



FINANCIAL REPORTING COUNCIL'S REVIEW OF THE IMPACT OF THE COMBINED CODE

Comments from ACCA
20 July 2007



Page 1

ACCA (the Association of Chartered Certified Accountants) is the largest and fastest-growing global professional accountancy body with 296,000 students and 115,000 members in 170 countries.

We aim to offer the first choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management. ACCA works to achieve and promote the highest professional, ethical and governance standards and advance the public interest.

www.accaglobal.com

ACCA's is pleased to comment on the questions asked by the FRC's consultation on its review of the impact of the Combined Code.

1. Does the Code support better board performance over time?

We consider that the Code does support better board performance over time but feel this could be accomplished better with some minor changes to the Code.

Firstly we suggest giving greater focus on investor responsibilities. We continue to see little interest from many fund managers in governance issues. Large investment houses have corporate governance departments which ask the occasional question before an AGM. We are not convinced, however, that corporate governance features significantly in fund managers' analyses of whether to buy or sell particular stocks.

Secondly, as we have suggested in responses to previous consultations on the Code, we should like more emphasis on the importance of the Code principles, as distinct from its provisions. We would like fuller disclosure of how companies apply the principles. For example, few company reports give full explanation of how either the first main principle 'that every company should be headed by an effective board, which is collectively responsible for the success of the company', or its supporting principles, have been applied. Fuller disclosure of how companies apply the principles should result both in more informed and constructive attention to governance from investors and contribute to better board performance.

2. Is the "comply or explain" approach working effectively?

Generally yes. The effectiveness of the approach, however, depends upon good disclosure of governance practices and on investors taking an active interest in such disclosures. Not all investors are interested. Investors concerned only in short term gains will generally have little interest; others, wanting long term growth and dividends and holding their shares for the long term are likely to take more interest. Only a minority however, take a strong interest in the governance of companies they hold shares in; those who take lesser interest often tend towards a tick box approach.

The 'comply or explain' approach is central to the UK's approach to corporate governance; its operation and effectiveness should be nurtured. Recent changes in the make up of capital markets, including the impact of hedge funds and delistings as a result of private equity, could threaten the continued success of the approach.

We believe the approach could work even better if, as suggested above, greater attention is given by companies and investors to how the Code principles are applied.

3. What impact has the Code had on smaller (listed) companies?

The Code exempts smaller listed companies from complying with the provision 3.2 (at least half the board should be independent NEDs). Nevertheless the Higgs Report says there should be 'no differentiation in the Code's provisions for larger and smaller companies' and implies that smaller listed companies should aspire to comply fully with the Code. Achieving 50% independent NEDs sometimes encourages the Board to reduce the number of executive and other non-executive directors on the board – which can be harmful.

ACCA held a seminar recently to debate research on the benefits of good governance for SMEs. One factor to emerge, which we believe is relevant to some smaller listed companies, is the benefit that NEDs can have beyond their role in monitoring executive activity and contributing to strategy as articulated by Cadbury, Hampel and Higgs. Without in any way seeking to undervalue that role, NEDs in smaller companies also sometimes act as a mentor to other directors. They may also undertake some operational activity such as assisting in raising finance. We see nothing wrong with NEDs doing this provided they are objective although we accept this could appear to, or in fact, compromise their independence. We are concerned that smaller listed companies may feel constrained by the Code from making best use of what NEDs can do for them.

Notwithstanding our comments above, we think that there is an increased awareness of, and attempt to apply, the broad principles of the Code by smaller listed companies. Two main factors seem to influence how the principles are adopted:

- the level of family ownership, where unfortunately a higher level of family involvement sometimes seems to deter companies from bringing in independent directors owing to a fear of loss of influence;

and

- the size and influence of their audit firm, where the more prominent the firm, the higher the level of governance adoption.

Smaller listed companies, beginning to improve their governance, seem to find the practical guidance in the *Higgs Report* useful. Improvements begin with the introduction of one or more NEDs, this enables the practical use of an audit committee, and then gradually the company applies other areas of Code that seem most relevant to them.

4. Do disclosures on the Combined Code in annual reports provide useful information to shareholders at proportionate cost to companies? If not, in what respects and how do you believe they should be modified?

Disclosures do provide useful information. Further, the reporting framework encourages a level playing field to enable investors to assess companies' attitudes to governance. The extra cost of disclosure for a FTSE100 company is quite modest (circa £20k according to one company).

As stated in our responses to questions 1 and 2 above, we consider there is scope to improve the quality of disclosures. We would like to draw the FRC's attention to a report by Independent Audit called *Better Governance Reporting - A practical framework*. This report, sponsored by ACCA, was based on discussions with company executives, company secretaries, investors and other interested parties and, as the name implies, sets out a useful framework for boards to report on their governance and how they create value for shareholders. It is available at

<http://www.independentaudit.com/news/documents/BetterGovernancereporting-Apracticalframework.pdf>.

OTHER COMMENTS

There is the potential for conflicts of interest involving directors with executive functions which would need to be managed in a clear and transparent manner. We believe there is still a need for practical guidance on the distinction between governance and management. Such guidance could cover how boards can make the monitoring role of non-executive directors both effective and conducive to board effectiveness. An example of the Code failing to distinguish between the board and management is main principle C.2 on internal control which we consider is poorly phrased. It states that the board should maintain a sound system of internal control. We would consider that 'maintenance' is a management responsibility whereas oversight is the equivalent board responsibility.

We recognize that the Code may also need to change to reflect the implementation of the recent additions to the EC 4th, 7th and 8th Directives. We trust that any new UK legislation or other regulation will be kept to an absolute minimum. If there is a choice between legislation and an amendment to the Code, we hope that the latter will prevail provided that the 'comply or explain' character of the Code is maintained. For example we believe it may be possible to implement the 8th Directive requirement on audit committees by introducing a new principle on audit committees. The Code of course requires companies to state how they apply principles, so in that sense the Code is not voluntary.

Finally, we would like, once again, to suggest that a future more substantial revision of the Code should introduce a principle on sustainable development: a matter of increasing interest to many shareholders and stakeholders.

TECH-CDR-673.DOC

The Association of Chartered Certified Accountants

29 Lincoln's Inn Fields London WC2A 3EE United Kingdom

tel: +44 (0)20 7059 7000 fax: +44 (0)20 7059 7070 www.accaglobal.com