



Ms Catherine Woods
Financial Reporting Council
8th Floor
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18 July 2014

Dear Ms Woods

Comment letter in response to the Financial Reporting Council's proposed changes to the UK Corporate Governance Code

The Corporate Reporting Users' Forum welcomes the opportunity to comment on the Consultation Paper regarding the *Proposed Revisions to the UK Corporate Governance Code* published by the Financial Reporting Council (FRC) in April 2014. Our response is set out below.

The CRUF's main focus is on accounting and directly related issues. We are therefore not going to comment on the remuneration proposals, save to say that the related disclosure should be transparent, comprehensive and verifiable. It should always be possible for shareholders to understand the derivation of historical variable pay, especially when it is based on formulae linked to key performance indicators, such as ROCE or sales growth. Both the formulae and the KPIs should be disclosed so that the process is transparent. The method of calculating future variable pay should also be transparent.

Moving on to going concern and risk management, the CRUF is broadly supportive of the FRC's proposals. We think that a simple statement that a company is considered to be a going concern is of much less use than a detailed and considered discussion of the risks that the company faces. The future is by nature uncertain and we cannot recall any occasion where a qualified going concern statement gave advance warning of future problems. Indeed, the reverse is normally true, with investors becoming aware of a company's problems long before any cautionary statement appears in the annual report.

We therefore welcome the proposal that companies should "robustly assess their principal risks and explain how they are being mitigated", provided that the disclosure is informative and company-specific. Bland boiler plate statements about macro-economic risks serve no purpose. For example, companies that face operational or financial risks associated with long-term contracts should provide enough disclosure for investors to understand both the nature and scale of the risks and how these



risks are being managed. The underlying aim should be that investors can see the risks as they appear to management, subject to the need to protect commercial confidentiality. There have been too many cases where management was aware of material risks but failed to disclose the risks until the problem became acute.

Where material risks can be quantified, then companies should be required to do so. For example, a company that receives a material and unreplaceable revenue stream from a patent which is about to expire should be required to disclose the size of the stream. Other examples could include residual value risks for leasing companies, reliance on dominant customers, assumptions on long-term contracts and so on. We would expect the directors to be monitoring these risks very carefully and it should not be acceptable for the directors to disclose the scale of a material risk only after it has materialised, for example after the patent has expired.

We also like the suggestion that companies should add colour to the going concern statement by specifying the period over which they expect to be able to continue in operation and explaining why the chosen period is appropriate. Some companies are by their nature more stable over time than others, making it undesirable for the FRC to specify a set period. The suggested solution, that companies choose whatever period they deem appropriate, is elegant. We would expect a combination of peer and investor pressure to drive companies to choose sensible periods for their sector over time, although there may be considerable divergence in the short term.

We would however also like to comment on two points that concern us.

First, the proposed requirements are by nature quite vague and we see a risk that the quality and utility of the risk disclosures will vary very widely. For example, the suggested text includes a requirement for the directors to describe risks that threaten "future performance". We worry that some directors might respond with platitudes about "competitive pressure" whereas what investors really want is a thoughtful explanation of how those pressures might evolve and what the company can do about it.

Our second and related concern is about enforcement. We expect the FRC to adopt a robust approach to ensure that companies obey the spirit as well as the letter of the new code. The FRC should be active in promoting good behaviour and addressing bad behaviour. It should be relatively easy for the FRC to assess whether a company's disclosures are satisfactory and we would therefore expect poor behaviour to be addressed quickly, and certainly within one reporting period.

To conclude, one of the CRUF's underlying principles has been that investors should be able to see the company as far as possible through the eyes of management. We think that these proposals, if properly implemented and policed, should help achieve that aim.



The Corporate Reporting Users' Forum

About the Corporate Reporting Users' Forum (CRUF)

The CRUF came together in 2005 as a discussion forum to help its participants in their approach to the debate on current and future corporate reporting requirements. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters such as the IASB. CRUF participants come from across the City of London and around the world, including individuals from both buy- and sell-side institutions, and from both equity and fixed income markets.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. It does not seek to achieve consensus views, though at times some or all of its participants will agree to make joint representations to standard setters or to the media. It would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative.

CRUF participants take part in discussions and joint representations as individuals, not as representatives of their employer organisations. The participants in the Forum that have specifically endorsed this response are listed at the end of this letter.

(Signatures)

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