



Grant Thornton

Our Ref GM/SAM
Your Ref 2009 CODE REVIEW – JULY 2009 UPDATE

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For the attention of Chris Hodge

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Dear Sirs

2009: Review of the effectiveness of the Combined Code (“Code”)

We welcome the opportunity to provide further comment to the FRC’s interim report on the Combined Code review. We support the approach taken by the FRC in seeking views from stakeholders at various stages within the process, and we support initiatives to facilitate debate and discussion on issues relating to corporate governance.

1. Guiding principles of change

We fully support the guiding principles of change set out within the interim report.

“Where there is a demonstrable need for best practice to be clarified or strengthened, this will be addressed either through amendments to the Code or additional, non-binding guidance”

Any amendments to the Code or other non-binding code should be supported by a demonstrable need for change and we are encouraged to see the FRC resisting the call for change for the sake of change.

“Where not constrained by regulatory requirements, we will seek to rationalise disclosure requirements in the Code to encourage more informative disclosure on the issues of most importance to investors and to discourage boiler-plate and box-ticking”

The principal users of financial statements are investors and we welcome the FRC rationalising disclosures to meet investor needs, where there is demonstrable evidence of the need to do so.

“We will seek to avoid an increase in the overall level of prescription in the Code and to preserve its principles-based style”

A principles based approach is the best framework for governance as it allows companies to determine the most appropriate governance systems for their circumstances and to provide transparent information to users about the reasons for the judgements they exercise.

2. Walker Review

We believe there is a clear distinction between the nature and response to risk between financial and non-financial companies. The FRC should avoid structural changes from Walker where there is no demonstrable evidence that change would significantly improve governance.

There may however be merit in certain sectors considering their own systemic risks, as the next global crisis may not necessarily originate within the banking sector.

While we do not see evidence that all recommendations arising from the Walker review should be imported into the Code, we support the FRC reviewing those recommendations with an open mind and making use of them to amend the code where evidence shows that the Code could usefully be updated.

3. Responsibilities and time commitment of the chairman and non-executive directors

We believe the provisions set out within the Code in respect of the roles and responsibilities of the chairman and non-executive directors, are sufficient to ensure companies have the correct ‘tone from the top’ which is critical to good governance.

Chairmen and non-executive directors may benefit from additional guidance outside of Code provisions and this could include what is reasonably expected of these roles. At the same time, companies could be given guidance as to how to help chairmen and non-executive directors discharge their duties, such as access to the company secretary and the need for concise and timely board papers.

We would discourage the FRC from seeking to define the amount of time that a chairman or non-executive director should spend on their role as this could have the unintended consequence of reducing the pool of non-executive directors available to companies. Most chairmen and non-executive directors understand the importance of their role and will spend the appropriate amount of time relevant to the organisation. Guidance outside the Code to companies on how to help chairmen and non-executive directors discharge their duties might help to ensure the time that they do devote is spent efficiently and effectively.

4. Board balance and independence

We support the FRC reviewing Section A.3 in its entirety and we encourage the balance to be in favour of experience and personal attributes. The importance of board members who understand the business, have experience in dealing with the sector and have personal attributes relevant to the culture of the organisation should take precedence over independence since the former will inevitably impact directors' ability actually to perform their duties, whereas the latter has a tendency more to impact perception of other stakeholders.

The “nine year rule” is one area where we believe the Code has inadvertently hindered good governance through the loss of continuity and valued experience, and we support this provision specifically being considered.

5. Board evaluation

Board evaluation is vital to good governance as it encourages continuous improvement. We would support the relaxation of the annual cycle providing there was some form of external facilitation of board evaluation every two to three years. Boards should be left to decide

whether they chose an internal annual cycle or some form of rolling committee cycle providing there is external facilitation of board evaluation every two to three years.

We believe that there should be some form of reporting on this process (and specifically whether or not the effectiveness of the Board and main committees has been subject to external evaluation) but believe any public reporting of this matter should be around process and overall board evaluation as opposed to specific outcomes and actions which should be addressed privately between boards and investors.

6. Risk management and internal control

Boards should have the overall oversight of risk management and should consider the organisation's appetite for risks in key areas such as acquisitions, capital investment and financing. This could be usefully be made more explicit within the Code.

We do not believe that risk committees and Chief Risk Officers should be recommended for all listed companies. Risk processes and managements should be embedded within the organisation and fundamental risks should be debated by the whole board. There is a risk that the introduction of risk committees could have the unintended consequence of delegating the entirety of this important function from the main board.

We believe that the time is right for greater clarity and guidance as to the way in which risk management and internal control is reported on (both by the company and potentially by the external auditors) and the linkage of risk identification and management to the issuer's strategy. A recent survey due for publication shortly and compiled by a highly respected research firm, indicated that around a half of fund managers would favour further debate on the scope of internal controls reporting obligations. Although we do not believe that a clear consensus of user views has yet emerged, we believe the FRC should consult with users and preparers to develop guidance in this important area.

7. Remuneration

We believe the linkages between remuneration and an individual's attitude towards risk is more prevalent within financial institutions than non-financial institutions. Performance related remuneration, with the exception of the sales force, tends to be more company focused as opposed to transactional in nature.

The recommendations in Walker are more relevant where there is a significant amount of transaction related remuneration. We would encourage the FRC to resist calls for the recommendations of Walker and FSA regarding remuneration to be exported wholesale into non-financial institutions, although there might be some specific cases where remuneration policy will form a manage risk which the audit committee needs to ensure is managed.

8. Comply or explain basis and the quality of disclosures

We support the comply or explain basis but recognise that it only works through engagement by both investors and companies.

Our own research¹ in this area has uncovered that only 44% of companies claim full compliance with the Code, and where they do comply, only a quarter of these companies make all the disclosures to support their claim.

¹ "Harmony from discord: emerging trends in governance in the FTSE 350" February 2009, Grant Thornton UK LLP, which tracks FTSE 350 compliance with the Code since 2003

External challenge could be improved through the FRC being a promoter of good governance. This could be achieved through case studies, best practice identification and guidance, and through working with other bodies such as investor groups.

The FRC should ask boards to explain where companies fail to give explanations for non-compliance or claim full compliance but do not make the necessary disclosures to support their claim.

We support the FRC seeking to rationalise disclosures with the aim of placing more emphasis on outcomes. Preparers would be more likely to move away from boilerplate disclosures if disclosure requirements were refocused in this manner. The FRC should also consider the use of sector disclosures as this may be a further mechanism to improve disclosures.

9. Engagement between boards and shareholders

We believe there is an important role for the FRC to be a promoter of good governance and to facilitate greater dialogue between investors and companies through this role.

We would support the FRC sponsoring and jointly reviewing the Principles of Stewardship based on the ISC Statement of Principles as this could be a useful step in helping to develop best practice stewardship by investors.

If you have any questions on this response, please contact Steve Maslin (phone: 020 7728 2736; email: steve.maslin@gtuk.com) or Giles Mullins (phone: 01908 359609; email: giles.m.mullins@gtuk.com).

Yours sincerely



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