

# **Comments on behalf of The Association of Corporate Treasurers**

in response to

## ***Suggested Revised Code***

*Following Higgs and Smith reviews, January 2003*

*Financial Reporting Council*

### **I. Introduction**

#### **The Association**

The ACT welcomes the opportunity to submit views on this important topic.

We would be pleased to further expand any point made herein or to assist the FRC in any other way.

The note giving information about the ACT which was included in our comments to Higgs Review is shown in Appendix 1.

#### **These comments**

The ACT welcomed the Higgs and Smith reports and generally supported their findings. These comments are against that background.

We were pleased to note the draft comments on the Suggested Revised Code published by the ICAEW on April 1<sup>st</sup> 2003. We generally find them constructive and helpful.

We do have serious disagreement with the ICAEW draft comments in some cases. However, in order to avoid duplication of comments to the FRC and reduce the length of our own comments we have normally not commented where we support the ICAEW April 1<sup>st</sup> draft.

Contact details for the ACT are on page 9.

April 2003

## **II Summary of principal points**

### **1. Implementation of Higgs and Smith Reports**

We would be concerned if the main thrusts of the reports were to be altered. (See II 1.1, page 2)

We believe that the FRC should take comments now on the suggested Revised Code generally (not just on fatal flaws). The FRC should re-expose for comment the next draft of the Revised Code. Time should be allowed for orderly adoption by companies of necessary changes in their practice or arrangements.

Implementation should be deferred to July 2004. (See 1. of III below)

### **2. Comments on drafting of the suggested Revised Code**

We broadly support the April 1<sup>st</sup> draft comment by the ICAEW but our comments indicate where we disagree with the ICAEW's draft. (see Section III below.)

We would emphasise the chairman's role in shaping the board and disagree with the proposal to exclude the chairman from taking the chair of the appointments committee. (See A.4 of Section III below)

We recommend that independent non-executive directors be able to attend meetings of every board committee even if they are not a member of that committee - including the audit committee. (See 3.6 of D. of Section III below)

### **III Comments**

#### **1. General**

##### **1.1. Implementation of Higgs and Smith Reports**

The Association welcomed the Higgs and Smith Reports. More recently, we have noted in the press a number of critical comments. We would be concerned if the main thrusts of the reports were to be altered as a result of such comments or related submissions to the FRC.

##### **1.2. Revised code: consultation, implementation and timing**

###### **1.2.1. Extent of consultation now**

The FRC has asked for comments only of “fatal flaws” in the proposals, with a view to implementing the Revised Code from July 2003.

We believe that that approach is inappropriate.

We believe that the FRC should seek to take constructive comments on the proposals generally, provided they do not re-open the main conclusions of the reviews. A robust attitude to preserving the main conclusions is desirable.

###### **1.2.2. Timing of publication; re-exposure.**

It is better to take a little more time and produce an output which will last for some years and not give rise to further consultation and change (and associated uncertainty).

The FRC should be prepared to re-expose for comment the next draft of the Revised Code, for say one month, perhaps July 2003, with a target of publishing a final version in October 2003.

###### **1.2.3. Timing of implementation**

Premature implementation risks early reporting being full of “non-compliance” statements. This may devalue the recommendations and lead to complacency about non-compliance. Non-compliance should be exceptional and come with clear and persuasive explanation in those cases where there is good reason for it.

We urge that implementation be deferred to July 2004 to allow orderly transition without excessive non-compliance.

We do not believe that that runs any material risk – and not only because of the continuing effect of the existing Code. The revised Code’s purpose is to influence behaviour. Publication of the Higgs and Smith reports has already begun to influence behaviour as companies prepare for implementation. It takes time to make changes in behaviour which will last and go beyond formal compliance and time too to make new appointments to bring board composition etc. into line with new requirements.

## **2. Comments on drafting of the suggested Revised Code**

Numbering in this section follows that of the suggested Revised Code. We have not commented where we broadly support the April 1st draft comment by the ICAEW.

### **Part 2 Code of Best Practice**

#### **A. Directors**

##### **A.1 The Board**

###### **A.1.5 Non-executives' meetings**

Given that “non-executives” may include non-independent directors it would be better to specify that “independent directors” should meet.

We disagree with the ICAEW’s comment at page 1 of their section 2 that the requirement for regular meetings be removed. It can be very difficult for an independent non-executive to request such a meeting and such a meeting becomes special and controversial in a way in which a regular meeting does not.

###### **A.1.6 Directors' unresolved concerns/resignations**

We agree with the ICAEW’s comment at page 1 of its section 4 to make clear who would write the statement on resignation.

Whether or not the original wording or the ICAEW’s wording is chosen, we recommend the inclusion of a further sentence noting that a resigning director should consider the appropriateness of making a public statement or a statement to shareholders immediately on resignation or for circulation to shareholders with the company’s next report and accounts or interim report (“noisy resignation”).

##### **A.2 Chairman and chief executive**

###### **A.2.3 Chief Executive becoming Chairman and**

###### **A.2.4 Chairman’s independence**

A.2.3 is a special case of A.2.4 as the ICAEW point out at page 1 of their section 4. However, given the importance of the chairman’s role, contrary to the ICAEW’s draft view, we believe that A.2.3 is correctly in the code, even though, as a special case, moving it to best practice would not exempt it from the comply or explain requirement.

Logically, as a special case of A.2.4, A.2.3 should follow it rather than precede it. It could then be instanced as an example of the lack of independence required.

##### **A.3 Board balance and independence**

###### **A.3.2 Executive representation**

We disagree with the ICAEW’s suggestion at page 1 of section 4 of their draft comments that the provision is unnecessary. We believe it is important to

avoid the position in the US and some continental jurisdictions where the executive is often inadequately represented, reinforcing the power of one or two individuals. Code principle A.3 is not specific enough to ensure that this point is covered.

A.3.2 should remain.

#### **A.3.4 Independence**

It is important to educate about independence. The Association in its submission to Higgs emphasised the importance of a number of items listed here, particularly the leveraged remuneration and pensions items.

Many directors, like people in most walks of life, are inadequately aware of potential conflicts. They over rationalise the impact of their own good faith in the minds of observers. For this reason we support the non-inclusive listing included in the suggested Revised Code and not the broader wording proposed by the ICAEW.

If, however, the FRC should be minded to adopt the ICAEW's "Institute amendment" proposed in their draft comments of 01 April 2003, at page 3 of its section 1, we recommend

- i. that "current or previous" in line 9 be moved to before "relationships" in line 6 in order to avoid the implication that other relationships to be taken into account are current relationships only, which would be quite wrong; and
- ii that the sub-paragraph below the bulleted points in the suggested Revised Code ("The board should identify ...") be retained.

But we consider that the wording in the suggested Revised Code is preferable. We suggest a new sentence be added at the end to emphasise that the list is non-exclusive and that the board should reach its own conclusion on the consideration of all the relevant facts.

#### **A.3.6 Senior independent director**

The ICAEW's draft comment has drawn attention to the suggested Revised Code's possibly restricting communication with the senior independent director. If that is right, we would deprecate it and urge less restrictive wording in the Code.

### **A.4 Appointments to the Board**

#### **A.4.01 Chairmanship of the nomination committee**

A key role of a company's chairman (in this paragraph "Chairman") is to look to the composition of the Board and succession. It seems logical, then, that the Chairman should indeed be chairman of the nomination committee.

We presume that the recommendation in the Higgs review that the Chairman may be a member of but not chair the committee arises from the possible need to consider replacing the Chairman. This is of course a very difficult issue. Under such circumstances the senior independent director would be involved and would convene a meeting of the nomination committee without the Chairman, or, alternatively and preferably, of the independent directors as a whole.

Accordingly, we can see no reason to restrict the Chairman but do see disadvantage in so doing. We support the ICAEW's proposal at page 1 of section 5 of their draft comments.

## **A.5 Information and professional development**

### **A.5.1 Management obligation to provide appropriate and timely information**

As the ICAEW points out in its draft comments at page 1 of their section 5, the chairman has responsibility in the provision of "accurate, timely and clear" information under A.2.5. It is a responsibility for "ensuring" it happens.

We thus disagree with the ICAEW's draft comments' acceptance of Higgs' recommendation to delete the reference at A.5.1 of management's responsibility actually to provide the information. The chairman is himself dependent on management's furnishing the information and their responsibility in that regard should be noted.

### **A.5.3 Independent professional advice**

We support the proposed drafting of this paragraph of the suggested Revised Code and its applicability to all, not just non-executives or independent non-executives.

However, external advice can be costly. The process of getting that advice can be inefficient too as it will be based on incomplete information.

Under A.5.4 the company secretary is responsible for assuring good information flows between non-executives and senior management. We believe it is necessary to go a little further.

We propose that a further sentence be added before the existing sentence of A.5.3 to provide that management should facilitate access of non-executive directors, through the company secretary, to senior professional staff of the company below board level. In the vast majority of cases, a discussion, for example, with the head of taxation or treasury and corporate finance can often reassure/clarify issues. These professionals are covered by their own professional bodies' ethical codes and may be expected to conduct themselves properly in such a discussion.

Such internal discussion may appear less confrontational than going through the process to get external advice, which a non-executive may be reluctant to do. If external advice is considered necessary, a preliminary discussion with the relevant employed professional can make the issues clearer and help the non-executive to better formulate the question to the external advisor.

### **A.5.5 Appointment and removal of the company secretary**

We recommend the addition of a sentence providing for consideration of the remuneration and terms of employment of the company secretary by either the board or the remuneration committee. It is not appropriate that such matters are left to executive management alone.

### **A.5.6 Director induction**

We recommend that the last sentence be expanded to refer to meeting senior management below the board. In companies of any size, most reports, proposals, etc. received by the board will have been written by (or on the

advice of) these executives. Non-executives should have an early opportunity to meet them and form a view as to their quality.

## **B. Remuneration**

### **B.1. The level and make-up of remuneration**

#### **Remuneration policy**

##### **B.1.7 Non-executive remuneration; share options**

We have difficulty with the ICAEW's comment at page 2 of section 5 of their draft comments.

The ACT in its comments to the Higgs Review strongly urged the inappropriateness of leveraged remuneration or remuneration depending on performance of the company for independent non-executives. A.3.4 stipulates that such receipt would make a director non-independent.

Accordingly, rather than deleting the point on share options in B.1.7, we suggest that it be replaced by a statement that, as referred to in A.3.4, share options or remuneration linked to company performance is inappropriate for independent non-executive directors.

## **D. Accountability and Audit**

### **D.3 Audit Committee and Auditors**

#### **Guidance on Audit Committees**, to be attached to the Code

##### **3.6 Attendance at audit committees**

In our submission to the Higgs review, we recommended that all independent non-executive directors should be entitled to attend any meeting of any board committee, even if they are not actually a member of that committee. Such a practice is already followed at some FTSE 100 companies.

Our purpose in making such a recommendation was to guard against any small group of directors being able to "bury" an issue rather than exposing it to the necessary scrutiny. Independent non-executive directors will in many cases be dependent on proper consideration of matters at board committees, such as the audit committee. It is very difficult to pursue an issue at Board level when one can be assured that it has been dealt with fully by a committee, or even that it is within the purview of a committee. This is even more so when the conduct or proposals of executive directors are at issue.

With a provision such as we propose, in the Enron case, for example, non-executive directors whose suspicions had been aroused would have been able to attend and hear for themselves the quality of probing of executive and auditor proposals.

We are concerned that the Smith report has recommended that only directors who are members of the audit committee should be entitled to attend meetings.

The report notes that "... the audit committee itself is, and should be seen as, a committee of the board. Audit committee members are not, and are not intended to be, independent of the board. But they must be independent of the

executive management." We agree with those sentiments and that it is necessary to emphasise that in general non-members of the audit committee not be entitled to attend but find it perverse to include independent non-executive directors in the exclusion.

We believe that the exclusion should be modified accordingly.

**3.9 Committee members keeping in touch**

We recommend addition to the list in the last sentence of this paragraph of the company secretary. General references elsewhere to the company secretary would not make up for the secretary's exclusion from this list.

**5.12 Appointment and removal of the head of internal audit**

We are pleased that the audit committee is proposed to be required to take an interest in the appointment and termination of the head of internal audit but we believe that it is necessary to go a little further than this. Internal auditors are potentially subject to undue influence by executive directors.

In our submission to the Higgs review we commented:

"We regard the head of internal audit as having one of the potentially more difficult but important jobs to do. If internal audit work throws up suspicion of any senior executive or executive director, the head of internal audit, who is often lower in grading than other heads of function below board level, can have a difficult path to tread.

"... External auditors' work in relation to major corporate clients tends to concentrate on testing principles and systems, with much less testing of specific transactions. Internal auditors, who undertake rather different kinds of work, are thus usually better placed to detect problems of fraud, false accounting or failure to comply with company policies, etc., than external auditors. It is also appropriate that the Audit Committee – or the remuneration committee – may also take an interest in the remuneration and benefits of the head of internal audit, to reduce the potential for undue influence. Similarly, any proposed dismissal of the Head of Internal Audit, or their movement to another post in the company should be considered by the Audit Committee."

Thus we believe the audit committee's remit should be extended to movement of the internal auditor to other posts within a company and that the audit committee or remuneration committee of the board be required to keep under review the internal auditor's remuneration and benefits.

London, April 14<sup>th</sup> 2003



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## Appendix 1

### **The Association**

The Association of Corporate Treasurers was formed in 1979 to encourage and promote the study and practice of finance and treasury management and to educate those involved in the field.

Today, it is an organisation of professionals in corporate finance, risk and cash management operating internationally. It has over 3,000 fellows, members and associate members. With more than 1,200 students in more than 40 countries, its education and examination syllabuses are recognised as the global standard setters for treasury education.

Members adhere to the Association's ethical code and professional ethics are included as part of the membership examination syllabus.

The Association has published in its series "The business of finance" a number of guides on finance and treasury issues for directors, executive and non-executive, with an accounting or other, non-financial, background.

Members of the Association work in many fields. A number of members are on the boards of major companies in both executive and non-executive capacities. For example, certain former members of the Association's Council are Chairmen of some of the largest quoted European companies. The majority of fellows, however, are professionals working as senior executives below the board level in large public companies, responsible for the treasury and corporate finance functions.

Perspectives from the board and from senior management below the board inform our comments.