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Investor Relations and Markets Committee

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Dear Madam

FRC Draft Guidance to the Directors of Companies applying the UK Corporate Governance Code and associated changes to the Code ("the Draft Guidance")

I am writing in my capacity as Chairman of The 100 Group Investor Relations and Markets Committee to share with you our views on the FRC's consultation document on the above stated topic.

We have not sought to address all of the specific questions raised by the FRC but have identified, highlighted and commented on certain areas that we believe are the most important to our members; specifically, whether we believe the Draft Guidance achieves the stated objectives in relation to boards' responsibilities re: risk management and internal control. We have adopted this approach in large part as we believe that the Draft Guidance was not as clearly written as more recent releases from the FRC that we have commented on; navigating the 49 pages of guidance is difficult, particularly given that conceptually, the new guidance is derived from five or so previous FRC releases. This was particularly prevalent in the format of the questions as posed within this Draft Guidance.

Who we are

The 100 Group represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the FTSE 100, collectively employing over 7% of the UK workforce and in 2013, paid, or generated, taxes equivalent to over 14% of total UK Government receipts. Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

Our views

As stated in our response letter dated 28 April 2013 on implementing the recommendations of the Sharman Panel on going concern, we are supportive of the FRC's desire to improve the transparency of reporting on corporate governance. Nevertheless we had raised a number of points of unease in our response letter and are pleased to note that the Draft Guidance has satisfactorily addressed some of those points; specifically around the two meanings of going concern. The newly clarified distinction between an assessment of solvency and liquidity risks and the going concern basis of accounting is helpful in reducing confusion to users of Annual Report and Accounts.

However we believe there is a fundamental issue with the Draft Guidance. The Draft Guidance seeks to provide more in-depth guidance than that which is in existence now re: how Boards can consider its *"other responsibilities for risk, in particular that "In determining its policies with regard to internal control, and thereby assessing what constitutes a sound system of internal control in the particular circumstances of the company, the board's deliberations should include consideration of the following factors:*

- *the nature and extent of the risks facing the company;*
- *the extent and categories of risk which it regards as acceptable for the company to bear;*
- *the likelihood of the risks concerned materialising;*
- *the company's ability to reduce the incidence and impact on the business of risks that do materialise; and*
- *the costs of operating particular controls relative to the benefit thereby obtained in managing the related risks"."*

You have sought views on whether the Draft Guidance has achieved this objective. In our view, the Draft Guidance is not substantially different from current guidance, and therefore does not add any noticeable clarity. We see this as a missed opportunity for the FRC to drive forward a reduction in complexity and an enhancement of the understanding of users of Annual Report and Accounts.

We would emphasise that we agree with the above structure and that the FRC ask a good question as to whether better or different guidance would help deliver the five components or factors more consistently. We recommend that the FRC takes a step back and assesses with respect to each of the five components a) do companies struggle with the concept or the reporting against the component b) only if the answer is yes make it clear which of these two elements the enhanced guidance is aimed at and issue new guidance. Otherwise the FRC is urged to refrain from issuing new guidance.

Further, in order to reduce clutter, we recommend that companies should make a reference to the FRC guidance as giving the context to the risk and control section (in the same way as many do to the Turnbull guidance). A note for users of accounts could be incorporated upfront in the guidance which included the following points in addition to the current explanation:

- the assessment of risk and its mitigation is an area requiring the board and management to exercise business judgement;

- the risks that are to be covered are not the universe of risks but the specific risks that are relevant to the company's strategy and operations; and

- that risk management must weigh up the costs to mitigate vs. the probability and impact of a risk.

Our detailed comments on each of the five factors are set out below:

- *The nature and extent of the risks facing the company*

  Generally we believe this is an area well addressed by companies and question how much additional or new guidance is required. We would underline that users of accounts need to understand that this is a judgemental area.

  We welcome the added clarity around solvency and liquidity risks in the Draft Guidance. Although recognising that the term is now used in a more narrow context, we re-iterate our unease with the term "high level of confidence" when referring to boards' ability to manage such risks in the context of going concern. Such a term will inevitably lead to a wide range of interpretations and we therefore question whether users of Annual Reports and Accounts will really benefit from this assertion. We are also concerned that one interpretation of the term would mean the requirement for a higher degree of financial conservatism, resulting in potential knock-on consequences for investment.

We further note that the Draft Guidance states that "*users may reasonably expect that matters disclosed as material uncertainties in the financial statements would have been discussed in the Strategic Report in earlier annual reports… unless they could not reasonably have been identified… at that earlier time*." This could lead to defensive disclosures in companies' annual reports in order to avoid being judged with the benefit of hindsight. A "shopping list" of risk disclosures is not desirable in an era when more clear and thoughtful reporting is encouraged. To avoid reports becoming cluttered with disclosures of remote possibility risks, we suggest that the FRC gives more clarity around the circumstances under which it would be reasonable to expect a material uncertainty to have been disclosed in an earlier annual report.

- *The extent and categories of risk which it regards as acceptable for the company to bear*

  In our view, the Draft Guidance does not provide additional clarity over and above current guidance in this area. The Draft Guidance is not clear on how a company should define and report on *"risk which it regards as acceptable for the company to bear".* For instance, a company's residual operational risks after mitigating controls and actions have been taken may be acceptable to a company but these are clearly different from strategic risks that the company seeks to take on, or accept, in order to create and increase shareholder value. We recommend that guidance be issued which requires companies to highlight the strategic risks that they are in business to accept vs. the residual operating risks, so that the mitigation can be seen in this context.

- *The likelihood of the risks concerned materialising & the company's ability to reduce the incidence and impact on the business of risks that do materialise*

  In our view, the Draft Guidance does not provide additional clarity over and above current guidance in this area. There is a general lack of consensus over the level of detail of required disclosure in this area and, indeed, how companies interpret this requirement. A clearer distinction in the guidance between risks that are outside of companies' control, such as macro and socioeconomic risks and those risks that are particular to a company, could help reduce boilerplate disclosures. If the FRC were to state as suggested above in guidance to users of accounts that macro and socioeconomic risks should not be included, unless the business was particularly sensitive to such risks.

  Furthermore, we also note the FRC's comments updating existing guidance "*that companies should confirm that any necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from [the] review"* to *"the board should explain what actions have been or are being taken to remedy any significant failings or weaknesses identified from that review".* We recommend that guidance is explicit that the board would have to consider what was a significant failure in this context and, if possible, give examples. Absent any illustrative examples, we believe this has not been developed sufficiently for practical usage.

- *The costs of operating particular controls relative to the benefit thereby obtained in managing the related risks*

In our view, the Draft Guidance does not provide any clarity over and above current guidance in this area. We recommend the point is made to users in the manner described above.

Conclusion

As set out above we recommend the FRC takes a step back and considers the fundamental nature of what revised guidance should do and take account of the following points.

The UK has made good progress in changing the way in which it reports its business and operations to a variety of stakeholders. Annual Reports and Accounts have changed considerably over the years, with more companies focusing on providing a more holistic overview of its operations, its risks, its value creation and various other factors.

Since the financial crisis, audit committees have moved on in their response to increasing investor demands. We note that the Turnbull Guidance is well understood by our members. Adding any more/new requirements in an area where it is very difficult to be generic is may not be required.

We will continue to support any drive to reduce boilerplate disclosures, reduce the complexity and length of companies' reporting and focus users' attention on the key performance indicators of a business, what helps and may hinder achievement of strategy, and its results. We urge caution to ensure that any proposed amendments by the FRC do not create a shopping list of disclosures that are not material to an assessment of stakeholder or shareholder value.

Please feel free to contact me if you wish to discuss the views contained within this letter.

Yours faithfully

Matthew Lester
Chairman, The 100 Group: Investor Relations and Markets Committee