FRC Consultation Document: Revisions to the UK Stewardship Code

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 Stewardship Code". 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

We support the FRC's view that the UK Stewardship Code, "the Code" is still very much in its infancy and therefore does not require to be subject to a fundamental revision at this stage. However we do believe that there is a strong need to include content on the need for institutional investors to engage with their investee companies in relation to the quality of their corporate reporting output.

We note that new wording has been proposed under the heading of principle 3 to the effect that Institutional investors should monitor their investee companies. This wording is as follows: "consider the quality of the company's reporting". Whilst we welcome this development we do not believe that it goes far enough. We believe that a new principle should be included to the Code as follows:

"Institutional investors should be willing to engage with their investee companies on the quality of their reporting and the assurance provided on that reporting".

We have outlined further guidance on this new principle in section 3.

Our response to the specific consultation questions

1. ***Views are invited on whether the proposed revisions correctly describe stewardship and its purpose.***

    In general, we believe that the proposed revisions are an improvement on the existing text and better reflect the substance of what is meant by the term 'stewardship'.

    However, in relation to page 8 "The Principles of the Code" we question whether the wording is too strong: i.e. "So **as to** protect and enhance the value to the ultimate beneficiary, institutional investors should..." In contrast on page 9, the wording used in the guidance to the 1st principle is "…towards the aim of enhancing and protecting the value for the ultimate beneficiary or client". We believe the wording of the latter better reflects the reality.

2. ***Views are invited on whether the respective responsibilities of asset owners and asset managers have been correctly described.***

    We believe that the new proposed wording better reflects the respective responsibilities of asset owners and asset managers and that these have been reasonably described, as opposed to "correctly", as this is too precise a term to use in this context.

3. ***Views are invited on all of the proposed revisions to the Code summarised above.***

(i) We believe that a new principle should be included in the Code to highlight the importance of holding investee companies responsible for the quality of their corporate reporting as follows:

"Institutional investors should be willing to engage with their investee companies on the quality of their reporting and the assurance provided on that reporting".

Guidance on this new principle

As part of this engagement institutional investors should:

- Seek to satisfy themselves that the reporting of the company is sufficient for their needs as investors;
- Where that reporting is not sufficient, seek to challenge the Board to improve its reporting;
- Seek to engage with the audit committee on the quality of the assurance provided on the annual report including the financial statements and any other assurance provided;
- Seek to engage with the audit committee where there is a formal review of the external audit appointment every 5 years;
- Seek to engage with the audit committee where there is a re-tendering of the external audit appointment;
- Challenge the audit committee and the Board where they have any concerns relating to the independence or objectivity of the external auditor - for example, there could be concern in respect of the re-tendering policy or non-compliance with that policy;
- Notify the company of any concerns on the appointment of the external auditor; and
- As a last resort, be prepared to vote against the appointment of the external auditor if appropriate, explaining the reasoning to the company.

The need for this principle was identified by the ICAS Future of Assurance working group which published its report in December 2010. The full report can be found at: http://icas.org.uk/futureofassurance/. We note the inclusion of some material in the guidance section of principle 3, i.e. to 'consider the quality of the company's reporting' but do not believe that this goes far enough.

(ii) In relation to principle 3 and the wording: "If they have concerns they should seek to ensure that the appropriate members of the investee company's board or management are made aware of them". Consideration should be given to adding the words "in early course" or "timeously" at the end of this sentence.

(iii) Given the current headlines in relation to the importance of an appropriate corporate culture, consideration should be given to including guidance to the effect that institutional investors should seek to influence the culture of an entity where they believe that the existing culture represents a barrier to the longer-term sustainability of the entity concerned. This we believe would be influential in ensuring that a Board establishes an appropriate tone at the top and hence culture within an organisation.

Boards should be encouraged to disclose the key aspects of a company's culture and how they reinforce it by the tone from the top in their annual report.

4. ***As well as commenting on the detail of the individual changes summarised in the remainder of this consultation document, views are invited on whether those changes meet these tests, and whether the Code as a whole is well-structured, balanced and clear.***

Other than the points raised above we do believe that the proposed text does meet the tests set by the FRC and that the resulting proposed revised Code as a whole is well structured, balanced and clear.