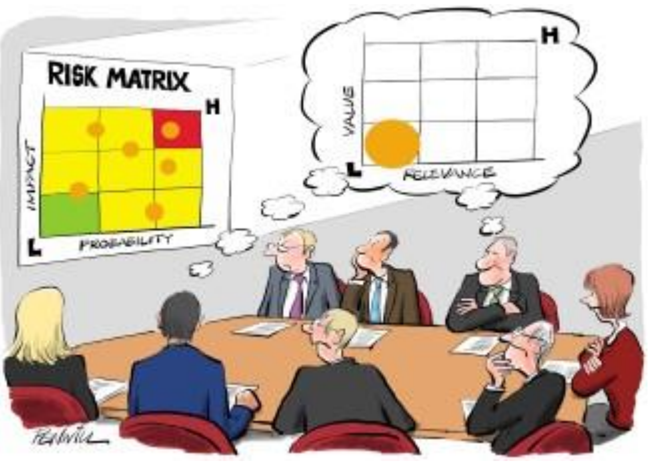
The Effective Board

INDEPENDENT BOARD REVIEW

September2014

Revisiting Risk

After a rather long gestation the revisions to the Code on Corporate Governance have just come out. A lot of it (alongside the remuneration-related bits) is about the linkage of going concern to uncertainty and risk – and pushing boards to look more at risks to achieving short- and long-term strategic objectives. The changes are beefed up with new Guidance on risk management, internal control and reporting (and we'll all have to get out of the habit of referring to "Turnbull"). It's tempting to think "there's not much change" and just the odd tweak is needed.



But boards should see this as an opportunity to rethink what they're doing around risk and internal control. That's a big topic – more than we can cover here (but we'd be very happy to discuss). We're not covering all of them, but here are a few thoughts on how the changes might impact boards and audit (risk) committees.

Good practices to consider...	Things to avoid...
Boards are now to look "robustly" at the "principal" risks tied into business objectives. How that differs from the previous "significant" risks doesn't matter too much – what it's emphasising is threats to the business model, future performance, solvency or liquidity. This ties in to the longer-term emphasis around going concern – and an emphasis on linking risk and strategy further into the future. So a board should take stock of what it's doing with its "strategic risk list": what's in it, what's not in it and what we're doing about it. Then you have to talk about this externally, probably more fully than before.	Simply carrying on with what you do already – or at least not stopping to think where something different is needed. With the strategic risk list: Are these really the risks which could undermine the business model and performance? How far does the board really understand how they are being managed – or how far they can be? And are we really reporting what matters? Scratching the surface and seeing it all as a compliance-driven, unavoidable process is not where you want to be.
Using the Code changes as an opportunity to think through what you want from the board's review of risks. Working out how the risk matrix presentation can be used to support strategic discussion, whether it makes sense to look at it standalone (as most boards do) or as an integral part of the strategy discussions, and using it to consider what's not on the list as a starting point.	Getting stuck in a rut around the risk presentation. Having done it now for a long time, and seeing it come around all too regularly (and often when the Annual Report approval is needed), too many boards have lost sight of what they are trying to do with the risk matrix and just accept that they're supposed to do it without questioning why.

Good practices to consider...	Things to avoid...
There's now more emphasis on the longer-term. So boards need to think more about the risk profile: What's principal and might hit us today? What might be out there in the future as a fundamental threat to our model? And how does this fit with the assumptions we're using for our modelling and forecasts? The link between strategy, risks and assumptions – now and in the future – needs drawing out.	Simply saying "we don't know what's out there – so thinking long-term is pointless". That's dodging the responsibility to think ahead. Forward thinking around risks is just part of longer term strategy development. And boards should have a clear picture of the main assumptions – and have an opportunity to discuss them.
There's a new challenge around internal controls for the audit committee – and management. It's now a matter of monitoring risk management and internal control systems as an on-going process. So some thinking is needed on how to use a combination of good risk-controls-assurance mapping and more effective use of all three Lines of Defence to get a clearer picture and more structured comfort.	Sticking with the current process for reviewing the internal control framework. It's a bad but common habit for this to be tied to the annual statement on internal controls. That puts it in a compliance context when it needs to be a strategic question. And some audit committees just don't give it enough time or don't demand enough justification or evidence from management. Tie it into strategy and principal risks better, and it might just be possible to get more value from the exercise.
There's much more emphasis on organisational culture coming out of the Guidance – with more being expected from the board and committees. It's clear on this: simply setting the desired values is not enough. A board should be looking at what's meant by "tone at the top", what programmes management have in place – and the board's role in this, and how it can get a picture of the "culture" with practical, meaningful KPIs.	Putting it in the "too difficult" box. Or simply thinking that remembering to review the Code of Ethics from time to time is enough. A structured approach is now needed with the topic appearing specifically on the board agenda with clear objectives for the discussion and an open-minded approach to helping management think through how to embed values. And don't just accept that "it can't be measured": quite a few existing KPIs can give a picture if viewed in a culture context.

If you have any questions on the issues covered here, please contact Richard Sheath at richard.sheath@independentaudit.com

This eBulletin is published monthly. To see back issues click here: "The Effective Board". To subscribe click here

We are leading specialist advisors on corporate governance. We assess the effectiveness of boards, committees, internal audit, external audit and risk management.

INDEPENDENT AUDIT LIMITED

We perform full independent reviews or support your internal self-assessment or external facilitation using our online service:

THINKING BOARD