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Dear Sir,

**Re: Consultation on the Revised UK Corporate Governance Code**

Thank you very much for the opportunity given to make our contribution for the above.

I am pleased to make my contribution with my empirical research on the role of NEDs and relevant research evidence is made available in this paper for your understanding as otherwise, my contribution will not be complete.

- (1) Significance of board committees and therefore the need to highlight the board committees as a supporting principle of the Main Principle under A.1.; though there is a separate consideration of the board committees in B 1:.
- (2) Significance of one technical term to be used in the annual reports for the designations of company officials especially the Chairman.
- (3) The need to separate the corporate governance report from the Directors' report. I have found that few firms listed in the Alternative Investment Market insert the corporate governance statement within the Directors' Report.

I hope I make a useful contribution and I am so pleased if you need me to clarify these points in any suitable way you wish.

Thank you.

Yours sincerely,

Sgd.

Walter Gunetilleke

## (1) Significance of board committees

Many of the principles and provisions have been accepted by listed companies in the Alternative Investment Market (AIM) too (in addition to premier companies) although they are not required to either comply or explain whether they follow the Code. I analysed a random sample of 75 annual reports of AIM companies and found 52 per cent of the companies have a non-executive chair (NED chair) (Table 1). However, it is required to note here that the use of the term 'chair' is not so rigorous in some annual reports. For instance, in the statement of the chair, the title is mentioned as chairman and in the bibliography page of the same annual report, it appears as non-executive chair. However, many of these NED chairs are not truly independent NED Chairs when we look through their interests and criteria of the Higgs Report. Majority of the NED chairs of AIM companies have shares in the companies they work and not truly independent as the NED chairs of FTSE companies.

*Table 1*

### **Type of Chair**

<b>Type of Chair*</b>	<b>Number of firms</b>	<b>Per cent</b>
Chair	19	25.3
Executive Chair	17	22.7
Non-Executive Chair	39	52.0
Total	75	100.0

*Source:* Survey data

\* as the designation appears in the statement of Chair in the annual report.

Table 2 shows that the audit and remuneration committees are more established in listed firms (74.7 and 73.3 per cent respectively) while the nomination committees (41.3) are still to appoint. However, there is no clear term of reference for the board committees of the AIM

companies as in the premier companies. Table 2 further shows that 26 companies (34.7 per cent) have all three committees and 25 companies (33.3 per cent) have two committees, mainly the audit and the remuneration committee. At least in 25.3 per cent of companies (19 companies), have no any board committee although there are NEDs.

*Table 2*

**Board Committees of the AIM Boards**

<b>Committee</b>	<b>Number of firms</b>	<b>Per cent (out of 75)</b>
Audit	56	74.7
Remuneration	55	73.3
Nomination	31	41.3
All three of above committees	26	34.7
Two committees	25	33.3
Only one committee	5	6.6
No sub committees	19	25.3

*Source:* Survey data

**(1.1) More board committees make more involvement in corporate governance**

In order to prove this point, I have done a content analysis of the same annual reports used for the above findings. Content analysis is a research method of collecting data and I have designed the content analysis of the annual reports ensuring reliability and validity of data collection and analysis thus I am able to reach towards the above finding. Data is explained below. Table 3 shows that when the number of NEDs is two to three in the board, annual reports have the largest number of sentences coded (35.4 per cent and 30.5 per cent of 1,020 coded sentences respectively). This suggests to me that there is more dynamism in the board room when there is the optimum number of NEDs to suit the needs of the firm.

*Table 3*

**Relationship Between Number of NEDs and the Number of Coded Sentences**

Role of NEDs*	Number of NEDs						Per cent of role
	0	1	2	3	4	5	
Approvals	-	-	2.3	2.5	-	-	7.3
Inputs	-	-	2.5	-	-	-	5.5
Meetings	-	-	3.6	3.4	-	-	9.8
Organisation	-	2.2	3.1	3.7	-	-	11.0
Responsibilities	-	-	4.2	2.7	-	-	9.9
Revisions	-	-	3.1	3.2	-	-	9.2
Monitoring	-	-	2.4	-	-	-	5.8
Total	20	170	361	311	142	16	1,020
Percent of total	2.0	16.7	35.4	30.5	13.9	1.6	100

\* *Out of twenty roles, only those roles which take more than 2 per cent of sentences coded are included for this table.*

**Source:** Survey data

Significance of the board committees in dynamic corporate governance is explained using the tables 4 to 6. Most number of coded sentences appears when there are board committees as well as where there are NED chairs (table 4 to 6). In listed firms, where there are audit committees, number of coded sentences are 87.6 per cent as against the companies where there are no audit committees. The corresponding values for the corporations with the remuneration and nomination committees as against those corporations, which do not have such committees, are 84.2 per cent and 54.7 per cent respectively (table 5 and 6).

**Table 4**

**Distribution of Coded Sentences and Audit Committee**

<b>Committee</b>	<b>Type of Chair</b>			<b>Total</b>
	<b>Chair</b>	<b>EC</b>	<b>NED</b>	
<b>Audit</b>				
No audit committee	35	1	90	126
% of sentences	27.8	0.8	71.4	100
% within chair	15.7	0.5	15.2	12.4
% of total	3.4	0.1	8.8	12.4
Audit committee	188	204	502	894
% within committee	21.0	22.8	56.2	100
% within chair	84.3	99.5	84.8	87.6
Count	223	205	592	1,020
% within committee	21.9	20.1	58.0	100
% within chair	100	100	100	100
% of total	21.9	20.1	58.0	100

Source: Survey data

**Table 5**

**Distribution of Coded Sentences and Remuneration Committee**

<b>Committee</b>	<b>Type of Chair</b>			<b>Total</b>
	<b>Chair</b>	<b>EC</b>	<b>NED</b>	
<b>Remuneration</b>				
No remuneration	19	25	117	161
% of sentences	11.8	15.5	72.7	100
% within chair	8.5	12.2	19.8	15.8
% of total	1.9	2.5	11.5	15.8
Remuneration	204	180	475	859
% within committee	23.7	21.0	55.3	100
% within chair	91.5	87.8	80.2	84.2
Count	223	205	592	1,020
Within remuneration	21.9	20.1	58.0	100
% within chair	100	100	100	100
% of total	21.9	20.1	58.0	100

Source: Survey data

*Table 6*

**Distribution of Coded Sentences and Nomination Committee**

<b>Committee</b>	<b>Type of Chair</b>			<b>Total</b>
	<b>Chair</b>	<b>EC</b>	<b>NED</b>	
No nomination	84	79	294	457
% of sentences	18.4	17.3	64.3	100
% within chair	37.7	38.5	50.6	45.3
% of total	8.3	7.8	29.1	45.3
Nomination committee	139	126	287	552
% within committee	25.2	22.8	52.0	100
% within chair	62.3	61.5	49.4	54.7
Count	223	205	581	1,009
% within committee	22.1	20.3	57.6	100
% within chair	100	100	100	100
% of total	22.1	20.3	57.6	100

*Source:* Survey data

The above three tables point out (tables 4 to 6) the significance of the board committees of in corporate governance. However, the degree of significance given for the board committees varies among the firms. This could be due to the firm specific factors such as the phase of growth of the company, appraisal of cost and benefit of board committees, growth of the market and so on.

The above findings are important to say that there is a need to emphasise the significance of the board committees in the Corporate Governance code too. In the draft code, Section B under B:1 writes about the board committees but I believe the significance of the board committees should be strongly emphasised as a supporting principle too to the main principle of A. 1: The Role of the Board.

## (2) Significance of one language or technical term to be used in the annual reports

I have found in some annual reports that the designation of the Chairman beneath the statement of Chairman and within the bibliography page is contradictory. Table 7 below is an illustration of such contradictions in relation to three annual reports of AIM listed firms.

*Table 7*

**Differences of the title** (page number of the annual report within parenthesis)

<b>Name of the company annual report</b>	<b>Title in statement of chairman</b>	<b>Bibliography page</b>
LPA Group plc 2006	Chairman (5)	Non-executive chairman (3)
Glen Group plc 2006	Chairman (1)	Non-executive chairman (11)
DCD Media plc 2006	Chairman (5)	Non-executive chairman (10)

*Source:* Survey data

As earlier pointed out, when a NED chair has shares and other interests in a company, it is highly unlikely to be mentioned he or she as a NED chair if we go by the Higgs recommendation (2003) as well as the Combined Code of definition of the independence. This factor is important for the investors in particular and to the market participants in general.

## (3) Corporate Governance report

Corporate governance report is an essential document to be included in the annual report. However, I have found that some companies insert the corporate governance statement within the Directors' report. The Directors' report is required according to the Companies Act 2006 (Chapter V of Companies Act 2006). Corporate governance report is more about the board behaviour rather than the discussion of the business activities and the legal responsibilities of the directors which have to be included in the Directors' report. The above factor deserves the attention in the proposed UK Corporate Governance Code.