

The Association of Corporate Treasurers

Comments in response to:

***FRC review of the effectiveness of the Combined Code:
Call for evidence,***

March 2009

28 May, 2009

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvassed the opinion of our members through *The Treasurer magazine*, and our Policy and Technical Committee and Council.

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General

Where there have been a number of negative events that have triggered a review of governance / regulation there is a tendency to increase process. In our view there is little missing from the Code and governance structures have been broadly fit for purpose – the weaknesses appear to have stemmed from ineffective challenge or lack of objectivity.

We want Directors and senior managers to justify their actions – what is the test here? We have all heard of the “man on the Clapham omnibus”. However, we should have higher expectations of Directors and senior managers.

Accordingly senior managers/directors should expect to be challenged to justify their actions if failures do occur. Where they have not exercised their duties & responsibilities

(the test should be linked to what a reasonable and appropriately qualified / experienced person would have been expected to do in the circumstances) then there should be a remedy – perhaps loss of office with reduced or no compensation. The aim here is not to expose directors to additional liability but rather to ensure that failure is not rewarded and that there is a genuine expectation that a negligent or reckless approach will not be rewarded by automatic payment of compensation for loss of office.

Specific questions

In your paper you ask for comment on specific topics. Accordingly we group our comments under those broad headings.

The composition and effectiveness of the board as a whole

The Code already recognises the need for an effective board including the appropriate people and skills. As mentioned in our general comments the issue is how one makes sure that this objective is turned into satisfactory outcomes – perhaps through more assiduous challenge or through refinements in governance.

- A rigorous appointment system is the start, with proper specifications as to skills, knowledge and experience, for both executive and NEDs. Clearly the requirements will vary from company to company – a large company with highly qualified resources might seek NEDs with broad financial experience, whereas a smaller company might have needs to access specialist skills that it cannot maintain in-house. It should become the expectation that Board appointments are openly advertised and if they are not, the Board should explain subsequently why that was not appropriate.
- It is apparent that Boards need to be refreshed from time to time, either because the individuals energy and motivation has declined or the specifications for the job have moved on. To trigger consideration of a change the appointment of the CEO and/ or FD for a fixed period of 4 to 5 years should be considered (but with suitable shorter notice periods). Whilst it should be expected that in some cases the term may be extended, it does offer the opportunity to refresh the board and reduce the stigma associated with the departure of a senior director.
- The Code already includes provisions on the evaluation of performance of the board and individual directors. Again with the theme of trying to make the implementation of that principle more effective we believe that there should be an encouragement for external assessment of effectiveness every 3 years, say. Annual reports already include masses of data on remuneration but relatively little on the skills and experience of directors and the extent to which they are contributing to the success of the company. A summarised disclosure of any external appraisals could provide an incentive for improvements – clearly this needs to focus on the overall workings of the Board.
- The effectiveness of the Board could also be improved by inclusion of a recommendation that the executive directors should have a programme of one to one meetings with the SID, providing the opportunity to cover matters not easily discussed in the full board meetings.

The respective roles of the chairman, the executive leadership of the company and the non-executive directors

No specific issues highlighted.

The board's role in relation to risk management

Although the Code does cross refer to the Turnbull guidance, risk gets little specific mention other than in A1 and that is rather more in the context of financial controls and reporting. The ACT believes that risk management could be given a great deal more weight within the Code, starting with the need to ensure there is a process for an overall business risk assessment. The board itself will need to concern itself closely with the top 6 to 10 risks and be satisfied that there is a robust process in place for management to be dealing with the many other risks likely to be indentified.

Within the heading of financial risk we would highlight treasury risk – the financial crisis has made apparent to all the importance of liquidity and funding availability and of credit risk - and this provides a good example of the requirements.

The board needs to be satisfied that it is able to identify and manage the key risks. This is referring to the broad risk characteristics (pension, complex financial instruments, commodity risk etc) of the business not to specific operational risks. Where the risk area is significant the Board needs to consider its own competence and whether additional competence is needed. We accept that advisers may be appropriate in many cases – one off situations or in stable environments. However, it is crucial that a board is able to challenge the advice and test this against the company's needs. It may be appropriate to set up separate committees comprising board members and “non executive” experts to advise the company and maintain a more detailed oversight of key risks.

Much has been published with regard to the review of internal control systems within companies and we do not want to see an increase in process here. However, pressure should be exerted on senior mangers/directors to “walk the talk” and be seen to carry out their own reviews to ensure that key stated controls are in fact operating. This is common practice where health and safety is concerned - If you, as a senior manager, observe unsafe practices it is incumbent on you to take action!

It is worth noting here the Audit Commission report on the local authorities and the investment of their cash.¹ The Audit Commission stated that good practice was evident where there were well trained staff and engaged elected members, strong governance and regular review and scrutiny of policies and procedures. Professional qualifications or competency through experience were deemed important. Use of external experts was acceptable but the local authorities still needed sufficient treasury awareness to be able to question and interpret that advice.

The role of the remuneration committee

No specific issues highlighted.

¹ Audit Commission National Report: Risk and return: English local authorities and the Icelandic Banks, 26th March 2009. <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/riskandreturn.aspx>

The quality of support and information available to the board and its Committees

The effective management of a company or group requires the flow of good quality and relevant management information to the appropriate level of management. The Code as it stands concentrates rather more on external financial reporting and related internal control and audit. The ACT believes that the code could be improved by inclusion of references to internal management information to the board and senior management, bearing in mind the need to avoid excessive information if serving no useful purpose.

The dialogue with institutional shareholders

We are seeing increased shareholder activism – where this is constructive this must be a welcome development. However, too much goes on behind closed doors. Smaller shareholders can access the presentations that are discussed with major shareholders but how does a small shareholder find out the mood of the major shareholders?

Although there are signs that shareholders are taking a more active role in some AGMs for many companies they are largely procedural. Company accounts have become too complex and at many AGM's there are no questions on the accounts: major shareholders send in proxy votes only. Shareholders should be encouraged to hold management more accountable and the boards should provide the AGM with feedback from private meetings with major shareholders.

Referring back to our initial general point that that boards need to be challenged and to justify their action if failures do occur, institutional shareholders have an important role to play on this. The Institutional Shareholders Committee's "The responsibilities of institutional shareholders and agents – statement of principles", referred to in the Code, provides helpful guidance, although of course there are other types of institutional shareholders who are not party to this. The press and public opinion generally can be a powerful force.

The Comply or Explain regime

The current Code is based upon "comply or explain" – we applaud this concept but note that if companies don't "comply" they are usually criticised. This means that companies need to explain their rationale better or that investor groups need to invest more time in understanding reasons for non compliance – or both. Certainly, investors need to devote time to understanding the "explain" section rather than just ticking the non-compliant box. Satisfactory explanation equals compliance.

The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at <http://www.treasurers.org/technical/resources/manifestoMay2007.pdf>.

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