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Submitted by email to
codereview@frc.org.uk

Dear Mr Hodge,

Prism Cosec response to the Financial Reporting Council (FRC) Consultation on the Revised UK Corporate Governance Code (the New Code)

Prism Cosec is a company secretarial practice and corporate governance consultancy that seeks to promote integrity and effectiveness within the boardroom. Our principle activity is in assisting companies with quoted securities on the Main Market of the London Stock Exchange and AIM on company secretarial and governance matters. A number of our clients are listed in the FTSE100 Index and we are the Company Secretary for one FTSE100 quoted company.

In May 2009, we submitted a response to the *Review of the Effectiveness of the Combined Code: Call for Evidence* paper published by the FRC. In December 2009, the FRC invited further comments on the proposed changes to the UK Corporate Governance Code (previously known as the Combined Code). We set out our responses to the proposed changes and ancillary matters below.

1. Leadership and Effectiveness

- 1.1 Many of the changes proposed in establishing the New Code are sensible and welcome. The split of Section A of the old Combined Code into sections on Leadership and Effectiveness is a good one and makes the Board section of the New Code more balanced. We still consider that more could be done to reinforce these sections of the New Code.
- 1.2 More emphasis could be placed on defining the role and accountability of the Chief Executive Officer as well as majoring on the role of the Chairman and Non-executive Directors. The spotlight was placed on the role of Chief Executive Officers in exceeding their powers during the Walker Review and we believe that this issue could still be addressed further. It would be helpful if additional guidance could be provided on how the role of the Chief Executive Officer should be defined within the written statement on the roles of the Chairman and Chief Executive as required by the proposed provision A.2.1 of the New Code. This may be a matter that the forthcoming review of the Higgs Guidance could consider.
- 1.3 The flow of information to the Board is an important component of the governance process and there is still no guarantee that management will flag up issues that the Board needs to consider. Consequently, we believe that the Schedule of Matters reserved to the Board should be given more prominence and that checks should be made – by either internal or external audit – to ensure that all such matters are reported to and approved by the board as required. This may be a matter for the FRC's forthcoming review of the Turnbull Guidance in respect to the review of the system of internal control to address.

2. Risk

- 2.1 Placing more emphasis on the monitoring of risk within section C (Accountability) of the New Code is helpful. It will encourage directors to ensure that they regularly review the risk profile of the company and monitor how the executives are managing the strategic risks. The disclosures on such matters required by the New Code could be aligned more closely to the disclosures on risks and uncertainties required by the Disclosure and Transparency Rules and the best practice guidance issued by the Accounting Standards Board in its Reporting Statement: Operating and Financial Review.
- 2.2 The evaluation of risk is the starting point for the internal control review processes advocated by the Turnbull Guidance (as subsequently developed). Consequently the new emphasis on board monitoring of risk should be considered as part of the FRC's forthcoming review of the Turnbull Guidance.
- 2.3 Making the link between remuneration and risk more explicit is sensible. We would agree that remuneration should encourage value creation that is both responsible and suitably controlled. Ensuring that remuneration takes account of both risk as well as growth is a useful feature of the New Code.

3. Board Performance and Behaviour

- 3.1 We note that the New Code places added emphasis on board behaviour and performance but question the likely effectiveness of the steps proposed in this regard.
- 3.2 The expectation that the chairman will agree a training and development plan with each director is curious and seems to turn the chairman into a form of line manager for the directors. If directors are recruited to the board on the basis of their knowledge and experience then it seems counterintuitive to suggest that they will then need to agree a training plan with the chairman. Furthermore this requirement could be even more baffling for non-UK issuers who will be seeking to comply with the New Code as a result of a Premium Listing.
- 3.3 The FRC notes that the provision of external board evaluation guidance is currently variable and we would agree. We do not consider that the board evaluation "industry" is sufficiently mature to be able to add value consistently and meaningfully to boards if mandated on a triennial basis.

4. Disclosure

- 4.1 The requirement to explain the business model and overall financial strategy is being adopted by many issuers in response to the ASB's Reporting Statement. It may be helpful for the FRC to make its expectations in this regard more explicit and state how they may expect issuers to augment disclosures made in accordance with the ASB Reporting Statement: Operating and Financial Review.
- 4.2 The expectation that the chairman of the board should personally comment on compliance with sections A and B of the New Code is a powerful one. It will be interesting to see how practice develops in this area.
- 4.3 The FRC suggests that it may be possible for disclosures on corporate governance to be posted on the website in accordance with Section 7.2 of the Disclosure and Transparency Rules rather than the annual report. For UK registered companies, at least, this may be a problem if the company has implemented procedures to allow shareholders to receive information by post, email or, by deemed consent, through the website. Shareholders who elect to receive hard copy communications may argue that this process discriminates against them. In any event it adds complexity to the compliance reporting process by requiring both a full statement and an edited version.

5. Auditor Independence

- 5.1 It is our understanding the ICAEW has produced guidance on auditor's independence and the policies on non-audit services which are widely adhered to by companies. We would suggest that the FRC should co-ordinate any initiative in this area with the ICAEW.

6. Directors Re-election

- 6.1 Much comment has been made about the possibility of the Board or certain key directors (e.g. chairman) being re-elected annually rather than triennially. Annual re-election seems to encourage a short-term focus on performance and carries a theoretical risk (if not particularly likely in reality) that the whole board could be voted off in one go. A more pragmatic option may be to require half the board to retire each year with the Chairman and Chief Executive Officer alternating their re-election. This would provide a meaningful way for shareholders to give a vote of no confidence without either personalising the issue or risking short-term actions which may not be in the long-term interests of shareholders.
- 6.2 We agree with the flexibility being introduced for non-executive directors to continue to serve after nine years of service.

We hope that these observations and suggestions are helpful. Please contact us if you would like to discuss any of the points made in this submission in more detail.

Yours sincerely



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Director
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