



Institute
and Faculty
of Actuaries

FRC Risk Reporting Guidance for Boards

Revisions to the UK Corporate Governance Code and the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting:
Assessing Responses to the Guidance

Final Report

Research by ComRes

24 November 2014



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Executive summary

Following the publication in September 2014 of revisions to the UK Corporate Governance Code and to the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting¹, the Institute and Faculty of Actuaries commissioned research consultancy ComRes to explore and analyse the industry's response to the guidance to date.

ComRes's research indicates a number of important trends, with key findings including:

- The majority of stakeholders say that they understand the revised guidance well – three quarters (75%) say that they understand the revisions either “very” or “fairly” well.
- Most companies interviewed (63%) say that they have started work on assessing the impact of the revised guidance, although a very low proportion have completed this work. Nearly a quarter (22%) have not yet started to consider the potential impact of the revisions.
- Many stakeholders think that the revisions will have little or no impact on their business in terms of their organisation's risk management approach (78% think this), their organisation's year-end risk or audit committee reporting process (63%) and their organisation's risk disclosures in annual reports and accounts (62%). Where stakeholders think that the revisions will have an impact, this is anticipated to be limited.
- The difficulty of quantifying long-term strategic risk is widely felt to be the toughest challenge that companies will face in implementing the guidance – this is selected by two thirds (63%) of respondents.

The research findings suggest that the majority of companies have made a start on assessing the impact of the UK Corporate Governance Code and associated Guidance. However, companies may be underestimating the challenges of meeting the new requirements.

The new guidance expects companies to consider not only the desired culture within the company but also whether this culture has been embedded. This will be a challenge for many firms and they will need to give early consideration as to how they can go about demonstrating this.

There is a danger that the FRC's intent to embed a healthy risk culture in organisations will not be realised if companies do not consider it an important part of their organisation. The findings indicate that there remains a cultural challenge in some firms in getting business leaders to engage fully with risk management. This needs to be addressed if the guidance is to be fully effective and work as intended.

¹ Financial Reporting Council (2014) <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf>



Methodology

ComRes interviewed 63 stakeholders between 3rd October and 19th November 2014. Stakeholders were defined as key decision-makers involved in implementing the revisions to the FRC guidance for their companies, the 902 companies with a Premium Listing of equity shares in the UK. Job functions interviewed included:

- Chief Financial Officer
- Chief Risk Officer
- Senior Finance Manager
- Senior Risk Manager
- Company Secretary
- General Counsel

Interviewees worked for the following types of companies:

- 7 FTSE 100 companies
- 20 FTSE 250 companies
- 36 Other UK listed companies

Interviews were conducted via telephone, lasting approximately 10 minutes.

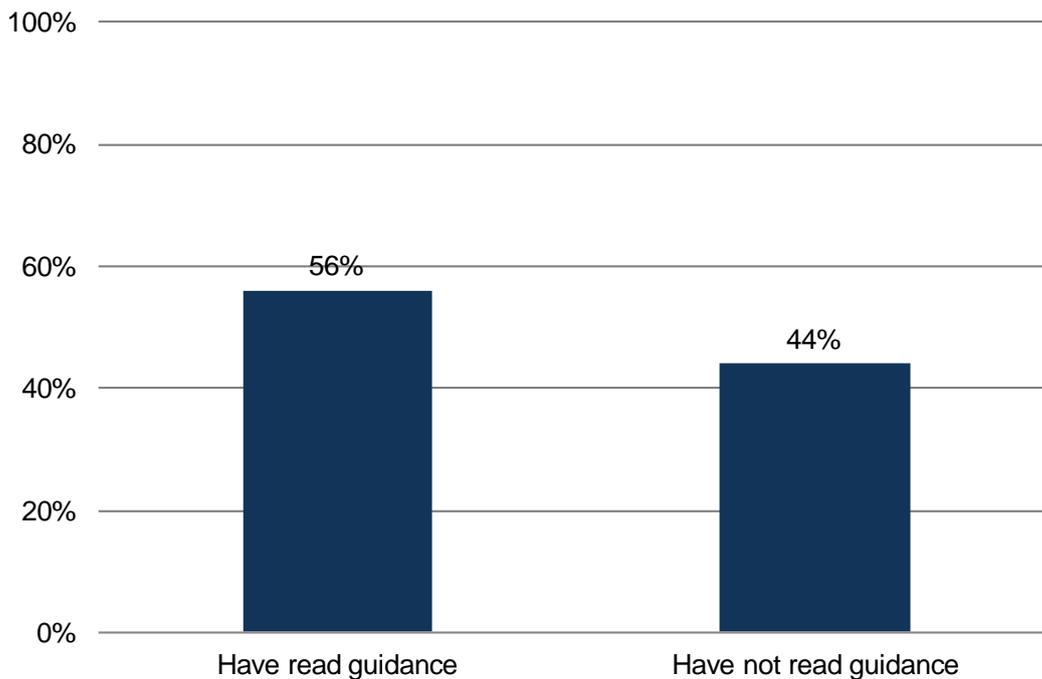


1. Familiarity with revisions to the guidance

Knowledge

There is a mixed picture of interaction with the guidance, with slightly more than half of those who are aware of the guidance having read it (56%), and slightly less than half (44%) having not read it.

Interaction with revisions to the UK Corporate Governance Code and to the Guidance on Risk Management and Internal Control



Q: Have you read the revisions to the UK Corporate Governance Code and to the Guidance on Risk Management and Internal Control? Base: All respondents (n = 63)

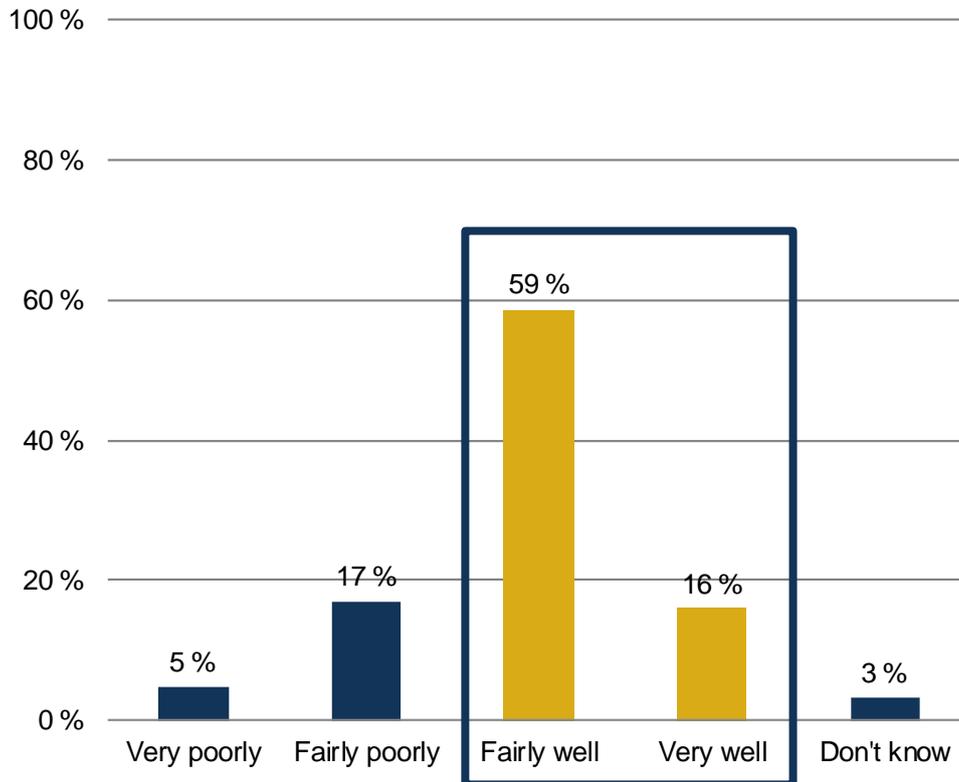
While this could suggest that some stakeholders may not be fully familiar with the guidance, it is also possible that a significant proportion of these senior stakeholders have sought to understand the changes by reviewing summaries, rather than by reading the FRC documents personally and in full.



Understanding

On the whole, stakeholders say that they have a relatively good understanding of the revisions to the guidance, with three quarters (75%) saying that they understand them either “very well” or “fairly well”.

Reported understanding of revisions to the guidance



Q: How well or otherwise do you feel that you understand the revisions to the UK Corporate Governance Code and to the Guidance on Risk Management and Internal Control? Base: All respondents (n = 63)

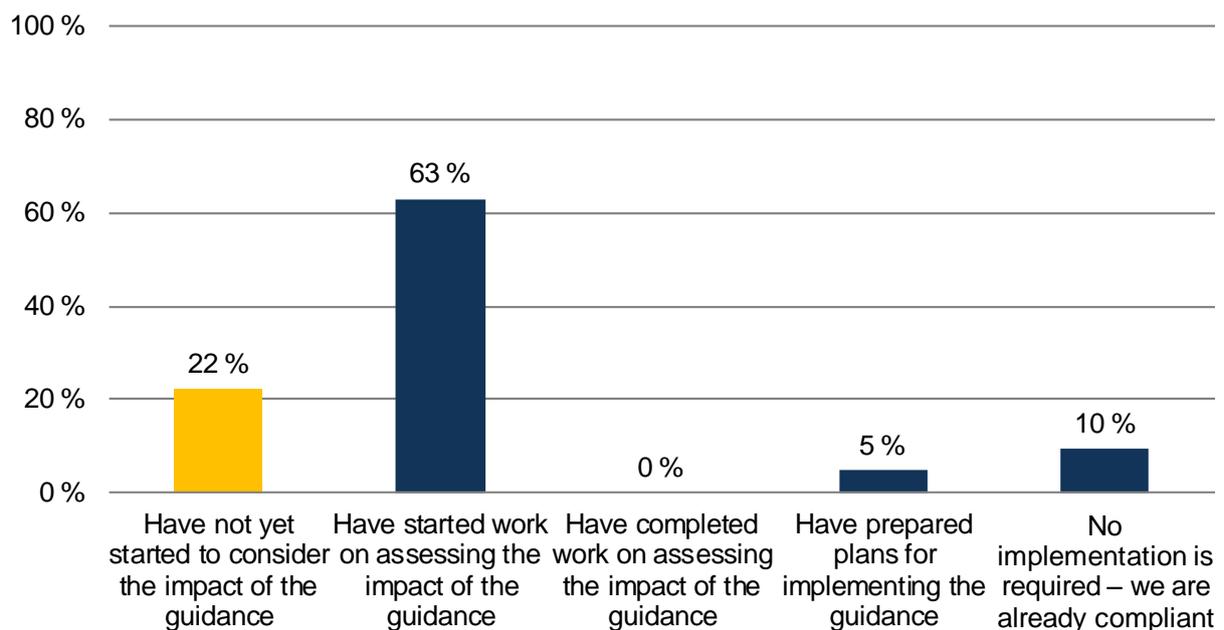
The Institute and Faculty of Actuaries notes that while 75% of respondents indicated that they understand the changes well or fairly well, a significant minority (22%) indicated that they have a poor or very poor understanding. It will be important for companies to engage soon with the new requirements as there may be material changes required to their risk management processes during 2015.



Progress in responding

For the great majority of the companies included in this study, the process of assessing and responding to the guidance has either not yet started or is incomplete. Most respondents (63%) say that their companies have started to consider the impact of the guidance. At the same time, a relatively large minority (22%) say that their companies have not yet started to consider the impact of the guidance.

Response to guidance to date



Q: Which of the following best describes your response to the new FRC guidance so far?

Base: All respondents (n = 63)

Only a very small proportion of companies say that they have prepared plans for implementing the guidance (5%) and no companies reported that they have completed working on assessing the impact of the guidance. With work ongoing, attitudes towards the guidance may change and perceptions of its impact may be revised as key decision-makers become more familiar with it.

The Institute and Faculty of Actuaries believes that companies should by now have started to assess the impact of the guidance. It will be important for the firms that have not yet considered the impact of the guidance to commence this work soon. For firms with a calendar year end the new guidance comes into force on 1 January 2015.

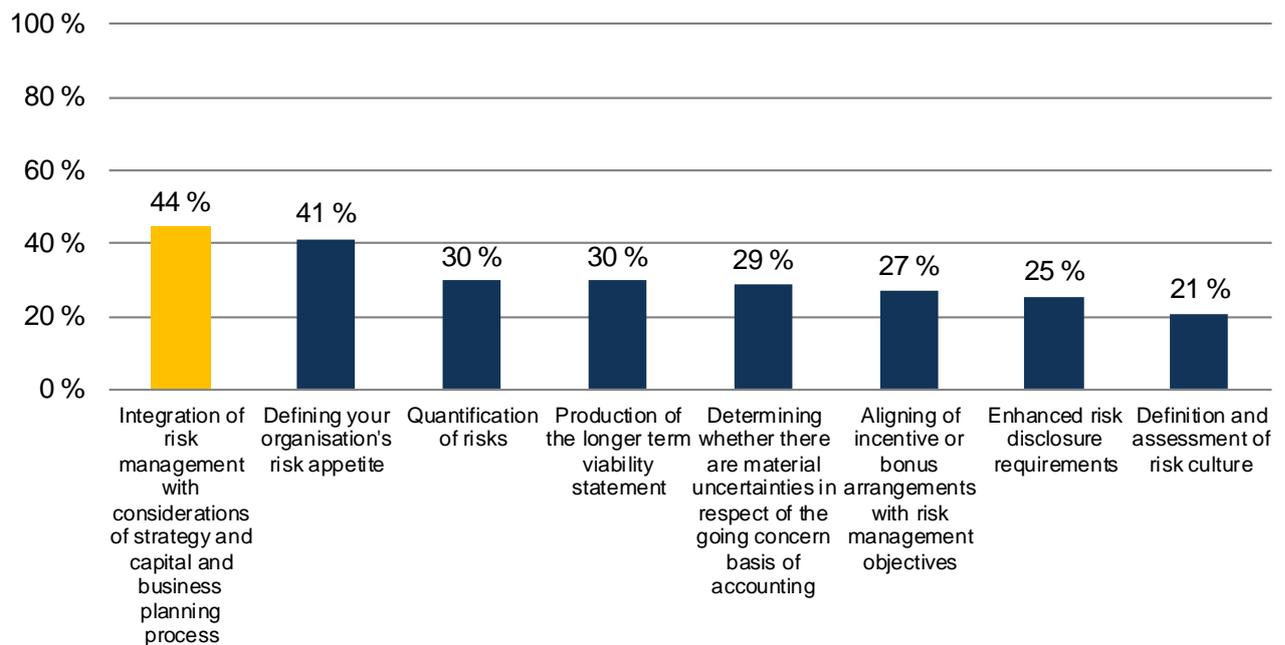


2. Anticipated impact of the revised guidance

Key elements

Stakeholders consider a wide variety of aspects to the guidance to be important, indicating that different aspects of the guidance are perceived to be of varying importance to different companies.

Most important elements of the revised guidance



Q: What are the most important elements of the guidance, from your perspective? Base: All respondents (n = 63)

The elements that are selected most frequently as among the most important elements of the guidance are:

- Integration of risk management with considerations of strategy and capital and business planning process (44%)
- Defining the organisation's risk appetite (41%)

The low focus on the definition and assessment of risk culture (selected by only 21% of respondents as one of the most important elements of the guidance) appears to represent a challenge in terms of the FRC's original aims when developing the guidance, given the emphasis placed on risk culture when the consultation on the guidance was launched in 2013.

The range of issues chosen by respondents is generally closely aligned with the Institute and Faculty of Actuaries' views on the challenges that firms will face in responding to the new guidance. We believe that the top four items identified by firms will require them to enhance their risk identification, risk quantification and risk modelling capabilities to allow them to understand their evolving risk profile over the medium and long term and how this relates to their business strategy. The production of the new long term viability statement will also be a challenge for many firms and will require them to



consider a wide range of potential stress and scenario tests to understand the circumstances in which viability would be challenged.

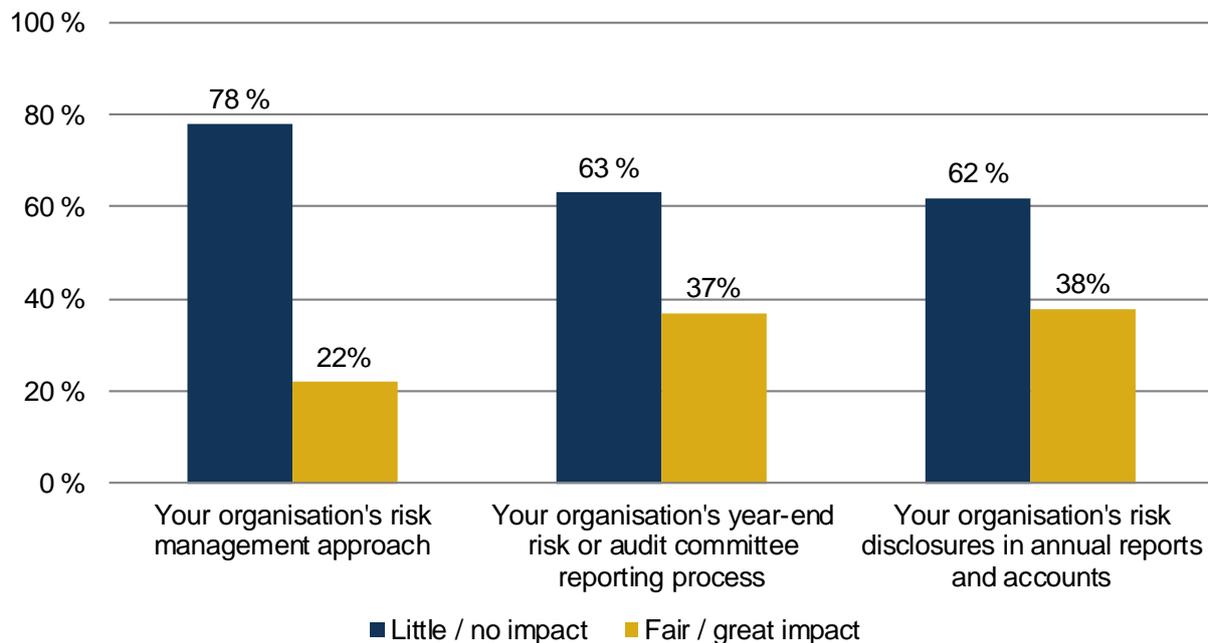
The Institute and Faculty of Actuaries believes that risk culture will also be a challenge for firms. The new guidance expects companies not only to consider the desired culture within the company but also whether this culture has been embedded. We believe that this will be a challenge for many firms and that they will need to give early consideration as to how they can go about demonstrating that this culture has been embedded.



Impact

The majority of stakeholders think that the revisions will have little or no impact on their business in terms of their organisation's risk management approach (78% think this), their organisation's year-end risk or audit committee reporting process (63%) and their organisation's risk disclosures in annual reports and accounts (62%).

Anticipated impact of revised guidance on business



Q: What impact, if any, do you expect the new guidance to have on each of the following aspects of your business? Base: All respondents (n = 63)

Where stakeholders expect that the revisions to the guidance will have an effect on their business in terms of the aspects identified above, the expected scope of the impact is perceived to be “fair” rather than “great” – the proportion of stakeholders who believe that the revisions to the guidance will have “a great deal of impact” is **very low** for each of the options offered:

- Organisation's risk management approach (2%)
- Organisation's year-end risk or audit committee reporting process (2%)
- Organisation's risk disclosures in annual reports and accounts (5%)

At this stage, it is unclear the extent to which this assessment is based on detailed assessments or assumptions – further research is needed to understand the factors underpinning these viewpoints among these audiences.

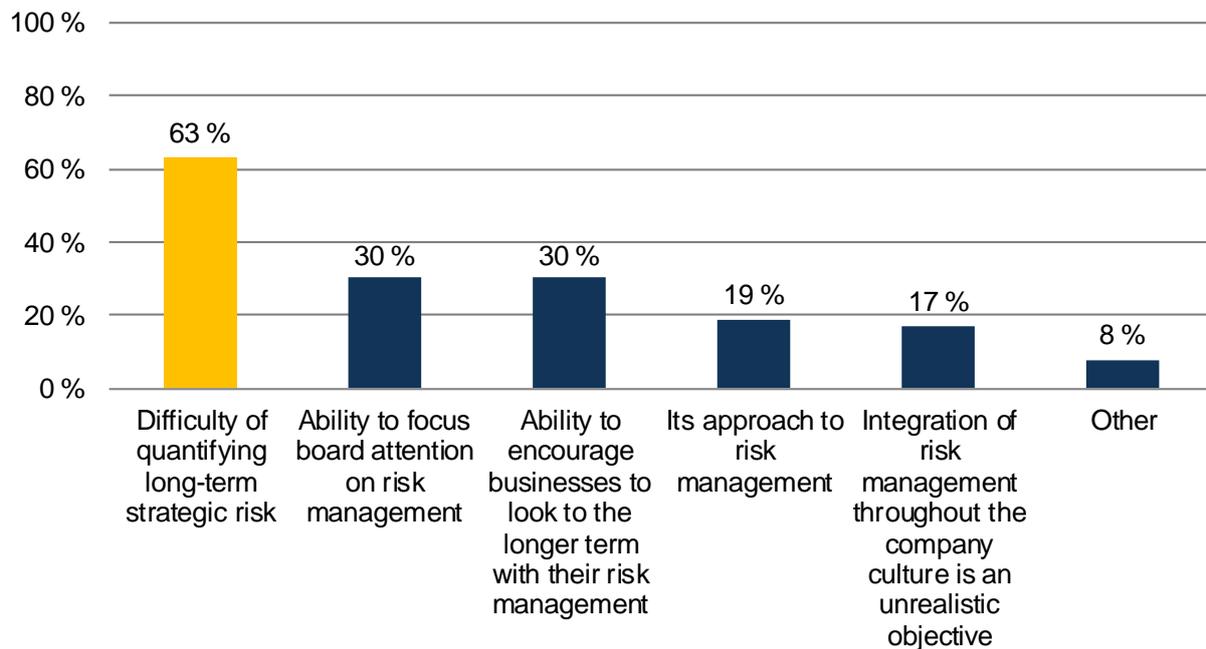
The Institute and Faculty of Actuaries believes that many respondents are underestimating the level of change required to meet the new guidance. The current guidance and the current processes in many firms are based on a traditional, control-focussed approach to risk management. We believe that the new guidance is asking firms to embrace a much more advanced, enterprise-wide risk management process that encompasses many advanced elements such as a focus on culture, decision making and sophisticated quantification and modelling of risks.



Challenges

When asked about challenges that they may face in implementing the guidance, there appears to be a relatively consistent viewpoint across this audience – above all, the difficulty of quantifying long-term strategic risk is widely anticipated to be one of the toughest challenges posed (it is selected by 63% of respondents).

Toughest anticipated challenges to implementing revised guidance



Q: What, if any, do you consider to be the toughest challenges to implementing the FRC guidance? Base: All respondents (n = 63)

Other challenges anticipated by relatively high proportions of this audience relate to internal dynamics at a senior level within the affected businesses – three in ten say the ability to focus board attention on risk management (30%) and the ability to encourage longer term approaches to risk management are likely to be key challenges (30%).

In contrast, the guidance's approach to risk management (19%) and integrating risk management throughout the company (17%) are not as frequently chosen as major challenges facing those implementing the guidance.

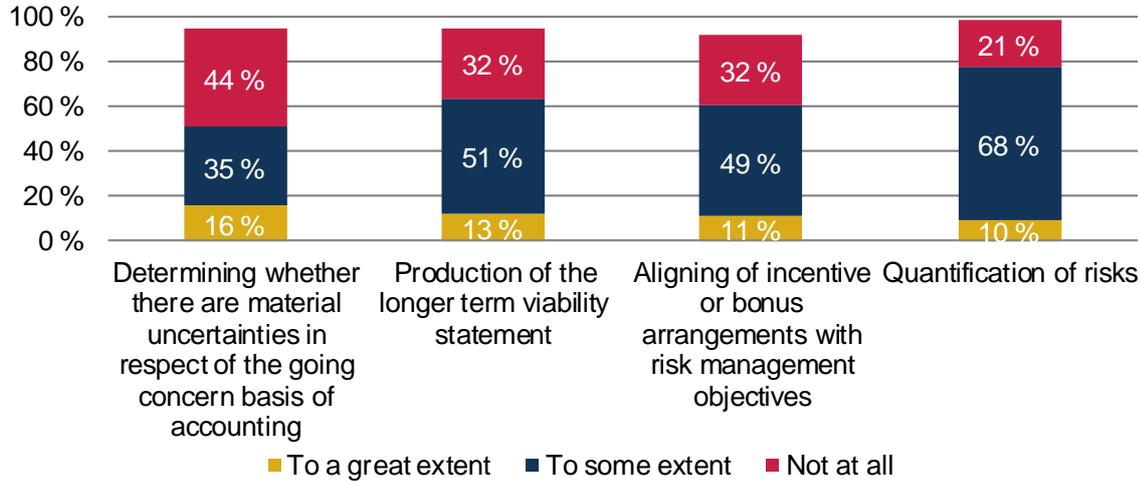
The Institute and Faculty of Actuaries finds these responses particularly interesting. We agree with the challenge of quantifying long term strategic risks. The other responses indicate that there remains a cultural challenge in some firms in getting business leaders to engage fully with risk management.



Need to change

As identified above, expectations about the need for businesses to change appear relatively limited. However, when stakeholders are asked about the need to change in specific areas, higher proportions of stakeholders think that they will need to change at least “to some extent” in each of the areas tested.

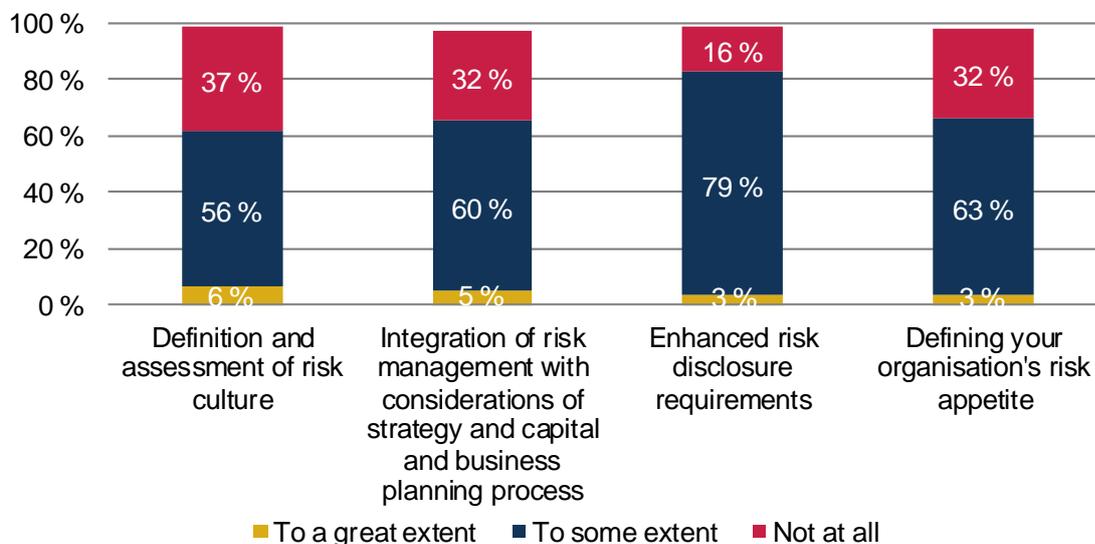
Anticipated need to change (1/2)



Q: To what extent, if any, do you feel it will be necessary for your organisation to change to address the new FRC guidance, in each of the following areas? Base: All respondents (n = 63)

For each of the options tested, stakeholders are most likely to think that their companies will need to change “to some extent”.

Anticipated need to change (2/2)



Q: To what extent, if any, do you feel it will be necessary for your organisation to change to address the new FRC guidance, in each of the following areas? Base: All respondents (n = 63)



In terms of areas where companies are expected to need to change “to some extent” or “to a great extent”, enhanced risk disclosure requirements (82%), quantification of risks (78%), defining an organisation’s risk appetite (66%) and the integration of risk management with considerations of strategy and capital and business planning process (65%) are all frequently identified.

The Institute and Faculty of Actuaries notes that when challenged to consider specific areas of the FRC guidance a much greater proportion of companies recognised that changes would be required. This further emphasises the need for companies to assess the impact of the guidance as we believe the impact is likely to be greater than many firms might initially assume.



Confidence in key parties' ability to respond effectively

Strong majorities of those interviewed say that they are confident in the ability of key internal figures to effectively exercise their responsibilities in line with the new guidance.

Confidence in senior management's ability to exercise responsibilities effectively



Q: How confident, or otherwise, are you in the ability of each of the following to effectively exercise their responsibilities in line with the new guidance? Base: All respondents (n = 63)

With more than four in five respondents saying that they are either "very" or "somewhat" confident in each of the parties tested, this indicates that there are no major concerns about the ability of these figures to effectively exercise their responsibilities in line with the new guidance. Indeed, high proportions of those questioned say that they are "very confident" in the ability of each of the parties to exercise their responsibilities (ranging between 49% and 59%).

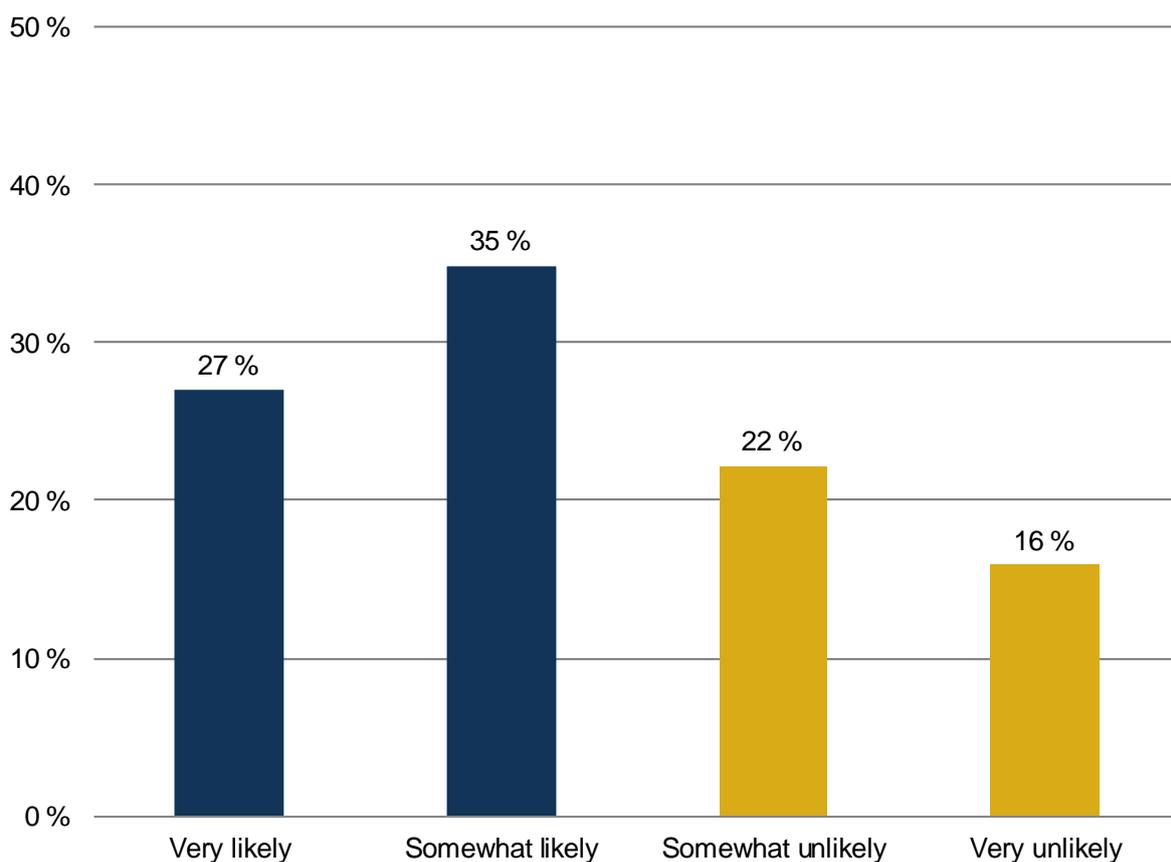


3. Expected next steps

Approaching a third party for assistance

Respondents are more likely than not to say that they or their organisation would approach a third party for assistance or advice on the revised guidance – while three in five (62%) say that they are either very or fairly likely to approach a third party, two in five (38%) say that they are very or fairly unlikely. One quarter (27%) say that they or their organisation are very likely to approach a third party for assistance.

Likelihood of approaching third party for assistance on revised guidance



Q: How likely, or otherwise, are you or your organisation to approach third parties for assistance or advice in relation to the new FRC guidance? Base: All respondents (n = 63)

There is a significant proportion of stakeholders who sit in the middle ground, and appear not yet to be firmly set on one course of action or another. The ultimate decisions of these people will be crucial in terms of understanding the likely impact of the revised guidance on third parties such as the actuarial profession.



Desired qualities in a third party

When asked about the qualities that they would look for in an external party, stakeholders point to two key factors that influence their decisions.

Firstly, finding an organisation or body with **experience in this specific area** is often seen as fundamentally important when deciding who to approach for assistance:

“We would look for someone who has a track record in that area and also someone who has experience of working within a large organisation.”

“Track record and proven knowledge, so industry leaders is [sic] who we would look for and a big accountancy company would be on top of our list.”

“We would like to know they had experience of advising businesses on our scale and complexity, and are aware of guidance and rules that needed to be implemented.”

Secondly, the importance of any third party having a **good understanding of the company in question** is also mentioned by a relatively large number of stakeholders:

“They would have to have knowledge of our existing business.”

“They would need to have an understanding of our business and evidence of similar relevant advice, and I guess the organisation or team would need to have a good reputation.”

Where stakeholders say that they would consider approaching a third party for assistance, many say specifically that **they would approach their existing auditors** on this:

“I would go to our auditors who are knowledgeable in those specific areas.”

“We would discuss it with the auditor, and look for someone with an audit background and we would also run through it with auditors to see if we are complying with the FRC guidelines.”

This viewpoint, shared by numerous respondents, suggests that auditors appear set to benefit from the changes to the guidance – the perception that these auditors are particularly knowledgeable in this area and have a good understanding of the individual companies in question appears to be driving this viewpoint.



Conclusion

This research suggests that the majority of companies have made a start on assessing the impact of the UK Corporate Governance Code and associated Guidance – however, nearly a quarter of companies have not. It will be crucial for those companies that have not yet started to consider the impact to do so now, as the guidance will come into force for many companies on 1 January 2015.

Companies believe that the most important areas of the new guidance are the integration of risk management with considerations of strategy and capital and business planning process, defining the organisation's risk appetite, quantification of risks and production of the longer term viability statement. The Institute and Faculty of Actuaries believes that meeting the guidance in these areas will be challenging for many firms and will require firms to enhance their risk management processes.

Respondents to the survey generally believe that the new guidance will have limited impact on their risk management processes, year-end processes and the disclosures on their report and accounts. However, companies may be underestimating the challenges of meeting the requirements of the new guidance.

The findings also indicate that risk culture will be a challenge for firms. The new guidance expects companies not only to consider the desired culture within the company, but also whether this culture has been embedded. This will be a challenge for many firms and they will need to give early consideration as to how they can go about demonstrating that this culture has been embedded.

The current guidance and the current processes in many firms are based on a traditional, control-focussed approach to risk management. However, the new guidance is asking firms to embrace a much more advanced, enterprise-wide risk management process that encompasses many advanced elements such as a focus on culture, decision making and sophisticated quantification and modelling of risks.

There is a danger that the FRC's intent to embed a healthy risk culture in organisations will not be realised if companies do not give it sufficient focus. The findings indicate there remains a cultural challenge in some firms in getting business leaders to engage fully with risk management. This needs to be addressed if the guidance is to be fully effective and work as intended.



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