



**Revisions to the UK Corporate Governance Code and Guidance
on Audit Committees - Consultation Document**

RESPONSE FROM ICAS TO THE FRC

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Background

The Institute of Chartered Accountants of Scotland (ICAS) Business Policy Committee welcomes the opportunity to comment on the FRC's consultation paper "Revisions to the UK Corporate Governance Code and Guidance on Audit Committees". Our CA qualification is internationally recognised and respected. We are a professional body for over 19,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.

Our Charter requires its Committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key Points

ICAS is concerned that whilst seeking to operate a corporate governance code which is principles based there is a gradual creep towards more of a rules based code. The great success of the Code is largely due to the fact that it is principles based. Therefore, great care has to be taken to ensure that this basis is maintained.

Our response to the specific consultation questions

Question 1

Views are invited on the proposed revisions to Section C of the Code and the Guidance on Audit Committees, including whether the right balance has been struck between changes to the Code (which is subject to 'comply or explain') and the Guidance (which is not).

In general we believe that the right balance has been struck between changes to the Code and the Guidance for Audit Committees.

C.3.2 Main Role and Responsibilities of the Audit Committee

We have concerns in relation to a specific aspect of C.3.2., i.e. the main role and responsibilities of the audit committee:

"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".

It should be made explicit that the responsibility for ensuring that the annual report is fair, balanced and understandable rests with the board and not the audit committee which is merely a sub-committee of the board. This comment also applies to the draft revised guidance on audit committees, i.e. in relation to the second bullet point at 2.2 under the heading of 'establishment and role'.

Audit Committee Guidance – Sections 3.3. and 4.4

We also draw attention to the second bullet point at paragraph 3.3 of the audit committee guidance: "The basis for its **advice** that the annual report is fair, balanced and understandable....."

Again, in light of our earlier comment above, we believe that clarification of this point is required.

The same also applies to paragraph 4.4 in relation to the new paragraph on narrative reporting.

“The audit committee should review, and report to the board on, the content of the annual report, including the narrative report, to determine whether it provides the information necessary for shareholders and other users to assess the company’s performance, business model and strategy, and whether it is fair, balanced and understandable.”

We are supportive of the inclusion of the first and third bullet points at paragraph 3.3, i.e.

“The significant issues that it considered in relation to the financial statements and how these issues were addressed”; and

“Its assessment of the effectiveness of the external audit process and its recommendation on the appointment or reappointment of the external auditor, including the steps taken in deciding whether or not to recommend that the audit be put out to tender.”

Question 2

Views are invited on whether the proposed wording achieves the desired effect and, if not, how it might be improved.

C.1.3. 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 believe that the new wording achieves the desired effect.

Question 3

Views are invited as to whether the transitional arrangements outlined above are workable, and whether there are alternative arrangements that should be considered. Any data on the frequency and pattern of tendering in FTSE 350 companies would also be very welcome.

We agree that it is essential that the introduction of regular retendering will need to be carefully managed. We are supportive of the scope of the FRC’s proposal, i.e. FTSE 350 companies in the first instance. However, we still believe that actually adopting an approach based on requiring the audit committees of such entities to publicly set their retender policies and then for them to have to comply or explain those policies would be the preferred way forward. We do however accept that the favoured period for putting audits out to tender may well in practice be ten years in any event.

As a result of the uncertainty which is currently in the marketplace due to the proposals from the EC we do not provide comment on the FRC’s proposed transitional arrangements. Indeed, we believe that a number of companies in the FTSE 350 may consider putting their audits out to tender prior to any changes coming into force.

Question 4

Views are invited on whether it would be helpful to identify the features of a meaningful explanation in the introduction to the Code and, if so, whether the proposed addition correctly identifies those features.

On balance we believe that there is merit in identifying the features of a meaningful explanation of deviances from the Code in the introduction. However, the wording also illustrates our concern that the Code may inadvertently be diverging from being principles based.

“It should set out the background, provide a clear rationale for the action it (the company) is taking, and describe any mitigating actions taken to address any additional risk and maintain conformity with the relevant principle. The explanation 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 with the Code’s provisions”.¹

In our view what is absolutely key is to achieve conformity with the spirit of the principles of the Code. The danger is that as the supporting provisions get added to over time, the Code becomes more rules based, as opposed to principles based, and this has to be guarded against.

Question 5

Views are invited on all of these proposed changes.

We have concerns over the proposal to include in the preface a statement encouraging chairmen to recognise the contribution made by debt investors in providing capital and to confirm the board’s interest in listening to the concerns of bond investors insofar as these are relevant to the company’s overall approach to governance. The primary responsibility of the directors is to promote the interests of shareholders and we have concerns that the inclusion of such a statement might be seen to muddy the waters in this regard.

We are supportive of the proposals to amend provision B.2.4, i.e. to require companies that have made use of an external search consultancy to disclose whether they have any other connection with the company. This ensures consistency with disclosures required in relation to the use of other professional advisers.

We are also supportive of the proposed requirement to identify the external facilitator in the annual report in relation to the board evaluation process.

¹ <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Consultation-Dicument-revisions-to-teh-UK-Corporat/Appendices-to-Consultation-Documnt/Appendix-to-Consultation-Documnt-Draft-Revised-UK.aspx> (para 3, page 4)