

Mr Christopher Hodge
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Dear Mr Hodge

Review of the impact of the Combined Code

We welcome the opportunity to comment on the above consultation issued on 18 April 2007. In general we are supportive of the continuous effort of the FRC to improve the quality and impact of the Combined Code. We believe that the Combined Code has to date, in many respects, enhanced good practice in corporate governance and improved transparency of corporate reporting. However, we see a variety of approaches in the market and many companies can further improve their corporate governance processes and disclosures, learning from the best practices exhibited by those who are committed to being the leaders in this field.

The views and recommendations which we present below, stem from our knowledge of the challenges that our clients experience in practice and from our ongoing review of published corporate governance statements in annual reports.

We set out our detailed comments on the four issues on which the FRC is consulting below. However, in addition to these, we wish firstly to draw to your attention a couple of issues that we believe to be important in terms of maintaining the well-respected system of corporate governance for listed companies that we currently have in the UK. These are matters that you may wish to consider referring to the Financial Services Authority.

In discussions with clients and others, we consider that some confusion may exist in the market place, amongst both companies and investors, in respect of exactly which companies have to apply the Combined Code. For example, in situations where a company has a secondary listing in the London Stock Exchange, or listed debt rather than equity. Whilst the Listing Rules do set out the applicability in a number of different sections, and a reader can establish the correct approach through referral to these, the FRC may wish to consider whether it may be helpful to summarise the applicability within the Code possibly, for example, in Schedule C.

Our second point is that we observe a small number of companies that choose voluntarily to follow the Combined Code's recommendations, but only in a limited way. For example, they may begin their corporate governance statement by stating that they have complied with all the provisions that they consider appropriate. We think that this approach is particularly unhelpful for investors to be able to appreciate where omissions in good practice may have been made. As auditors, we always

encourage our clients who wish to report against the Code voluntarily, either to seek to comply fully and to disclose clearly where they have not complied, or alternatively not to include a corporate governance statement which could be misleading. If FRC was able to incorporate comments, perhaps in the preamble to the Code, which would support this position, we believe this would encourage good disclosure and practices.

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

In our opinion, the Code does provide a framework for promoting better board performance over time.

From our experience, we have observed the following improvements:

- Performance evaluation increasingly appears to be recognised as conducive to a board's effectiveness. In recent years, companies have invested significantly in establishing an appropriate framework for their board performance evaluations, often acknowledging the benefits of relying on external advisors to bring an independent perspective on the board's operations and effectiveness. Effectiveness reviews are found to result in changes to boards' membership and mix of skills, processes, areas of focus and professional development. As a result, boards: (a) focus on strategic issues; and (b) ensure they have the appropriate membership, including non-executive directors with a sound knowledge of the business and industry.
- Professional development is gaining greater prominence in the board's agenda, with companies investing more time and effort, both in their induction processes and their ongoing directors' development. Enhancing the directors' (particularly non-executives') knowledge of the business and its operations emerges as one of the key areas of focus for professional development programmes.
- Succession planning is increasingly acknowledged as essential. We see evidence that companies are becoming more proactive in appointing key members and aiming to ensure appropriate transition periods as part of their succession planning.

We believe that the above practices contribute significantly both to bridging the monitoring role of non-executive directors with the board's cohesive nature, and to ensuring that the board's real priorities are not subordinated by disproportionate attention to the letter, rather than the spirit of the Code.

Furthermore, we believe that the Code has contributed to a change of mindset in most boards, which has had a beneficial knock-on effect into a number of other critical elements of the overall governance model, namely executive remuneration and corporate reporting.

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

From our perspective as auditors, the 'comply or explain' principle appears to be working effectively, with many companies opting for practices appropriate to their circumstances, even if this results in departures from the Combined Code and the consequential explanations.

One factor that we believe can impact the effective operation of the 'comply or explain' approach is the clarity of disclosure in corporate governance statements. We have observed that some companies have increased considerably the length and volume of information included in their corporate governance statements. In certain cases, this has resulted in reports that are incoherent and comprised principally of 'boilerplate' statements. In our view, such practice can significantly

impede the degree to which disclosures can be easily understood and practices appropriately assessed by users.

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

In our experience, smaller listed companies have welcomed the provisions that permit fewer independent non-executive directors to sit on the board and board committees for those companies outside the FTSE 350.

We have observed that smaller listed companies tend to provide shorter, less detailed and more boilerplate disclosures than larger listed companies in their corporate governance statements. Whether this should be interpreted as indicative of fewer resources available in the preparation of corporate governance statements, or as a lack of appreciation or development in corporate governance practices amongst smaller listed companies, is open to debate.

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?

We believe the quality of reporting on corporate governance in annual reports has considerably improved in recent years. Companies have made significant progress, both in meeting the Combined Code minimum disclosure recommendations and providing additional voluntary good practice disclosures. The scope of disclosure has also improved, with many companies providing disclosures that include current as well as forward-looking information.

We endorse the importance of Schedule C of the Combined Code as a guide to what represents the minimum recommended disclosures. Where companies opt to improve their disclosures over and above what is required in Schedule C and volunteer more insightful information, we welcome this transparency. However, we question the value of much of the information being disclosed to investors. In a recent survey of investors only 10% considered corporate governance information to be important. We sense that, as with other aspects of reporting, the information value is reduced where the disclosures are perceived to be part of a compliance process. To quote an investor “there’s nothing you see in the statements that’s going to tell you anything either that you don’t already know or can’t assume, or if there’s a problem it’s not going to be disclosed there anyway.”

Furthermore, we note that a number of companies provide only scant details. In some cases, this fails to meet the minimum level of disclosure recommended by the Code.

In particular, the quality of disclosure in annual reports could be improved in:

- descriptions of and explanations for balance in the membership of boards and committees; and
- details around the performance evaluation process in respect of the board, the committees and individual directors.

Conclusion

We note that this review of the impact of the Combined Code is coinciding with the DTI's consultations on the implementation of the 4th and 8th Company Law Directives in the UK. As some of the requirements of these Directives overlap with the Code recommendations, we believe that the FRC will need to consider further the outcome of the DTI's consultations and their potential impact on the Combined Code.

We trust that our comments are helpful in contributing to the assessment of the impact of the Combined Code and in suggesting future potential enhancements to the Code. We would be happy to discuss any particular issues with you further; if you have any questions, please do not hesitate to contact Margaret Cassidy.

Yours sincerely,

PricewaterhouseCoopers LLP