

27 June 2014

[codereview@frc.org.uk](mailto:codereview@frc.org.uk)

Catherine Woods  
Financial Reporting Council  
5<sup>th</sup> Floor Aldwych House  
71 – 91 Aldwych  
London WC2B 4HN

Dear Catherine

## **PROPOSED REVISIONS TO THE UK CORPORATE GOVERNANCE CODE**

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of approximately £4.5 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, IMA members manage holdings amounting to just over 30% of the domestic equity market.

In managing assets for both retail and institutional clients, IMA members are major investors in companies whose securities are traded on regulated markets. IMA welcomes the FRC issuing this consultation and considers the FRC has moved a long way from its last consultation on the disclosures around risk management, going concern and future viability to address investors' concerns. The directors' assertions as to a company's going concern and future viability are of vital importance to investors and underpin the trust they place in directors.

Thus we welcome the FRC reinstating Code Provision C.1.3 on "the going concern basis of accounting". This encourages boards to pay due consideration to the matter. We agree this needs to be distinguished from the assertion that the company will continue in operation in the long term. This latter statement is the higher hurdle and is particularly important for investors, including bond investors, in ensuring companies do not abuse their limited liability protection. Nevertheless, we still have certain concerns about the proposals which we set out below and in the attached Annex, our comments on the specific questions raised.

- **Location of viability statement.** There are concerns that including the long term viability statement in the risk management and internal control section of the Code limits its scope, i.e. the assertion of continuing in operation should not be limited to the

65 Kingsway London WC2B 6TD  
Tel: +44 (0)20 7831 0898 Fax: +44(0)20 7831 9975

[www.investmentuk.org](http://www.investmentuk.org)

Investment Management Association is a company limited by guarantee registered in England and Wales.

Registered number 4343737. Registered office as above

directors' view of risks, but should be wider and also look at the current state of affairs and accounts (see question 6).

- **Timeframe.** The time period is being largely left to directors to determine in that they have to explain "over what period they have done so [assessed the company's prospects] and why they consider that period to be appropriate".

The Sharman Panel suggested that that the board's assessment of the risks to the ability of the company to meet its liabilities should be done prudently and should be for the "foreseeable future", not just for one year.

In IAS 1 on the going concern basis of accounting "foreseeable future" is defined as 12 months from the end of the reporting period. We recognise that using the term in the Code to mean a longer period could give rise to confusion. However, we firmly believe directors should draw on all available information in making their assessment of viability and take account of the business cycle and exercise their professional judgment. Whilst the guidance is clear that the period should not be limited to 12 months from the approval of the accounts, we are concerned that the Code gives directors too much latitude to determine the time period. We consider Directors should consider "such future period as may be reasonably anticipated taking into account the business cycle and their professional judgment" and that this should be clear in C.2.2.

- **Degree of certainty.** In our letter of 1 April we proposed that the directors should state whether "in their *opinion* the company will be able to meet its liabilities as and when they fall due and continue in operation". The consultation paper, however, now refers to whether the directors "have *a reasonable expectation* that the company will be able to continue in operation and meet its liabilities as they fall due".

We believe a reasonable expectation is much weaker than directors having to confirm in their opinion. We understand that directors have expressed concern that in forming an opinion on the company's future viability they are in effect giving a guarantee. We do not consider this to be the case. However to give directors some assurance over this, consideration could be given to the safe harbour in the Companies Act being extended to give them protection from suit for such statements (question 7).

- **The risks.** Investors, the shareholders, as the providers of risk capital and bearers of residual risk, want to know the risks to a company being able to continue as a viable business. They want to know of "any risks or material uncertainties" to the directors' assertion on viability and consider requiring directors to draw attention to "any qualifications or assumptions" is too narrow and will not result in the clarity that investors seek. The text "any qualifications or assumptions" in C.2.2 should be replaced with "any assumptions, risks or material uncertainties" (question 7).
- **Suggested revised text for Provisions C.2.1. and C.2.2.** In view of the above, we consider that the following text meets our needs and is in keeping with the recommendations of the Sharman Panel:

*C.2.1. The directors should confirm in the annual report that they have carried out a robust assessment of the current position of the company and any risks that would threaten its viability, including threats to its solvency and liquidity. They should describe those risks and how they are being managed or mitigated.*

*C.2.2. Based on that assessment, the directors should state whether, in their opinion, the company will be able to meet its liabilities as they fall due and continue in operation for such future period as may be reasonably anticipated taking into account the business cycle and their professional judgment. They should explain any assumptions, risks or material uncertainties relevant to that assertion and how they are being managed.*

- **Reference to accounts in the guidance.** Our letter of 1 April was underpinned by the need for the Guidance to give consideration specifically to the audited accounts and financial controls and whether there is a risk that, taking into account its contingent and prospective liabilities, the company's assets could be less than the amount of its liabilities. The accounts provide a reliable and prudent view of capital, including distributable reserves, such that directors have a solid basis on which to form a view about the future.

We understand concerns have been expressed about linking this to the accounts in that it might inadvertently limit consideration to the balance sheet date. We do not agree with this and believe it important that directors look at the business in the round rather than in a way that may be construed as focusing on the risk register (question 8).

- **International perspective.** The UK asset management industry invests internationally – around 67% of all equities managed are listed overseas – in other EU countries or outside the EU. In places the proposed guidance introduces new terminology and seeks to redefine certain concepts that are in IFRS.

Ideally concepts and terminology should be standardised in corporate reporting and auditing standards internationally to avoid unnecessary confusion and complexity. Moreover, in developing policy on corporate reporting and auditing, it would be helpful if the FRC sought to influence the international agenda and ensure there is comparability globally as opposed to developing a separate regime for UK companies.

- **Review.** The changes now proposed will have implications for both companies and investors and we consider they should be kept under review. The FRC should commit publicly to reviewing how the proposals are working at, say, the next biennial review of the Code, and reaffirm they are fit for purpose or otherwise.

We trust the above is self-explanatory. However, please do contact me if you require any clarification of the points in this letter or if you would like to discuss any issues further.

Yours sincerely



Liz Murrall  
Director, Corporate Governance and Reporting

## IMA's ANSWERS TO THE SPECIFIC QUESTIONS RAISED

IMA's answers to the specific questions raised are set out below.

### ***Section 2: Directors' remuneration***

*1. Do you agree with the proposed changes in Section D of the Code?*

IMA supports the proposed changes to the Principles and Supporting Guidance in Section D of the Code and consider they make the intention clearer.

*2. Do you agree with the proposed changes relating to clawback arrangements?*

IMA welcomes the proposed changes and the addition of text relating to clawback to accord with the Regulations. The Code should require disclosure of the circumstances in which these provisions could be used, but not prescribe the specific circumstances.

*3. Do you agree with the proposed change relating to AGM results? Is the intention of the proposed wording sufficiently clear?*

IMA supports the introduction of this provision and agrees that it should apply to all resolutions and not just those related to remuneration. This will ensure that all resolutions are given equal priority. However, as currently drafted "what actions it intends to take to understand the reasons behind the vote result" may result in standardised reporting in that companies would merely state that they intend to engage with shareholders. It is important that companies not only understand concerns but also take steps to address them. The Code should reflect this.

It would also be helpful if the Code referred to the GC100 and Investor Group guidance on this issue.

*4. Do you agree with the proposed amendments to the Schedule?*

We support the proposed changes to the Schedule.

### ***Section 3: Risk management and going concern***

*5. Do you agree with the changes to the Code relating to principal risks and monitoring the risk management system?*

As regards C.2.3. as currently drafted it would appear that the board's obligation to monitor could be fulfilled by an annual review of effectiveness. We consider it should be for the board to decide how frequently it reviews the risk management and internal control systems in ensuring that such systems are maintained, as required by the main principle. Thus "at least annually" should be replaced with "as appropriate".

*6. Do you agree that companies should make two separate statements? If so, does the proposed wording make the distinction between the two statements sufficiently clear?*

IMA welcomes that steps the FRC has taken since its initial consultation of November 2013. We were concerned about the removal of the express assurance in C1.3 - the confirmation that the company is a going concern. This is a vital protection for investors and creditors.

## IMA's ANSWERS TO THE SPECIFIC QUESTIONS RAISED

As the Sharman Review Panel observed, there is confusion about what "going concern" means. First, there is the interpretation that the company can meet its liabilities as they fall due and secondly, whether it is appropriate to use the going concern basis of accounting.

We consider it important that the FRC separates the two. As the Panel concluded, the ability of a company to meet its liabilities as they fall due is, de facto, the higher hurdle, and an important one for investors - it helps ensure that companies do not abuse their limited liability protection. However, we consider that including this in the risk management and internal control section of the Code limits its scope, i.e. the assertion of continuing in operation should not be limited to the directors' view of risks but should be wider and also look at the current state of affairs and accounts.

To address this, we consider the Risk management and Internal Control section should precede the Financial and Business Reporting section in the Code. The assertion about continuing in operation could then be included as a separate paragraph in the Financial and Business Reporting section to separate it clearly from the risks section.

7. *Do you agree with the way proposed provision C.2.2 addresses the issues of the basis of the assessment, the time period it covers and the degree of certainty attached?*

*Time period.* The Sharman Panel suggested that that the board's assessment of the risks to the ability of the company to meet its liabilities should be done prudently, that it should be made for the "foreseeable future", not just for one year. Any assumptions and qualifications to this should be clear and if viability is in doubt, it should be reported.

We are concerned that the time period is being largely left to the directors to determine in that they should explain "over what period they have done so [assessed the company's prospects] and why they consider that period to be appropriate".

In IAS 1 on the going concern basis of accounting "foreseeable future" is defined as 12 months from the end of the reporting period. We recognise that using the term in the Code to mean a longer period could give rise to confusion. However, we firmly believe directors should draw on all available information in making their assessment of viability and take account of the business cycle and exercise their professional judgment. Whilst the guidance is clear that the period should not be limited to 12 months from the approval of the accounts, we are concerned that the Code gives directors too much latitude to determine the time period. We consider Directors should consider "such future period as may be reasonably anticipated taking into account the business cycle and their professional judgment" and that this should be clear in C.2.2.

*Degree of certainty.* In our letter of 1 April we proposed that the directors should state whether "in their **opinion** the company will be able to meet its liabilities as and when they fall due". The consultation paper, however, now refers to whether the directors "have **a reasonable expectation** that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment".

We believe a reasonable expectation is much weaker than directors having to confirm in their opinion. We understand that directors have expressed concern that in giving an opinion on the company's future viability they are in effect giving a guarantee. We do not consider this to be the case. However to give directors some assurance over this, we

**IMA's ANSWERS TO THE SPECIFIC QUESTIONS RAISED**

support consideration being given to the safe harbour in the Companies Act being extended to give them protection from suit for such statements

Moreover, shareholders, as the providers of risk capital and bearers of residual risk, want to know of the risks to a company being able to continue as a viable business. They want to know of "any risks or material uncertainties" to the directors' assertion on viability and consider requiring directors to draw attention to "any qualifications or assumptions" is too narrow and will not result in the clarity that investors seek. The text "any qualifications or assumptions" in C.2.2 should be replaced with "any supporting assumptions, and any risks or material uncertainties".

8. *Do you have any comments on the draft Guidance in Appendix B on the going concern basis of accounting and/or the viability statement?*

We consider it helpful to provide guidance to companies on matters to be considered when making the assertion as to the going concern basis of accounting and the broader statement on the company's longer-term viability.

Our letter of 1 April was underpinned by the need for the Guidance to specifically give consideration to the audited accounts and financial controls and whether there is a risk that, taking into account its contingent and prospective liabilities, the company's assets may be less than the amount of its liabilities. The accounts provide a reliable and prudent view of capital, including distributable reserves, such that directors have a solid basis on which to form a view about the future.

We understand concerns have been expressed about linking this to the accounts in that it might inadvertently limit consideration to the balance sheet date. We do not agree with this and believe it important that directors look at the business in the round rather than in a way that may be construed as focusing on the risk register.

Moreover, whilst we have concerns about certain of the detailed drafting given the importance of this Appendix, once finalised we consider it should form part of the main guidance.

9. *Should the FRC provide further guidance on the location of the viability statement?*

See answer to question 6.

10. *Should the recommendation that companies report on actions being taken to address significant failings or weaknesses be retained? If so, would further guidance be helpful?*

Moreover the obligation to report in C.2.3. is likely to become boilerplate in that companies will simply state that they have undertaken the review of effectiveness of the risk management and internal control systems. Investors would like such disclosures to be more informative and if the review revealed major deficiencies would like to know what remedial steps are being or have been taken. Thus we support the recommendation in the guidance being retained. Companies are likely to value further guidance in this regard.