

Catherine Woods
Financial Reporting Council
8th Floor
125 London Wall
London EC2Y 5AS

By email only to: codereview@frc.org.uk

30 June 2014
Our ref: DB/TG

Dear Ms Woods

Proposed revisions to the UK Corporate Governance Code – April 2014

Deloitte LLP is pleased to respond to your request for comments on the consultation on proposed revisions to the UK Corporate Governance Code ("the Code").

We have provided our detailed comments on the proposed revisions in the appendix to this letter.

Overall, we support the proposed revisions to the UK Corporate Governance Code ("the Code"). Given the importance of implementing the Sharman principles without further delay, we have aimed to provide practical and specific comments on the proposals. In summary we:

- support the changes around remuneration and AGM results subject to clarification of the wording in the Main Principle;
- continue to believe that the proposed amendments around risk management and internal control represent good business practice and should serve to increase confidence in the governance of UK listed companies;
- support the proposed introduction of a new future viability statement which allows boards the flexibility to look forward over a period which best fits their business planning and investment cycles; and
- support the retention of the specific statement on the appropriateness of the going concern basis of accounting. The FRC's introduction of this statement in its current form in 2008 has done much to promote good discipline in the board's involvement in forecasting.

In our view, without further guidance, some elements of the proposed new disclosures and practices could result in differing interpretations being adopted by companies. We believe that this is particularly true of the requirement to explain what actions have been or are being taken to remedy any significant failings or weaknesses identified in the review of the systems of risk management and internal control; in this area we think that executive directors, audit committees and auditors would welcome guidance on interpretation. This would provide clarity into what might otherwise be difficult conversations in the boardroom and provide investors with confidence that the principles have been applied consistently across their portfolio.

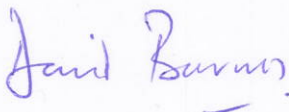
We believe that, with the suggestions we make above, it should be possible to have a revised 2014 UK Corporate Governance Code and revised Guidance available for directors by 1 October 2014. It is important that directors are given these as soon as practicably possible, given the requirement for the monitoring in proposed provision C.2.3 to be carried out throughout the financial year.

Finally, we have a few further points for the FRC to address to support practical implementation:

- The FRC acknowledges the need to discuss with the FCA whether an amendment to the Listing Rules may be required. It is important that the FRC ask the FCA to consult soon after the Code is finalised; this did not happen after the 2012 Code was issued and almost two years later the Listing Rules continue to require compliance with the 2010 Code. The practical problems with this are that the cross-references from DTR 7.1 and DTR 7.2 and the auditor review requirements in the Listing Rules are unclear as they refer to provisions of the 2010 Code. The further renumbering of provisions in 2014 may make this more confusing.
- In our previous response we noted a number of other pieces of FRC guidance refer to existing material which will be superseded by these proposals (and, indeed, by other recent and not so recent changes to the Code, FCA rules and the law), notably APB Bulletins on going concern, economic conditions, governance and remuneration. The FRC should consider revising or withdrawing this guidance on a timely basis.
- The consultation paper explains that the Guidance to Directors of Banks and the proposed changes to auditing standards will also be updated to be consistent with the outcome of this consultation and issued at the same time as the revised Code. Given the complexity of these changes, we suggest that an informal consultation with a very short turn around or alternatively use of the FRC's various advisory groups would be helpful to check technical accuracy and internal consistency of these documents.

We would be happy to discuss our letter and the proposals further. If you have any questions, please contact Tracy Gordon on 020 7007 3812 or trgordon@deloitte.co.uk.

Yours sincerely



David Barnes
Managing Partner, Public Policy
Deloitte LLP

Appendix: Deloitte's responses to questions raised in the consultation document

Remuneration

Question 1: Do you agree with the proposed changes to Section D of the Code?

D.1 Main Principle

We support the change to the main principle which now puts the key focus on designing remuneration to promote the long term success of the company. However, we suggest that the second part of the principle could be reworded as follows:

"Performance-related remuneration should be linked to targets which are appropriately stretching and rigorously applied."

We consider this will help avoid the potential for encouraging excessive risk taking which can occur when targets are made too stretching. It would also encourage companies to think about the balance between the level of awards and the degree of stretch in the targets. It also clarifies that this relates to the performance targets.

D.1 Supporting Principle

We support this change.

D.2 Supporting Principle

We support this change which will encourage the remuneration committee to be aware of the potential conflicts of interests when considering the views of the CEO and other executive directors.

Question 2: Do you agree with the proposed changes relating to clawback arrangements?

The new statutory remuneration disclosure regime requires companies to explain, as part of the remuneration policy report, whether there are any provisions for the recovery of sums paid or the withholding of the payment of any sum. We are increasingly seeing companies adopt clawback provisions as part of the remuneration arrangements. We support the inclusion of the proposed changes to the Code relating to clawback arrangements which will require both UK incorporated (subject to the statutory reporting regime) and non-UK incorporated premium listed companies to either include such provisions as part of their remuneration policy or explain why not.

Question 3: Do you agree with the proposed change relating to AGM results? Is the intention of the proposed working sufficiently clear?

We agree with requiring companies to respond where a significant proportion of shareholders oppose a resolution. However, we do have some concerns with the timing. The announcement of the voting is usually made the same day, or the following day. If a company is required to identify the actions it intends to take to understand the reasons behind the vote result as part of this announcement there is a danger that this will become a standard 'boilerplate' response that they will discuss the matter with major investors. We believe that the provision should also say "The board should provide feedback on the outcome of their engagement with shareholders at an appropriate time."

Question 4: Do you agree with the proposed amendments to Schedule A?

We support all of the proposed changes to the Schedule.

Risk management and going concern

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

We continue to support the Code amendments on risk management in the interests of good business practice and instilling confidence in UK listed companies.

Question 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?

We acknowledge that there was a need to make a clear distinction between the board's statement on the appropriateness of use of the going concern basis of accounting and a broader assessment of the company's ongoing viability. As stated in our previous response to you, we hope that clarifying and retaining the existing Code requirement for boards to state that the going concern basis of accounting is appropriate will continue the good practice whereby boards consider a detailed paper on going concern before reaching their conclusion for the annual report.

We believe that the drafting of new provision C.2.2 makes it sufficiently distinct from amended provision C.1.3.

Question 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?

We believe that the new provision C.2.2 represents a practical compromise between the needs of shareholders and the ability of boards to comply. The new Code provision allows boards to provide a disclosure tailored to the circumstances of their organisation within the parameters of existing planning and investment cycles. The "reasonable expectation" assertion represents a more achievable degree of certainty than was proposed in earlier consultations.

It should be recognised that with flexibility will come variability. These disclosures will be challenging to draft to be meaningful and practice will no doubt evolve over time in part in response to feedback from investors; once the first year of reporting under the new provision is complete this may well be worthy of a project by the Financial Reporting Lab to highlight good practice and consider whether further guidance is needed.

Question 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?

Our response to the November consultation paper included our concerns that the draft guidance went beyond the current requirements of IAS 1 and noted that the FRC was better placed to seek to influence global initiatives and should only make changes to UK requirements if international progress is not forthcoming. We accept that there has been further delay in the IASB's considerations of going concern and therefore support the FRC in taking a step towards better disclosures in this important area.

We hope that the FRC's material will influence the IASB's future considerations. We would be glad to discuss with you further how any future IASB initiatives might usefully be reflected in future FRC materials.

We have one specific suggestion relating to half-yearly reports. The existing FRC guidance on going concern makes clear that the minimum period for assessing whether the going concern basis of accounting is appropriate should be twelve months from the date of approval of a half-yearly report. This is not explicit in the FRC's proposed paragraph on page 31 of the consultation paper, and footnote 12 might give the impression that it is only necessary to consider the remaining six months of the year. We believe the period should be as in the existing FRC guidance and this should be made explicit. In addition, the footnote 12 cross-reference to the FRC's 2007 Statement 'Half-Yearly Reports' is unhelpful as this statement (a) makes clear it does not apply to entities adopting IAS 34, which is the vast majority of listed companies; (b) has not been updated for the 'new' UK GAAP; and (c) makes no mention of going concern.

Question 9: Should the FRC provide further guidance on the location of the viability statement?

We do not believe it is necessary for the FRC to provide further guidance on the location of the viability statement. Boards will make their own judgements on where the statement should be located within their annual report.

Question 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 useful?

Yes, the recommendation should be retained. We can appreciate that shareholders will be interested to understand how a company has addressed significant failings or weaknesses which have been identified.

The value of the disclosures provided will be dependent on the individual companies and the judgements which they make in relation to what is significant. We can see the merit of the view that boards should be free to use judgement when determining what constitutes a "significant failing or weakness" in the system of risk management and internal control. However, there is a danger that the bar may be set too high and only catch those weaknesses which are disclosed as "material internal control aspects of any significant problems disclosed in the annual report and accounts" (already a requirement of paragraph 36 of the FRC's existing guidance); we assume that the FRC's intention was to catch a broader range of failings or weaknesses.

We recommend that the FRC considers providing guidance as to what should be considered a "significant failing or weakness". Additionally, given the increased focus on the ongoing monitoring of "material controls" we suggest that similar guidance on what is a "material control" would also be helpful to directors, auditors and investors in interpreting the Code, Guidance and resultant disclosures consistently. Without guidance, boards may be tempted to look to other frameworks (for example, to the Sarbanes-Oxley Act, related regulations and the COSO framework) for guidance. If the FRC does not provide guidance, it would be helpful for the Guidance to encourage directors to explain how they have interpreted these terms.

As we have done with the new reporting requirements introduced in the 2012 Code, Deloitte will work with the FRC and companies to share best practice in this area and seek to drive up the quality of disclosures in the best interests of shareholders.

Question 11: Should the option of giving companies the possibility of putting the full corporate governance statement on their website be considered further? If so, are there any elements of the corporate governance statement that should always be included in the annual report?

There is merit in considering giving companies the choice of whether to make some of their corporate governance disclosures available on their website but we do not believe that the entire corporate governance statement should be presented in this way. Disclosure of governance arrangements are important to shareholders but can be fairly static. We recommend that the annual report should highlight all significant changes arising in the governance arrangements during the year (e.g. changes in board

membership, board activities, board committee terms of reference or compliance with the Code provisions) and the following key matters:

- the outcome of the annual board performance evaluation exercise;
- the audit committee's disclosure on significant issues considered and how they were addressed;
- the disclosures around going concern/future viability; and
- disclosures on the directors' review of the systems of risk management and internal control.

Our comment letter to the FRC on the IAASB's proposed revision of ISA 720 suggested that the FRC will need to consider the impact of website publication on the auditor's duty to read the rest of the annual report for consistency. The two most obvious issues are:

- will it be clear which version the auditor has read for consistency? If not, investors might take undue comfort; and
- will there be an obligation on the company to go back to the auditor if this "static" material is revised? If not, there is a danger that material which the auditor would not have accepted is published by a company.

Finally, care will be needed around the overlap between the disclosures required by the Code and those by DTR 7.1 and DTR 7.2, and the interaction with the statutory requirements for additional auditor reporting by exception when the corporate governance statement does not legally form part of the directors' report.

Question 12: Are there any disclosure requirements in the Code that could be dropped entirely?

In our view, all the disclosures in the Code represent important aspects of a company's governance arrangements which active shareholders should be interested to understand and observe and should be retained. However, a radical review of what can be posted as standing data on the company's website would be most welcome; this might usefully look at statutory requirements as well, particularly the remaining statutory requirements of the directors' report. We would be willing to participate in such a project.