to **the business model**, we feel that the guidance could also emphasise more strongly that a full understanding of the business model and its interface with the external environment provides a sound basis for understanding risks in a comprehensive and systematic way. The need for the board to engage with the external environment through exceptional **risk radar** should also be emphasised.

In preparing this response, we have drawn on a new research report, *Roads to Resilience*, which was undertaken by Cranfield School of Management and Airmic and will be launched at the end of this month. We will forward a copy of the report as soon as it has been published and would particularly draw your attention to *Section 8: Implications for board members.* This includes an extensive list of structured questions that boards can ask to understand the extent to which the five principles of resilience[1], identified by the research, are embedded within the business and the extent to which the four business enablers[2] have been enhanced to increase resilience.

Comments on individual sections/appendices

Section 1 – introduction

Section 1 is a comprehensive introduction to the guidance and provides a good context for what follows. Perhaps there is scope to re-write paragraph 5 so that the bullet points are compatible with the structure of the guidance, as this would serve to clarify and simplify the key messages.

Section 2 – responsibilities

Clarification of responsibilities is a welcome addition to the guidance. The '*Roads to Resilience'* [3] report provides guidance on the roles and responsibilities of board members and the need for risk information to be available to the board. The business structure and 'risk architecture' within the company should ensure that there is no 'glass ceiling' that restricts the internal reporting of risk information to the board, as this can result in board risk blindness.

Section 3 – exercising responsibilities effectively

Paragraph 24 – we would prefer that the wording was changed to 'strategy, business model and risk' as we believe that it is clearer and more comprehensive than 'strategy, capital and risk'. There should be recognition in the guidance that business assets are increasingly intangible to the point

[1] The five principles of resilience are (1) exceptional risk radar (2) resources and assets that are flexible and diversified (3) strong relationships and networks (4) rapid response capability (5) review and adapt processes following adverse events.
[2] The four business enablers are (1) people and culture (2) business structure (3) strategy, tactics and operations (4) leadership and governance.
[3] *Roads to Resilience* report by Cranfield School of Management and Airmic (2014)

that reputation is often the main asset of the company. Also, there should be recognition that business partners, including (for example) franchisees, are integral to the delivery of customer services and products and should be included in risk management and internal control processes.

Section 4: identifying and assessing principal risks

Overall, this section was confusing in places and, in our view, is the weakest section in the guidance. There needs to be a clearer explanation of what constitutes a 'principal risk' and that 'solvency and liquidity risks' are a subset of that category. The previous terminology of 'significant risks' conveyed the message that a threshold should be identified above which closer scrutiny of a risk would be appropriate. Paragraphs 26 and 30 would benefit from tighter drafting to help in this respect. Paragraphs 45 and 46 in Section 7 are much clearer as they explain that principal risks include but are not limited to solvency or liquidity risks. We would also recommend that paragraph 26 should refer to 'failures of strategy, **the business model,** operations, organisation or behaviour …'

Section 4 also needs to make reference to how identifying and assessing principal risks relates to the going concern assessment. Again, section 7 does this more clearly. Also, there is confusion and overlap between section 4 and paragraph 34 in section 5. Section 4 has the heading '*identifying and assessing principal risks'* but paragraph 34 provides the step by step summary guidance on how to undertake the risk assessment.

Section 5: establishing the risk management and internal control system

Overall, we agree that this section remains fit for purpose, but it would benefit from reference to Appendix D that includes information on how the board should evaluate the appropriateness of the risk management and internal control system. .

Section 6: reviewing the risk management and internal control system

Overall, we agree that this section remains fit for purpose.

Paragraph 40 – we recommend that this is amended to read 'the integration of risk management with considerations of strategy and the business model…' also, if there is to be a reference to 'risk appetite' it should be made clear that this concept extends beyond operational constraints to a wider consideration of the attitude of the board to the risks involved in the strategy and tactics, as well as the operations, of the company.

Section 7: communication

We agree that this section remains fit for purpose, in that it is well structured and provides well-presented and consistent guidance.

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Appendix B – assessing solvency and liquidity risks

This section would benefit from a brief explanation as to the relationship between solvency/liquidity risks and principal risks. In particular, it should be possible for the reader to gain a clear idea of when a principal risk would NOT be considered a solvency or liquidity risk.

We believe that the 'severe distress' section now in Appendix C would be better moved back to Appendix B as it is essential to the understanding of solvency and liquidity risks.

Appendix C – determining and reporting on the going concern basis of accounting

We have concerns over the positioning of this appendix in the guidance as a whole. The placement in the middle of the appendices does not convey that the going concern assessment is a distinct subset of the entire risk management process and that a decision not to adopt the going concern basis of accounting is a very rare event. It would be better positioned at the very end of the document.

Appendix D – questions for the board to consider

Please see our general comments about content. We would like to see these points reflected in this appendix. We would also suggest the inclusion of some of the questions from the checklist from *Roads to Resilience*[4] as referred to earlier. The structured checklists for board members include challenging questions about a wide range of risk and resilience topics, such as risk awareness, board risk blindness, risk architecture, crisis management, risk attitude, risk assessment, resilience agenda and risk governance.

Appendix E – warning signs

We believe that it is useful to include warning signs, but this appendix needs considerable further work if it is to fulfil the desired objective. Some of the statements need some expansion to help boards understand if they do indeed have a problem, for example 'mechanical and static processes' and 'organisational complexity' need some elaboration and context.

Other warning signs could include:

- Lack of understanding of the business model (including the wider supply chain)
- Lack of awareness of reputational implications of problems.
- Lack of awareness and policies in relation to the influence of social media
- Inability of the board to listen/hear what employees are saying – the risk information 'glass

[4] *Roads to Resilience* report by Cranfield School of Management and Airmic (2014)

ceiling' that can result in board risk blindness.

Proposed revisions to the UK Corporate Governance Code

We are comfortable with the changes proposed. The new provision C.2.1 makes the relationship between the principal risks, solvency/liquidity risks and the going concern basis of accounting very clear and succinct.

Provision C.2.2 effectively clarifies that the board must both monitor continuously and conduct an annual review.

We hope that our comments are helpful, but please do not hesitate to contact us if you have any queries. We are delighted to assist in any way we can to ensure that the final version of the guidance continues to build the UK's reputation as the leader in governance development.

Yours sincerely

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