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Dear Chris

## **CONSULTATION ON THE REVISED UK CORPORATE GOVERNANCE CODE**

Independent Audit Limited is a specialist consultancy which amongst other things advises boards and their committees on the effectiveness of their corporate governance. Our clients include a wide range of companies, both large and small.

We welcome the changes proposed to the Code. Reflecting the fact that this is the final round of consultation, our comments are limited to observations on proposals where we are not fully in agreement rather than making more general observations.

### **B.6.2 External board evaluation**

We remain of the opinion that requiring an external review every three years runs the risk of box-ticking. Also it may force companies into such a review when the timing is not right for them, also possibly leading to a superficial approach.

Recognising, however, that a "three yearly requirement" is likely to be introduced, we would suggest that, for two reasons, there may be benefit in stating that "evaluation of the board and board committees should be externally facilitated..." Firstly, this highlights the importance of including the committees in such a review: too often they are seen as an afterthought. Also, it would intentionally exclude the external evaluation of individual directors: few companies would find it desirable to invite external facilitators for this purpose and quite what they would do is unclear. As few would "comply", either many would need to "explain" or, as is more likely, will just decide to turn a blind eye to this aspect of board review: either way, it is unhelpful.

## **B.7 Frequency of director re-election**

We do not agree that the chairman of the board or the non-executive directors should be proposed for election annually. We think that the potential benefits of this are, on balance, outweighed by the risk of instability and of discouraging candidates. Also, it implies that shareholders would have enough information to judge whether individual directors are performing well – it is difficult to see how this would be the case. What is more important than re-election in the manner suggested is to help increase investor confidence that the board is effective. This implies a combination of stronger board evaluation and better reporting on how the board operates, including a discussion of how the chairman assesses the board as a team and as individuals, and what is being done to recruit and “train” the right people.

The proposal in B.7.2 (both versions) that the chairman should confirm that “an individual’s performance continues to be effective...” is part of the current version of the Code. Taking this opportunity to reflect on it, however, we suggest that this is, in practice, without meaning: if the confirmation were anything other than positive, why would the director be put forward for re-election? Also, evaluating individual directors is fraught with difficulty: if any progress is to be made in this area, it is important that the issue does not become caught up in the question of shareholder meeting resolutions connected to annual election. It is important that the Code does not contain provisions that are seen as unhelpful or impractical as it can undermine attitudes to other parts of the Code or to the Code in general, so the opportunity should be taken to remove this requirement.

Such confirmation should, in any case, be part of the board’s discussion of its annual evaluation that appears in the annual report; the problem is that few companies undertake formal individual evaluations and even fewer mention it in their report, whether as a description of the process or as an “explanation” of non-compliance.

If it is a question of having to choose between the two versions proposed, we would favour the second option, but only because it is already part of the Code (A.7.2) and so have the benefit of avoiding making a change.

## **C.2 Risk Management and Internal Control**

You might consider changing the statement of the board’s role to “The board is responsible for defining the company’s risk appetite and tolerance and accepting significant risks at a strategic level”. Our work during 2009 on researching risk governance on behalf of The ICAEW Foundation showed that there is a distinction between “risk acceptance” and “risk oversight” and risk appetite/tolerance is only one aspect. “Risk acceptance” also involves making major decisions on taking risk and then continuing to monitor whether the level of risk remains at an acceptable level. We also suggest that there would be benefit to defining the term “risk appetite” as it is an expression that is widely used but not necessarily found to be useful, particularly in a non-financial services context.

Yours sincerely

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