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THE
INSTITUTE OF
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Dear Mr Hodge

REVIEW OF THE IMPACT OF THE COMBINED CODE

The Business Law Committee is the Institute's committee which monitors developments in the rules and regulations affecting businesses generally and considers legislative and other proposals deriving from bodies such as the DTI, the FRC, the FSA and the European Commission. The Committee is broadly based, with members representing different sizes of accountancy practice, industry, the investment community, and the legal profession.

We have the following general points to make regarding our experience of implementing the Combined Code and in response to the specific questions in the review paper.

General points

In larger companies the provisions of the Code appear to be accepted and effective and we do not believe that any major changes are required.

The principles of corporate governance put forward in the Code are increasingly being applied in smaller companies such as AIM companies and those with ambitions to grow. This would indicate that the principles of the Code are considered to be useful and that corporate governance can be used to encourage good corporate and director behaviour. As with all matters, used sensibly and on a proportionate basis, the principles of good governance should be an essential feature of the corporate landscape. For your information, we are currently preparing guidance for ICAS members involved with smaller, unlisted companies on appropriate principles of corporate governance, which we plan to issue later this year. This is because we strongly believe good governance is beneficial for all companies and should apply in an appropriate form from the start.

We have some reservations, however, about the level of emphasis that is sometimes attached to compliance with the Code as written and believe this may be at the expense of focusing on corporate strategy and entrepreneurial success. The Combined Code was put in place following a number of large, high profile corporate scandals and whilst governance should support, not constrain, the entrepreneurial leadership of the company, in practice it can lead to a focus on managing risk rather than generating success. A paragraph along the following lines could usefully be included in the preamble to the Code:

'As stated in the Companies Act 2006 directors have a duty to promote the success of the company. They should seek to increase shareholder value over the long-term. Whilst effective corporate governance is important to long term success, the focus on corporate governance should not be to the detriment of the company's business strategy and entrepreneurial success.'

ICAS is currently sponsoring research by Professor M Page of the University of Portsmouth, on 'Corporate Governance and Corporate Performance', which considers whether the costs of corporate governance in listed companies have been matched or exceeded by the benefits. We anticipate this will be published in late 2007 or early 2008, and we will forward a copy to you at that time.

Specific questions

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

We consider that board performance has improved significantly in response to the various governance codes. More recently, there has also been a greater awareness amongst non-executive directors of the responsibilities and time commitment attaching to their position.

Directors and advisers are increasingly attentive to corporate governance. It is debatable, however, whether the underlying reason is because corporate governance enables directors to run their companies more successfully or whether it provides a certain level of assurance and comfort which may be advantageous in a litigious environment. Feedback is mixed as to whether boards focus on the spirit of the Code or just ensure they follow the detailed requirements.

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

We strongly support the 'comply or explain' principle as opposed to a more rigid regulatory solution but, in practice, we do not think that it always works in the most beneficial manner for companies. Too often, 'explain' is viewed as 'bad' and 'comply' as 'good'. As a result companies may tend to amend their procedures to secure full compliance regardless of whether it is sensible and this can lead to unnecessary burdens. For example, 'independence' of directors can often be seen as more important than 'experience' whereas the long term nature of corporate strategy benefits from longer serving directors who have 'been there before'. Furthermore, the complexity of a large multinational may require several years of service from a director before they can be truly effective. Thus, long service should not be seen as an aspect of non-compliance, but as a benefit. The Code should explicitly state that it is a good thing for a company to explain its policies and practices in support of compliance or non-compliance.

3. What impact has the Code on smaller companies?

It is notable that medium sized listed companies, some of which had not fully applied all the principles of the Code when it was originally published, have since changed and now generally comply. The impact of the Code on smaller listed companies is also growing although some of the requirements may be onerous. As discussed in question two above, we believe that it would be helpful if there was a more positive approach to the 'explain' requirement and this is particularly so for smaller companies, which could then focus on the key principles of corporate governance rather than 'box ticking' full compliance.

4. Do disclosures on the Combined Code in annual reports provide useful information to shareholders at proportionate cost to companies?

We have mixed feedback from our members regarding this question. On the one hand, transparency suggests that there should be governance disclosures. However, there are others who question the value of the current level of disclosure by reference to its cost and whether it leads to 'boiler-plating'. There is a risk that 'standardised disclosure' does not add value to current or potential shareholders.

Please do not hesitate to contact me should you wish to discuss any of the above points further.

Yours sincerely



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