



Review of the Turnbull Guidance on Internal Control

Evidence Paper

Turnbull Review Group

16 June 2005

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Introduction

The Review Group has sought to gather evidence and views about the impact and implementation of the Turnbull guidance to ensure that its recommendations on the way forward were well founded. The evidence is set out in this paper.

The paper:

- analyses the responses to the evidence gathering public consultation paper issued on 2 December 2004. Over 100 responses were received, including from listed companies representing over 56% of the total market capitalisation of UK listed companies on the London Stock Exchange's Main Market, from institutional investors that are between them responsible for funds under management in excess of £2,350 billion, from many representative bodies and most of the major accountancy firms;
- presents the main findings from telephone surveys of company directors and investors; and
- summarises other information.

The Turnbull Review Group would like to thank all those who provided evidence.

This evidence paper should be read in conjunction with the public consultation paper issued on 16 June 2005.

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1. Experience of implementing the Turnbull guidance

1.1 Summary of evidence

There is evidence that the Turnbull guidance and the requirement in the Combined Code for companies to disclose certain information in their annual report and accounts has contributed to greater awareness and improved management of risk among listed companies in the UK. 73% of company directors surveyed by MORI said that the guidance has helped to improve the quality of risk management and internal control in their company, while 70% of the investors surveyed thought that companies' understanding of risk has improved.

These findings are strongly supported by anecdotal evidence from responses to the consultation exercise. The guidance is widely considered to have been a success. In its response, the Institute of Chartered Secretaries and Administrators said that the guidance was *“largely considered [to be] the most effective piece of corporate governance guidance to have appeared in the UK over the last 10 years or so.”*

The vast majority of responses, from investors as well as companies, took the view that no significant change was needed, in part reflecting concerns over the burden a more prescriptive framework would impose and in part acknowledging the achievement of the current guidance. It is believed that this success is largely attributable to the breadth and principles-based approach of the guidance. By covering all controls and linking internal control to risk management, it has allowed boards to focus on the most significant risks facing them. By setting out high-level principles rather than detailed processes, it has enabled them to apply the guidance in a way that fitted their own circumstances.

The Review Group is aware that the guidance has been adopted and adapted by other organisations in the UK that are not subject to the Code, which supports the view that it has proved to be sound business practice.

It was the strong view of respondents that the guidance had succeeded in its original objective that each company should be able to apply it in a manner which takes account of its particular circumstances, and that by doing so it had also succeeded in remaining relevant over time. This view is supported by the company directors surveyed by MORI, 89% of whom felt that the guidance could be adapted very or fairly well to suit a company's particular circumstances. However, some respondents felt that in some companies the initial impetus provided by the Turnbull guidance had not been maintained, and were concerned that those companies may not be paying sufficient attention to the impact of changes in their circumstances.

Views differ on the extent to which the guidance has succeeded in its third objective of embedding internal control in normal business processes, although the majority view was that it had done so. Nearly three-quarters of the company directors surveyed by MORI said that risk management and internal control had become largely or fully integrated in the standard operating practice for normal business activity at their company. Anecdotal evidence from the consultation exercise and other discussions suggests that the extent to which internal control has become embedded may in part depend on the approach taken by the board. It was felt that those companies that viewed internal control as sound business practice were more

likely to have embedded it into their normal business processes, and more likely to feel that they had benefited as a result, than those that viewed it primarily as a compliance exercise.

It appears that company size may be a factor in the way the guidance has been implemented. While 65% of directors at companies with a market capitalisation of under £100 million said that risk management and internal control had been largely or fully integrated in normal business activity, this rose to 87% at companies with a market capitalisation of over £500 million. Similarly, while the majority of company directors surveyed by MORI felt that the benefits of implementing the Turnbull guidance had exceeded or equalled the costs, directors at small companies were more likely than those at large companies to feel that the costs had exceeded the benefits.

1.2 Consultation Paper: Question 1

Has the Turnbull guidance succeeded in its objectives?

The objectives of the Turnbull guidance were to:

- **reflect sound business practice whereby internal control is embedded in the business processes by which a company pursues its objectives;**
- **remain relevant over time in the continually evolving business environment; and**
- **enable each company to apply it in a manner which takes account of its particular circumstances.**

Comments from investors and their representative bodies

A majority of investors commented on this question stating that the guidance (to companies) had either wholly or partly succeeded in its objectives. Standard Life Investments said that “*We believe the Turnbull Guidance has succeeded in its objectives. The guidance itself has maintained its relevance to ‘the continually evolving business environment’. Furthermore, in our experience, companies generally see the implementation of the guidance as part and parcel of good business management as opposed to a separate exercise undertaken to meet regulatory requirements.*”

Morley Fund Management considered the guidance to be “*an important element of the UK’s corporate governance framework, one that is both largely effective and proportionate. The guidance correctly places responsibility on the board of a listed company to ensure that the company has a sound system of internal control, including a thorough and regular evaluation of the nature and extent of the risks facing the company. It also recognises that the purpose of controls is to help manage these risks rather than to eliminate them altogether.*”

UBS Global Asset Management considered that “*investors in UK companies benefit from the fact that the guidance is in place and that it leads companies to regularly review their internal control systems.*”

The major area identified by some investor respondents was disclosure. The Association of British Insurers (ABI) and some others commented that the guidance has been less successful in promoting meaningful disclosure.

Comments from companies and their representative bodies

Almost all respondents to this question thought that the guidance had, overall, been successful. For example Dixons Group plc commented “*Companies vary in their sophistication, size, managerial approach, stage of development and in other ways and the existence of the Turnbull guidance and its regulatory underpin through the Combined Code ensures that all companies pay regard to the important issue of internal control regardless of circumstances.*” Vodafone Group Services Ltd (Vodafone) stated that “*The Turnbull guidance was and remains a sound explanation of the risk based control principles that should be applied in a business environment. As such it achieves its objectives.*”

Respondents commented that the guidance:

- takes a common sense, principles-based approach without undue prescription that fits well with other parts of the UK corporate governance framework;
- focuses boards and others on issues of significance by linking risk and control;
- correctly covers the wider aspects of control rather than internal control over financial reporting;
- is concisely written as guidance for directors. Those wanting more detail could look to larger frameworks;
- has been adapted by other bodies in the public, private and not-for-profit sectors in the UK;
- is sufficiently flexible that it can be implemented by companies according to their circumstances and in response to changes in their business model and environment. This flexibility is seen as a key strength of the guidance by some commentators; and
- recognises that listed companies exist essentially to engage in risk-taking activities and that their internal control systems must therefore focus on identification and management of risk rather than risk elimination. One commentator noted that risk is often the source of competitive advantage.

There was overwhelming agreement that the guidance had positively focused the attention of boards on risk management and internal control. Respondents commented that:

- there is now a more thorough and better quality discussion and evaluation of risk at board level;
- Turnbull provided the framework within which internal controls can be applied in a more consistent and visible manner; and
- many elements of risk are debated at board level but the discipline involved in looking at risk holistically helps the board and management focus their time on what is important.

One respondent, going into some detail on how the guidance had affected their group, noted that the guidance was instrumental in:

- formalising risk management practices, resulting in a consistent, structured and co-ordinated approach and common risk terminology;
- developing greater acceptance amongst managers and other employees to integrate risk and control practices into their day-to-day responsibilities, which resulted in

greater insight into the impact that significant risks may have on the achievement of objectives; and

- developing managers' ability to identify risk issues and mitigation strategies based on a thorough understanding of business objectives and risk tolerance levels.

Some respondents thought that these improvements were not due solely to the Turnbull guidance as other factors may have been relevant such as increasing good practice in this area, changes in requirements in some regulated industries, and concerns at board level following recent high-profile financial scandals.

Respondents from the financial services sector noted that due to the highly regulated nature of the sector such organisations have for some time been required to operate an effective internal control framework. As a result the impact of the Turnbull guidance may have been less on this sector when compared to others. That said, Alliance & Leicester plc noted that *“implementation of the Turnbull guidance has provided the framework within which internal controls can be applied in a more consistent and visible manner.”*

A few respondents noted that implementation of the Turnbull guidance is evolving. One respondent stated *“This journey still continues and every year we improve our analysis and now have extensive debate about risk, potential impact and connectivity between risks (few of the major risks sit in isolation of others and we find ourselves constantly adjusting definition and accountability). It has also generated a more open debate about risk.”*

From the perspective of companies outside the FTSE 100, most of the individual respondent companies believed that the guidance had succeeded in its objectives. For example, Stagecoach Group plc, a member of the FTSE 250, said that *“We believe that the Turnbull guidance has succeeded in its objectives. Our experience is that boards of directors and audit committees consider business risks and internal controls in a more structured way and look to receive structured assurance that internal controls are properly designed to mitigate risk and that those controls are operating effectively.”*

The Quoted Companies Alliance, which represents the interests of smaller quoted companies, whilst believing that that the objectives of the guidance have been achieved, went on to note that *“It is, however, difficult to be certain, given annual review for regulatory purposes, whether or not full incorporation of the intended approach within normal management and governance processes has become part of the culture of a company or a protective measure because the next review is close at hand.”*

Comments from others

Respondents in this category generally thought that the guidance, when seen as guidance to directors rather than risk and control specialists, had been successful. In its response, the Institute of Chartered Secretaries and Administrators said that the guidance is largely considered as *“the most effective piece of corporate governance guidance to have appeared in the UK over the last 10 years or so.”*

Whilst noting some matters for the attention of the Review Group, KPMG said *“we believe that the Turnbull Guidance has been one of the most successful additions to the UK corporate governance framework and has succeeded in meeting its stated objectives of remaining relevant over time; reflecting sound business practice; and being adaptable to the specific circumstances of companies.”* They went on to say that *“it is important to recognise that the Guidance is only part of a broader regulatory framework governing internal control and that its clear focus is on providing appropriate guidance to directors of UK listed companies (including non-executive directors) on the internal control aspects of the Combined Code and what is expected of them. In this context, we believe the Turnbull Guidance is rightly both concise and highly principled.”*

The accounting firms made some comments on areas for improvement, particularly relating to the need for all boards continually to review their risk assessments. The continuing success of the guidance is seen as being dependent on boards' willingness to revisit and re-energise their commitment to it.

Ernst & Young, whilst of the view that *“Turnbull was effective in challenging the thinking of boards and consequently improved the quality of risk management”*, noted that *“we are nevertheless conscious that not all boards are continually re-challenging their risk profiles and assessments and there is a danger that familiarity with the reports produced for the board may reduce the effectiveness of the board's review. Accordingly, we think it is important that the Review Group finds a way to reinvigorate the application of the Turnbull framework in practice and try to embed the requirement that the board constantly re-challenges the company's risk profile and the effectiveness of its controls.”*

In addition to referring to the need to refresh a board's approach to risk management and internal control, other commentators noted that:

- although many companies had embedded internal control in the company's business processes, sometimes this was more for compliance purposes and not as part of everyday decision making. Some respondents suggested that some companies viewed the guidance more as an exercise to meet regulatory requirements;
- the extent to which the guidance has become embedded in some companies varies. It was noted that, in particular, smaller companies may have more problems as they have fewer resources;
- the identification and assessment of key operating controls was not being done effectively enough; and
- disclosures were becoming boilerplate or standardised.

The Tax Justice Network gave its opinion on whether the guidance had succeeded in its objectives and stated that *“with regard to the issues with which we are concerned, no, it has not.”*

Concluding comment

The CBI wrote “Many originally sceptical CBI members have come to realise that the guidance is very useful. The main reason for this is the fact that the guidance does not lay down lots of detailed, prescriptive rules, but has set high level principles which are worth rereading and which have positively changed attitudes and the way in which businesses are run. The fact that the guidance is relatively short and clearly written means that it is accessible to members of the board, auditors and employees. It is useful that the objectives clearly set out at the start the purpose of the guidance as being to establish a sound system of internal control, which should be treated as part of the normal management and governance processes, rather than as a separate regulatory exercise. The guidance has changed the culture within companies but without major additional costs for companies in complying with the guidance.”

1.3 Consultation Paper: Question 2

Are companies behaving differently as a result of the guidance? In particular, has the guidance had an impact on:

- **The understanding of risks and controls (a) at board level; and (b) more widely within companies and groups?**
- **The way boards have approached business risk and strategy?**
- **The risk appetite of the board?**
- **Improving the quality of risk management and internal control within companies?**

Comments from investors and their representative bodies

Investors who responded to this question noted that their answers were based on their discussions with companies, individual directors and advisers.

Barclays Global Investors commented that “companies we have questioned on risk confirm that risk is discussed at board level and the requirement for statements from the auditors gives us some comfort that those companies where practice and systems were previously inadequate have adopted better standards.”

The ABI stated “While it is difficult to generalise, we believe there is greater understanding of risk and control within companies and a corresponding increase in the quality of risk management. We believe that the guidance strikes a balance that, by and large, should not reduce the risk appetite of boards. Rather it is calibrated to help them to be more considered in the risks they take and thus more confident in their ability to take and implement strategic decisions.”

Other commentators generally agreed, noting in addition that:

- the guidance has provided a focal point and an effective catalyst for the greater awareness and understanding of the importance of risks and controls at board level, both by executive and non-executive directors, and within organisations;
- non-executive directors in particular are spending more time on discussion of internal controls although this could be partly due to US experience of the Sarbanes-Oxley Act or concerns about director liability;

- a key risk is that the guidance becomes ‘stale’ and that boards apply it in form rather than in substance. The Review Group was urged to consider ways in which it can encourage boards and executives to adopt a thoughtful and businesslike approach which is maintained over time.

In so far as risk appetite is concerned, investor respondents generally felt that they have seen no evidence that the guidance has inappropriately reduced the risk appetite of companies and their directors, although this is difficult for investors to pinpoint and evaluate. This view is not entirely consistent with the evidence from the MORI survey of investors (see section 1.5).

Comments from companies and their representative bodies

- **Has the guidance had an impact on the understanding of risks and controls (a) at board level; and (b) more widely within companies and groups?**

Many respondents who directly answered this question believed that companies and boards are generally behaving differently. For example, the CBI reported *“There have been positive changes in boards’ and companies’ understanding of and approach to business risks, strategy and controls.”* The Institute of Directors (IoD) reported that *“there is greater understanding of risks and controls at board level. It is certainly the case that these issues are frequently referred to by our members and attract great interest whenever dealt with at seminars and courses.”*

Some companies referred to the guidance as a catalyst for change. However, the extent of the change and the initial impact of the guidance appear to have varied depending on the circumstances of individual companies at the time when the guidance was introduced in 1999.

A number of respondents, particularly those in regulated sectors, believed that they were already undertaking most of the requirements of the Turnbull guidance, but that it forced them to establish a process to formalise their already existing behaviours. Tomkins plc commented, *“Whether the guidance has resulted in companies behaving differently depends upon the starting point of each company. It is clear that the guidance has forced each board to focus on the importance of understanding controls in the context of a risk-based framework. Tomkins has a strong internal control framework in place based on risk assessment. It has however given greater visibility to the control framework and ensured there is a formal review each year.”*

Anglo American plc said that the Turnbull guidance was instrumental in providing the board with additional information about selected significant risks, thereby enabling a deeper understanding of some risk issues, risk mitigation and assurance processes. They also noted that the guidance served to enhance the discussions between the independent directors and the executive directors on risk related matters. They further indicated that effective risk management is increasingly seen as a key performance area that should have a bearing on remuneration of senior managers in all disciplines.

As a large decentralised group, Daily Mail and General Trust plc stated that *“The Turnbull requirements have helped central management better to identify areas that*

might not have been focused on at divisional level and have focused operational management themselves on understanding risks, which previously might not have been analysed as robustly.”

Another respondent referred to acquisitions, noting that the Turnbull guidance has also helped ensure that newly acquired businesses have been brought into compliance faster than would otherwise have been the case.

Several respondents mentioned the impact on non-executive directors. One respondent said that the requirement for non-executive directors, particularly those on the audit committee, to scrutinise risk and control has led to greater understanding and focus and has shown the value to companies of knowledgeable, independent non-executives.

Referring to audit committees, the CBI wrote that the guidance *“is a useful tool for the non-executive directors as it has given them a framework within which to ask for details of the management’s risk analysis, with emphasis on the importance of openness of communication by management with the board.”*

Below board level, a respondent wrote that the understanding of risks and controls is achieved more widely across the company by each segment, function and region explicitly considering risks and responses as part of the preparation of annual and long-term plans; and defining and responding to risks to the delivery of plans within their performance management process.

- **Has the guidance had an impact on the way boards have approached business risk and strategy?**
- **Has the guidance had an impact on the risk appetite of the board?**

Respondents generally indicated that, while the guidance has not materially impacted the way boards approach business risk and strategy, it had raised the level of risk awareness and the improved recognition of the need to manage risk more formally than may have been seen in the past.

BP plc commented that *“Our board recognises that running a business successfully and operating quality risk management systems are synonymous. A thorough understanding of risk enables decisions to be taken with confidence as to the range of business outcomes; this in turn can lead to decisions to take more and sometimes less risk.”*

One respondent noted that the guidance emphasises that the board should concentrate on monitoring risk management rather than on the detail, such as risk registers. For them, this had resulted in more focused information on the company’s risk profile and the control framework being presented to the audit committee and to the board, which had enhanced their understanding of the overall business risks and control issues of significance facing the company. This high-level, top-down approach had set the agenda for the audit committee and the board, who in turn had given direction to management on the key risks and control issues to be considered.

The general view was that the Turnbull guidance has not significantly changed boards’ appetite for risk taking. However, some respondents indicated that with improved understanding of business risks through the provision of better information and monitoring from management, the guidance may have helped to clarify a board’s risk appetite.

- **Has the guidance had an impact on improving the quality of risk management and internal control within companies?**

As noted earlier, some respondents, particularly those in regulated sectors, believed that they were already undertaking most of the requirements of Turnbull, but that the guidance forced them to establish a process to formalise their already existing behaviours.

Diageo plc noted that *“Companies have certainly behaved differently, devoting more time and rigour to understanding and managing significant risks and developing and monitoring control processes to support this. In Diageo’s case these procedures were largely already in place but the guidance has served to sustain these procedures. Over the last 6-7 years understanding and improving the quality of risk management and control has been embedded as an integral part of the way our business is managed.”*

There seemed to be a general belief that the guidance has contributed to a greater awareness of risk and, therefore, to the improved selection and design of approaches to managing risk, including internal control. However some respondents expressed different views about the internal control part of this question:

- One respondent said that the guidance had not had an impact on improving the quality of internal control within companies, because *“we already had formal processes in place which were underpinned by our business culture. Moreover, we reviewed and re-enforced them following the reforms introduced by the Cadbury report.”*
- Another respondent commented *“at the moment it is clear that the quality of risk management has changed and is still evolving not least because management are required to set time aside to articulate their risks and actions on a more formal basis. It is debateable as to whether the guidance has had a similar impact on the quality of internal control as yet.”*

Finally, some respondents commented on internal audit and risk management departments, indicating that a natural consequence of the guidance had been an increased role for the internal audit and risk management functions. The CBI commented that *“following Turnbull, and general spread of good practice, more and more companies have established internal audit functions. The profile of the internal audit function within organisations has greatly increased, which makes them more effective.”*

Comments from others

Other respondents included individuals from firms and representative organisations covering non-executive directors, company secretaries, accountants, internal auditors, risk managers, and consultants. Whilst there was general support for the Turnbull guidance from company secretaries and accountants, there was some disagreement from others.

The London Stock Exchange noted *“Views we have received from listed companies tend to be supportive of the guidance, which has encouraged them to focus on the risks facing their businesses and the controls to be implemented to manage these risks. Where improvement by companies on management and reporting of internal controls is necessary, we believe that the existing guidance provides the framework to do this.”*

Accounting firms and related professional bodies

These respondents were generally supportive. Deloitte commented *“We think that many listed companies are behaving differently as a result of this guidance. In particular, processes for identifying risks and appropriate controls have become more systematic and formalised. Boards have attached more weight to business risk when taking decisions and the quality of risk management and internal control has generally improved.”*

PricewaterhouseCoopers (PwC) noted that *“there was, and still is, a very wide diversity of practice in implementation of the guidance and in the extent to which the board is truly engaged. This is a function of principles-based guidance, because it allows for flexibility of approach, which we would not wish to see disappear. However, there is a case for sharing the experience of five years, and raising the bar overall, so that companies that have not implemented the recommendations quite as rigorously as others, have the opportunity and the motivation to do so.”*

With respect to staff within organisations, the Institute of Chartered Accountants in England & Wales (ICAEW) noted that concerns have been raised over how successfully Turnbull can be embedded. It believed that *“the real success of Turnbull has been that embedding can occur naturally. In continuing to perform their roles as before, staff within an organisation – consciously or otherwise – are part of management’s system of internal control, which is now reviewed by the board and evaluated against the risks faced by the company.”*

On risk appetite, KPMG was not aware that the guidance had had any detrimental effect on the risk appetite of boards, *“Indeed, some companies that were previously risk averse may be more willing to take on additional risk having better understood its nature and the ability to manage it within acceptable limits. Notwithstanding the above, we believe a more prescriptive regime may well make boards more risk averse.”*

Other accounting firm respondents were also generally supportive. BDO Stoy Hayward commented that *“there has been a general increase in awareness of risk and its management since 1999 which has often led to a change in company behaviour. This has especially been the case where companies did not seriously address risk issues prior to the implementation of Turnbull guidance.”* However, they found it difficult to say whether this is a direct result of the guidance or whether it is a reaction to shareholders’ demands in the light of the relatively recent accounting scandals.

Mazars expressed some caution. They lauded the guidance for putting the issue of risk management and internal control on boards’ agendas and noted that if a board then decides not to apply the guidance, at least it is a conscious decision by it to not do so. However, they also commented that *“companies haven’t wholly taken on board the guidance and that more could be done by them. Often there is not a top-down approach within companies, meaning that too little importance is attached to the internal control process at board level with consequent detrimental effects to the process.”*

RSM Robson Rhodes commented that the attention paid to risk management had probably decreased in some boardrooms in the years since the initial implementation of the Turnbull guidance, in the sense that they believed that some will have seen it as mainly an issue of updating the previous year’s approach to risk management rather than assessing whether a more fundamental review was required.

Internal auditors, risk managers and others

In answer to the question whether the guidance has had an impact on the way boards approach business risk and strategy, the Institute of Chartered Secretaries and Administrators stated that the guidance *“has given boards increased confidence to be re-assured that the risks endemic to their business are being properly and systematically evaluated and managed. As a result boards should feel more comfortable that they are taking on only manageable risk or consciously taking on higher risk projects and be able to recognise and avoid unacceptable risks that they might otherwise have incurred unknowingly.”*

However, some commentators in the internal audit, risk management and consultant community were less supportive.

The Institute of Internal Auditors (IIA) was concerned that *“boards have not demonstrated a full understanding of the responses to the risks, nor of the assurances that they need to satisfy themselves that risks are not only being identified but are being addressed every day.”*

Independent Audit Limited considered that whilst Turnbull *“has encouraged the use of risk registers and risk maps, it is our impression that, in many cases, boards are still not paying sufficient attention to the way risk is managed across the business.”*

The Institute of Risk Management (IRM)/AIRMIC joint response noted that in some companies *“momentum on risk reporting and control had lost the initial impetus that was evident when the Combined Code and the Turnbull Guidance was new, and that many companies have reached a ‘comfort zone’ of reviewing the same ‘Top 10’ risks without questioning whether these remained so, or whether they had been accurately aligned with the key business objectives.”*

On the topic of risk appetite, the IIA commented that most boards now know the term ‘risk appetite’ but they were not convinced that boards have formally articulated what it is or linked it to their risks, to levels of authority and its delegation or to the assurances they need. The IIA recommended that ‘risk appetite’ and ‘risk tolerance’ should be defined in the guidance and an explanation given for how these should be used. The IIA thought that it might also be appropriate to require organisations to disclose their risk appetite and tolerance, perhaps in the OFR, where risks are discussed in greater detail.

One respondent criticised the Turnbull guidance because, in their view, it only considers the system of internal control as a means of managing risk. No mention is made of the other possible responses: tolerate, take, transfer and terminate. By contrast, another individual respondent commented *“I think companies, both at Board level and operational level, are behaving differently as regards risks, but I do not believe that they are behaving significantly differently as regards controls. I don’t think Turnbull has added to the Board’s understanding of high level risk, nor that it has materially changed the risk appetite of Boards. It has improved the quality of operational risk management, but paradoxically I don’t believe it has made a massive difference to internal controls.”*

1.4 Consultation Paper: Question 3

What difficulties, if any, have organisations had in implementing the Turnbull guidance?

Comments from investors and their representative bodies

Not being involved in the day-to-day detail of running a company, many investors felt they were not in a position to answer this particular question.

Of those who did respond, one said that they had not been made aware of any difficulties by companies. Other respondents commented that the most apparent problem in the implementation of the guidance is companies' reticence in making more than the minimum disclosures. Their experience suggested to them that although paragraphs 36 and 38 to 41 of the existing guidance set out clearly what is expected, not all companies were doing so, and suggested the Review Group consider how the message can be reinforced.

Other issues mentioned were:

- a key challenge is to ensure that boards are reminded that this is an on-going process and not merely a one-off exercise and that they should have adequate resource allocated for the purpose;
- the extent to which internal controls are seen as an ongoing board issue as opposed to a set of policies and procedures that are left to employees and only subject to an annual review of their effectiveness; and
- suggestions that there have been inconsistencies in the effectiveness of implementation in relation to subsidiary companies, particularly overseas subsidiaries.

Comments from companies and their representative bodies

Many companies provided information on some of the difficulties they had experienced in implementing the Turnbull guidance.

The information suggests that, perhaps unsurprisingly, implementation has been more difficult for some than others and, in part, depended on the circumstances of a company at the time of the introduction of the guidance in 1999.

Commentators generally fell into three categories:

- those companies for whom the guidance mostly reflected existing regulatory obligations and/or good practice, who believed that they already possessed a sound system of internal control embedded in the business and for whom implementation of the guidance was not particularly difficult;
- companies whose main difficulties arose during the early stages of implementation where the guidance has not created significant lasting difficulties;
- companies that were experiencing ongoing difficulties, perhaps linked to a desire for continuous improvement.

Comments on the difficulties experienced may also be categorised into a number of headings including:

- initial and early stages of implementation;
- people issues;
- embedding, resources, reporting and associated issues;
- on-going continuous development; and
- other matters.

Initial and early stages of implementation

One respondent commented that when the guidance was first introduced, there was some concern that companies had to establish bureaucratic and expensive systems and that some consultants had over-complicated the requirements to create a demand for their services.

Other comments covered:

- the initial time and cost of implementing people or process changes;
- the move to operational risk assurance, which (for some) was a relatively new concept;
- the formal implementation and documentation of the risk management process that previously existed in a more informal format;
- the level of detail required to provide the necessary evidence that a review of effectiveness had been properly undertaken;
- introducing more formal review processes at board level;
- establishing a risk committee;
- insufficient explanation of the benefits of more formalised risk management as a key element of how a company delivers returns to its stakeholders; and
- a lack of common definitions (e.g. risk appetite), recognised tools and techniques and best practices to assist companies.

People issues

Requiring the commitment of resources for documentation, monitoring and reporting, difficulties have included persuading – at least at the outset – senior executive management and then business unit managers of the value of the implementation of the guidance as opposed to it being another purely compliance-based exercise.

One respondent noted that in implementing the guidance, it had been a challenge to ensure that all levels of management across their group not only understood the importance of risk management and control frameworks but also appreciated the need for them to be periodically reviewed, amended and validated so that adherence to good practice can be demonstrated on a continuing basis rather than just once or twice a year.

Other issues mentioned included:

- the lack of familiarity of some business leaders with formalised risk management techniques, among both non-executive and executive directors; and
- problems created by changes in leadership at the CEO and senior executive levels.

Embedding, resources, reporting and associated issues

ITV plc commented that *“the key difficulty has and continues to be the extent that risk assessment and internal control processes should be embedded throughout an organisation. Whilst bi-annual/annual risk assessments have become a recognised and effective element of the overall governance process, the challenge remains the identification of the appropriate level that processes should be further embedded throughout an organisation.”*

Other comments covered:

- the availability of time, largely in the identification of risks. A respondent said that although the guidance rightly focuses on significant risk, all risks have to be identified before they can be assessed;
- the need to ensure the Turnbull guidance was fully implemented by all business units. A respondent noted that this was particularly challenging for smaller business units with limited resource, who tend to view formal risk management processes as bureaucratic and a distraction from running the business;
- the impact of resource constraints and competitive pressures in making it difficult to embed risk management fully into day-to-day procedures;
- providing a proper level of procedure for evaluating and reporting risk whilst ensuring that such systems are not overly bureaucratic and that it is undertaken in a way that is meaningful for the individual business units providing both a useful management tool for those involved operationally as well as providing assurance to the board; and
- the establishment of a periodic reporting mechanism by executive management, which, as they interpreted the guidance, at least one respondent required some form of sign-off by management as frequently as monthly or quarterly.

On the general issue of resources aligned with size of company, a respondent noted that in many ways it is medium-sized listed companies that have particular challenges in implementing corporate governance guidance. They commented that very large (typically FTSE 100) companies often have very substantial budgets and pools of resource to be dedicated to rolling out changes in risk management processes, whilst at the other end of the scale small companies with one or few operating entities may be able to control risk management centrally. Medium-sized companies with many business units but without the budgets and resource of the largest companies may need more time to ensure every unit properly adopts the guidance.

Ongoing continuous development issues

A number of respondents noted that implementing the guidance is not an overnight exercise, particularly in complex international groups. Cultural issues need to be addressed as well as technical problems.

One respondent noted that the challenge of implementing the guidance had been that of continuously developing internal control systems, and in particular of building a meaningful and effective risk management system. They noted *“This entails having a system which clearly categorises and defines different risks, is flexible enough to respond to evolving risks, can reflect the linkages and interdependencies between many risk areas, measures likelihood and impact of risk events and supports meaningful risk appetite statements. The system needs to link with internal audit and other relevant control systems, and be capable of being embedded within day to day business activities including operational line management, strategy setting, capital management etc.”*

Other commentators noted that:

- it is challenging to establish one, integrated reporting process within a company or group; and
- the danger of a bottom-up approach is evident and in some areas, a shift is needed away from form-filling towards developing and enhancing the control culture.

The CBI said *“When the guidance was first introduced, many companies felt they had to establish risk registers and other fairly bureaucratic systems in order to demonstrate to shareholders and regulators that they had appropriate controls and risk management policies in place. There was a lot of activity from consultants and promoters of IT software. However, the focus now is on board decisions rather than IT systems and on common sense and real risks rather than lists. There were therefore initially some cost difficulties, but those costs are now less since the systems are now in place, although of course these need to be kept under regular review and updated.”*

It is worth noting the comment of one respondent who said that in their company that while there is still more to do, risk management processes are now more accepted and built in to business processes. It has taken time to embed and needs continual reinforcement.

Other matters

Other individual comments included:

- whereas the Turnbull guidance was clear on generic principles and objectives for risk management, it did not provide guidance on a framework for risk management. To overcome this omission, businesses in the UK generally developed their own methodologies with the assistance of consultants, sometimes at considerable cost; and
- one area of difficulty had been the demarcation of the responsibilities for risk management between the board and the audit committee and the need to ensure that this has not resulted in the delegation by the board of the overall responsibility for risk management.

Comments from others

There were some differing views on difficulties and these, in part, depend on the type of respondent.

General comments

Commentators reported that the process of proving compliance with Turnbull has resulted in operational management taking more responsibility for risk as well as a greater focus on risk and its management including when reviewing strategy as well as the risks to achieving the company's objectives.

Many of the points raised in the comments from companies were repeated by respondents in this category. These points covered:

- the availability and quantity of financial and staffing resources and their potential link to the size and complexity of organisations;
- the initial bottom-up approach of some organisations centred around the creation of risk registers;
- the confusion and problems that can be created in highly decentralised groups when the bottom-up approach used at operating unit level tries to interact with the top down approach used by the board with its group focus and materiality level;
- the attitude of the company and the degree to which internal control has been embedded being strongly influenced by the attitude and support of the board, particularly at the Chairman, Audit Committee Chairman and CEO levels;
- deciding the lengths, particularly for smaller companies, to which they needed to go in order to fulfil the expectations of the Turnbull guidance; and
- cost/benefit issues.

It appears that these issues may well impact on the approach taken to implementation with some companies opting for minimum compliance and others fully embracing the recommendations.

The accounting firms

The accounting firms generally thought that following the initial implementation phase, many companies have not had that much difficulty in continuing to implement the guidance although this did partially depend on size, complexity and resources. However it was felt that in some cases the guidance was taken on board with rigour in its early years but there has been less energy devoted to updating the risk and related controls assessment and, therefore, to keeping the process fresh. This latter point was also noted by Ernst & Young who thought that "*many companies 'roll-over' their Turnbull process each year.*"

Mazars noted "*many companies have adopted too much of a checklist approach to compliance with the guidance, one of the difficulties that companies have is that there is too little detailed guidance to help them bridge the gap between the broad principles of the guidance and implementing a risk based internal control system in practice.*"

Finally, comparing the Turnbull guidance and the Sarbanes-Oxley Act, PwC commented *“In determining whether the nature and style of the Turnbull guidance resulted in implementation difficulties, there are cost/benefit considerations that should not be forgotten, and one can draw a stark contrast with Sarbanes-Oxley S404 in terms of the practical difficulties.”*

Internal auditors and risk managers

These respondents, being technical specialists, rather than the directors at whom the Turnbull guidance is pitched, provided a substantial volume of commentary.

The Institute of Internal Auditors noted a number of the difficulties referred to elsewhere. Their additional comments included that:

- there is a need for education and practical training of business managers in the areas of risk management;
- organisations were more likely to achieve benefits from implementing Turnbull if they were doing it on a voluntary basis as a business project than if they were undertaking the implementation as a compliance exercise;
- the flexibility of the guidance, while being mostly a strength, did carry with it a risk that it allows organisations to pay lip-service to the principles and to avoid any detailed review of risks and consideration of the responses to them; and
- organisations often face difficulties in updating their risk registers. The initial establishment of these requires considerable effort and it is often the case that the need for regular updating is not programmed into the processes or that it is the victim of ‘risk-management fatigue’.

The Institute of Risk Management referred to a number of matters including:

- “1. *the lack of adequately experienced and skilled non-executive directors;*
2. *inadequate involvement by some non-executive directors to enable them to fulfil the obligations that their office now clearly carries;*
3. *the lack of understanding of risk management beyond that recognised by financial auditors (how many boards have a director of risk management, whilst all Boards have a financial director?)”*

Disclosure

Since 2002, Grant Thornton has undertaken a survey of corporate governance disclosures in the financial statements of a large number of companies in the FTSE 350. They commented *“Most difficulties arise not with developing the system of internal control but with deciding what to tell shareholders about internal controls and risk management. Many companies outside the FTSE 100 worry that they might be giving away competitive advantage, or showing themselves in a less than positive light. Even disclosures by many larger companies are bland and add little to the understanding of what the board does and why the board does it. Disclosures might improve with the development of the OFR, and also with discussion between management and the auditor once the risk and fraud ISAs [International Standards on Auditing] come into force.”*

1.5 Other information

The following headline results from the MORI surveys are drawn from the questions in the surveys that relate to the Turnbull guidance and to its implementation.

MORI survey of directors

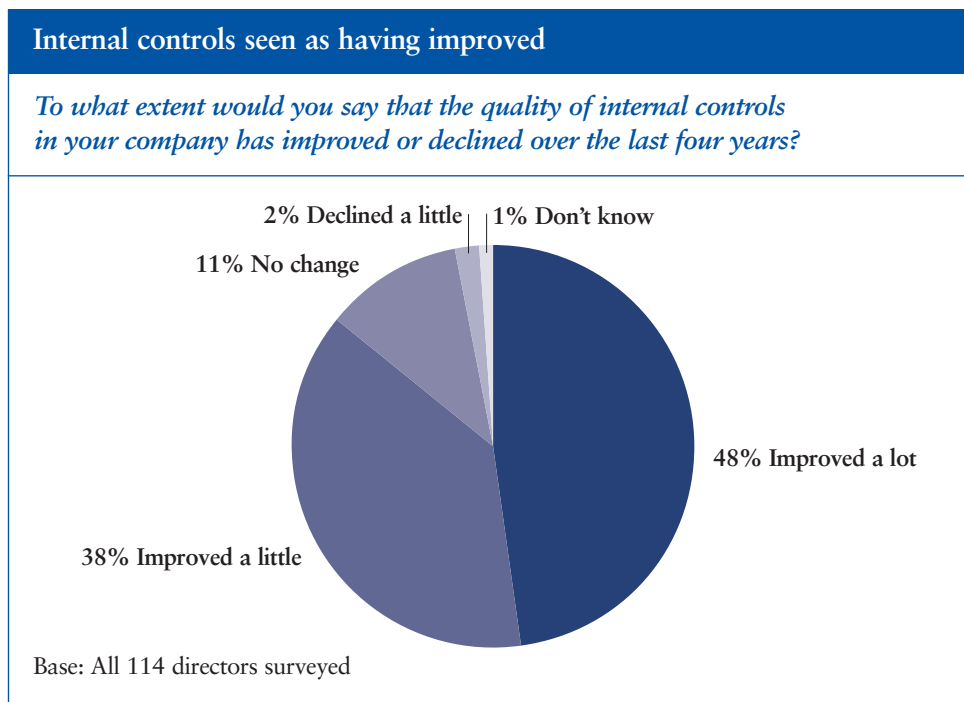
Impact of the Turnbull guidance

93% said that they were familiar with the Turnbull guidance.

89% said that in their experience, the guidance can be adapted to suit a company's particular circumstances.

79% said that the Turnbull guidance had helped their company to comply with the internal control requirements of the Combined Code on corporate governance.

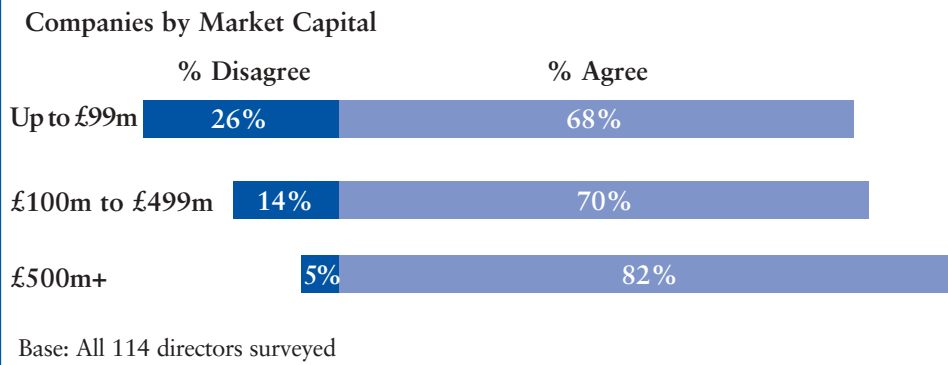
86% said that the quality of internal controls in their company had improved over the last four years.



73% said that the Turnbull guidance had helped to improve the quality of risk management and internal control within their company. The greatest improvement rating was noted by directors in companies whose market capitalisation exceeded £500m.

Most think Turnbull has made a positive contribution

*To what extent do you agree or disagree with the following statement?
Overall the Turnbull guidance has helped to improve risk management
and internal control within [company name].*



Understanding and management of risk

97% felt they were confident that their company's risk management systems are able to deal with the significant risks facing their business.

On a scale of 1 to 5 where 5 = understands extremely well, and 1 = understands not at all well; when interviewees were asked 'how well, if at all, did they feel the following groups within their company understood the risks to which their business is exposed' the 'mean' results were:

- 4.6 for the board;
- 4.2 for the senior management team below board level; and
- 2.8 for all other employees below senior management.

To follow on, asked whether this understanding had improved, stayed the same or declined over the last 4 years, the views of directors were:

- the board – improved 88% (54% – improved a lot) with none saying that it had declined;
- the senior management team below board level – improved 79% (44% – improved a lot). Less than 1% said that it had declined a little;
- all other employees below senior management – improved 66%, declined 1%.

On a scale of 1 to 5 where 5 is 'completely integrated in normal business activity' and 1 is 'not at all part of normal business activity', when asked the extent to which risk management and internal control has become part of standard operating practice for normal business activity at their company, the 'mean' result was 3.96. The percentage, by market capitalisation, of interviewees who gave a 4 or 5 rating was:

- £500m+ 87%
- £100m to £499m 68%
- Up to £100m 65%

Only 11% of boards included the review of 'risk and control' matters as a specific item on the agenda of board meetings as an annual item. 57% did so at every or most board meetings with the balance being twice a year.

Asked how frequently were reviews of internal controls undertaken by senior management and their support teams, the results were 41% continuously, 21% monthly or 3 or 4 times a year, 17% twice a year, and 19% annually.

Costs and benefits

Overall, 77% of the directors who felt they were able to respond said that the benefits of implementing the Turnbull guidance exceeded (37%) or equalled (40%) the costs. These figures varied between size of company.

Size of company (by market cap)	Benefits exceed costs	Cost/benefit neutral	Costs exceed benefits
Up to £99m	21%	50%	29%
£100m to £499m	32%	36%	32%
£500m+	48%	36%	16%

MORI survey of investors

Implementation of the guidance

88% felt that in general the boards of companies that they followed or invest in understood the risks to which their business is exposed.

70% of investors felt that this understanding had improved over the last four years, 24% felt it had stayed the same and 6% did not know.

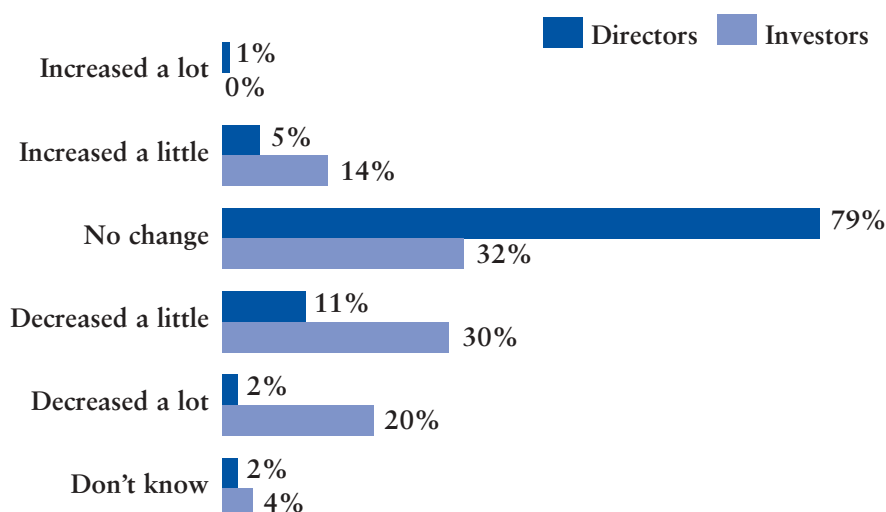
82% of interviewees were confident that the companies which they analysed/invest in would take action to deal with significant shortcomings in internal controls which the companies had identified. Only 2% disagreed.

Investors and directors were asked, in their respective surveys, whether they felt that boards have become more or less willing to take risks over the last four years. The results showed a difference of views:

Some difference in views of the board's appetite for risk

Directors: Have the changes made within (company name) to implement the Turnbull guidance increased or decreased the board's willingness to take risks, or have they made no difference?

Investors: Do you feel that boards have become more or less willing to take risks over the last few years?



Base: All 114 directors surveyed; all 50 investors surveyed

2. The scope and content of the guidance

2.1 Summary of evidence

There was overwhelming agreement among respondents to the consultation exercise that the guidance should continue to cover all internal controls, as this had encouraged companies to focus on their most significant risks. The CBI was of the view that *“the Turnbull approach represented a leap forward for many companies in focusing on the broader reasons why businesses fail rather than the purely financial ones. This key change has led to better risk management”*.

The breadth of coverage was seen as a major strength of the Turnbull guidance in comparison with other approaches that focused narrowly on financial reporting controls. One listed company noted in its response that *“emphasis only on financial control is a very narrow focus and does not take into account the overall custodial responsibility of the directors who have been entrusted with properly managing the risks to which the shareholders’ invested capital is exposed”*. Research by Deloitte into the causes of the 100 largest one-month declines in share price for the 1,000 largest international companies from 1994 to 2003 found that fraud or manipulation of accounting information featured in only a small number of those declines and that, for example, operational and external risks were more frequent causes¹.

There was also overwhelming support from respondents for the guidance remaining high-level and not becoming more prescriptive. It was felt that the comparative lack of prescription was an important factor in the success of the guidance, as it required boards to engage with issues of risk management and internal control. To quote another listed company, *“business is about balancing risks with potential returns, and the guidance must recognise the importance of sound management judgements in evaluating the risk-return trade-off. A more prescriptive approach could disadvantage shareholders by discouraging management from taking informed judgements”*.

This is consistent with comments from investors. The Investment Management Association (IMA) commented that the principles-based approach *“allows companies flexibility in applying the guidance and addressing their own circumstances and risks. A more prescriptive approach could engender a box-ticking, mechanistic approach to ensure compliance with the detail of the guidance rather than allowing companies to produce meaningful reports tailored to their own circumstances”*. The ABI stated that *“we strongly believe [the guidance’s] usefulness would be diminished by a prescriptive approach, which led further down the road of boilerplate disclosure and a focus by directors on compliance rather than substantive assessment and management of risk”*.

Companies that responded to the consultation exercise overwhelmingly supported retention of the principles-based approach as it enabled them to apply the guidance in a way that was compatible with their existing internal assurance frameworks, and for the internal control system to evolve over time as the risks faced by the company changed. This flexibility had also made it easier for the guidance to be adopted in different sectors and industries.

This support for a principles-based rather than rules-based approach in part reflects familiarity with, and confidence in, the UK’s overall approach to corporate

¹ ‘Disarming the Value Killers: A Risk Management Study’, Deloitte, 2005

governance. In a survey of UK and US investors carried out by the Institute of Chartered Accountants in England & Wales (ICAEW) in 2004², the principles versus rules approach was cited more frequently than any other reason by respondents who expressed more confidence in UK rather than US audited financial information.

Respondents to the consultation exercise made many suggestions for possible changes to the guidance. The majority of these fell into one of the following categories:

- definitions of terminology used in risk management and internal control, such as ‘risk appetite’ or ‘significant risk’;
- more detailed guidance on the respective roles of the board, management, audit and risk committees, risk managers and internal auditors;
- more detailed guidance on particular aspects of the internal control system;
- more detailed guidance on how to review the effectiveness of the internal control system;
- examples of best practice techniques that could be used to apply the guidance;
- references to types of risk not currently referred to in the guidance, and/or more detailed guidance on controls for managing specific types of risk;
- amendments to reflect or refer to other, more detailed risk management frameworks, such as the COSO Enterprise Risk Management framework or the Institute of Risk Management’s Risk Management Standard; and
- additions to the existing appendix, or new appendices.

2.2 Consultation Paper: Question 4

Should the guidance continue to retain a high-level and risk-based approach to internal control rather than move to a more prescriptive approach?

Comments from investors and their representative bodies

Investors favoured retention of the high-level and risk-based approach.

The IMA commented that the principle-based approach “*allows companies flexibility in applying the guidance and addressing their own circumstances and risks. A more prescriptive approach could engender a box-ticking, mechanistic approach to ensure compliance with the detail of the guidance rather than allowing companies to produce meaningful reports tailored to their own circumstances.*”

The ABI stated “*we strongly believe [the guidance’s] usefulness would be diminished by a prescriptive approach, which led further down the road of boilerplate disclosure and a focus by directors on compliance rather than substantive assessment and management of risk.*”

Other respondents made the following points:

- principles require compliance with their spirit whereas prescriptive rules may be complied with, without achieving their objective. A more prescriptive approach would not be helpful either to companies or their investors;

² ‘Investors’ confidence in audited information – Wave 2’, The Institute of Chartered Accountants in England & Wales, December 2004

- the guidance must retain flexibility and be applied sensibly by executives and independent directors to the specific circumstances of each company;
- a more prescriptive approach could be slower to respond to newly identified risks; and
- smaller companies in particular must not be distracted or made uncompetitive by a disproportionate compliance burden.

Comments from companies and their representative bodies

Corporate respondents also supported retention of the high-level and risk-based approach.

3i plc commented *“We support the retention of a high-level, risk-based approach. This provides flexibility to accommodate businesses of varying levels of complexity and scale. It also requires companies to think through and exercise judgement on the application of higher-level principles in the context of their own organisations circumstances and objectives. A more prescriptive approach would be more likely to lead to implementation difficulties and higher costs for some companies and, therefore, be less effective on balance.”*

Stagecoach plc noted that *“business is about balancing risks with potential returns, and the guidance must recognise the importance of sound management judgements in evaluating the risk-return trade-off. A more prescriptive approach could disadvantage shareholders by discouraging management from taking informed judgements.”*

Other respondents made the following points:

- the UK legal framework, the UK corporate governance framework (including the convention of ‘comply or explain’) and the Turnbull guidance all expect a high standard of diligence from boards. This places the onus on directors and senior management to establish how best to achieve sound risk management and control in the particular circumstances of the company, analysing genuine risks to the business and ensuring that controls effectively cover these areas;
- individual company circumstances vary and will involve different business models, corporate cultures and complexities, as well as uncertainties arising from a dynamic business environment both internally and externally;
- the flexibility inherent in the Turnbull approach must remain not only to accommodate these different business circumstances, but also to allow companies the flexibility to change their own approach as their business changes;
- companies in different industry sectors, with different stakeholder needs, at different stages in their strategic development may need to apply the guidance in different ways;
- a prescriptive approach could lead to a ‘tick-box’ mentality that does not engage the necessary thinking or professional experience and judgement about risk and control; and
- it is essential that the guidance continues to be high-level and risk-based rather than prescriptive as this allows companies to apply it in the way that best dovetails with other regimes that are prescriptive.

Some respondents noted that it would be impossible to develop sensible prescriptive guidance on all likely areas of internal controls within the diverse range of companies in the UK listed sector. Consequently, more prescriptive guidance would have to focus on more generic control areas, thus potentially also narrowing the scope.

Some respondents noted that a prescriptive approach would also:

- not prevent control failures as mistakes can still occur and controls may still be ignored;
- carry the risk of diverting the focus of attention and activity away from the board's responsibility to sponsor a genuine 'top-down' risk and controls assessment;
- potentially narrow the focus of managers and enhance the possibility of risk management becoming rigid and of little commercial value;
- more likely be seen by management as an administrative burden which could defeat the purpose of the guidance which is to improve risk management and internal control;
- require additional explanations and definitions to provide consistency and conformity;
- result in the process becoming the objective rather than the means to an end;
- be difficult to apply to all industries and would require more frequent review and updating; and
- be more expensive to operate, without there necessarily being any greater benefit.

A few respondents were concerned that the US approach might be replicated in the UK. One example of a number of such comments is, *"We believe that moving away from the flexibility of the current approach that is based on principles and 'comply or explain', towards, or even beyond, the prescriptive approach of the Sarbanes-Oxley Act would introduce a level of rigidity and costs that would far outweigh the benefits for investors and could introduce a number of adverse effects on companies including a greater regulatory burden, a dilution of the focus on achieving strategic objectives, increased litigation and difficulties in recruiting non-executive directors."*

Some respondents, whilst agreeing with the high-level and risk-based approach also, commented that:

- consideration should be given to enhancing the guidance by reference to best practice in the area of risk management and controls, particularly in the context of Sarbanes-Oxley and the possibility of additional EU regulation;
- the flexible approach of Turnbull makes sense in the UK as it follows the UK tradition of applying substance over form and allows the conscientious company to make sure that guidance is followed or not followed for appropriate, positive reasons. However, the key danger with this approach is that organisations may choose to apply with too light a touch;
- the guidance could beneficially adopt a more risk-based approach by amending its title to 'Risk management and control' and making modest amendments to adopt the consistent key principles from the risk management standards that have been published around the globe since Turnbull was published.

Tesco plc said *“Turnbull is complementary to normal business activity in its approach by allowing businesses to use their embedded processes with regular management review. The danger of a prescriptive approach is the spawning of a separate industry that tries to re-engineer businesses to focus upon a single objective of risk management and leaves out of risk management the very people best able to spot and manage risks in a complex organisation.”*

Comments from others

Responses from most accounting firms, professional and representative bodies, other organisations and individuals were strongly in favour of retaining the high-level and risk-based approach. For example, the Association of Corporate Treasurers said *“The original guidance was short and readily understandable. This apparently informal approach and style has with hindsight been very successful in making the guidance applicable to a variety of circumstances. Companies have been able to develop an internal control system appropriate to themselves, and which then stands a better chance of being applied well and continuously adapted to changing circumstances, internal and external.”*

Looking at the issue from the perspective of the UK stock market, the London Stock Exchange believed that the existing high-level, risk-based approach is more appropriate than a more prescriptive approach. It added *“Moving towards a more prescriptive approach would be most unwelcome to issuers, especially given the already increasing burden of regulation upon them. Since the US imposed the Sarbanes-Oxley Act, there have been many delistings, and a similar reaction could be predicted in the UK if it were to move in a similar direction. This would be of benefit neither to ‘UK plc’ as a whole, nor to the UK’s successful financial markets.”*

Other supporting comments included the following:

- the current guidance is robust, and provides a suitable framework to help businesses think about and improve their system of internal control;
- it is the characteristics of the risk-based business management approach to internal control and the high-level approach to the guidance that have enabled the guidance to become so widely accepted and used, which has added to its credibility;
- the original rationale for adopting a flexible approach i.e. a continually evolving business environment and differing circumstances faced by companies remains just as valid now as it was in 1999;
- over-prescription could discourage management from taking risks, yet it is through the controlled taking of risk that companies earn returns for their shareholders. Moving to a rules-based prescriptive approach would not lead to a striking of the appropriate balance between entrepreneurship and risk management and would be potentially harmful to business prosperity;
- a prescriptive approach cannot hope to foresee every possible outcome and will therefore leave loopholes which could be exploited. Turnbull’s strength is in its flexibility; and
- it would be almost impossible for the guidance to be effective if it was written in any other way as it would either be far too cumbersome (by attempting to capture all companies’ circumstances) or it would not adequately ‘fit’ any company.

Whilst agreeing with the retention of the high-level, risk-based approach, some respondents wanted to take the guidance further.

One individual respondent disagreed with the Turnbull guidance more comprehensively saying that *“I don’t think the high level risk approach is working particularly well. Strategic risk is getting muddled up with operation[al] risk, and risk evaluation I believe is crowding out management of key controls. Whilst I do not want a replica of the process heavy SOX 404 approach, I believe a financial controls based approach would be more relevant for corporate governance purposes.”*

Nevertheless, the balance of opinion was more in line with the views of Deloitte. *“A more prescriptive approach is likely to lead to a box-ticking approach, which is unlikely to serve investors well. Moreover, increased levels of prescription would mean that management spend more time on compliance and incur additional expense in this area, reducing the resources available to them to grow the business. We note that a high level, risk-based approach is consistent with the principles-based approach used in other areas of UK regulation.”*

2.3 Consultation Paper: Question 5

Should the guidance continue to cover all controls?

Comments from investors and their representative bodies

The investors who responded to this question agreed, many expressing strong agreement, that the guidance should continue to take the wider approach to internal control and not revert to the narrower approach of internal control over financial reporting. A number of respondents argued that it would be a retrograde step to revert to the narrower approach.

The IMA stated *“The IMA supports the Guidance covering all controls, including financial, operational and compliance controls and risk management systems. A company is subject to a variety of risks and must have an effective system that monitors and controls all of them to safeguard shareholders’ investments and its own assets. We do not believe that guidance that only covered controls over financial reporting, as required by Sarbanes-Oxley, would provide sufficient assurance.”*

Investors also made the following points:

- the current approach is consistent with the proposed scope of the operating and financial review (OFR);
- because understanding of risk changes over time and new risks periodically come to the fore, boards should show they are alert to the changing nature of risk and adapting their management processes accordingly;
- an effective, dynamic internal control culture must be well rounded and aligned with the company and risks that potentially affect its strategy and the execution of that strategy;
- controls over financial reporting should not dominate at the expense of others since operational and compliance risks are also material; and
- boards need also to consider that social, environmental and ethical risks may have a material impact.

Comments from companies and their representative bodies

Corporate respondents and their representative bodies were also in agreement that the wide approach of the current guidance, issued in 1999, should be retained. As the IoD noted, *“There is very much more to the risks facing an organisation than financial controls and financial reporting. The breadth of coverage has had a beneficial effect in many areas such as health and safety where, although the ultimate risk to the organisation may be reduced to financial terms, the ability to point to wider best practice and the guidelines can ensure that risk evaluation and assessment is considered at an appropriate stage and level.”*

Anglo American plc said that *“The going concern objective and the competitiveness of UK businesses require effective risk management of all significant risks – irrespective of their nature. Investors may be hurt as a consequence of the materialisation of a variety of internal and external risks, not just fraudulent financial reporting. Limiting the scope of risk management processes to (say) financial reporting would fundamentally undermine the overall effectiveness of the board’s risk management processes – it would be a regression compared to the progress made by UK companies since 1999.”*

Recognising that the wider approach is linked to overall responsibilities of directors for running the business and the proposition that boards should have an all-encompassing view of the internal control framework, Tomkins plc stated *“Business is about risk-taking but a framework of control has to be in place to ensure the risks are evaluated and managed. A framework based on purely financial controls implies that the level of strategic or business risk taken by an enterprise does not matter providing the financial controls are in place to capture the financial consequences. Emphasis only on financial control is a very narrow focus and does not take into account the overall custodial responsibility of the directors who have been entrusted with properly managing the risks to which the shareholders’ invested capital is exposed.”*

The link with the new OFR (which underlines the importance of identifying and managing all principal risks) was often quoted. Respondents also pointed out that the Combined Code on Corporate Governance (revised in 2003), upon which the Turnbull guidance is based, continues to take the wider approach. It was also pointed out that the Financial Services Authority requires companies in the sectors that it regulates to work on the wider approach to controls.

Other commentators pointed out that:

- a fundamental objective of the guidance is to *“reflect sound business practice whereby internal control is embedded in the business processes by which a company pursues its objectives.”* The objective is not restricted to any particular category of business process or any category of risk, therefore the exclusion of any category of internal controls would not support the objective and significantly weaken the overall intent and value of the guidance; and
- the current guidance permits an integrated approach that is in line with how management operates rather than creating an artificial distinction between aspects of a risk. If any revised guidance were to be restricted to certain risks and controls, companies would still have to identify, assess, evaluate and manage all such risks to achieve their objectives. Also, investors would still want information relating to all significant risks and controls;

- financial controls alone are of limited value if operational or other controls are weak; and
- attempting to separate out certain categories of risks and controls can be a difficult and somewhat arbitrary exercise.

Some respondents contrasted the Turnbull scope with that of the Sarbanes-Oxley Act in the USA which is specifically designed to cover internal control over financial reporting. Some respondents considered that:

- the emphasis of Sarbanes-Oxley on financial statements and controls around financial reporting ignores many of the operational and compliance risks and control activities that companies face and that may well pose much greater risks to shareholder value; and
- the US approach is too prescriptive and ultimately may not add much to the approach enshrined within Turnbull which is understood and applied in the UK.

There was some concern that consideration of all material internal controls only remains feasible in a principles-based regime. If the UK were to move to the rules-based approach of the USA and continue to have the wider approach to internal control, then the time and costs involved would become prohibitive for companies.

A few respondents suggested that the guidance should go further, noting that risk management is more engaging to business leaders when it covers a broader view of risks, includes both threats (downside risks) and missable opportunities (upside risks) and is linked to return. They suggested that the examples of significant risks provided in the current appendix to the guidance should be expanded to demonstrate a broader view of risk, linked to all aspects of performance and stakeholder protection. This would include risks, both threats and missable opportunities, that arise from:

- the business environment in which the company operates;
- choosing and implementing the wrong strategy; and
- failing to operate effectively the major elements of their business model, as well as financial and compliance risks.

By way of conclusion to this section, the CBI stated *“Yes, companies should review all risks and controls, not just those related to financial reporting. This is preferable to the more limited reporting previously carried out under the original Ruttman guidance, which only addressed internal financial controls in implementation of the Cadbury Report, which was primarily concerned with the financial aspects of corporate governance. The Turnbull approach represented a leap forward for many companies in focusing on the broader reasons why businesses fail rather than the purely financial ones. This key change has led to better risk management.”*

Comments from others

Virtually all respondents in this category were of the view that the wider approach should continue. For example, the Association of Corporate Treasurers stated that *“Financial controls are inevitably important and indeed essential to the integrity of a company’s financial reporting, but are by no means paramount when it comes to managing the overall business. Many risks may end up being measured in terms of financial impact but the crucial risk will very often not be directly caused by financial matters. For example, product or service quality and the many factors*

affecting brand image and reputational risk generally can, if not well managed, have as great a destructive effect as financial fraud or poor financial risk management.”

A few respondents had supplementary comments. As with investors and companies, the link to the new OFR and the wording of the Combined Code were cited by many respondents.

Fully supporting the current approach, Ernst & Young commented that *“in our view it would be a retrograde step to move from the broader Turnbull framework (focused on all internal controls) to one more strictly focused on financial controls and would not necessarily lead to an improvement in corporate governance in the UK.”*

Linked to the concern, noted in the companies section, about retaining the UK’s wider approach to control but with US style reporting requirements with its consequences for time and costs, PwC noted that *“The amount of prescriptive material issued in the US as a result of the S404 requirement to focus only on the financial controls gives an idea of what would be necessary if the UK were to follow suit with a prescriptive approach applied to all material risks and controls.”*

A few respondents were nevertheless more receptive to the Sarbanes-Oxley approach. The accounting firm Mazars said *“We would expect that for many companies, the riskiest control areas will be financial areas. Given that Sarbanes-Oxley sets out stringent reporting requirements for internal controls over financial areas, there must be some risk that UK companies will be rated adversely compared to their US competitors should they ignore reporting developments in the US. We therefore suggest that it may be advisable for the guidance to refer to Sarbanes-Oxley as a possible way of addressing internal control reporting in financial areas whilst not going so far as to force companies to adhere to it.”*

The IIA commented that the *“your review might be an opportunity to remind boards that they are responsible for managing all risks. All too often boards concentrate their efforts on strategic risks or issues that may be high profile at the time but fail to consider ongoing risks, for which they are equally responsible. This may include the financial reporting risks, which are addressed by Sarbanes-Oxley.”*

2.4 Consultation Paper: Question 6

Are there parts of the guidance on internal control that are (a) out of date or now unnecessary; (b) unclear; or (c) lacking in sufficient detail? If so, please identify them.

Comments from investors and their representative bodies

Four respondents provided comments. Collectively they believed that:

- the broad nature of the principles of the guidance is still appropriate;
- no significant parts of the guidance are out of date or now unnecessary, unclear or lacking in sufficient detail; and
- the guidance strikes a practical and flexible balance which appears not to have inappropriately reduced the risk appetite of companies and their directors.

Comments from companies and their representative bodies

Many of the corporate respondents did not believe that any parts of the guidance on internal control were out of date or now unnecessary, unclear, or lacking in sufficient detail. For example, British Sky Broadcasting (BSkyB) said that *“as the guidance has been around for over five years, it has stood the test of time in that it is a straight-forward and relatively concise structure. There are no specific areas that need clarification due to it being out of date, unclear or lacking in sufficient detail. Where this may have been the case when the guidance was first published, it has subsequently being surpassed by several years’ worth of application.”*

Many respondents commented that significant additions to the existing guidance are unnecessary. Tate & Lyle PLC commented *“The recommendations in the Turnbull Report have retained their relevance over the past five years even though the regulatory environment has changed considerably in that time due to their high-level nature and principles-based approach. No specific changes, therefore, are requested although it is hoped that the Review Group will take into account the risk reporting requirements of the new statutory operating and financial review and also any conflicts with the Combined Code to ensure that an inconsistent approach to public reporting does not occur.”*

Scottish Power plc noted that the ethos of linking risks to business objectives then aligning controls was as relevant today as when the guidance was first implemented in 1999. They went on to say *“as the guidance is not prescriptive it allows implementation to be achieved regardless of the size or complexity of the organisation as much is left to the professional judgement of those involved in its implementation and ongoing operation.”*

Although the significant majority of respondents suggested no change nevertheless there were some suggestions for additions. These are summarised in section 2.5.

Several respondents made reference to other frameworks, and in particular the ‘COSO Enterprise Risk Management – Integrated Framework’ in the US. However not all commentators agreed how the Review Group might approach this matter, variously suggesting that:

- the guidance could cross refer to other international frameworks;
- COSO ERM might be used as a model for additional information and more detailed examples of applications; and
- the detail of the appendix should be dropped and reference made to internationally recognised frameworks or guidance such COSO ERM.

Reference was also made to the Australian/New Zealand risk management standard (AS/NZS 4360) and the Institute of Risk Management’s Risk Management Standard in the UK.

One respondent cautioned against adding details to the guidance that could be interpreted as a checklist or imposing greater levels of prescription, but noted that any updating of Turnbull needs to reflect the existence of the Sarbanes-Oxley Act. They noted that, whilst its prescriptive nature and low materiality threshold are causing problems, its enhanced accountability for internal financial controls is not unreasonable. They suggested that it might be helpful if the Turnbull guidance were to encourage boards to address financial controls from the top-down perspective, starting with the key risks, to ensure that investors can rely on financial information.

A few respondents suggested a change to the title of the guidance from ‘Guidance on Internal Control’. Suggestions included were:

- Risk Management and Control; and
- Risk Management & Internal Control.

Comments from others

There was consistency between the comments from companies and other respondents.

For example, the London Society of Chartered Accountants stated “*We do not believe that any of the guidance is out of date or unnecessary, although there may be a mistaken perception that this is the case because it was written before Enron and other similar scandals. In terms of clarity and detail, it depends on the extent to which businesses need advice and assistance. It is sufficiently clear and detailed in terms of what it is currently seeking to achieve.*”

A number of respondents in this category also raised more detailed technical points which included matters under the following headings:

Internal audit

A number of respondents referred to the internal audit section in the current Turnbull guidance which had been included to provide guidance on Provision D.2.2 in the 1998 Combined Code. With the update to the Code in 2003, taken together with the Smith guidance on audit committees, most respondents who mentioned this topic considered that the internal audit section in the current guidance was now superfluous.

For example the IIA stated that “*The section on how to conduct a review of the need for an internal audit activity if the company does not have one is now unnecessary since it is dealt with in Section C3 of the Combined Code, supplemented by the Smith guidance.*”

Whilst agreeing that much of this section is now addressed by the Smith guidance, the ICAEW noted that some of the direct guidance in paragraphs 42 to 47, for example that relating to whether a company needs an internal audit function, has no direct equivalent in the Smith guidance.

However, others considered that the Smith guidance does not address internal control in sufficient detail. Therefore, they wanted the review of Turnbull to guard against the loss of the text on internal audit in paragraphs 42 to 47 of the present guidance and material on the role of the audit committee in assessing internal control. Another respondent went further by stating that a revised guidance should include an explanation of the expected role of internal audit rather than referring only to the existence or otherwise of an internal audit function.

Drafting comments and specific paragraphs

Comments were made on paragraphs 25 and 26 in the existing guidance. These included:

- the phrase ‘due and careful enquiry’ may need to be revisited in the light of the debate surrounding the process by which the OFR is prepared;

- there is a tension between the role of board committees set out in the current guidance and the role of the audit committee as articulated in the Smith report, and the guidance should set out more clearly the roles and responsibilities of the whole board, board committees, and management.
- a clear distinction should be drawn between management’s role (the identification and evaluation of risk; and the design, operation and monitoring of the system of internal controls) and the board’s oversight role.

Clarification

Clarification of some matters was suggested. Examples quoted by respondents included:

- Materiality – *“The revised Combined Code requires that the board’s review consider ‘all material controls’. This term is not well understood and we recommend that further clarification is provided in paragraph 28.”*
- Risk management systems – *“The revised Combined Code refers to ‘risk management systems’ rather than ‘risk management.’ This has been interpreted by some as meaning that the board should move away from active consideration of individual risks and instead focus on the processes by which risk is managed. Additional clarification in this area would be helpful.”*

Other matters

The IIA provided a number of detailed comments, many of which have been covered elsewhere. Below are some of their additional points:

- the guidance should be redrafted so that it reflects the Combined Code’s format of principles and provisions;
- relevant parts of the guidance should be redrafted to refer to ‘risk management and responses to risk’ rather than to the narrower ‘internal controls’;
- the Turnbull Review Group should consider adding a clear principle that the board must receive appropriate assurances, including objective assurance, that responses to risks are in fact working; and
- some harmonisation of requirements would be helpful so that companies subject to the Sarbanes-Oxley Act are not required to complete two reviews of diametrically opposed styles.

Concluding remarks

We have provided, for the sake of completeness, many of the comments provided by respondents whose responses suggested changes to the guidance. However, they need to be seen in context. The majority of companies and investors did not consider there was a need for significant change to the guidance. We conclude by quoting a ‘representative organisation’ in each category.

Investors

The ABI stated *“Since the guidance articulates principles rather than detailed procedures, we would not look for the revision to include more detail.”*

Companies

The CBI stated “*We are not aware of anything which is out of date, unnecessary or unclear. This is itself a tribute to the drafting of the original working group. As regards the question of sufficient detail, we believe that one of the reasons for the success of the Turnbull guidance has been the fact that it has been kept short and simple. This has made it accessible to boards and managers, rather than requiring the assistance in interpretation of lawyers and accountants. This helps to ensure that the responsibility for risk management rests where it should – with the board and management.*”

Others

Grant Thornton stated “*The guidance is still relevant and necessary. The guidance is clear. There should be no more detail in the main body of the guidance.*”

2.5 Consultation Paper: Question 7

If additions are needed to the guidance, what form should they take, what should they cover, and why would they be useful? Examples might include:

- **additional questions in the current appendix;**
- **indicators to help boards and board committees identify where there may be potential cause for concern, for example of fraud or aggressive earnings management; or**
- **more examples of the types of risks that boards should consider, for example business continuity risk.**

Comments from investors and their representative bodies

Overall, investors believed there should not be additions to the guidance. They cautioned that, if any additions were to be considered, they should not seek to change the non-exhaustive nature of the appendix.

The ABI commented “*We do not consider that the guidance should include more detail on either indicators to help boards identify specific risks, or specific examples of the type of risk that boards should consider. Boards need to be aware that a wide range of risks may materially affect their company’s business and consider for themselves how to monitor and manage them. The guidance should avoid providing any templates which would prevent boards making their specific assessment of which risks most affect their business.*” However, the ABI’s comments included reference to guidance on the oversight of subsidiary operations, particularly where these are in remote locations, with the additional stresses that places on internal controls.

Morley Fund Management, fully supporting the ABI comment, also noted the continuing developments in risk management and suggested the Review Group might consider whether updating the appendix would add value. They cautioned that “*in doing so, however, the ‘non-exhaustive’ nature of the appendix should not be changed.*”

Standard Life Investments, referring to a new preface to the guidance, suggested that *“the additions which are needed to the Guidance should not take the form of additional questions, indicators or examples. Rather, they should take the form of a preface by your Chairman on behalf of the Group. The preface would contain points of emphasis to assist boards in implementing and applying the revised Guidance.”* The three suggested points of emphasis were:

- boards are ultimately responsible for maintain a sound system of internal control;
- boards have responsibility for setting the right ‘tone from the top’; and
- the significant potential adverse consequences of ‘off balance sheet risks’.

Comments from companies and their representative bodies

A substantial majority of respondents either favoured making no changes or made only tentative suggestions and recognised the risk of fostering a checklist mentality.

Diageo plc commented that *“No additions should be made to the guidance. Substantial guidance is already available in the market-place. Additional guidance in Turnbull itself would easily become de facto additional prescription.”*

William Hill PLC said *“As noted in the existing Guidance, the questions in the appendix to the Guidance are not intended to be exhaustive and need to be tailored to the particular circumstances of each company. We believe that the current list of suggested questions provides a useful starting point for Board members’ questions on the effectiveness of a company’s risk and control processes, and we do not recommend any additional questions.”*

Some companies considered that additions to the guidance were not needed, as this would be unduly prescriptive. It was noted by other respondents that the Turnbull guidance is one part of a broader regulatory framework governing internal control, and that when assessing the existing guidelines it was necessary to take into consideration the other component parts of the regulatory framework. This now includes the OFR.

The CBI did not see the need for additional questions in the appendix noting that it *“provides sufficient support that companies can then use this as a basis to develop additional questions of most relevance to their own circumstances, but does not create so much detail that it creates the dangerous impression that all risks have been covered, which might lead to complacency towards risk.”* Nevertheless, the CBI did make one tentative suggestion *“The one exception, where CBI members feel that some additional wording might be useful, would be on fraud and fraud related issues, which are of concern to all companies.”*

The IoD noted that *“smaller organisations rely more on these aspects [of guidance] than do large organisations which have the resources to develop a tailor-made approach. However, we would be averse to the Review resulting in tick-box checklists. We hear of concerns from investors that the reporting tends to be standardised and this problem would be exacerbated by introducing too many such indicators.”*

Whilst a number of respondents considered that the preliminary ideas mentioned in the first consultation paper were worthy of consideration by the Review Group, respondents were generally cautious and were not always in agreement about the relative merits of additional questions, indicators, or examples of best practice.

Some respondents suggested possible additions but in the context that, as Alliance & Leicester plc stated, *“The Turnbull guidance is considered to be both necessary and current, clear and does provide detail at the right level.”*

The Smiths Group plc favoured questions, stating *“We do not believe that there are any specific parts of the guidance that are out of date, unclear or lacking in sufficient detail and that significant additions to the existing guidance are unnecessary. In the event that additions are made then they should take the form of additional questions in the current appendix.”*

Friends Provident plc took a different view on additional questions and commented on the embedding of risk management and internal control. They stated *“We do not see the need for any additional questions in the current appendix. We would not object to indicators of potential causes for concern or examples of risks that boards should consider. However, in both cases, care would be needed to ensure that the examples did not simply become a checklist.”*

Nevertheless, some companies thought that the preliminary ideas in the first consultation paper were acceptable. For example, Boots Group PLC said *“All of the above would be useful not least to improve the ability of the Board to challenge the process adopted by management. Specific guidance as to how much enquiry Boards ‘should’ be making would also be useful.”*

A few respondents suggested more substantial changes to the guidance.

Pearson PLC suggested *“the development of a framework of common generic risks/types of risk to be considered by company boards would be helpful. This framework could include strategic risks, external risks, fraud/ethics, key accounting policies, operational matters, BCP, IT risk, project management and CSR/SEE risk.”*

Vodafone noted that the current appendix does not provide practical examples of techniques used when applying the principles-based approach of Turnbull. Mentioning the application techniques volume of the COSO *Enterprise Risk Management* publication, they suggested that *“the current appendix should be withdrawn and replaced by the equivalent of the application techniques in the UK environment.”*

Other suggestions included that the revised guidance could:

- include some best practice examples;
- list more exhaustively the key areas that should normally be covered by a company’s risk and control processes;
- provide guidance on what level of weaknesses should be disclosed;
- include a clearer definition of what is meant by ‘significant weakness’, ‘material control aspects’ and ‘significant problems’;
- provide further guidance on risk management, including a clear definition of risk and risk management framework;
- place less emphasis on internal control, recognising this as one, albeit key, component of a wider risk management process;
- put more emphasis on the business proposition of sound risk management;
- adjust the tone of the guidance to embrace a more holistic viewpoint that risk management is not only about reducing threats but also about realising opportunities;

- provide a statement of how the guidance links into the relevant requirements of the Sarbanes-Oxley Act;
- expand the appendix to increase the practical utility of the guidance which could be helpful, especially if set in the context of OFR requirements; and
- include additional detail on how to evaluate the system of internal control, for example, to state that the evaluation should be undertaken against an established control model.

Comments from others

The comments from respondents in this category were wide ranging, in part reflecting the particular interests and technical specialisms of some of the respondents. For example, the Tax Justice Network and the London Resilience Business Forum wanted more in the guidance, respectively, on tax and business continuity risks.

Some respondents in this category did not want any additions to the guidance. For example, Institute of Chartered Secretaries and Administrators commented *“We do not see the need for any changes at this time.”*

An overview was provided by the London Stock Exchange which said *“the guidance as it stands is popular with both issuers and investors, and does not require a radical redesign or any significant amendments.”* It also said *“The raison d’être of a principle-based approach is to avoid lengthy lists of detailed requirements, and to provide companies with a framework that they can adapt to the specificities of their business. Therefore, we do not believe that there should be extensive additions to the guidance as it stands.”* It went on to suggest that some examples of good practice could be beneficial to companies, especially smaller companies.

One respondent commented *“Whilst further guidance would not do any harm, management, boards and board committees should be doing such thinking for themselves. It is important to make sure that guidance does not develop into checklists that discourage thinking. However, some more detail may be of benefit to smaller companies.”*

There were some differing views from the accounting firms. KPMG were clear in stating that *“We do not believe additional questions are required in the current appendix”*. They went on to say that *“Furthermore, we do not believe the Guidance should include lists of fraud risk indicators or set out various types of risk that boards should consider. There is a danger that such lists are considered to be comprehensive with the result that boards do not look any further.”*

On the other hand there were various suggestions for additions to the guidance from other accounting firms. These included:

- providing more guidance on assessing the effectiveness of the company’s risk and control processes in the areas of fraud and accounting estimates;
- appending explanation of how organisations have sought to meet the recommendations of the Turnbull guidance by sharing best practice, through illustrations;
- good practice examples of internal control statements;
- implementation guidance including alternative ways by which the board can identify, evaluate and prioritise risks;

- more guidance on the types of risks to be considered;
- a revised appendix with an increased emphasis on documentation and distinctions between the board and management; and
- how a board might typically consider risk management issues in the course of an annual cycle and the consideration of risk in a structure where there are divisional boards.

Risk managers and risk consultants, as well as internal auditors, variously wanted definitions of concepts such as inherent risk, risk appetite and residual risk, information on these concepts and the relationship between them and a question in the appendix asking whether risk appetite has been formally defined.

Internal auditors made many suggestions for potential additions to the guidance. For example, they thought that the guidance should:

- identify the key principles of the ‘tone at the top’;
- emphasise the importance of an effective whistle-blowing process ;
- set out the principles of an assurance framework including an explanation of the nature of management assurance;
- explain the role of professional internal audit;
- refer to material produced by the IIA; and
- highlight the role of the audit committee in reviewing internal controls and in providing oversight for the professional internal audit activity.

Finally, respondents variously suggested that any revised guidance could:

- include a glossary of terms (including the definitions of risk, internal control and risk appetite);
- refer to fraud, accounting estimates and taxation issues;
- provide practical examples of the techniques that can be used in applying Turnbull on matters such as risk appetite and embedding risk management;
- provide greater clarity on how to conduct a review of effectiveness;
- include definitions for significant control failings and weaknesses; and
- include descriptions of the roles with respect to risk management undertaken by the board, the business units and the risk management function.

2.6 Consultation Paper: Question 8

Do you have any other suggestions for changes to the guidance that are not covered by questions 6 and 7 above?

Comments from investors and their representative bodies

No comments were received that have not already been summarised in sections 2.4 and 2.5.

Comments from companies and their representative bodies

The great majority of companies either stated that they had no additional comments to make or did not respond to this question.

A small number of respondents commented on a number of topics including:

- the proposed amendments to the 4th and 7th Company Law Directives;
- defining what is meant by ‘effectiveness’ and guidance on the criteria for judging effectiveness;
- a refocusing on risk management rather than internal controls;
- requiring boards of companies that do not have internal audit functions to explain the compensating arrangements that make this function unnecessary;
- guidance around those areas which are known to be causing significant difficulties in the context of Section 404 of the Sarbanes-Oxley Act;
- adding some further principle-level statements to the guidance (or relevant questions within the appendix) that explicitly examine the ability effectively to oversee the operations of subsidiaries, particularly those that are distinct from the rest of a group in terms of geography or business profile;
- drawing out the distinction between strategic risk, commercial risk, operating risk and financial risk; and
- recommending the Turnbull guidance as good practice for adoption by all companies, not just listed companies.

Comments from others

The small number of other respondents who commented made reference to a number of matters not already covered in sections 2.4 and 2.5, including:

- further guidance on the role of risk committees;
- the wish of some directors for more guidance on what to do when failures in controls are identified;
- the possibility of cross references within the guidance to where other helpful information can be found; and
- a stronger business case for the business benefits of formalised risk management should be articulated.

2.7 Other information

The public consultation paper provided the main evidence on the scope and content of the Turnbull guidance. The Review Group did not concentrate on this matter in the MORI surveys.

As part of the desk research into the scope of the guidance, the Review Group identified a Deloitte Research Study on risk management published in February 2005, entitled ‘Disarming the Value Killers’. The study examined instances of major losses in shareholder value experienced by major, global companies over the 10-year period 1994 to 2003. Patterns in the data were identified and an overall picture emerged of what they described as the ‘value killers’.

One of the conclusions of the study was that losses in value had occurred due to failures in correctly anticipating and managing diverse risks. These risks included product and demand related risks, mergers and acquisitions, poor financial management and cost control risks, controls over operations, as well as industry specific issues.

When compared with the wide range of other risks facing companies, the frequency of ‘accounting problems’ (being defined in the study as fraud or manipulation of accounting information) was not one of the more significant contributing causes to the largest falls in value.

3. The internal control statement

3.1 Summary of evidence

The impact on companies

Anecdotal evidence from the consultation exercise suggests that the requirement to disclose information about the internal control system and confirm that a review has been carried out at least annually has helped to focus boards on the need to manage risk, and in doing so has helped to improve overall standards of risk management and internal control. This view is shared by the ABI, which said in its response that *“we believe that the requirement to disclose has caused boards to think more deeply about the issues and take steps to improve risk management”*, and is consistent with the results of the MORI surveys.

There was no consensus among companies about whether more informative internal control statements might benefit a company by improving the market’s perceptions of the way in which it managed risk. Some respondents felt that there may be a commercial advantage in doing so, but others were concerned that they should not be required to disclose information that they considered commercially sensitive. Many did not believe that investors differentiated significantly in a positive way between companies on the basis of the perceived strength of their internal controls. Over 80% of the company directors interviewed by MORI who attended meetings with investors said that internal control matters were rarely or never raised in those meetings. This view was also expressed by many of the companies that responded to the consultation exercise, but it conflicts with the results of the survey of investors carried out by MORI.

The value to investors

88% of the investors interviewed by MORI for this review said that risk management and internal control is a very or fairly important factor when they are making judgements about a company.

What is less clear is the relative value that investors place on the internal control statement in the company’s annual report in coming to an overall judgement about a company’s risk management. In their responses to the consultation exercise, most investors said that they found many statements to be uninformative and ‘boilerplate’. It appears that currently the main value of the internal control statement to investors is as a health check. In the words of one investor, *“the disclosures are rather like audit reports insofar as if they weren’t there, they would by their absence undermine the confidence which investors would place in the control environment.”*

Institutional investors appear to use means other than reliance on the statement to reach a judgement on the quality of a company’s internal controls. The IMA stated *“our members tend to rely on their discussions with a company’s management, customers and suppliers as well as an analysis of results.”* This appears to be borne out to a certain extent by the MORI survey of investors – as noted above, 88% said that the quality of risk management and internal control was an important factor when reaching a judgement about a company, whereas 68% felt that the internal control statement was in itself important. However, this is still a high figure.

It is not clear to what extent the comparative value to investors of the internal control statement would increase were disclosures seen as more informative. To quote the IMA again, “*although more detailed and descriptive disclosures would assist investors they are not vital to a decision as to whether to buy a particular company’s shares or to retain an existing holding.*”

That said, many of the investors that responded to the consultation exercise felt that their judgements would be aided by concise but informative disclosures that were specific to the company. In particular investors said that they would welcome more information about how the board assesses and manages the key risks facing the company. It was recognised that this demand should be met at least in part by the requirement for companies to comment on the directors’ approach to the principal risks facing the company in the new OFR.

3.2 Consultation Paper: Question 9

How useful to investors and companies are the existing disclosures on internal control? What value is placed on such disclosures by investors when making investment decisions?

Comments from investors and their representative bodies

‘How useful to investors are the existing disclosures on internal control?’

The substantial majority of investors described the disclosures made by companies as often ‘boilerplate’ or generalised in nature. For example the IMA said “*the existing disclosures in many annual reports are of limited use in that they tend to be standardised and boilerplate.*”

Morley Fund Management suggested that the disclosures were “*boilerplate, using wording driven by lawyers.*” Pensions & Investment Research Consultants (PIRC) went further describing them as “*bland and anodyne.*” The Co-operative Insurance Society noted that it was “*usually not able, at present, to make meaningful use of internal control disclosures in either its stock selection process or in its exercise of voting powers.*”

Despite these limitations, several respondents considered that the disclosure requirements had had an important effect that might not be immediately apparent. For example, Morley stated “*the requirement to disclose has caused boards to think more proactively about the issues and take steps to improve risk management.*”

Standard Life noted that “*the disclosures are rather like audit reports insofar as if they weren’t there, they would by their absence undermine the confidence which investors would place in the control environment and consequently a disclosure void would influence investment decision-making. Accordingly, we do not advocate dispensing with disclosures entirely.*”

‘What value is placed on such disclosures by investors when making investment decisions?’

Fidelity Investments International said “*The existing disclosures are not that important to investment decisions by Fidelity. We rely upon our own discussions with management, customers and suppliers and our analysis of results in forming our own view on internal controls that are in place. Where after investment we have*

raised a governance issue with the Chairman or Non-Executive Directors of a company the statement on internal controls has not been a matter that we have discussed.”

The IMA said *“Although more detailed and descriptive disclosures would assist investors they are not vital to a decision as to whether to buy a particular company’s shares or to retain an existing holding.”*

Commenting on companies’ compliance with the existing disclosure requirements, PIRC noted *“Based on our most recent annual review the majority of companies are complying with the basic disclosure requirements with only 15 companies (3% of the sample) not complying in PIRC’s assessment. The majority of these were for failing to meet disclosure requirements regarding whether the system of controls had been in place for the full year and had been reviewed by directors.”*

Some respondents made reference various to paragraphs in the existing guidance. For example, the ABI suggested that the guidance should avoid specific prescriptions and that *“directors should be comfortable with the liability aspects of making appropriate disclosures. The language in paragraph 37 of the guidance should not be the core of the statement itself, but rather a means of providing comfort to directors in making more discursive disclosures.”*

Comments from companies and their representative bodies

Corporate respondents also commented on the inherent limitations of generic disclosures. For example Anglo American plc stated that *“It is inevitable that the disclosures, on the business processes and structures that collectively comprise the risk management system of a major international organisation, will be reduced to a series of statements that are fairly common to similar sized organisations. Such generic disclosures are unlikely to have a significant bearing on investors’ judgement on the merits of investing in a particular company.”*

Dixons Group plc also said *“We doubt whether existing disclosures on internal control are of great value to investors and believe that there has been an unwarranted tendency for corporates to proliferate material in annual reports to no real purpose. Investors need the comfort and assurance that the directors have discharged their Turnbull obligations properly but this should be capable of being provided in fewer words than has become the convention. We assume that investors form a judgement on the quality of the covenant underlying the disclosures when assessing the quality of management generally.”*

Standard Chartered plc commented *“The current Turnbull statement provides comfort that the necessary risk assessment and controls are in place. The effect is greater on the downside – i.e., not having it, not having it adequately disclosed – than on the upside. It is expected of large companies. In this respect it is a hygiene factor, like an unqualified audit report.”*

A number of respondents noted that the requirements are a useful discipline for boards. For example, the CBI stated *“The key value of the disclosure lies in the fact that the requirement to make a statement [in accordance the Turnbull guidance] focuses the mind of boards.”* Dixons Group plc agreed, adding *“The value to companies of disclosure is of course the due diligence which precedes its preparation.”*

Many respondents observed that whilst investors routinely discuss critical business risks with the company, they rarely (if ever) ask about risk management processes and internal controls. For example GUS plc noted *“we can say that at none of our many meetings with institutions in the past 12 months has the topic of Turnbull been raised. We believe that this is because investors accept that a relatively large company such as ours has reasonable controls and our Report & Accounts sets out that we comply with Turnbull. The risks that they want to debate are those associated with the markets in which we operate and the way that we are tackling them.”*

Lloyds TSB Group plc agreed, stating *“In our experience since 1999, we are not aware of any investor queries or concern on specific internal control related matters. This may indicate that the current form of disclosure provides sufficient value and comfort to investors, or may indicate that investors do not use the disclosures as a significant differentiating factor between organisations.”*

The Review Group noted that the findings of the MORI surveys, summarised in section 3.7, suggest that companies and investors have different perceptions of the level of discussion on internal controls.

Respondents also noted that disclosure is of less value because it is historical information and investors are likely to rely on more timely information obtained by other means in making decisions. For example Vodafone noted the *“the final publication of any disclosure can take place many months after the control weakness has taken place, and consequently it is likely that investors are more influenced by their personal communications with the board and senior management than on subsequent disclosures.”*

The CBI suggested *“From the point of view of investors, the value of the disclosure is more one of governance than investment. The disclosures should assist the shareholders to question the stewardship of the directors and their management of the company over the last year, to exercise their voting rights at the AGM and to influence future policy. The disclosure in itself is of less significance than the reassurance that there is a process within the company whereby the board considers risk management.”*

Comments from others

Comments from respondents in this category echoed those of investors and companies, referring to boilerplate disclosures but also recognising the positive effect of having to make disclosure. For example, BDO Stoy Hayward said *“Given the degree of boilerplate reporting, we do not believe that the current disclosures are of great practical use. However, it is perhaps unrealistic to expect detailed information to be presented. What is important to shareholders is for some demonstration that internal controls have been assessed on an ongoing basis, under an appropriate process, and corrective action has been taken where necessary.”*

Grant Thornton, having undertaken three annual surveys of corporate governance disclosures in annual reports, believed that companies could improve upon the quality of disclosure, but said that this *“is not an area that should be addressed by more words in the guidance, or by more prescription. Company boards must decide what to say and how to say it. Shareholders should engage with the board to seek better disclosure on internal controls and risk if that is what is important to them.”*

Respondents also mentioned the disadvantage of lengthy disclosures and the potential contribution of the new OFR requirements.

Finally, the academic respondents, Professors Page and Spira, thought it *“unlikely that investors make much use of the Turnbull disclosures although unusual disclosures might form the subject of discussion during meetings with analysts. This does not mean to say that the disclosures are valueless since they ensure that reviews of internal control take place and thereby improve the accountability of management.”*

3.3 Consultation Paper: Question 10

Would a different or extended form of disclosure facilitate better decision making? If so, how?

Comments from investors and their representative bodies

There was a general, but not unanimous, response from investors that they would like more disclosure. The majority indicated that the disclosure should be concise and informative. Investors also strongly noted the link to the disclosures in the new OFR. What is somewhat less certain is just what the revised disclosures in the Turnbull guidance should be. Whilst there was some consistency, comments ranged from suggestions that could result in significant additional disclosure, to comments that no extended disclosure is required as it will not affect some investors' decision-making process.

Whilst noting the requirements of the OFR, the IMA suggested that *“It would be helpful if companies highlighted what they see as the key risks to their business and detailed how these risks are monitored and controlled.”* Hermes Pensions Management Ltd referred to *“the framework in place to manage those risks”* and preferred a brief insight into four or five key areas of risk suggesting that this should not result in voluminous disclosures.

Barclays Global Investors wrote that *“It would not affect our investment decision-making process. It may lead to more discussion with companies as part of our engagement process if more detail suggested that some companies were not meeting the same standard achieved by their peers.”*

Both the IMA and Hermes used the word 'how', as did Morley and the ABI which suggested that *“The disclosure format needs to be structured to highlight the main risks and show how the board takes responsibility for assessing and managing them.”* Morley noted that the need for extended disclosure, beyond what is currently envisaged by the guidance, has already largely been addressed by the OFR, and the ABI commented that *“An extended disclosure, which obscures the central issues and priorities, would not be helpful.”*

The CIS, noting the alignment with the OFR, believed that *“meaningful disclosures of internal control structures can be made in two main areas. The first relates to how the enterprise as a whole is controlled and the second area concerns how the business exerts control or influence over its key risks.* They suggested that *“companies should be expected to report such ‘risk-specific’ control responses within the relevant part of the OFR so as to allow investors to understand the*

degree of risk that they are accepting when buying a given stock. This would also facilitate more meaningful discussion by analysts with companies by removing the need to ask elementary questions.” They went on to suggest that the more generalised ‘enterprise’ level internal controls should continue to be disclosed within the internal control statement. They also stated that *“We also believe that greater prominence should be given to the management of non-financial risks, including social, ethical and environmental risks, and in particular reputational risk.”*

At the other end of the spectrum was Fidelity Investments International who commented that even the existing disclosures are not that important to their investment decisions.

Comments from companies and their representative bodies

Overall:

- most corporate respondents either did not favour a different or extended form of disclosure or suggested that there should not be any significant extension to the current disclosure requirements. They expressed in a variety of ways their belief that the current disclosure requirements were adequate; and
- their perception that little or no value would be obtained from extending or amending the disclosure requirements.

These views, however, were not unanimous and the Review Group received a few suggestions for potential changes. One suggestion was for an additional statement that not only had internal controls been reviewed but that, where identified, any deficiencies had been acted upon.

Link with the OFR

As with investors, reference was often made to the disclosure requirements of the new OFR. Many believed that to the extent that the new OFR requires commentary on risks and controls, ideally these will be consistent with and complementary to those required by the Turnbull guidance.

Noting the development and future evolution of the OFR disclosures will provide boards with the opportunity to explain the outcome of such processes in a meaningful way that addresses both risks and opportunities, BP plc commented that *“in view of the development of the OFR since the adoption of the guidance, it is submitted that extended disclosures will now be unnecessary.”*

Another respondent noted that the value of disclosure may be improved by integrating with the OFR to create a more discursive element of how key risks in a business have been managed during that period. They believed that there should still be a requirement in Turnbull to have some minimum level of disclosure to confirm that the company has in place appropriate risk management structures and controls.

Disclosure and decision making

A number of respondents referred to this matter. Tesco plc commented that *“It is unlikely that better decision-making would result from different forms of disclosure. Good decisions result from the right people with the right skills making the right decisions bearing in mind good internal controls. A good process alone is no guarantee of a good decision. However disclosure helps to explain the arrangements. Companies should be allowed to respond individually to requests for*

further disclosures from shareholders. Competitive advantage can be achieved through improving shareholders' understanding of a business but the detail of risks can be commercially sensitive so disclosure should be left to the discretion of the Board."

Interaction with investors

As noted in section 3.2, many companies felt that whilst investors routinely discuss critical business risks with companies, they rarely (if ever) ask about risk management processes and internal controls. For example, one respondent noted that it was their *"impression is that investors don't really want much greater detail, rather they want the reassurance that internal controls and risk management satisfy a basic test of fit for purpose, so that they can then focus on analysing and making decisions on the basis of business performance and prospects."*

Other reasons provided by respondents for not extending the disclosure requirements included:

- the objective of the internal control disclosure is to encourage the business to control the risks faced, rather than having a culture that ensures the business can 'tick all the disclosure boxes'. The more prescriptive the disclosure requirements, the more businesses will move to a 'tick-box' approach which devalues the original intention and lessens the value of the output;
- comparing theory and practice, a respondent commented that in theory, providing an extended form of disclosure should facilitate better decision making. In practice however the answer is probably that it would not because investors are generally more interested in the performance of the company and may only be concerned about governance when it falls below a particular threshold; and
- several respondents noted that as annual reports of quoted companies continue to become longer and more complex, the benefit from any increased disclosure requirements has to be balanced with the associated costs. In this context, one respondent suggested that investors and analysts still concentrate on a relatively small number of items of information contained in annual reports, and another respondent believed that the balance is currently about right and thought that making the requirements more onerous may have little upside.

The topic of potentially unintended consequences of disclosure was raised. One respondent, who believed that increased disclosure in relation to specific internal controls is not to be encouraged, commented that *"Potential additional information would be to provide an overview of the key controls in place against the company's most significant business risks. From the perspective of the disclosing company, this would lead to similar issues in respect of turning the board's private assessment of control effectiveness into a public statement of their conclusion on effectiveness, namely the:*

- *possible creation of an 'expectations gap';*
- *potential for increased litigation and liability;*
- *risk that companies will be discouraged about being frank internally in respect of required control improvements."*

Another respondent, Friends Provident plc, noted that boards will always have more information about risk and internal control than they can disclose and they cautioned against disclosure that might discourage sensible risk taking, and lead to management becoming risk averse.

The Review Group was reminded by respondents that there needs to be a balance between disclosure requirements and commercial sensitivity and confidentiality. Boards need to make sufficient information available to investors for them to make informed decisions while not inhibiting management from taking managed risks through a need to make excessive or intrusive disclosures.

The following comment from the CBI appears to summarise the views of many people in business: *“We do not believe that a different or extended form of disclosure would facilitate better decision-making. It is the fact of disclosure of whether the company’s processes are consistent with the Turnbull guidance rather than the detail of the disclosure which has the most effect on focusing boards’ minds on the need to consider risk management processes.”*

Comments from others

As with responses from companies, a number of respondents believed that the current disclosures should not be extended. For example, Mazars did not believe that it was necessary to require a different or extended form of disclosure. They noted that the existing disclosures give leeway to management to decide upon the level of disclosure that they deem to be most appropriate. They also noted that companies with transparent policies on corporate governance in general are more highly valued by the market, and there is therefore already a considerable incentive for companies to make their disclosures as robust as possible.

Paragraph 36 of the 1999 guidance

This paragraph encouraged boards to provide additional disclosure. The ICAEW suggested that further encouragement would be welcomed, perhaps by providing examples of best practice. They suggested that *“the proposal in paragraph 26 of the consultation document that ‘where the board’s review has highlighted areas for improvement, the board might be asked to state whether it has taken remedial action, or to describe the changes it has made to the system of internal control’ is a good example of the sort of additional disclosure that might be appropriate.”*

Other comments

Other suggestions or comments on extending the current guidance included:

- improved disclosure should help to ensure the board takes action on weaknesses in internal control;
- the results of the board’s review of the system of internal controls should be disclosed;
- the company should confirm that its risk appetite of the company has been approved by the board; and
- where the company is also subject to the Sarbanes-Oxley Act, the disclosures in each should be consistent.

Independent Audit Limited suggested that the current disclosure paragraphs should be substantially expanded to include information on:

- the way in which the board defines the risk strategy/risk appetite;
- how assurance is obtained over the quality of controls including details on testing;
- action taken to correct identified material control weaknesses; and
- the nature of an independent review of controls.

3.4 Consultation Paper: Question 11

What distinctions or linkages should be made between the business risk-related disclosures to be made in the Operating and Financial Review and the disclosures made as a result of the Turnbull guidance?

Introductory comments

Quoted companies in the UK are now required by law to prepare an OFR for financial years beginning on or after 1 April 2005. The new OFR will be included in the company's annual report and accounts, and compliance with the regulations will be enforced by the Financial Reporting Review Panel (FRRP) for financial years beginning on or after 1 April 2006. The OFR must include, inter alia, information on the principal risks and uncertainties that may affect the company's long-term value.

The Accounting Standards Board (ASB) published the reporting standard for the OFR in May 2005, after the closing date for responses to the Turnbull Review Group's evidence gathering consultation paper. The reporting standard states that *"the OFR shall include a description of the principal risks and uncertainties facing the entity together with a commentary on the directors' approach to them."*

The OFR's mandatory disclosures will be enforced by the FRRP and subject to legal sanctions. The Turnbull guidance, being guidance on a part of the Combined Code, falls under the 'comply or explain' regime. Very few respondents, perhaps not realising this distinction, mentioned this important distinction in their responses.

Comments from investors and their representative bodies

Investors recognised links between the OFR and the Turnbull guidance, and that duplication should be avoided. There was a divergence of views as to how closely or not they should be linked.

Some investors noted that the Turnbull guidance is intended to be general in nature and that the OFR will require disclosure of specific principal risks, and therefore believed that the two documents should be separate. Others took the view that there needed to be a close link.

Hermes considered that *"there is full alignment between the risk-management processes undertaken in response to the Turnbull guidance and the risk disclosures required in OFRs. Furthermore, we believe that it would be helpful to have this alignment made more explicit so that the limited role of lawyers and auditors in the production of the OFR can be carried over to Turnbull reporting."* Noting the current Turnbull disclosures, they said *"Not only should there not be distinctions between these disclosures, nor should they simply be separate, linked disclosures; they need to form a single, integrated disclosure."*

The IMA noted both links and anomalies. They “*believe that the main risk-management processes disclosed as part of the Turnbull guidance should be aligned with the risks disclosed in the OFR.*” They suggested that it would help if the guidance made this explicit in the interests of ensuring comprehensive and consistent disclosures. They also noted that “*there are certain anomalies in that the scope of the requirements relating to the OFR and the Turnbull Guidance are different – the requirements relating to the OFR are in the Companies Act, and apply to UK incorporated quoted companies, and the Turnbull Guidance is in the Combined Code which is a listing requirement and applies to companies with a listing in the UK, wherever incorporated. This also means that there are different sanctions if companies fail to fulfil their obligations under the respective requirements.*”

Comments from companies and their representative bodies

As with investors there were different views as to how closely or not the two documents should be linked.

There was strong sentiment that the Turnbull guidance and the OFR should complement rather than duplicate each other. The Hundred Group of Finance Directors said “*to the extent that the new OFR requires commentary on risks and controls, ideally these will be consistent with and complementary to those required by Turnbull.*”

A number of respondents, wanting to avoid duplication and a lengthening of the content of annual reports, echoed the sentiments of GUS plc when it stated “*to avoid duplication of what has to be done internally within the company and what has to be reported externally these need to be as integrated and consistent as is possible.*”

The Quoted Companies Alliance commented “*We believe that it is important that the reporting of the review of internal controls is closely aligned with, or integrated with, the Operating and Financial Review. The discussion of opportunities and threats could therefore give an adequate overview for investors of these matters.*”

There were however different views on just how closely linked or not the two documents should be. For example, on the one hand 3i Group plc stated “*We believe a clear distinction needs to be drawn between the OFR and Turnbull. Turnbull should deal with process by which risk is identified, assessed and addressed and how that process is monitored by the board. By contrast the OFR should deal with the outputs of the above process.*”

At the other end of the spectrum, expressing concern about overlap and duplication, Provident Financial plc said that they wished to “*provide one statement on internal controls and risk management issues in the annual report, ideally based on the Turnbull guidance.*”

A number of respondents commented that there should be cross-reference between the documents. For example, Tomkins plc believed “*that the business risk-related disclosures in the Operating and Financial Review are risks specific to the business. The disclosures relating to Turnbull relate to the system to control and manage risks rather than the description of the risks. There should however be a cross reference to systems of internal control in the Operating and Financial Review.*”

Comments from others

As with investors and companies there were different views on how closely or not the two documents should be linked. Many respondents noted the issue of the need to avoid potential duplication.

From the accounting firms, KPMG noted that *“The ‘principal risks and uncertainties’ disclosed in the Operating and Financial Review (OFR) and the disclosures made as a result of the Turnbull Guidance are clearly complementary.”* They went on to say that *“while the OFR will include a description of the principal risks and uncertainties facing the company and its subsidiary undertakings, the summary of the process the board have applied in reviewing the effectiveness of the system of internal control, as currently required by the Turnbull Guidance, would generally be included elsewhere as part of the general corporate governance disclosures.”*

There were also some opposing views. For example BDO Stoy Hayward said *“There is considerable scope for linkage between the two statements but we would not support the inclusion of the corporate governance statement within the OFR.”* By way of contrast Grant Thornton suggested *“The new OFR seems to us to be the most appropriate place for directors to make disclosures on internal control.”*

The ACCA, Chartered Institute of Management Accountants (CIMA) and ICAEW believed that there should be a co-ordinated approach to the complementary disclosures under Turnbull and the OFR. The ACCA also wanted disclosure of a company’s risk appetite. CIMA summarised by stating *“there are clearly linkages between Turnbull and the OFR in the sense that boards will have to undertake the same work of reviewing risks and processes. However the actual aims and objectives of the two disclosure mechanisms are clearly distinct. Nevertheless, there should be appropriate cross-referencing between the two.”*

The Tax Justice Network also believed the two documents dealt with different issues and noted *“it is vital that these issues be seen as related elements of the management of risk, but to merge the two would be a mistake.”*

The IIA, on the other hand, had a somewhat different view. They noted that *“The introduction of the OFR provides an opportunity to reconsider where such disclosures should be. Since the risks that a company faces or is taking belong in the OFR, it might be appropriate for disclosures about the appetite for taking them, the responses to them and the assurances received to be included in the same location.”*

3.5 Consultation Paper: Question 12

What are the advantages and disadvantages of turning the board's private assessment of effectiveness into a public statement of their conclusion on effectiveness?

Comments from investors and their representative bodies

Some respondents in this category were in favour of turning the board's private assessment of effectiveness into a public statement of their conclusion on effectiveness. The other respondents either thought that a public conclusion added little or no value, or variously wanted more discursive information.

Three investment institutions, Barclays Global Investors, Fidelity Investments International and Merrill Lynch Investment Managers, considered that effectiveness statements had little or no value.

Barclays Global Investors stated *"We see little value in requiring a statement on effectiveness. It would be difficult to establish a benchmark for effectiveness therefore such a statement would have little value. There would be a greater risk of litigation based on the definition of effectiveness, with consequent legal costs eroding shareholder value."*

Fidelity Investments stated *"A statement by a Board that its controls are 'effective' would add no value to Fidelity as an investor. We are endeavouring to find the best companies to invest in nationally and internationally and a subjective self-certification does not aid in a comparison of one company with another. There is increased potential for litigation if investors allege that they relied on such a statement that later proved to be untrue. There is a risk that fear of such litigation could stifle risk-taking and innovation amongst London list companies."* Referring to the Sarbanes-Oxley Act, they went on to note that in the US *"It is too early for there to be any firm conclusions on the value of this information to investors but there does not appear to have been any change in share price as a result of the new disclosures."*

Merrill Lynch Investment Managers considered that there should be no requirement for *"a public statement which might lead to additional costs and even discourage disclosure."*

In paragraph 26 of the Review Group's evidence gathering consultation paper, the Review Group noted that there may be other forms of disclosure that would provide useful information to investors while avoiding some of the perceived pitfalls (some of which we identified for respondents to agree or disagree with) associated with effectiveness statements.

The ABI stated *"We agree with the reservations on this approach set out in paragraph 26 of the consultation document, particularly the difficulty of defining the word effective, the potential for increased liability and the possible creation of an expectations gap. The reality is that no system of risk management and internal control can provide an absolute guarantee."* Morley agreed and both went on to suggest alternative disclosures in their answers to Question 13.

The IMA commented that as stated in the first consultation paper *"the difficulties of requiring the board to state publicly their conclusions on the effectiveness of the internal controls are that: effective can be difficult to define; and directors could be*

concerned that such a statement would leave them open to increased litigation and liability. We would question the value of the existing disclosure that ‘the board has reviewed the effectiveness of the system of internal controls’ if, as stated in the CP, requiring them to conclude on the effectiveness would discourage them from being frank about shortcomings and would involve additional costs.” They also went on to suggest alternative disclosures in their answer to Question 13.

PIRC commented that “we recognise that companies that lead on disclosure issues can find themselves at a competitive disadvantage or subject to greater scrutiny because of their increased transparency.” They concluded “there is always of the danger of creating unduly negative sentiment so that the disclosure of a risk creates a self-fulfilling prophecy.”

Hermes approached the matter differently. They noted the directors’ personal liability concerns but believed that “the scope for litigation on such matters in the UK is extremely limited, and the personal financial risks have been further reduced by the recent changes to the law on directors’ liability. We think therefore that directors should feel more confident in expressing to their shareholders their view that risks are being managed as effectively as is reasonably to be expected in our uncertain world.”

Two institutions, the CIS and Standard Life Investments supported effectiveness statements.

CIS stated “we cannot understand why the board would not share its view of effectiveness with shareholders; we consider that, regardless of whether the internal control system is deemed effective or not, this information should be disclosed to shareholders, together with an indication of the corrective actions that are being taken to address any material deficiencies.” In the context of Section 404 of the Sarbanes-Oxley Act they commented “Whilst we accept that this has led to an increase in audit fees and the ‘compliance burden’ for affected companies, we regard this as a form of insurance against the sort of failings that led to that Act in the first place.”

Believing that the audit committee should have responsibility for reaching conclusions as to the assessment and effectiveness of internal controls and recommending to the board the substance of the public statement that should be made, Standard Life “favour strongly the private assessment being made public in accordance with good principles of corporate governance and the spirit, if not the letter, of the continuing obligations under the Listing Rules.”

Comments from companies and their representative bodies

Fifty-one listed companies responded to the consultation paper. Of these, only two companies were in favour of turning the board’s private assessment of effectiveness into a public statement of their conclusion on effectiveness. There was no support from representative bodies.

Comments from the respondents who thought that disadvantages outweighed the advantages

We outline below the comments received in each main category from the overwhelming majority of respondents that believed that disadvantages significantly outweighed the advantages.

Advantages

The two main potential advantages identified by those that responded to this matter were:

- increased disclosure; and
- increased focus and attention

Increased disclosure

A number of respondents thought that this might provide some visibility of the effectiveness of internal controls. A small number of these respondents thought, in theory, that the advantage of turning the private assessment into a public statement may increase investor confidence in corporate reporting and governance. However, one respondent also noted that there is no evidence to suggest any lack of confidence in the UK reporting and governance environment.

Another respondent thought that it potentially may equip investors with increased information on the system of internal controls, to the extent this information is not provided elsewhere in annual reports and other public statements.

Increased focus and attention

A smaller number of respondents thought that it might add additional rigour within some companies or further focus the attention of the board and others within the company on risk management and internal control. However, a number of these respondents noted that risk management and internal control was already high on the agenda within companies and a respondent commented that the added value in a well run company with clear business objectives and regular monitoring is questionable.

Another respondent mentioned the effect of the existing guidance when they noted that making a public statement on the conclusions drawn from the assessment would have the advantage of holding people to account and should encourage, as they believed the Turnbull guidance already does, good stewardship.

Disadvantages

Overall comments

Tesco plc stated that *“We would be strongly against the introduction of a public assessment of effectiveness. A thorough assessment of effectiveness of the company’s internal controls demands open and frank scrutiny by the Directors. This could be compromised if these matters were to be made public. Turnbull recognises it is the nature of business to take calculated risks.”* Noting Section 404 of the Sarbanes-Oxley Act, Tesco commented *“The likely result will be a distraction for Boards. They will spend time determining what constitutes a ‘material weaknesses’ for disclosure, rather than concentrating on the effectiveness of controls to mitigate the risks themselves.”* In concluding, they noted that a public statement of effectiveness will mean extra costs and added bureaucracy without corresponding benefits.

William Hill PLC, supporting a point raised by the Review Group’s consultation paper, said *“we note that disclosing that a system of internal controls is effective may imply that controls can offer absolute assurance against misstatement or loss, when in fact, no system of control is proof against human error or deliberate override.”*

The consultation paper identified some issues associated with any move to publicly stated conclusions on the effectiveness of internal control. Respondents generally agreed that these issues were of concern to them and provided the Review Group with many additional comments and concerns which are sub-categorised in the following headings:

- the potential for increased litigation and liability;
- increased costs, resources, time and compliance burden;
- a more cautious approach and a potential impact on risk taking;
- the potential for misinterpretation of resultant disclosures;
- prescription and definitions; and
- other matters.

The potential for increased litigation and liability

This was a major concern for many respondents. For example, Anglo American plc said *“Opening the door for litigation on such a judgmental matter as the effectiveness of an enterprise’s system of control, which is partly based on the opinion of various parties internal and external to the organisation, is not in the investment community’s interest.”*

BP plc commented that *“liability concerns may then be considered to drive the process rather than a more enlightened, holistic view, necessary to leverage the potential upside for the business in refining internal control systems.”*

Dixons Group plc commented *“We are nervous in an increasingly litigious society, of any proposals that would require the Board to say more in published statements about their conclusions on effectiveness. Any expanded statement would be likely to be so qualified as to be of dubious value in any event. We see no advantages in such a requirement but it would lead inevitably to greater costs.”*

Noting that a key issue with any such public statement is liability, other points specified by respondents included:

- an obligation to report publicly on these matters would inevitably increase the scope for legal challenge, a consideration that could have the effect of reducing the clarity, comprehensiveness and, therefore, the value of the public statements which would be heavily caveated;
- the board’s review would be turned into a defensive exercise; and
- public statements could make companies more risk averse to a degree that affects business performance.

Some respondents noted the potential consequences for recruiting non-executive directors. For example, one respondent noted *“Non-executive directors are increasingly concerned about their personal risk and an increased pressure for this type of disclosure is likely to reduce the number of willing non-executive directors and increase the cost.”* Another respondent noted that directors may be faced with increased workloads and personal risk, and therefore decide to limit the number of directorships they hold and this may result in the scarce resource of experienced non-executive directors becoming scarcer.

Increased costs, resources, time and compliance burden

A considerable number of respondents noted the likelihood of a substantial increase in costs, use of resources and an increased compliance burden with a substantial level of documentation that would be required to support such a public statement. One respondent summed up by noting that this would potentially end up as a major exercise driven simply to protect the organisation from the liability of making the statement, rather than necessarily improving the system of internal control.

Experiences in the US and elsewhere on the costs and time devoted to Section 404 of the Sarbanes-Oxley Act have become well known over the last few months and are not repeated here; except to say that a number of commentators noted that Section 404, being limited to internal control over financial reporting, is much narrower in scope than the Turnbull guidance.

The Review Group were informed that there would be substantial consequences for such a move in the UK, particularly for the many medium and smaller listed companies and potentially on the London Stock Exchange.

ITV plc which suspended its US registration (with SEC) and thus its reporting obligations commented that *“It is estimated that the US reporting obligations would have resulted in cash costs to ITV of £4 million in 2005, be very costly in management time, and confer no material benefit to ITV.”*

A more cautious approach and a potential impact on risk taking

This matter was mentioned by a number of respondents. For example, Cadbury Schweppes plc stated that such a statement *“may detract from the appetite of boards to pursue the rewards for successful risk-taking.”*

Comments from other respondents included:

- the quality and timeliness of the board’s judgment on major issues could be adversely affected by the greater disclosure requirements. This could make boards more risk averse and less likely to make decisions going against conventional wisdom; and
- such statements may lead to risk and control processes being regarded less as matters of sound business practice and more as an exercise in regulatory compliance.

The potential for misinterpretation of resultant disclosures

Comments from respondents included:

- shareholders and other stakeholders may over-react, creating unnecessary volatility in the share price. Directors and management could be diverted by this from other more valuable activities; and
- a reader of a statement that describes internal controls as effective may not share the board’s view of what constitutes an acceptable risk, or an acceptable degree of exposure to a risk. Thus the reader might look for a greater degree of control than the board before regarding that control as effective.

The CBI commented that *“as the Turnbull guidance recognises, there will always be mishaps. The danger is that company statements on effectiveness may become either glib or foolhardy, and that statements of ‘effectiveness’ may be misinterpreted by investors, as no system can ever be 100% effective.”*

Finally, the Royal Bank of Scotland Group plc noted that such statements raise *“the question of whether the majority of investors realise the difference between a board which makes a public statement that it has reviewed the system of internal control and a board which actively comments on the effectiveness of the system of internal control. Although this may at first glance seem to increase transparency and allow comparison of effectiveness of similar organisations’ internal controls, there are significant difficulties in defining and interpreting control effectiveness to ensure a consistent standard, without over-burdening companies with too prescriptive an approach.”*

Prescription and definitions

A significant number of respondents commented on this matter. William Hill PLC noted that *“Even if something as subjective as ‘effectiveness’ could be defined in a manner that would meet the varied situations of all companies, there would be the inevitable difficulty in ensuring that each company discloses in a comparable manner. Investors may make ‘inappropriate’ investment decisions when comparing those companies favouring a more open and comprehensive approach to disclosure against the disclosures of other companies with less transparent approaches. We believe that given how subjective any definition of ‘effectiveness’ would be, any difficulties currently faced by investors in comparing companies would only be exacerbated by introducing a public statement on boards’ conclusion on effectiveness.”*

Diageo plc said *“There is a major block to making the board’s assessment public: there are widely differing interpretations that can be placed on ‘effectiveness’. No risk management or control framework can or should prevent all failures. Boards and senior management continually have to take judgements on an appropriate balance of cost and benefit in relation to the management of risk. After a risk management or control failure has occurred, it is especially likely that a judgement properly taken would be called into question.”*

We were informed that, if the UK were to move towards public stated conclusions of effectiveness statements, then there would be a need to introduce into our principles-based approach a substantial amount of prescription which as Reckitt Benckiser plc noted *“would defeat one of the original purposes of Turnbull to enable each company to apply the guidance in a manner which takes account of its particular circumstances.”*

Other matters

The Review Group received a number of additional comments on the potential consequences of turning the board’s private assessment of effectiveness into a public statement of their conclusion on effectiveness. These included:

- the possibility that such a requirement may discourage companies from being frank internally about shortcomings and the need for improvements in their risk management and control framework;
- transparency to shareholders will also give rise to transparency to competitors who may be able to exploit potential weaknesses (and not have to report themselves if they are not listed); and

- there is an additional risk of making disclosures too detailed and prescriptive, which is that companies could be forced to disclose information which is commercially sensitive or to disclose information which increases the risk of being defrauded. Published disclosures should therefore be kept high-level rather than detailed.

The Quoted Companies Alliance said *“Market uncertainty would inevitably result and, indeed, it is difficult to believe that if such information were significant (and therefore helpful to shareholders) the board could continue unchanged. The key issue is that the board examines the effectiveness of the company’s internal controls and shareholders must be concerned to see that such examination is happening. On this issue, we believe that the investors must rely on the independent non-executives to ensure that the private assessment of effectiveness is in itself effective. We are convinced that the board’s private assessment should remain exactly that, private.”*

Comments from the two respondents who thought that advantages outweighed the disadvantages

The Review Group were informed by Vodafone that their *“Group board took the view that there seemed little point in informing the shareholders that an evaluation had been undertaken without confirming the conclusion of that evaluation and explaining the limitations implicit in any such review.”*

Pearson plc, whilst noting the current disclosure requirements as well as the disadvantages of the board publicly giving an effectiveness conclusion, said *“On balance, however, we believe that boards should communicate their effectiveness conclusion.”* They added that any reporting change should not *“be accompanied by, a requirement to introduce a prescriptive, externally audited, verification of controls.”*

Comments from others

Although there were a wide range of views, respondents in the ‘other’ category reflected many of the earlier comments made by companies and investors. A number also quoted the matters referred to in paragraph 26 of the Review Group’s first consultation paper.

Overall there was a negative or cautious attitude to the idea of turning the board’s private assessment of effectiveness into a public statement of their conclusion on effectiveness. However, at the other end of the spectrum, there were a few respondents who were in favour, including a special interest group.

The London Stock Exchange said *“As the consultation paper points out, there are a number of issues militating against a public statement on the effectiveness of internal controls. We agree that the concept of such a public statement differs in the circumstances of the UK and US regimes, in that the principles of the former are far broader than the rules of the latter, making ‘effectiveness’ problematical to define in the UK. Also, the additional liability leads to the risk of greater litigation, which would be of considerable disbenefit to UK plc.”*

Of the accounting firms Ernst & Young, Grant Thornton and KPMG did not favour the idea of public statement of their conclusion on effectiveness. Ernst & Young said *“in our opinion the interests of users of annual reports would be better served by improved information on specific business risks and the controls in place to mitigate them, than by assertions about the effectiveness of internal controls as a whole.”*

Many of the other accounting firms expressed concerns about a public effectiveness statement, noting the potentially significant liability and litigation risks for boards and the experience of implementing Section 404 of the Sarbanes-Oxley Act.

PwC noted the difficulty within the UK wide context of internal control of the use of the word ‘effective’. However they also stated that *“The current position, in which if nothing is said publicly, the presumption is that all is well with the controls, is not likely to be acceptable to meet the needs of investors and regulators in the future, because of the comparisons that will be made with SEC registrant companies’ reporting under S404 of Sarbox. In the UK, in order for directors to report publicly, there would need to be some kind of framework for their reporting.”*

The ACCA stated *“We are unsure what value public statements on effectiveness may have, given the inherent subjectivity of the assessment process. We would therefore prefer that there is no regulatory requirement for companies to make public effectiveness statements. We would, however, be happy if any revised guidance recommended or encouraged companies to make such a disclosure and hope that best practice would develop via which the users of such statements (internal and external) receive a benefit that exceeds the cost of producing them.”*

Finally, a few respondents were in favour of turning the board’s private assessment of effectiveness into a public statement of their conclusion on effectiveness. For example, the Tax Justice Network commented that *“If a risk is known to exist then a shareholder, as owner of the company, valuing their interest on the basis of likely future cash flow needs to be made aware of it if it is material to that process of valuation. In addition, other stakeholders such as employees and the government have a right to know that the taxation affairs of the company, in the fulfillment of which it has a duty to broader society, are properly managed. For both these reasons disclosure is essential and if this exposes management to criticism for failure to manage risk, then that is to be seen as a benefit of the system, not a weakness. There is no case for not disclosing the assessment.”*

3.6 Consultation Paper: Question 13

Would boards and investors wish to see additional disclosures on the outcomes of the boards’ review of effectiveness and actions taken following that review? If so, what information would be appropriate?

Analysis of the responses to question

Five main themes were identified on additional disclosures:

- a general desire for more informative disclosure;
- information about key risks and how they are managed;
- information on the outcome of the results of the board’s review, stopping short of an effectiveness opinion by the board;
- information on the outcome of the results of the board’s review, to supplement an effectiveness opinion by the board; and
- actions taken on weaknesses.

Comments from investors and their representative bodies

The majority of investors want more informative discursive disclosure that would provide an opportunity for companies and investors to engage on the topic of risk management and internal control. What is somewhat less certain is just what that disclosure should be and how much there should be. Some respondents wanted concise information and others wanted fuller disclosure.

A number of respondents wanted disclosure of some information about key risks and how they are managed. For example, Hermes suggested that companies highlight perhaps four or five key areas of risk and give a brief insight (no more than a single paragraph) into:

- the framework in place to manage those risks;
- the ways in which the manageable aspects of those risks are being managed; and
- ways in which the management of those risks has been improved over the year.

The IMA suggested *“more informative disclosures that indicated areas of risk, how those risks are monitored and controlled and that those controls that are effective and those which need to be developed.”*

Both the ABI and Morley commented that *“the opportunity for engagement with shareholders which should follow from discursive discussion of risks and how they are managed should of itself contribute to good management of risk and improved confidence.”*

Two respondents, the CIS and Standard Life Investments, specifically suggested that boards should disclose the outcome of the results of the board’s review, as well as providing an effectiveness opinion by the board.

Standard Life Investments stated that they *“would welcome additional disclosures on the outcomes of a board’s review of effectiveness and the actions taken following that review.”* They went on to say that *“the sort of information that would be appropriate includes a summary of the scope and/or limitations of the internal control review and the key actions being taken to improve the control environment. The level of disclosure should be sufficient as to be meaningful but it should respect issues such as commercial confidentiality.”*

The CIS wanted the board to *“share its view of effectiveness with shareholders; we consider that, regardless of whether the internal control system is deemed effective or not, this information should be disclosed to shareholders, together with an indication of the corrective actions that are being taken to address any material deficiencies.”*

A number of respondents commented on disclosure on actions taken on weaknesses. Morley suggested that where controls have been found wanting, the report should recognise this and report on the remedial action taken.

Another investment institution suggested disclosure of an action plan which followed the board’s decision to amend its control systems. They acknowledged that this would leave the company subject to potential litigation, especially US class actions, which might limit what companies may be prepared to disclose for fear of compounding the situation.

PIRC wanted disclosure of both the outcome of reviews and the action taken. They referred to part of their response to Turnbull working party in 1999 saying “*Companies need to admit to failings, not as part of some ritual soul-cleansing, or to ‘wipe the slate clean’ following a change of management but to stress management ability in the remedial action being taken. Provided that a clear rectification strategy is set out, and directors are not seen to be receiving excessive remuneration at the same time, responsible investors will be able to take these statements in their stride.*”

Comments from other respondents called for:

- information that enables investors to detect when companies fail to maintain adequate systems (UBS Global Asset Management (UK) Ltd);
- more information on management processes and systems (Merrill Lynch Investment Managers).

Finally, both the ABI and Morley considered that paragraph 38 of the 1999 guidance (which refers to the disclosure of the process boards have applied to deal with material internal control aspects of any significant problems) needed to be re-examined and, if necessary, clarified.

Comments from companies and their representative bodies

The overwhelming majority of respondents considered that additional disclosure was not needed. A number of respondents referred to the disclosure requirements of the new OFR. Some respondents recognised that on this issue the views of boards and investors may not be in agreement.

Many respondents expressed general satisfaction with the current disclosure requirements. In addition, the Review Group was advised by some to wait and see how OFR disclosures develop and thus how additional disclosure might evolve as companies respond to investor demand. BP plc said “*given the impending development of OFR disclosures, it is suggested that the prevailing view is that those developments should be assessed in practice before further intervention is necessary.*”

A considerable number of companies in both the FTSE 100 and 250 were concerned about the provision of additional disclosure. One respondent commented that it is not unreasonable for investors to assume that in the absence of specific disclosures, internal controls are adequate. Another stated that “*The guidance provides for circumstances where if there are significant breakdowns in control then these should be disclosed. If there are no breakdowns then there seems little to gain by encouraging further disclosures.*”

Other specific disadvantages cited by individual respondents included a danger that more specific disclosures on weaknesses could result in undue concern by investors and could be taken out of context; and the potential volume of disclosures could overload annual reports.

The majority view was summed up in the response from the Quoted Companies Alliance, which stated:

- “*Concentration in disclosures on an effectiveness problem might disguise an otherwise excellent record on effectiveness. Full information, however, might lead to many pages of, at best uninteresting and at worst self-serving, disclosure.*”

- *We cannot see that it would be in the interests of either companies or their investors to make public declarations of actions taken following a review. Action taken will clearly be remedial action arising from an effectiveness problem. Publicising a problem, even if it has been dealt with, could have an unnecessary negative impact on market sentiment. Identifying problems that have not yet been dealt with will inevitably result in uncertainty.”*

The CBI, noting that the current Turnbull approach remains sound, also commented *“If investors feel that disclosure could be improved, boards would welcome more direct feedback to that effect to see whether this could be resolved via dialogue rather than additional disclosure requirements.”*

The Review Group received some suggestions for additional disclosure including:

- focusing on the changes made since the last annual report and the board’s plans for improvements in the future;
- encouraging companies to reflect the fact that they are taking steps to develop their controls or risk management in specific areas where this is the case; and
- recommending a maturity assessment of the internal controls framework.

On the matter of disclosure of the outcome of the results of the board’s review, stopping short of an effectiveness opinion by the board, Scottish Power plc made the comment that *“investors would benefit from receiving additional information with respect to the outcome of the board evaluation, especially when ‘material internal control aspects’ have been identified during the evaluation. The information should include a high level summary of the process adopted by the board to perform this evaluation together with a statement on whether the board’s review has assessed the internal control system to be effective.”*

Disclosure on actions taken on weaknesses found favour with a number of respondents, but there was not full agreement on the extent of disclosure. Views were expressed that there could be some additional value in confirming that any findings have been acted upon, but the benefits might not outweigh the costs of detailing the outcomes of the review and the actions taken.

Friends Provident plc suggested that disclosure *“on the actions taken or being taken to strengthen internal controls may prove helpful and allow an insight into the identified weaknesses without the requirement to explain those weaknesses in detail.”* Pearson plc went further: *“additional disclosure would be helpful on any significant control weaknesses and any corresponding actions. However, it is clear that what constitutes a significant control weakness would need to be more clearly defined, without becoming prescriptive.”*

However, there was not universal agreement. BSkyB, noting the difficulties in highlighting areas for improvement and saying that there was no great appetite to make such disclosures, took a different view. They commented *“We believe that there is little value in the addition of disclosure along the lines of ‘where the Board has found areas for improvement it has taken the appropriate remedial action’.”*

Comments from others

Comments from respondents in this category spanned a wide range of views from ‘no additional disclosure necessary’ to specific suggestions for potentially substantial additional disclosure on taxation, risk appetite, and assurance and matters related thereto. The disclosure requirements of the mandatory OFR were mentioned by a number of respondents.

Expressions of general satisfaction with the current disclosure requirements were received from some respondents. For example, individuals who are directors suggested firmly that there should not be additional disclosure.

Several respondents referred to the topic of litigation risk. The London Society of Chartered Accountants and BDO Stoy Hayward both noted that boards are likely to avoid highlighting errors and the resultant disclosures of outcomes are likely to be defensive. They believed that directors may feel more inclined to report outcomes more openly if they did not feel at risk from litigation.

Supporting the disclosure of some information about key risks and how they are managed, Ernst & Young commented that *“the interests of users of annual reports would be better served by improved information on specific business risks and the controls in place to mitigate them, than by assertions about the effectiveness of internal controls as a whole.”*

Going further, Deloitte suggested *“investors would find useful more explanation of the outcomes of the review of effectiveness, such as steps taken or planned to improve controls where significant problems that are disclosed in the annual report arise from weakness in internal control.”*

On the subject of disclosure on actions taken on weaknesses, Grant Thornton stated *“We believe that a description of the significant changes made to the system of internal control would be useful. The reader might benefit from knowing whether the changes arose from ‘remedial action’ or from fundamental changes in the composition of the group (such as a major acquisition that materially affects the nature and focus of the business).”*

3.7 Other information

The following headline results from the MORI surveys are drawn from the questions in the surveys that relate to the internal control statement made by companies in their annual reports.

MORI Survey of directors

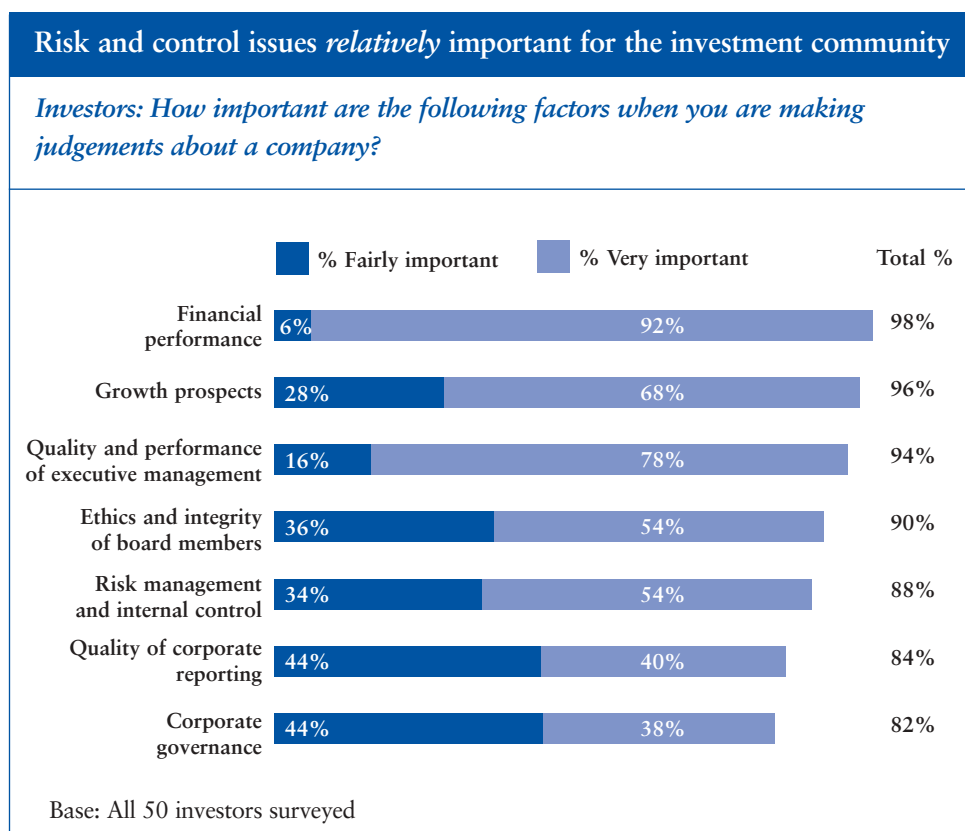
Asked how happy they would be making a personal statement in a public document on their conclusions about whether your company’s internal controls are effective or ineffective (excluding those respondents who do not offer an opinion), 54% would not be happy, 32% were fairly happy, 13% were very happy. Directors of companies whose market capitalisation was up to £99m were the most happy to make such a statement, whilst those who were not all happy to do so were directors of companies in the £100m to £499m range.

Asked how frequently significant problems mentioned elsewhere in the annual report led to disclosures in the internal control statement, interviewees responded: always 11%, frequently 5%, occasionally 12%, rarely 20%, never 36%, and 16% did not know.

When asked how often, if at all, were internal control matters raised in meetings that they attend with investors, those directors who attended such meetings responded: 34% – never; 49% – rarely; 15% – occasionally; 1% – frequently and 1% – always.

MORI Survey of investors

Investors were asked to rate the importance of a number of factors when making judgements about a company.

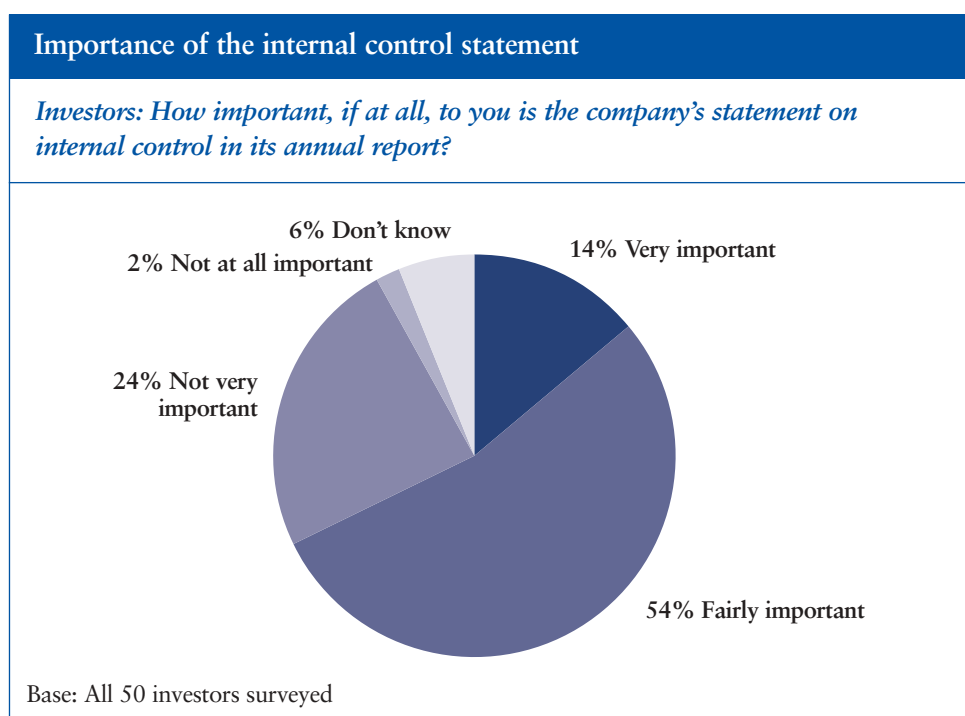


60% of investors interviewed said that they would be satisfied that shareholders would be made aware if the board identified significant shortcomings in the effectiveness of its internal controls. 32% were not very satisfied and 8% did not know.

When asked if a company reported problems with the effectiveness of its internal controls, how likely is it that that, in itself, to lead an investor to downgrade their rating or reduce their stake in that company, 46% said it depended on the circumstances. 36% said very likely, 8% were fairly likely, 4% did not know, and 6% were not likely to downgrade their rating or reduce their stake.

72% of investor interviewees said they were satisfied that they received adequate information about a company's internal controls. 22% were not satisfied and 6% did not know.

Investors were also asked about the importance of the internal control statement.



Asked how frequently, if at all, either in writing or at meetings with directors did the investors ask for further information on the internal control statement or query its contents, 22% indicated fairly frequently, 50% said not very frequently, and 28% stated not at all frequently.

Investor interviewees were also asked how frequently, if at all, they questioned company directors specifically about the following matters:

Asking questions about	Degree of Frequency			
	Very	Fairly	Not very	Not at all
Directors' understanding of the risks to which their business is exposed	30%	44%	12%	14%
The effectiveness of their risk management and internal controls in general	16%	42%	30%	12%
The effectiveness of their internal controls over financial reporting	14%	46%	30%	10%

Disclosures

In November 2004, Grant Thornton issued their third survey of corporate governance disclosures in the annual reports of many companies in the FTSE 350 (98 companies in the FTSE 100 and 216 companies in the FTSE 250). These disclosures included a number that related to the disclosure items of the Turnbull guidance.

Set out below are the results of Grant Thornton's judgements for 2004 (based on annual reports issued in the period up to July 2004).

Question	Overall		
	FTSE 100	FTSE 250	FTSE 350
1 Is there disclosure that the board regularly reviews the process of internal control?	98%	96%	97%
2 Is there a statement that a review of the effectiveness of the group's system of internal controls has been undertaken at least annually?	96%	93%	94%
3 Is there an indication that the review covers all material controls including financial, operational and compliance controls and risk management systems?	80%	73%	75%
4 Is there a statement that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, it has been in place for the year and up to the date of the approval of the accounts, and is it regularly reviewed by the board and accords with Turnbull?	92%	88%	89%

Question	FTSE 100	FTSE 250	Overall FTSE 350
5 Is there any additional information to assist understanding of the risk management and internal control process as a whole?			
• Good	79%	62%	67%
• Some	15%	35%	29%
• None	6%	3%	4%
6 Is there a summary of the process the board/committees have applied in reviewing the effectiveness of the internal control system?			
• Good	17%	19%	19%
• Some	46%	39%	41%
• None	37%	42%	40%

Overall, during the last three years there appears to have been continued improvement in disclosures, particularly those in the annual reports of FTSE 250 companies which are catching up to the levels achieved by the top FTSE 100 companies.

Some comments on specific questions:

Q3. Grant Thornton commented that 25% of companies in the FTSE 350 “*don’t make it clear that their review encompasses financial, operational, compliance and risk management controls. This may be because of weak disclosure, but this at least means that three-quarters of companies appear to recognise the need for consideration outside of the traditional financial controls.*”

Q5. Grant Thornton commented “*The level of additional information that we believe is useful to the readers of accounts continues to grow apace. Now over two thirds of companies in the FTSE 350 (from under a third in 2002 and around a half last year) provide a ‘good’ level of additional information. Furthermore the percentage of companies that provide no information in addition to the guidance set out in Turnbull, is down to just 4% of companies.*”

Q6. This question is based on paragraph 38 of the 1999 Turnbull guidance. Grant Thornton commented “*when asked to describe how they have conducted this review, around 40% of companies did not set out how this process was conducted, instead companies often list all the sources of assurance they have. A further 41% only minimally describe what is undertaken in this review leaving fewer than one in five companies giving a good indication of the review process.*”

4. The role of the external auditor

4.1 Summary of evidence

Responses to the consultation exercise were consistent on this issue, with similar views being held by business, investors and the accountancy profession. The general view was that the activities of the external auditor in reviewing the company's internal control statement, while limited, provide additional assurance to boards and shareholders and should therefore continue to be undertaken. However some investors considered that the auditors' oversight role in relation to the internal control statement may inhibit fuller disclosure by the company.

The existing powers and remit of the external auditors were considered sufficient and there was virtually no support for the external auditor's role to be extended; in particular, there was no support for the external auditor being required to attest as to the effectiveness of the company's internal controls.

The main arguments against an expanded role were that it was not appropriate for the auditors to be asked to second guess the board's decisions about how to respond to many non-financial reporting risks that could not be measured against an objective standard, nor were they qualified to do so; and that evidence from the implementation of Section 404(b) of the Sarbanes-Oxley Act in the US suggested that there could be significant direct and indirect costs for the company if the external auditor were required to attest as to the effectiveness of internal controls, particularly as the range of controls covered by the Combined Code and Turnbull guidance was broader than those covered by Section 404.

4.2 Consultation Paper: Question 14

What benefit does the existing work performed by external auditors on internal control, and the subsequent dialogue with the board, provide to:

- (a) the board of a company; and**
- (b) investors?**

Comments from investors and their representative bodies

Most investors who answered this question generally believed that the work of the external auditor provides a welcome degree of external validation and perspective. Investors are comforted that there is a process for reviewing the system of internal control supported by documentation and the statements made by a board have credibility and are sustainable.

Fidelity Investment International stated that *“Whilst the statement on internal controls does not influence the investment decision it is important that a company has internal controls in place. Investors are not in a position to review the statement on internal control and so the auditor review is helpful to ensure that the Board addresses its mind to the issue.”*

One respondent noted that the review by the external auditors should also provide the independent non-executive directors with an appropriate degree of confidence to assist them to take responsibility not only for the internal control statement but also for the financial statements.

With an opposing viewpoint, the Co-operative Insurance Society thought that the assurance provided to investors at present can only be minimal at best and that external auditors should indicate in their audit report whether, in their opinion, there are any weaknesses in internal control that give rise to the potential for material mis-statement in the financial statements. They believed this would provide assurance on the standard of internal control without placing too great a burden on the external auditors.

Comments from companies and their representative bodies

Corporate respondents to the consultation paper said that the existing work of the external auditors on the controls work undertaken as part of their financial statement audit and their review of the internal control disclosures provided benefit to boards.

Whilst some respondents were more positive than others, overall respondents saw benefits in:

- an independent view;
- the additional comfort provided on the integrity of the financial statements;
- capitalising on the work on assessing/testing internal controls undertaken to support the auditors' opinion on the financial statements;
- the ability of auditors to form a view of best practice in control systems based on experience gained across their client base;
- the provision of auditors' analysis and observations on specific internal control issues;
- arm's-length observations of risk management processes, capabilities and culture in other parts of the business are useful to strengthen the boards' role in reviewing the effectiveness of internal control;
- an evaluation of the basis for the board's statement on internal control and confirmation that it is supported by documentation;
- providing some assurance to the board and investors at moderate additional cost;
- ensuring that the board and management would not lay claim to internal control processes that it knew were not actually in place.

Respondents also considered that investors benefited by receiving independent confirmation that the board has conducted an appropriate review process, supported by documentation.

One respondent stated that the external auditors' work "*provides a degree of external validation and perspective which is of undoubted value to both the board and investors. In our experience, the auditors' review provides sufficient challenge to ensure that the Turnbull statements are based on actual work performed and hence are sustainable. Any concerns raised by the auditors will be seriously scrutinised by management and audit committees and reported to the board who will seek assurance that appropriate steps are being taken to deal with the issue as part of their review of internal control effectiveness.*"

A small number of companies were less positive on the benefits to either the board, to investors or to both.

Comments from others

The external auditors generally believed that the existing work they performed on internal control, and the subsequent dialogue with the board, provides auditors with the opportunity to make common sense suggestions that can enable companies to improve their systems of control. In addition, they noted that the work on the Turnbull disclosure statement provides investors with some assurance that the directors' summary of the process used to review the effectiveness of the system of internal control is not misleading.

Overall, the auditors generally thought that their involvement in this area enables a useful 'sense check' to be made of what is disclosed without resorting to the level of work expected under the Public Company Accounting Oversight Board Auditing Standard No.2 in the US.

4.3 Consultation Paper: Question 15

What are the advantages and disadvantages of extending the external auditors' remit beyond the existing requirements? If you consider that any change should be made to the existing remit, what might this be and why?

Comments from investors and their representative bodies

In general investors were content with the status quo and saw no obvious advantage of extending the external auditors' remit beyond the existing requirements for the internal control disclosures (Auditing Practices Board – Bulletin 2004/3). Some commentators even noted that the remit might even be reduced.

Believing that the current remit of the external audit is appropriate, one institution also noted that the International Standards on Auditing will enhance the level of auditor scrutiny on internal control as part of their financial statements audit.

It was noted that if the external auditors' remit were to be more detailed in its requirement there would be a risk that external auditors would seek to protect themselves against liability in their statement, which would then become of little value to shareholders.

A few investors commented that the role of external auditors should be aligned with that required under the new OFR.

The IMA considered that *“the existing role of the auditor in relation to the disclosures is sufficient and does not need to be extended. To ensure it focuses on the substance as opposed to the procedure, we believe it should be aligned with the audit requirement in respect of the OFR: to state whether the information given in the OFR is consistent with a company's accounts as well as whether any other matters that came to their attention in the performance of their functions as auditors of the company.”*

Comments from companies and their representative bodies

There was virtually no support for an extension to the role of the external auditor in relation to the internal control statement.

Some potential advantages were identified:

- an increase in the auditors' independent contribution to the assurance framework that supports a board's assessment of the effectiveness of a company's internal controls;
- a greater challenge of boards' risk management judgements, along with the controls, and on their reporting;
- making it more difficult for a company to make a bland high-level statement if there are issues on internal control which are unresolved; and
- progress towards a minimum benchmark and standard on how internal control systems are applied, monitored and reviewed.

Nevertheless, many disadvantages were mentioned. For example:

- the requirement for auditors to report on risk management and control processes would impose a significant burden on companies in terms of incremental bureaucracy to meet the additional test of 'auditability';
- there is a very strong possibility that there would be a focus by management on 'box-ticking' and on achieving a 'clean audit opinion', which could divert their attention and resources from actually addressing the specific risks of managing the business and this was the opposite of what was intended;
- there are limitations in what it would be reasonable to expect the auditors to be able to report on. Auditors would be reporting on a system of internal controls where inherently there are subjective judgements which need to be made, and it is difficult therefore to define what a 'clean audit opinion' would mean in this context. Audit opinions would likely to be heavily qualified, in the light of the recognition that no system of controls provides 'absolute assurance';
- auditors should not assume management's responsibility to reach conclusions on the effectiveness of the entity's controls nor should management base its assertion about the effectiveness of its systems of internal controls and risk management based upon the results of the auditors' tests;
- it is likely that companies would be forced into following a particular risk management model, irrespective of the nature of the business and risks faced by that specific business;
- duplication of effort was inevitable as existing internal management structures should be providing oversight and assurance to the board, and an auditor can never have the same level and depth of knowledge as an employee;
- there would be significant (potentially prohibitive) cost implications as well as an additional regulatory burden to UK listed companies;
- the risk of a transfer of responsibility from the board and management onto the audit firms with more legal and less board input, leading to more boilerplate disclosures;
- increased time required for non-executive directors on the audit committee with the possibility that this will make the position less attractive to potential candidates;
- increased board and management time on compliance with internal procedures and thus diversion of time away from strategic planning;

- risk of missed opportunities as resources are diverted away from projects which would have increased shareholder value; and
- loss of competitive position against other companies not subject to the same requirements.

In addition, the following points were made:

- responsibility for internal controls rests with the board and management and should not fall into the remit of the external auditor who can only ever assist the board on internal control and who cannot be a substitute for good management. Gallaher Group PLC said that *“ultimately auditors are ‘watchdogs not bloodhounds’ and there is a limit on how far responsibility or liability can be placed upon them, particularly when it comes to internal controls.”*
- the work of the external auditor needs to be viewed as part of a wider assurance package that may also include internal audit, regulatory reviews/audits, external advisors on specialist matters; and that the precise package of assurance should be tailored to the needs of the individual company. One respondent noted that where boards are concerned about the level of information they are receiving on internal controls, they are likely to be better served by strengthening the resources, and if necessary, the remit of their internal review/assurance functions than by extending the remit of external auditors. External auditors may then be able to place increased reliance on the work of the internal review function; and
- the main emphasis should remain on ensuring that each company has an effective board of directors.

The responses from corporate respondents could be summed up by the comment from BP plc which in addition to cost considerations stated *“given the holistic definition of the system of internal control, tied intrinsically to a company’s business model, any extension to the auditors’ remit could lead them to have to consider areas beyond their natural remit.”* Another multinational, Diageo plc, stated that *“we see no case for extending the auditor’s remit which is rightly focussed towards the reliability of financial statements. In particular, our experience of S404 Sarbanes-Oxley shows that external auditor attestation in relation to internal control would be counter-productive.”*

Comments from external auditors and others

External auditors

The majority of external auditors considered that as they already undertake work on assessing relevant controls as part of their financial statement audit, the benefits of extending their remit appeared limited. Moreover, to the extent that auditors review internal controls in an audit their review is limited to internal financial controls and they therefore cannot provide assurance as to the effectiveness of internal controls as a whole. If this were to be the case, the impact on audit fees would be likely to be significant if very extensive testing were to be required to support a public statement on effectiveness.

KPMG noted that it is not possible to meaningfully extend the role of the external auditor without significantly extending the requirements placed on boards. They stated that any extension beyond the current requirements such as a requirement *“to provide an opinion on either the effectiveness of the system of internal control or the propriety of the process used to carry out such a review would, in turn,*

significantly increase the burden placed on the board without any significant benefit for investors. In managing their own risk, auditors will quite properly seek ‘audit’ evidence before reporting publicly on internal control. This will inevitably lead companies to develop auditable processes, documentation, additional bureaucracy, and divert management time from running the business.”

Others

A few respondents stated that International Standard on Auditing (ISA) number 315 could extend the work of auditors on internal control over financial reporting in connection with their audit of financial statements. Similarly ISA 240 will increase the external auditors’ work on fraud.

Such additional work should increase the external auditors’ understanding of internal control within a company and may help to place auditors in a more informed position when they relate the directors’ statement on internal control to their own knowledge.

The ACCA also commented that *“Requiring more detailed reporting will probably mean that the whole assessment process (both by boards and by auditors) will become overly focused on objective testing and that the arguably more important subjective assessments (such as in relation to the control environment) will be scaled down or ignored.”*

One respondent commented that if boards and audit committees wish to gain additional assurance they may request external auditors to undertake some form of ‘agreed upon procedures work’ so that reporting can then clearly set out criteria against which auditors have reviewed the systems and their findings.

4.4 Consultation Paper: Question 16

What impact, if any, might an extended role for the external auditor have on the relationship and dialogue between the external auditor and the board and its committees?

Comments from investors and their representative bodies

Not being party to discussions between boards and auditors, unsurprisingly most investors and their representative bodies did not answer this question. Barclays Global Investors did, however, specifically comment that *“as an institutional shareholder we are not party to this dialogue. We suspect that if the auditors’ role is extended to specific detail then the value of their broad, open-ended duty may be diminished. Discussion may focus on fine points but miss the spirit of the remit to confirm consistency.”*

Comments from companies and their representative bodies

Whilst not supporting an expanded role for the external auditor most corporate respondents noted that a properly managed external audit relationship provides boards and audit committees with sufficient opportunity for effective dialogue and they hoped this would not change as the value of the existing dialogue is in its openness and candour, especially at the audit committee. Boards expect the auditor

to be open and frank in raising issues relating to internal controls. One respondent noted that only in a company where there was a problem with the internal control culture would there be material change in the relationship at board level.

One respondent was concerned that relationships between external auditors and their clients could move from one of independent assessor to compliance watchdog. They warned that this subtle movement in the relationship could risk losing advantages such as openness between the company and its auditors.

An SEC registrant suggested that an extended role for the external auditors could give rise to friction in circumstances where business judgements on the risk intrinsic in a particular business are open to challenge by auditors in an environment where concerns prevail about auditors' joint and several liability. This could reduce the currently valuable informal dialogue that occurs on auditing matters where the external auditor has no formal role but may have relevant experience and input.

Comments from others

Whilst accounting firms generally did not seek or support an extended role for the external auditor, they tended not to view the impact of any extension on relationships as an important argument against extension. Deloitte commented that *"We do not think an extended role for the external auditor would have a significant impact on the relationship between them and the board and its committees, as internal controls are generally being discussed already."*

BDO Stoy Hayward stated that *"An extended role for the external auditor would inevitably increase and deepen the dialogue with the board and its committees. This would arise as auditors extend the scope of their work which would inevitably lead to additional questions and discussions and, at the same time, it would also provide the audit committee with additional insights into the operation of the company. Such an impact is to be welcomed."*

5. Other information

5.1 Consultation Paper: Question 17

Are there any other matters that should be brought to the attention of the Review Group?

The layout in this section is in the form of issues raised, rather than by category of respondent as for the other 16 questions.

Developments in the EU

A number of respondents referred to the relevant aspects of the proposed revisions to the 4th and 7th Company Law Directives. Comments from respondents included:

Barclays Global Investors said *“We are aware that the EU is currently examining the question of internal controls and we would urge the Review Group to promote the advantages of the UK principles-based approach. On the other hand we are aware that the principles approach is unfamiliar in some jurisdictions and compliance may be an issue.”*

The Association of Corporate Treasurers noted that *“Given what we believe to be the relative success of the current Turnbull guidance arrangements, it is important that they are updated as need be to capture relevant changes called for at EU level rather than their being interpreted in a more prescriptive and rule-bound manner if at all possible.”*

Deloitte warned that *“Turnbull should be expanded to address any new requirements. Otherwise, the ‘Son of Turnbull’ would not meet future requirements and could no longer be adopted by any EU member state including the UK.”*

Refreshing the guidance

Standard Life Investments suggested *“In today’s business environment the risks being faced by companies can vary significantly from one year to the next. New risks arise, sometimes for reasons outwith the company’s control, and ‘old’ risks are mitigated by, for example, technology developments. Based on our discussions with companies we are not wholly convinced that all boards and management are refreshing their risk assessment processes on a robust and sufficiently regular basis. Therefore, we should welcome emphasis being given in the preface to the revised Guidelines to the importance of boards and management ensuring that their risk assessment profiles and related internal control systems (i) take into consideration new risks to the business enterprise and (ii) evaluate the continuing importance of previously identified risks.”*

Listing on the UK markets

Standard Chartered Group plc noted that *“Some international companies are considering withdrawal from the US regulatory regime. We would hope that any changes to the UK regime will not compromise the City of London’s competitive position as a leading international business centre.”* They went on to suggest that *“We would also hope that the Review Group take into consideration the relative attractiveness of being a listed company. It is not in the interest of investors for overly bureaucratic disclosure and governance rules to drive more companies into private hands (where many of the same investors still invest in them through PE/VC funds, often without such protections).”*

Extension of the guidance beyond listed companies

Barclays Global Investors said *“The voluntary, principles-based approach to corporate governance has worked well in UK. We do not believe it is in the interests of shareholders if corporate governance becomes such a burden that significant parts of the stock market choose to delist. There may be some advantage in extending the Turnbull guidance to unlisted but large companies so that a level playing field exists between competing firms.”*

Other regulatory requirements especially for financial services companies

A number of companies in the financial services sector noted that they are governed by multiple regulations/legislation with the Turnbull guidance being one of a number of requirements on internal controls arising from different sources and with which they must comply. They variously noted that there are many versions of regulation with similar objectives. These companies hoped that there would be some consistency of obligations to help reduce multiple approaches to the same topic.

Timing of implementation of the new guidance

Two companies and the Hundred Group suggested that the Review Group should consider the impact and timing of any changes resulting from the output of the review.

Timings of future reviews of the Turnbull guidance

The Quoted Companies Alliance stated *“On the assumption that any changes ultimately made to the guidance are slight, would the Group recommend a significant (and specified) period before the next review?”* Standard Life Investments suggested a five-year interval.

Appendix A

Sources of evidence and statistics

Sources of evidence

To help inform the Turnbull Review Group's discussions, the Group gathered evidence by the following methods:

- a public consultation paper asking for responses to 17 questions;
- telephone surveys of company directors and investors;
- discussions with interested parties; and
- desk research.

Statistics

The public consultation paper

The Review Group received 103 responses to the initial consultation paper which originated from:

FTSE 100 companies	45
FTSE 250 companies	6
Non-listed companies	2
Investors	9
Investor representative bodies	2
Professional bodies	7
Other representative bodies	8
Accounting firms	8
Others	16
	103

A list of all respondents, excluding those that requested that their comments remain confidential, is at Appendix B.

Companies

The market capitalisation, as at 28 February 2005, of the 51 listed company respondents was £857 billion. This represented 56.6% of the total market capitalisation of UK listed companies on the London Stock Exchange's main market.

Investors

Based on the information provided by the individual respondents, the total funds under management (assumed to be worldwide) are £2,367 billion for the individual institutions who have responded; and £3,100 billion for the two investor representative bodies who responded.

Surveys

On behalf of the Review Group, MORI undertook two telephone surveys, one of company directors and the other of individuals within investment institutions.

MORI survey of company directors

MORI completed 114 interviews with directors of listed companies from across all sectors.

Over 73% had been a board director of their company for over three years.

The job title of interviewees were: Chairman, Non-executive Director, Chief Executive, Finance Director, and other executive directors on the board.

88% of the non-executive directors were audit committee chairmen.

The market capitalisation of these companies fell into the following bands:

Up to £99m	27%
£100m – £499m	39%
£500m and above	34%

MORI survey of investors

MORI completed 50 interviews with individuals who worked for investment institutions.

The job title of interviewees included: Chief Investment Officer, Head of Research, Senior Analyst, and Senior Portfolio Manager.

70% of respondents invested in or followed companies in the FTSE 100, 72% in companies in the FTSE 250, and 58% in companies below the FTSE 350.

UK equity portfolio (assets under management):

Less than £1bn	25%
£1bn – £4.99bn	15%
£5bn +	60%

Appendix B

Respondents to the evidence gathering consultation paper issued in December 2004

Note (1): this list excludes those respondents that requested their comments remain confidential.

Note (2): copies of the responses from organisations and individuals listed below can be obtained from the FRC on request by e-mailing turnbullreview@frc.org.uk

Alliance & Leicester plc

Allied Domecq plc

Anglo American plc

AON Limited

Association of British Insurers

Association of Chartered Certified Accountants

Association of Corporate Treasurers

BAA plc

Barclays Global Investors

BDO Stoy Hayward LLP

Boots Group Plc

BP plc

British Airways Plc

British American Tobacco plc

British Sky Broadcasting

BT Group plc

Cadbury Schweppes plc

CBI

Chartered Institute of Management Accountants

Co-operative Insurance Society Limited

Daily Mail and General Trust plc

Deloitte & Touche LLP

Diageo plc

Dixons Group plc

Ernst & Young LLP
Fidelity Investments International
Friends Provident plc
Gallaher Group Plc
Andrew Given
GlaxoSmithKline plc
Michael Graham Consultancy
Grant Thornton UK LLP
Dr. David Griffiths
GUS plc
Hermes Pensions Management Limited
Alex Hindson
HSBC Holdings plc
The Hundred Group of Finance Directors
Independent Audit Limited
Information Assurance Advisory Council
Institute of Business Ethics
Institute of Chartered Accountants in England & Wales
Institute of Chartered Secretaries and Administrators
Institute of Directors
Institute of Internal Auditors UK and Ireland
Institute of Risk Management [joint response with AIRMIC]
Investment Management Association
Investor Relations Society
ITV plc
Johnson Matthey plc
KPMG LLP
Land Securities Group plc
Matthew Leitch
Lloyds TSB Group plc
London Resilience Business Forum
London Society of Chartered Accountants
London Society of Chartered Accountants (Business Governance and Ethics Panel)
London Stock Exchange plc

Kenneth Ludlam
Marks and Spencer Group plc
Mazars LLP
Merrill Lynch Investment Managers
Morley Fund Management
National Grid Transco plc
Pearson PLC
Pensions & Investment Research Consultants Limited
Premier Farnell plc
Jeremy Prescott
PricewaterhouseCoopers LLP
Professors Michael Page and Laura F. Spira
Provident Financial plc
Quoted Companies Alliance
Reckitt Benckiser plc
Rolls-Royce Group plc
Royal Bank of Scotland Group plc
RSM Robson Rhodes LLP
SABMiller plc
Scottish Power plc
Smiths Group plc
Stagecoach Group plc
Standard Chartered PLC
Standard Life Investments
Tate & Lyle PLC
Tax Research Limited/Tax Justice Network
Tesco plc
3i Group plc
Tomkins plc
UBS Global Asset Management (UK) Ltd
Vodafone Group Services Limited
William Hill PLC