By email: codereview@frc.org.uk

Christopher Hodge, Esq
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
London
WC2B 4HN

27 July 2012

Dear Mr Hodge

Revisions to the UK Corporate Governance Code, Guidance on Audit Committees and the UK Stewardship Code

BT Group plc ("BT") is one of the world's leading communications service companies, serving the needs of customers in the UK and in more than 170 countries worldwide. The shares of BT are listed on the London and New York Stock Exchanges and BT is a constituent of the FTSE 100 index.

We welcome the opportunity to respond to the recent consultation papers issued by the Financial Reporting Council (FRC) in respect of proposed changes to the UK Corporate Governance Code, Guidance on Audit Committees and the UK Stewardship Code. Our detailed comments on the proposals are set out below.

1. Revisions to the UK Corporate Governance Code and Guidance on Audit Committees

The directors should set out in the annual report the basis on which they consider that:

- **the report is fair, balanced and understandable; and**
- **provides the information necessary for users to assess the company's performance, business model and strategy**

We agree with the overall objective underlying this proposal. However, in our view a 'fair and balanced' approach is already the position which companies take in preparing their annual reports. The rationale for this proposal still does not appear to be clear. There are already significant existing statutory and governance disclosure requirements (for example the directors' responsibility statement, the compliance statement on corporate governance and the auditors "true and fair" statement) in the annual report which provide should provide reasonable comfort on the quality of the disclosure. The addition of an explanation as to why the directors believe that the annual report is fair and balanced does not appear to add much value beyond the existing disclosure framework nor provide additional protection to users.

Andrew J Parker
Company Secretary
BT Group

BT Centre
81 Newgate Street
London EC1A 7AJ
United Kingdom

tel +44 (0)20 7356 5237
fax +44 (0)20 7600 9086
mob +44 (0)7802 773635
email andrew.j.parker@bt.com

BT Group plc
Registered Office:
81 Newgate Street, London EC1A 7AJ
Registered in England and Wales no. 4190816

www.bt.com

We believe that clarification is also required of the term 'understandable' in the context of the annual report. There is a wide range of users and uses, and we consider that companies have to be allowed to assume a reasonable level of understanding of the accounting and regulatory backdrop against which companies are required to report.

The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:

- **to advise the board on whether the annual report is fair, balanced and understandable and provides the information necessary for users to assess the company's performance, business model and strategy**
- **to report to the board on how it has discharged its responsibilities**

We agree that the audit committee has a specific role in reviewing and advising the board of directors on the more specialised area of the financial statements and related disclosure and narrative reporting matters. However, we do not agree the remit of the audit committee should be broadened as implied by this proposal; it would represent a significant increase in the audit committee's role and remit. We believe this recommendation should be reconsidered in light of the board's overall role and responsibilities and its importance in maintaining a strong corporate governance framework. Also, the proposal could cut across existing frameworks and established effective controls and processes (eg involving other committees better placed to give assurance on certain disclosures). It should be clarified that a more appropriate role for the audit committee is to review the process for preparing the annual report. We are concerned with the proposal that that the board should rely on the audit committee in judging whether the Annual Report is 'fair and balanced'. We believe this has the potential to undermine the board's importance in operating effective corporate governance and strongly believe that the Annual Report should be owned by the board as a whole.

A separate section of the annual report should describe the work of the committee in discharging its responsibilities. The report should include:

- **the significant issues that it considered in relation to the financial statements, and how these issues were addressed;**
- **an assessment of the effectiveness of the external auditor and approach taken to the appointment or reappointment of the external auditor, including the length of tenure of the current audit firm and when a tender was last conducted; and**
- **if the auditor provides non-audit services, an explanation of how auditor objectivity and independence is safeguarded**

Our Annual Report already includes details of the work of the Audit & Risk Committee, including the annual assessment of the effectiveness of the auditors, the auditor appointment process, their length of tenure (we disclose that PwC have been our auditors for many years) and the safeguards that are in place to ensure the auditors' independence and objectivity. We have no objection to a further disclosure of the time period since a tender was last conducted, subject to the comments we make on the audit tender proposal below.

We understand the desire to make the audit committee report more informative. However we are concerned how the requirement to include significant issues which were considered in relation to the financial statements will be interpreted and applied at a practical level and what this will add to users' understanding of the financial information. Companies are already required to disclose significant estimates and key judgements within the Annual Report. Accounting standards also require extensive disclosures in areas where there can be significant judgements such as goodwill impairment, pensions, share-based payments, provisions and contingencies and financial instruments.

Further clarification is needed as to the definition, and examples, of significant issues which the FRC believes should be disclosed in audit committee reports. Otherwise this provision could lead to additional clutter in annual reports due to large amounts of narrative that may not necessarily be of interest or benefit to users, and would also be contrary to the FRC's recommendations as set out in its publication *'Cutting Clutter – Combating clutters in annual reports'*.

FTSE 350 companies should put the external audit contract out to tender at least every ten years.

We object to any proposals which introduce mandatory audit firm rotation. In our view such a proposal would inevitably result in a reduction in audit quality in the initial and final years of the appointment and an increase to audit fees.

We have no objection to a principle that recommends audits should be tendered (rather than rotated) after a set engagement period. However the reference to a specific time period between tenders should be removed as its inclusion could undermine the decision making ability of audit committees. Whilst we acknowledge that the Code is applied on a 'comply or explain' basis, in reality, this proposal is likely to introduce automatic tendering every ten years.

So long as sufficient disclosure is provided in the audit committee report regarding the effectiveness and length of tenure of the current auditor, we believe the frequency of tendering should remain a decision for audit committees. There may be circumstances when a tender may not be an appropriate course of action (for example if a company is undertaking a significant transaction) and therefore the frequency of audit tendering should remain a decision for the audit committee. We would prefer that the time period is removed altogether or at a minimum replaced with a broader time band, for example 10 to 15 years. (We also consider this is more in keeping with the 'comply or explain' framework of the Code.)

We would also point out that there are a number of practical issues and complexities with any proposal to conduct a tender for a new auditor. At present there are four large audit firms (PwC, Deloitte, Ernst & Young and KPMG) that provide the scale, expertise and experience required to conduct an audit of a large global business. In reality, many FTSE 350 companies will have a commercial relationship with the three of those firms that do not provide the company audit, for a range of consultancy services such as tax, HR, accounting, remuneration, compliance and other consultancy services.

Therefore in order to place a tender for audit services, companies will have to plan the potential change of auditor sufficiently in advance such that a new incumbent (if not the current incumbent) will have enough time to cease and withdraw from its non-audit activities, to allow it to attain "independent" status for audit purposes. Therefore in tandem, those non-audit services provided by that successful firm will have to be re-tendered and transferred to another firm, with a suitable transition period to ensure no disruption to these other services. Some firms may not wish to do so and therefore may not wish to tender for the audit. This reinforces our view that the prescribed time period for audit tendering should be removed altogether or, at a minimum, replaced with a broader time band, for example 10 to 15 years.

The FRC should also bear in mind that those companies that have shares registered in the US, as well as the UK have to comply with the US auditor independence requirements, in addition to the UK Codes and EU regulations.

A company should provide more detailed explanations when it chooses not to follow the Code.

We believe that additional guidance on explaining non-compliance is helpful. However, we consider that there needs to be an express overriding principle that the company needs to adopt a freeform approach to provide a clear and adequate explanation.

We also note the draft revisions to the Code state that explanations "*...should indicate whether the deviation from the Code's provisions is limited in time and, if so, when the company intends to return to conformity...*" We would highlight that some companies may not intend to comply with certain provisions of the Code on a permanent basis and hence the Code should make it clear that the focus should be on the company providing a clear explanation and shareholders judging that explanation. There should be no presumption that companies which are non-compliant in an area should be fully compliant with Code provisions within a certain time.

2. Stewardship Code

Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, remuneration and corporate governance, as well as voting. Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.

Institutional investors' policy on stewardship should disclose how the institutional investor applies stewardship towards the aim of enhancing and protecting the value for the ultimate beneficiary or client.

This disclosure should be posted on the institutional investor's website, or if it does not have a website in another accessible form.

The statement should reflect the institutional investor's activities within the investment chain as well as the responsibilities that arise from those activities. In particular, the stewardship responsibilities of those whose primary activities are related to asset ownership may be different from those whose primary activities are related to asset management or other investment-related services.

We believe that a more detailed re-appraisal of the Stewardship Code needs to be contemplated in light of the increasing trend to improve shareholder engagement, particularly with issues such as binding votes on future remuneration currently being proposed by the Government. Three issues in particular require consideration:

1. The early lodging of institutional votes in the voting period prior to a general meeting should be expressly advocated in the Stewardship Code, so that issuer companies have more time to react to and engage with institutions, particularly where shareholders do not support a resolution. The receipt of institutional votes just prior to the proxy voting deadline can be a significant problem for many issuer companies (when busy focussing on the administration of the imminent AGM);early lodging needs to become best practice and a further example of good "stewardship" under the Stewardship Code. We recognise that there are various reasons across the share ownership and proxy voting chains for proxy votes not being submitted in a timely manner and hence the solutions to this problem would need to be equally broadly-based. We recognise that certain investors would also welcome a longer period in which to engage with issuers, but are sometimes constrained by the voting chain process. We would therefore welcome development of

best practice guidance or industry codes for voting agents and custodians within the voting chain in order to facilitate early, direct engagement between issuers and investors;

2. We believe that institutional investors who have signed-up to the Stewardship Code, should disclose the extent to which they rely on the services provided by proxy advisors. In addition, institutional investors with a material holding (i.e. a voting interest of 1% or above in a company) who have signed-up to the Stewardship Code, should be required to engage directly with issuers prior to lodging their votes, to the extent that they intend not to support the company's resolutions;

3. Many institutional shareholders are international, and the corporate governance practice for an overseas shareholder may differ from that in the UK. We believe that there should be emphasis placed in the Stewardship Code for overseas holders and proxy advisors to place greater recognition on accepted home country corporate governance practice in the jurisdiction of the issuer.

Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. The statement should disclose the extent to which they follow, rely upon or use recommendations made by such services.

We are supportive of both proposals. As already noted above, it would be helpful for institutional shareholders to disclose their use of, and reliance on, proxy voting advisors. It would also be helpful for institutional shareholders to clearly state where they use their own policy on specific issues rather than following proxy advisors' policies. This would foster a better understanding by issuer companies of when some of their institutional shareholders may not be willing to support certain issues.

Proxy advisors should be required to share their reports with issuers, prior to publication and at no charge to the issuer concerned, for the purposes of checking accuracy. This ensures that institutions that use proxy advisors are receiving reports that are factually correct. A number of the proxy advisors already do so, and this process generally works well, but this practice should apply across all proxy advisors.

We trust these comments are helpful in contributing to your deliberations. If you have any questions or would like to discuss these comments, please do not hesitate to contact me.

Yours sincerely

ANDREW PARKER