

# CIPFA's submission to the FRC on the review of the effectiveness of the Combined Code

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Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications includes the gold standard professional qualification for public sector accountants as well as postgraduate certificates and diplomas for people already working in leadership positions.

Our in-house CIPFA Education and Training Centre delivers the full range of our programmes at locations across the world, and works with other places of learning to provide our courses locally.

We champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance good professional practice and enable better public services.

## **CIPFA's submission to the FRC on the review of the effectiveness of the Combined Code**

### **1 Introduction**

- 1.1 CIPFA's main sphere of interest is the public services. Rather than addressing all aspects of the Combined Code we have therefore focussed on a small number of areas where we feel we have a relevant contribution to make.

### **2 General comments**

- 2.1 In CIPFA's view, one issue for the FRC to consider is how the Combined Code can reinforce the message that good governance must be demonstrated by the personal conduct of those responsible for governance arrangements within companies. The Board should set the tone of the company by creating a climate of openness, support and respect. Board members should act in ways that exemplify high standards of conduct and ethical behaviour. The standards of personal behaviour expected of board members and of staff should be clearly defined and communicated through codes of conduct and protocols.
- 2.2 It would be helpful for the Combined Code to emphasise the need for decision making to further the company's objectives and strategic direction in the medium and longer terms. Companies need to ensure that their decisions are made with appropriate rigour and scrutiny and that underpinning systems and procedures encourage development of strategies and actions which are sustainable in the long term.
- 2.3 Key policies should be clearly articulated and disseminated throughout the organisation to ensure they are adhered to and that there is clarity for decision making purposes. The company's key overall policies should act as a framework for sound decision making.

### **3 Issues for comment**

*Are there any aspects of good governance practice not currently addressed by the Code or its related guidance that should be?*

- 3.1 CIPFA has carried out significant work in leading the debate on governance arrangements in the public services. Two of our more recent projects in this area - although focussed on the public service organisations - may have relevance to the FRC's review. They are the development and promotion of the *Good Governance Standard for Public Services* and CIPFA guidance on the *Role of the Chief Financial Officer*.

*The Good Governance Standard for Public Services*

- 3.2 In 2004, CIPFA and the Office for Public Management (OPM) with support from the Joseph Rowntree Foundation established an independent commission to consider how the key principles of good governance should be applied to all publicly funded organisations. The Commission, chaired by Sir Alan Langlands, subsequently developed and published *The Good Governance Standard for Public Services* to provide guidance for directors and governors of public bodies (a copy is attached).
- 3.3 The Standard builds on the Nolan principles for the conduct of individuals in public life by setting out six core principles of good governance for public service organisations. It shows how these should be applied if organisations are to live up to the Standard and provides a basis for the public to challenge sub-standard governance. Although this publication is aimed at public rather than private sector organisations, it may be an interesting model for comparison purposes and cross referral. For example, the appendix which identifies questions which members of the public should ask to test governance in public bodies may

stimulate thinking about similar lines of questioning by shareholders.

#### *The Role of the Chief Financial Officer*

- 3.4 Over the past year, CIPFA has been developing a statement on *The Role of the Chief Financial Officer in Public Service Organisations*, the latest draft of which is attached. Although its focus is again on the public services, the approach documented here may have real resonance in the private sector.
- 3.5 The Chief Financial Officer, as the organisation's most senior finance professional, occupies a pivotal role, both for external stakeholders and within the leadership team. Chief Financial Officers everywhere have a responsibility to ensure that their organisations control and manage money well, and that strategic planning and decision making are supported by sound analysis. In the public service context, Chief Financial Officers must also meet the demands of openness and accountability in decision making, balance competition for limited resources across a range of worthwhile objectives, deliver value for money and safeguard taxpayers' money. However, in both the public and private sectors the mere existence of the Chief Financial Officer does not ensure that financial governance is subject to effective leadership and oversight.
- 3.6 Delivering the responsibilities outlined above requires careful positioning of the Chief Financial Officer role within the overall governance framework and structure as well as a range of personal qualities. CIPFA's Statement sets out five principles that should apply to ensure that a Chief Financial Officer is positioned correctly in practice. They define core activities and behaviours that belong to the role of the Chief Financial Officer:

#### *The Chief Financial Officer:*

- is a key member of the leadership team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest
- must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy
- must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively.

To deliver these responsibilities the Chief Financial Officer:

- must be professionally qualified and suitably experienced
  - must lead and direct a finance function that is resourced to be fit for purpose.
- 3.7 For each principle the Statement identifies the key responsibilities of the Chief Financial Officer role within the organisation. Summaries of personal skills and obligations then detail the leadership skills and technical expertise organisations can expect from their Chief Financial Officer. These are drawn from the key requirements of CIPFA and the other professional accountancy bodies' codes of ethics and professional standards to which the Chief Financial Officer as a qualified professional is bound.
- 3.8 The Statement sets out a compliance framework reflecting the organisational requirements to ensure that the Chief Financial Officer is able to operate effectively and perform core duties successfully. It recommends that

organisations should report publicly where their arrangements do not conform with the compliance framework.

- 3.9 Since there is a huge range in the size of public service bodies and in the scope of services delivered, the CIPFA Statement adopts a 'substance over form' approach. It focusses on the principles that capture the essential characteristics of the Chief Financial Officer role in any public service organisation.

*Is the 'comply or explain' mechanism operating effectively and, if not, how might its operation be improved?*

- 3.10 Paragraph 8 of the Combined Code notes that "companies and shareholders have a shared responsibility for ensuring that 'comply or explain' remains an effective alternative to a rules-based system. Satisfactory engagement between company boards and investors is therefore crucial..." CIPFA supports the 'comply or explain' concept, but for it to work effectively, non-executives and shareholders must be sufficiently well informed to challenge non-compliant behaviour. In CIPFA's view, it maybe helpful to emphasise this point in part D of the Code relating to relations with shareholders. At present, CIPFA is concerned that the 'comply or explain' concept may make it too easy for companies to justify non-compliant behaviour without significant challenge.

*Content of the Code*

*The role of the Remuneration Committee*

- 3.11 In CIPFA's view, the Remuneration Committee is an area where the FRC could usefully give further advice. The Remuneration Committee – and the Board as a whole – should ensure executive remuneration arrangements promote long term sustainable performance and appropriate risk taking. There should be clear linkages to the long term development of the business which points to a balanced scorecard of performance measures rather than excessive emphasis on financial results. It may also be helpful to use a system of deferred bonuses to ensure that there is a much stronger linkage to long term success. This should also help ensure retention of key staff.
- 3.12 Boards need to take into account the way their remuneration arrangements will be viewed outside the company. Transparency is important in establishing and maintaining the confidence of shareholders, other stakeholders and the general public.

*The quality and support available to the board and its committees*

- 3.13 In CIPFA's view, the FRC could consider giving some more information in the paragraphs relating to quality of support available to the Board. It is essential that Boards receive appropriate, clear, timely and reliable information on risk and financial results and forecasts to enable them to undertake an effective role in directing and controlling the organisation. Non-executive directors need to be in a position to be able to scrutinise and challenge the complex business strategies and proposals presented to them. They must have the information, specialist knowledge and training to enable them to understand the company's business and associated risks and to recognise when outside advice is needed.
- 3.14 Principle 2 of CIPFA's statement on *The Role of the Chief Financial Officer in Public Service Organisation's* (see paragraph 3.4 of this response) covers the duties of the Chief Financial Officer in providing information for the Board and more widely. It notes that "The Chief Financial Officer has an important role in ensuring financial information and advice is provided to the leadership team and decision makers at all levels across the organisation. Meaningful financial analysis and interpretation that is robust and impartial is a key component in performance management, asset management, investment appraisal, risk management and

control. The Chief Financial Officer's reporting and advice to the organisation's leadership must therefore be clear, concise, relevant and timely, and assist them in managing the organisation by highlighting issues that decision makers need to be aware of and offering options for action. The Chief Financial Officer must also work to develop strong and constructive working relationships with both the executive and non executive members of the organisation's leadership, creating mutual respect and effective communication."

- 3.15 Linked to this is the need for directors, managers and others to feel fully confident and comfortable in their ability to ask the right questions. Nothing should inhibit them from offering constructive challenge. Paragraph 2.1 of this response recommends that companies create a climate of openness, support and respect which will enable board members and others to maximise their contribution to the success of the company.
- 3.16 Companies need clear and open systems and processes for ensuring that board members have access to all the information they need in performing their role. This should include early notification of 'bad news' such as expressions of concern from regulators or a whistleblower.



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