spotlight RISK MANAGEMENT

DESPITE SUGGESTIONS THAT THE TURNBULL REPORT SHOULD BE TOUGHENED UP, ITS AUTHOR BELIEVES THE RECOMMENDATIONS HIS COMMITTEE MADE BACK IN 1999 ARE STILL HIGHLY RELEVANT FOR UK COMPANIES. EDITOR **LIZ SALECKA** TALKS TO NIGEL TURNBULL ABOUT HIS ROLE IN PRODUCING GUIDANCE ON INTERNAL CONTROLS.

PRACTISE WHAT HE PREACHED

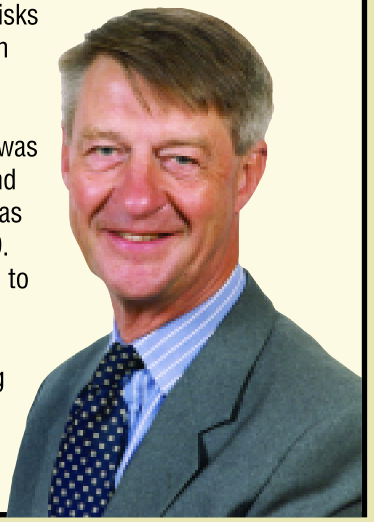
THE TURNBULL REPORT

The background

Nigel Turnbull was first approached in 1998 by the Institute of Chartered Accountants in England & Wales (under the oversight of the London Stock Exchange) to chair a working party on guidelines for directors and the internal control aspects of the Combined Code.

Earlier in 1998, Sir Ronald Hampel's Committee on Corporate Governance had completed a review of Cadbury's Code of Best Practice (1992). The end result, in combination with the recommendations made in the Greenbury Report (1995) was the first Combined Code on corporate governance. Guidance on internal control aspects in the new Code were considered a vital piece of the jigsaw.

The Turnbull working party met over a period of nine months to discuss the internal control guidance with the objective of emphasising the need for organisations to look at the entire spectrum of risks and controls, as outlined in the Hampel Report.



A consultation document was published in April 1999 and the 14-page final report was issued in September 1999. Companies were expected to fully implement the guidance with effect for accounting periods ending on or after 23 December 2000.

"It was Sir Ronald Hampel's Committee that was the real instigator," says Nigel Turnbull, author of the Turnbull Report (1999) – officially entitled Internal Control – Guidance for Directors on the Combined Code – as he reflects back on his contribution to an important part of the UK's corporate governance framework. "The Hampel Committee established several principles of good corporate governance, including one which said that a sound system of internal control was needed to safeguard shareholders' investments and the company's assets.

"These new Code requirements required a guidance framework for directors to follow which, while being robust and providing business benefit, did not overload companies with unnecessary and costly bureaucracy. That is why the Turnbull Committee was formed – to provide companies with that guidance".

RULES OR GUIDANCE? The impact that corporate governance has had on how companies manage their business risks while pursuing their business strategies has been the subject of much discussion. Many treasurers believe that increased financial, operational and compliance controls resulting from the Combined Code, of which the internal control guidelines are only a small part, have added significant bureaucracy to their daily working lives.

Turnbull is, nevertheless, quick to point out that the internal control guidelines produced by the Turnbull Committee go further than serving as a corporate governance report; rather, they are good management practise. They were drawn up to provide board directors with a set of considerations to bear in mind in relation to potential business risks – the onus being upon them to ensure that these risks, once properly identified, were effectively managed by appropriate controls within their existing business processes.

PRESCRIPTIVE RULES. He points out that each company is unique, has different risks and differing ways of effectively controlling those risks. "Our report was always intended to avoid a totally prescriptive set of rules – such as those more recently produced in the US. Rather, it prescribes a framework and a process for companies to work within. Effectively, the aim was to make board directors more aware of the most significant risks they may be facing, that is the 10 to 12 risks that could have the biggest and most adverse impact on their business, not forgetting the risk of lost opportunities.

"What we wanted to do was to put all these risks on the agenda in the corporate boardroom and get directors talking about them. Directors then have to act to effectively manage the risks with the appropriate controls", he says.

Turnbull emphasises that companies face a range of financial, operational and compliance risks, many of which may be "forgotten about" and, in some cases, even "unknown", and there is a risk in doing nothing about them.

REPUTATION RISKS. According to a survey, conducted by the Institute of Chartered Accountants in England and Wales last year, companies clearly recognise damage to their reputation as the greatest risk they face. However, the list of potential operational risks, as Turnbull explains, is very wide-ranging, depending on their business, and may include pollution, adverse weather conditions, terrorism, industrial action and natural disasters, such as fire, flood and earthquakes, as well as financial risks, such as exchange rate fluctuations and changes within an economy.

"There may also be geographical risks. Every time, a company enters a new country, it usually looks at the regime in that territory, but how often does it go back and reassess the regimes in countries where it has been long-established to ensure that the risks remain acceptable?

"There may also be risks present in the economy of a country – a company's board should always look at their expenditure in that country in relation to this."

He adds that treasurers, with their access to bank economists, are well placed to have an input into managing economic risk. However, although there is scope for treasurers to get involved with internal controls, the financial risks they deal with are generally less severe (on a scale of one to 10) than economic and country risks and risks to reputation.

HAS THE REPORT WORKED? So does he believe that the Turnbull Report has been successful in its objectives of enlightening board directors about the business risks they face, instigating more thought into their risk management processes?

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Overall, he believes that it has had a positive effect on boardroom behaviour, "although I am told that some companies did not take the top-down approach we had advocated," answers Turnbull. "We always wanted to see the guidance embedded at the top of organisations and then cascaded downwards. Instead, a number of companies gave the guidelines to people lower down the chain, who started to assess financial, business and operational risks from the bottom up, which was not the intention and might not capture significant risks for the whole company."

THE RIGHT TYPE OF CONTROLS. He, nevertheless, remains convinced that the guidance, drawn up by his Committee, is still highly relevant and useful for UK companies. He acknowledges that there have been developments in the European Union (EU) and in the US since 1999, and it appears right that the Financial Reporting Council should take a pragmatic look at the matter.

Recent reports in the EU refer to risk management systems and therefore the wider aspects of internal control. He believes that they are going in right direction, when contrasted to Section 404 of the Sarbanes-Oxley Act and the associated Public Company Accounting Oversight Board (PCAOB) guidance to external auditors, which is limited to internal controls over financial reporting.

HIGH RESPONSIBILITY. "The current UK system puts a high level of responsibility on companies," Turnbull says. He points out that directors are obliged to make a statement in the annual report and accounts every year on their companies' and this is reviewed by the auditors who will have regard to the knowledge they have obtained from their financial statement audit work. Should something go wrong, directors have a responsibility to the shareholders to identify whether this is because of the failure of the systems put in place or the omission of relevant controls. "If companies decide not to comply with the Combined Code, they are required to make a statement and from then on it is down to the shareholders."

DO NOT CLOSELY FOLLOW US MODEL. Turnbull is against any suggestion that internal control reporting requirements in the UK should closely follow the Sarbanes-Oxley Act in the US.

"Sarbanes-Oxley was a huge overreaction to events," he concludes. "It would be terrible if here in the UK, corporate governance requirements become overly bureaucratic, costly and legally driven, which could hamper directors from being effective business people."