HYMANS ROBERTSON
The Spirit of Independence

Financial Reporting Council
5th Floor
Aldwych House
71 – 91 Aldwych
London WC2B 4HN

Kind Attention: Ms. Catherine Woods

Dear Ms. Woods,

Subject: Response to Consultation paper on "Guidance to the Directors of Companies applying the UK Corporate Governance Code and associated changes to the Code"

Hymans Robertson LLP (www.hymans.co.uk) are pleased to respond on a non-confidential basis to the Financial Reporting Council's (FRC) Consultation on "Guidance to the Directors of Companies applying the UK Corporate Governance Code and associated changes to the Code". Please find our responses overleaf.

Established in 1921, Hymans Robertson is the longest established independent firm of risk management consultants and actuaries in the UK. We have worked with many financial sector entities on risk management at all levels of the firm and the comments below are based on the insights we have gained in this process.

Of course, we would be pleased to discuss our comments with you if needed.

Yours sincerely,

Vijay Krishnaswamy
Partner and Head of Enterprise Risk Management

Response to FRC Consultation Paper on "Guidance to the Directors of Companies applying the UK Corporate Governance Code and associated changes to the Code"

We set out below our responses to the questions contained in the said FRC consultation paper.

1) **Page 3 of the consultation paper – "The FRC would welcome views on whether the draft revised guidance achieves these objectives and on the structure of, and level of detail in, the draft revised guidance."**

   Overall, we think that the draft revised guidance strikes a broad balance between the various considerations proposed in the paper. More specifically we think that including a section that describes more specifically and vividly the risks faced by firms enhances the current reporting guidance and we therefore welcome the proposed text. Within this context, however, we acknowledge that risk management is a complex area and that the measurement and reporting of risk raises issues related to the evaluation of those risks, which is often difficult. In our experience, a substantial amount of judgment and vastly different skillsets to those that exist today in firms are needed.

   We welcome the recommendations as a good step in the right direction but firms and auditors should keep in mind the challenges in implementing them. It is also important that risk management is not reduced to a "tick-box exercise".

2) **Page 3 – "Do you agree (with the wording in section 5 and 6 of the proposed guidance) or are more substantive changes to these sections required?"**

   We are broadly satisfied that the wording of the sections is appropriate. More specifically it addresses the main areas that would be expected for the design and assessment of a risk management system.

3) **Page 4 – "The FRC would welcome views on this proposed change to the guidance (introduced by section 7)."**

   We fully agree with the changes proposed in section 7. In our view "cutting and pasting" a sentence in the report is not sufficient. The Board should more clearly articulate issues related to the specificity of the Firm considered and modify their statements accordingly.

4) Page 4 – "The FRC would welcome views on whether these appendices (D and E) are of use to directors and, if so, how they might be improved."

With respect to appendix D, we agree with all the proposed items. It is clear that the list could possibly be lengthened but the present list gives an indication of the type of questions that may be considered.

Within this context, however, we think one area where the list of questions is not sufficient is in the area of reporting of risk to senior management by individuals not directly involved in the risk function. In essence we think that risk management should be embedded in the culture of the organisation and not confined to the realms of the risk management function. Furthermore, risk may be identified by individuals who are not employees of the firm such as contractors or consultants as are increasingly employed in the financial sector. It is our opinion that these groups external to the employees of the firm should be able to report areas of risk. The issue is particularly relevant as these groups may have been involved in different firms and therefore would have a different risk perspective to that that of the Board or the firm's management. They would therefore be in a situation to identify risks that have been missed by the internal management. Within this context we would suggest an additional question such as "how would a person external to the organisation be able to report areas of potential risk?" be included in the proposed list. Further, this would help to break down "group think" within the firm, which we come across a lot at very senior levels of firms.

With respect to appendix E, we have two comments:

- Reading the various bullet points, we are not sure who the intended users of the "warning signs" are. These seem to be written for an external person to assess the risk in the firm. We would recommend that the bullet points are written in a form that could be asked by the board about its organisation. For example: the first bullet point "Insufficient breadth of experience and expertise in the board or board committee" could be rephrased as follows "Have members of the Board received sufficient and appropriate formal training in Risk Management? Do they have sufficient relevant experience to understand their corresponding roles?"
- Also, a recurring issue is that of emerging risks. Nearly all the downturns having occurred in the past were created by emerging risks (e.g. internet bubble, sub-prime crisis, etc.....). Yet none of the questions in the list addresses the issues of forward looking for emerging risk. Overall, we would recommend that a few bullet points are included in appendix E related to this aspect.

5) **Page 6 – "Do you believe that the approach taken in Appendix B of the draft revised guidance is appropriate? If not, how should it be amended and why?"**

With respect to appendix B, we agree that the proposed approached is appropriate. We also agree with the proposed wording.

6) **Page 7 – "Do you agree with the guidance in Appendix C of the draft revised guidance? If not, how should it be amended and why?"**

With respect to appendix C we have three observations.

- In terms of the table presented on page 21, we think there is confusion in the paper between the concept of "credit quality" and that of "going concern". We think that the transactions in the column entitled "outside" are indicative of deterioration of credit quality. However, companies with a poor credit quality can still survive for significant periods of time on a going concern basis. Some of them can even regain their high credit status after some time. We would suggest that indicators of non-going concern should be included in the column entitled "outside" rather than indicators of deterioration of credit quality. For example we would include items such as negative net assets after re-structuring, rather than the re-structuring itself or negative net assets after emergency disposal rather than emergency disposal itself.

- In the "Reporting on the going concern basis" paragraph, we do not see any circumstances where a company would report under the second bullet point (- b) -) that is on the "going concern basis" but with material uncertainties. We think that companies will always report on the basis of the first bullet point and base their assumptions on "optimistic" financial projections. It would be difficult for the auditors to challenge the optimistic assumptions and therefore the auditors would not be in a strong position to challenge management. For this reason, we think bullet point b) is of limited use and could be removed.

- In the "Reporting on the going concern basis" paragraph, and the third bullet point, we expect the companies which are not going concerns NOT to report on a going concern basis. Therefore we are not sure whether this third bullet point should be included as this is already covered in other accounting standards. We propose to use the following text instead of the third bullet point: "where the company is not a going concern we expect the accounts to be **not** prepared on the basis of a going concern".

7) **Page 7 - Do you agree with the revised guidance (regarding the "supplement for banks")? If not, what needs to be amended and why?**

Due to their activities, banks play a specific role in the economy and they should therefore be treated with specificity related to their industry. As a result, we think that the specific guidance for banks is appropriate and should remain in its present form.

8) **Page 7 - Do you agree with the draft revised auditing standards? If not, what should be changed and why?**
We agree with the proposed changes to the accounting standards from "anything" to "anything material".

9) **Page 10 - The proposed revisions to Sections C.1 and C.2 of the Code are set out in full on the next page. The FRC would welcome views on whether the additions are required and, if so, on the detailed wording; and on whether the existing Provision C.1.3 (on the going concern statement) should be removed.**
We think that directors should make a clear statement on whether the company is a going concern and justify this statement in the annual report. We think that this is a specific responsibility of the directors and they cannot avoid addressing it. Therefore, we think paragraph C.1.3 should remain.

We also disagree with respect to the new paragraph C.2.1. We think that the directors should be aware of the principal risks facing the business on an ongoing basis, not only once a year as the wording suggests. We therefore propose the following text for this paragraph:

"NEW C.2.1. The board should ~~carry out a robust assessment~~ **be aware of** the principal risks facing the company, including those that would threaten its solvency or liquidity **at all times**. In the annual report the directors should confirm that they have **adequate policies and procedures comply with this requirement** and that they carry out an independent risk assessment at least on an annual basis and explain how the principal risks are being managed or mitigated. They should indicate which, if any, are material uncertainties in relation to the company's ability to continue to adopt the going concern basis of accounting. **They should also comment on whether material changes in the risk profile of the company have occurred during the year and since the previous reporting period."**

Other observations

The annual reports of large companies is often fairly long, and several hundreds of pages is common. We are not sure how the risk management section would provide more transparency given the volume of information already contained in these reports. We acknowledge that the transparency project is currently under way and that over the longer term, this would contribute to improve the transparency of such reports. But we have concerns over the medium term, between now and the finalisation of the transparency project which may be many years to complete.

We also believe that auditors may not have the skillsets to undertake complex risk related analysis of firms. The implementation of the current proposal would therefore require some retraining of auditors in the area of risk management.

Prepared by:-

Laurent Chauvet & Vijay Krishnaswamy

January 2014

For and on behalf of Hymans Robertson LLP