

February 2011

Dear Sirs,

## Effective Company Stewardship

I am writing in a personal capacity in response to the recently published consultation paper. ( I set out my credentials in appendix 1) I have no doubt that the FRC has the best interests of UK PLC at heart and that the proposals are a genuine attempt to head off the worst imaginable diktats of the EU. However, I do not believe that the proposals set out in the paper on Effective Company Stewardship are a good idea nor do I believe they will succeed in the aim of constraining European initiatives.

As the paper rightly points out the disastrous financial crisis of 2008 has caused many to argue that reform of the UK/Anglo Saxon system is necessary. However, I do not believe that the causes of the financial crisis have been satisfactorily explained, that the 'solutions' put forward are logically based nor that the fixes so far suggested adequate. The auditing profession has been declared 'not guilty', company directors have been tried and found guilty by the media, but of what is not clear. The Regulators have been examined by themselves and exonerated. (How this occurred when their reason d'être is to protect the consumer and the financial plumbing is a complete mystery to me but that is a different matter.)

I agree wholeheartedly that governance of the financial services sector needs fundamental change. Those who take retail deposits or promise significant benefits to consumers in the long term etc owe an enormous duty of care to consumers (who cannot reasonably be expected to look after themselves). Equally, the government has, in my view, a duty to protect National Security and the satisfactory maintenance of the financial system is or should be a critical part of that. These two aspects were notably left unattended and while there was much discussion about the need for risk of failure to be present for equity holders, it does seem to me that RBS and HBoS equity holders can be in little doubt that they took a very big hit.

I am struck that the IASB and their IFRS policies have not, satisfactorily, been queried as a contributory cause of the financial crisis. The *incurred loss* accounting policy that applies to financial institutions is in my view scandalous, very rarely understood by even financially literate people and a major factor in permitting Financial Institutions to report Capital figures when any reasonable person would recognise that the figures were overstated. This together with the complexity brought about by IFRS, which has as a by-product reduced comprehension, needs further examination in my view.

Non financial services companies have survived the crisis surprisingly well. Other than guilt by association I can see no reason why companies and/or directors in the non financial services sector should be subject to any change from a system which has been proven to be satisfactory and which hasn't caused any issues to consumers, governments or, except to a minimal extent, investors. In failing

to draw a distinction between Financial Institutions and other companies your paper falls short of a standard we should expect.

The UK system (single tier Boards, board sub committees and annual reports) has served the non financial sector well. There is risk to equity holders but they seem broadly happy with it; there is risk to lending banks but they are able to get their own protection. General creditors and the consumer have been largely unaffected. I recognise that the system may not be perfect but there is no imperative to fix it. In particular any attempt to improve it should have to satisfy a cost benefit-test. I doubt that your proposals could do this.

There is a danger that your paper is full of 'motherhood and apple pie' statements and that rejection is seen as unreasonable. You should worry greatly about this particularly as your paper is not entirely logically constructed.

Reporting that is more valuable must be a good thing. However I refute that more comprehensive reporting is more valuable. Currently Annual Reports are more comprehensive than they have ever been but arguably less comprehended. In this context we should think carefully about IFRS. It has been manically pursued by Prof Tweedie without due regard to investors' requirements or the communication between companies and investors. To illustrate this I refer you to the Cash Flow Statement. Presentations to investors usually contain a statement of cash sources and uses on a very different basis.

You argue for the Report and Accounts to be a comprehensive stand alone document which facilitates the conversation with investors and stakeholders. Personally I do not see the Annual Report fulfilling this role. It is not and should not be a Prospectus. It should in my view be a report on the year's performance. Other documents and sources which are available to diligent investors can and do supplement it and provide the other 'permanent file' information set out on the page 9 footnote. Technology can help here (though XBRL is not necessarily the answer to a maiden's prayer) but anything that can be done to get routine reports out of the Annual Report would be a good thing.

I am not convinced that your spirited defence of the Audit Committee is a good thing. The AC is a sub committee of the Board and helps make the current UK system work better but a director at the end of the day is a director and must satisfy that duty. I think it dangerous to suggest that the AC is the ultimate protector of truth and fairness. The time and money involved in the audit committee is a mere fraction of the cost of the audit. The knowledge of the NED's compared with the executives is tiny. Audit Committees cannot 'hold auditors to account' nor be the ultimate backstop.

I do not accept that telling people how a job has been done gives any reassurance. Contrast the current long audit report with the one of 40 years ago. In the public's mind there is no difference whatsoever.

Compare with the checks that a pilot does before flying a plane. I don't know what they are. I don't know how he does them. What I do know is that BA and the CAA (who are experts) lay out the right tests and ensure the pilot does them. That is why I fly safely week in week out. Please don't get the pilot to give me a long report...the delays at Heathrow are bad enough already! Similar principles should be

applied to Auditors and Boards of Directors and if you like Audit Committees...but lets stop the writing of meaningless boiler-plate.

By all means get directors to say that they are responsible and have done their job.... be it about auditors/ the audit or the information that the Board sees/uses. That should be enough. (I would also be happy for the auditors, the AIU or the FRRP to verify it but let's report by exception.)

The investors currently have the ability to ratify the appointment of the auditors and/or to vote out all the directors annually. Please don't confuse matters by giving them greater involvement in the appointment of the auditors.

On page 16 you suggest that the AC report should include 'Any matters of material significance identified by the auditors in their report to the Audit Committee that are not addressed elsewhere in the Annual Report and which, in the directors view, should be known to users if the Annual Report, taken as a whole, is to be fair and balanced'. If that's the directors' view wouldn't they just include it in the Annual Report anyway? There is a grave danger that those of us responsible for corporate governance make ourselves look silly if we adopt this sort of requirement.

You rightly raise safe harbour provisions and following Prof Davies review the Annual Report gives good protection. If we are to simplify and shorten the Annual Report similar protections need to be given to other statements made elsewhere.

I agree that the FRC should monitor market developments and international initiatives on corporate reporting and assurance. How this is best done is up to you but it would be self defeating if you were seen to hide behind a 'carefully selected' participants group.

I share your interest in better company stewardship but believe it important that any changes that are made are the right ones and would urge you to reconsider your proposals,

Yours faithfully,

David H Richardson

## Appendix One

### Current Roles:

Chairman    Forth Ports PLC ( FTSE 250)

NED, SID and Chair of the Audit Committee    Serco Group PLC ( FTSE 100)

Chairman    Spire Bidco Ltd ( t/a Four Pillars Hotels) Bank owned private company

Chairman    I H S GmbH ( owned by London based P/E House)

### Former Roles

#### EXECUTIVE

Finance Director of Whitbread PLC

#### NON EXECUTIVE

Chairman    De Vere Hotels PLC

Chairman    Sports Direct PLC

NED    Dairy Crest Group PLC

NED    Tomkins PLC

NED    The Restaurant group PLC

The views expressed are entirely my own and should not be attributed to any organisation past or present.

