

Consultation Response



REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS

Consultation Paper issued 7 June 2002 by Derek Higgs

Comments from the Association of Chartered Certified Accountants

September 2002



Page 1

ACCA is the largest, fastest growing, global professional accountancy body, with nearly 300,000 members and students in 160 countries. ACCA's headquarters is in London and it has 34 staffed offices and 34 active centres around the world. ACCA's mission is to provide quality professional opportunities to people of ability and application, to be a leader in the development of the global accountancy profession, to promote the highest ethical and governance standards and to work in the public interest.

Further information on ACCA is available on ACCA's website, www.accaglobal.com

Executive Summary

The Association of Chartered Certified Accountants (ACCA) is pleased to respond to the consultation paper 'Review of the Role and Effectiveness of Non-executive Directors'. ACCA welcomes this consultation exercise. It is timely as there is a pressing need to clarify the role of non-executive directors. ACCA believes that, at present, there is too much uncertainty about the role of non-executive directors and how they should perform.

While guidance is needed, it should, however, avoid being overly prescriptive. There is a danger that, by creating too 'defined' a role, the present unitary board structure and culture could be changed and boards will act less cohesively. Before introducing new UK requirements, the Government should take into account international experience and practice.

ACCA believes that non-executive directors will become more effective when there is greater understanding of, and consensus about, their role. We suggest that reforms should concentrate on three main areas:

- clarifying the role of non-executive directors
- improving disclosure
- and
- creating opportunities for non-executive directors to be more effective.

The Hampel Review found general acceptance that non-executive directors have both a strategic and a monitoring role. Recent corporate debacles in the US have raised concerns about the latter and our proposals concentrate on changes needed to improve this. The current emphasis on this must not, however, lead to changes which would undermine or hinder the strategic role of non-executive directors in either listed companies or in SMEs.

ACCA considers that reforms to improve the effectiveness of non-executive directors should be through revision or extension of the principles in the Combined Code rather than through changes in legislation. Our proposals on this are set out in the next section.

ACCA believes that the review should also address, in more detail than is implied by the consultation paper, the roles and effectiveness of board committees such as the audit, remuneration and nomination committees.

We provide responses in Appendix 1 to the questions asked by the consultation document. ACCA will be pleased to assist further in this review of the role and effectiveness of non-executive directors, or in any revision to the Combined Code.

The Way Forward

ACCA supports the present unitary board structure. It is important that any changes arising from this review do not have the effect of dividing the board by preventing executive and non-executive directors from working as a team. It is also important to ensure that public expectations of non-executive directors (NEDs) are not raised beyond what can reasonably be asked of them. We have a number of proposals for enhancing the effectiveness of NEDs.

CLARIFYING THE ROLE OF NEDS

The Combined Code does not define the role of NEDs other than to say that they should be on the audit, remuneration and nomination committees. ACCA recommends that:

1. The role of NEDs should be clarified.

This should be done primarily through revision to the Combined Code rather than by changes in legislation. It is important to understand that, in practice, there is not always a clear dividing line between executive and non-executive roles.

2. The strategic and the monitoring roles of NEDs should be carefully balanced.

ACCA agrees with the Hampel Review that NEDs have both a strategic and a monitoring role. ACCA sees NEDs' monitoring role as including:

- bringing external (and independent) influence to bear on issues such as financial performance, risk, internal control, standards of conduct, compliance, probity and the evaluation of management and board performance

- deciding the remuneration of the executive directors (EDs)
 - effecting changes in board composition when governance or performance issues suggest that this is necessary but it is unlikely to be initiated by the EDs
- and
- making recommendations to shareholders on the appointment of auditors. Recent events in the US have highlighted apparent failings in this function and a number of remedial changes are necessary.
3. **The last three functions in point 2 above should be carried out without the involvement of EDs.**
 4. **NEDs should act as the 'Corporate Conscience' in respect of CSR issues.**

As the issue of corporate social responsibility (CSR) rises up the business agenda, we believe that it is appropriate for NEDs to accept a responsibility for ensuring that social, environmental and sustainability issues receive an appropriate degree of board level attention. This will become particularly significant if the proposed mandatory Operating and Financial Review Statement becomes law in the near future.

NEDs should also be sensitive to the public interest issues inherent in balancing long-term sustainable growth with the short-term financial demands associated with the recruitment, retention, motivation and reward of the EDs.

5. NEDs should exercise individual judgement but they should act primarily through the board or in committees rather than individually.

NEDs would become more like EDs if they regularly made decisions on their own which committed the company or would be likely to do so.

6. Through the audit committee, NEDs should give prior approval to any non-audit work to be carried out by the external auditors and they should regularly assess the independence of the auditors.

The audit committee should disclose its assessment of the independence of the auditors, and the reasons for awarding any non-audit work to the auditors, in a report to shareholders (see 8 below). Trends in the balance of audit and non-audit fees should be monitored and significant changes fully explained.

DISCLOSURE AND ENHANCEMENT OF THE DIALOGUE WITH SHAREHOLDERS

Proper disclosure is a key factor in enhancing the dialogue between company and investor. With respect to NEDs, there is currently too little disclosure of important issues relating to the selection and performance of NEDs. ACCA recommends that:

7. The process for appointing NEDs should be more transparent.

Details of the policies and practices followed by the board in the appointment of NEDs should be disclosed.

8. NEDs should prepare their own governance report to shareholders, as part of the annual report.

This report should explain how NEDs consider that they have fulfilled their monitoring role (as set out in 2 above) and should cover the work of the non-executive committees such as the audit and remuneration committees.

9. More opportunities should be created for dialogue between NEDs and shareholders on governance matters.

The chairmen of the audit and remuneration committees should be available at the AGM to answer shareholders' questions. Consideration should be given to involving NEDs in investor relations presentations and including NEDs in meetings between EDs and shareholders and ratings agencies. It is of course necessary (a) to ensure that price sensitive information is not carelessly disclosed and (b) to differentiate between enquiries which have a genuine public interest dimension and those which do not.

10. NEDs should review the nature of the corporate relationship with small private investors.

It is natural for large institutional shareholders to be the main focus of ED attention. To ensure that there is equity across the whole shareholder base, we suggest that it would be appropriate for the NEDs to include in their governance report an assessment of the extent to which private investors receive equitable treatment in respect of issues such as earnings announcements.

11. Where the information would be in the shareholders' interest, there should be full disclosure of the reasons for a NED ceasing to hold office.

CREATING OPPORTUNITIES FOR NEDS TO BE MORE EFFECTIVE

The effectiveness of NEDs in fulfilling their strategic and monitoring roles will depend on their availability, their business / financial abilities, their independent status and their commitment to the company. ACCA's recommendations in this area are that:

12. The number of NED posts an individual holds should be continuously reviewed.

We believe that it is impractical to place a strict limit on the number of non-executive appointments that any one individual can hold. We recommend, however, that the criteria used for identifying suitable NEDs in all cases include a full analysis of their other commitments - personal, charitable, political or business.

Existing NEDs and EDs who consider invitations to accept an additional NED role should be under an immediate obligation to inform their current boards of the nature of the invitation. This will ensure that board chairs are fully informed as to the commitments of other board members.

If a NED is also a 'full time' ED of another listed company, we suggest that there is a case for saying that s/he should hold no other non-executive directorships.

We believe that the NEDs' governance report (see 8 above) should include an objective summary of NED days committed in the financial year under review. The board's self-assessment procedures should include continuous monitoring of the external commitments of both executive and non-executive board members.

13. NEDs should be required to devote sufficient time to their duties.

It is not practicable to specify a fixed number of days a NED should devote to the company. Although possibly an exaggeration, the table below illustrates how a committed NED, who is a member of both the audit and the remuneration committees, might need to devote 50 days a year to the role.

	Days
Attendance at one board meeting a month	12
Preparation for above	12
Attendance at quarterly audit committee meetings	4
Preparation for above	4
Attendance at 2 remuneration committee meetings	2
Preparation for above	2
Attendance at 'away weekend'	2
Preparation for above	2
Other duties and contingency	10
<i>Total</i>	<i>50</i>

14. There should be a senior independent NED.

We believe that it is necessary to identify one NED to act as a senior independent NED representative of the board. This person should co-ordinate the formal NEDs' governance report to shareholders, as well as representing the NED element of the board at AGMs and investor meetings.

15. Companies should be encouraged to find NEDs from a wider range of backgrounds.

There has been considerable discussion on the issue of 'widening the NED gene pool'. We believe that it is reasonable to expect public companies to advertise vacancies for NEDs in the same way as governmental bodies advertise for appropriately qualified members of QUANGOs. We also suggest that professional bodies and industry associations maintain up to date registers of individuals who would be willing to serve in a non-executive capacity.

We accept that recent events have made the risks - and in particular the reputational risk - associated with the NED role more obvious. This may impact upon the availability of potential candidates. It follows that the risk / reward ratio may need to be adjusted in order to ensure a continuing supply of suitably qualified individuals.

16. Mechanisms should be developed to give shareholders greater involvement in the appointment of NEDs.

Such measures could include:

- making it clear that board appointments of NEDs are probationary until confirmation by a general meeting of shareholders
 - describing in the annual report the expected contribution to the company of NEDs proposed for election by a general meeting
- and
- enabling shareholders to suggest to a nominations committee, candidates for non-executive directorships.

17. NEDs need to be remunerated fairly for their work based on their contribution to the company.

Remuneration should be based on the time spent and contribution made and should never involve stock related compensation.

18. The majority of NEDs should be independent of management.

We reject the check-list approach to assessing NED independence promoted by some organisations because independence needs to be considered in the round and such an approach can miss key considerations. Boards should decide which directors are independent and should explain in the annual report the reasons for their decision. Such an explanation could include a review of all significant factors which might compromise a director's independence.

19. The chairman of the audit committee should be required to be independent.

The Combined Code already requires the chairman of the remuneration committee to be independent.

20. The Combined Code should require boards to report upon their own performance in relation to company objectives.

This 'self-assessment' should cover the contributions of both executive and NEDs alike.

Finally, we recommend that, in any review of the Combined Code, the present 'comply or explain' basis for disclosure should be amended so that companies also report how they have met the best practice provisions. Shareholders, and other stakeholders, would then be better informed about their companies' corporate governance. We welcome the potential



involvement of the Financial Reporting Council in determining the future shape and style of the Code and we hope that the best practice aspects of the Code will continue to develop.

Appendix 1: Specific Comments

We set out below our response to the questions in the consultation document. These comments provide further background to the proposals in the preceding section, 'The Way Forward'.

A: WHAT ROLE SHOULD NEDS PERFORM, AND HOW DOES THIS COMPARE TO THE PRESENT POSITION?

The word 'director' is defined in company law. Company law does not, however, define the terms 'executive director', 'non-executive director' or 'chairman'. ACCA suggests that clarification is needed on each of these functions.

Defining the role of NEDs

The role of the board, executive and NEDs and the chairman differ from country to country. In the UK, directors' roles reflect custom and practice rather than law. ACCA supports the present unitary UK board structure where all directors have equal responsibility in law. Whilst the composition of each board will differ, ACCA suggests that all boards should have certain duties in common. Our view on what constitutes this set of common duties is set out in Appendix 2.

The UK Company Law Review recognised that many directors are unclear about their general duties and to whom their duties are owed. The new Companies Bill is likely to provide some clarification on these issues (for example, by proposing that a director must act in the way s/he decides would be most likely to promote the success of the company for the benefit of its members as a whole) but may not specifically address the duties of NEDs.

A NED is generally taken to mean a director without executive functions. The Combined Code does not define the role of NEDs other than to say that they should be on the audit, remuneration and nomination committees. ACCA agrees with the Hampel Review that NEDs have both a strategic and a monitoring role. ACCA sees NEDs' monitoring role as including:

- bringing external (and independent) influence to bear on issues such as financial performance, risk, internal control, standards of conduct, compliance, probity and the evaluation of management and board performance
- deciding the remuneration of the EDs
- effecting changes in board composition when governance or performance issues suggest that this is necessary but it is unlikely to be initiated by the EDs

and

- making recommendations to shareholders on the appointment of auditors. Recent events in the US have highlighted apparent failings in this function and a number of remedial changes are necessary.

The last three functions should be carried out without the involvement of EDs.

Responsibilities and liabilities of NEDs

Some people have argued that if NEDs take decisions they become EDs. If NEDs can only give opinions, however, then EDs can choose to ignore them. This would make NEDs completely ineffective.

If, on the other hand, EDs always follow the advice of NEDs then NEDs become the key decision makers and for practical purposes become EDs. In practice, some NEDs are more involved in making decisions than others.

'Executiveness' and 'non-executiveness' are therefore two points along a continuum with no clear separation. In practice each board has a different way of doing things which depends on factors such as the experience, ability and personality of different directors, the quality of board interaction and, of course, the needs of the business.

To ensure NEDs remain as independent and objective as possible, NEDs should form their own judgements but will normally act (i.e. make decisions) through the board or through a committee with other NEDs.

An appropriate number of NEDs

The Combined Code says (in Principle A3) that there should be a balance between executives and non-executives such that no individual or small group can dominate decision making. This is supported by provisions A3.1 and A3.2 of the Code which say that at least a third of the board should be NEDs and a majority of these be independent. Having one third NEDs will not necessarily prevent a very strong chairman or chief executive from dominating decision making. Achieving balance is as much a result of culture and personality as it is numbers. Therefore we make no recommendation for a minimum number of NEDs other than there should be sufficient NEDs of appropriate calibre to meet Principle A3.

Independence and the non-executive

For NEDs, as with external financial auditors, independence is a challenging concept. Both roles demand that the incumbent exercises objectivity and professionalism - but at the same time the incumbent is remunerated directly by the organisation s/he is monitoring.

Independence is vitally important for NEDs in their monitoring role but, at the same time, it is clearly important that NEDs work as an integral part of the board. They should, however, be objective and should be capable of acting independently. They should be able to contribute with ideas and be prepared to challenge EDs where EDs' views are too narrow, where EDs are acting in their own interests rather than the shareholders' or when they do not appear to take proper account of the company's wider social responsibilities.

The fact that many appointments of NEDs are from the same background or pool of people which EDs come from can sometimes make it difficult for NEDs to be genuinely independent of management in the sense of challenging pre-conceived ways of acting.

ACCA recommends that boards decide which directors are independent and explain in the annual report the reasons for their decision, including giving a consideration of any factors which could compromise a director's independence.

We reject the check-list approach to assessing independence promoted by some organisations. Just as the accounting profession has developed a 'principles based' approach to assessing the quality of auditor independence, so we believe that the independence of NEDs needs to be considered in the round. A prescriptive check-list approach can miss key considerations (such as the possibility of a NED being a neighbour or close friend of the chief executive) as well as acting as a straight jacket on initiative.

ACCA believes that it would be helpful if the Combined Code were reviewed to incorporate a principles-based approach to NED independence derived from the recently issued independence code of the International Federation of Accountants (IFAC).

Time commitment

NEDs need to be able to devote sufficient time to be effective in their role. The amount of time a NED needs will depend on many factors. These include: the size and complexity of the organisation, the organisational culture, the availability of relevant information, the business risks faced by the organisation, the adequacy and quality of assurance from internal and external auditors and the NED's informed perception of risks to probity and conflict of interest, as well as his/her prior experience and managerial skill.

In practice, NEDs will spend considerable time assessing information provided to them by management. Quality of information is obviously more important than the quantity. NEDs should make their own judgement about the sufficiency, relevance and accuracy of information and be prepared to devote time to making their own enquiries and to satisfying themselves as to the appropriate action to take, if the quality of information provided appears inadequate.

It is not practicable to specify a fixed number of days a NED should devote to the company. The table in the preceding section 'The Way Forward' illustrated how a committed NED, who is a member of both the audit and the remuneration committees, may need to devote as many as 50 days per year to the role.

Proposed statutory statement of directors' duties

ACCA supports the proposed statutory statement of duties.

B: WHAT KNOWLEDGE, SKILLS AND ATTRIBUTES ARE NEEDED AND WHAT CAN BE DONE TO ATTRACT, RECRUIT AND APPOINT THE BEST PEOPLE TO NON-EXECUTIVE ROLES?

Skills, knowledge and personal attributes

It is hard to prescribe particular skills requirements for NEDs, but in the current climate, when accountability and transparency issues are dominating the agenda, it would be reasonable to suppose that all NEDs should have a broad awareness of financial reporting issues and related assurance / corporate governance mechanisms.

In terms of specifics, companies must be free to determine the particular skills and knowledge required from each NED. Not every NED will serve exactly the same role within the board. Some may be chosen for their knowledge of a technology or an industry, some may be chosen because of their accepted management skill and achievements. Others may be selected because of their public prestige and for the intangible benefits which will accrue to the company via their presence on the board.

The board, however, needs to be able to act as a team. This includes being able to discharge their role (as set out in Appendix 2) so that decisions can be taken but challenged when appropriate. This implies that NEDs should have some 'soft skills' to back up the necessary qualities of integrity and objectivity.

Recruitment and appointment mechanisms

A possible reason for the present restricted pool of NEDs is concern by boards of appointing directors from different backgrounds from their own. Boards should to be aware, however, that diversity is a strength and that appointing a NED from a different background could result in improved governance, better management of risk and in new strategic opportunities.

In reality, there is probably no shortage of suitably qualified people, but new mechanisms for recruitment are needed and companies should be encouraged to search more widely for NEDs. We believe that it is reasonable to expect public companies to advertise vacancies for NEDs in the same way as governmental bodies advertise for appropriately qualified members of QUANGOs.

Professional bodies and industry associations should maintain registers of suitable appointees. Some registers do already exist, but they need to be strengthened, and companies actively encouraged to use them.

At the same time, a more transparent process for appointing NEDs is required. Companies should explain the appointment process to their shareholders. In order to avoid the situation where NEDs are appointed solely by the EDs, mechanisms should be developed to enable shareholders to become more involved in appointment of NEDs. Consideration could be given to enabling shareholders (and - more controversially - employees) to suggest candidates for non-executive directorships for the consideration of the nomination committee.

NEDs' remuneration

With regard to executive pay, there is often a conflict brought about by share incentive schemes which reward short term results and earnings management activity rather than rewarding long term earnings or share price growth.

Share option schemes for many companies result in significant reductions in shareholders' funds. In the US, share options result in a typical annual dilution rate of 3%. It has been calculated that such dilution will reduce the profitability of the US S&P 500 companies by an annual average of 25%. In the UK, annual dilution is nearer 1% but the effect on earnings can still be significant.

Recent events have shown that large executive pay packages can represent very poor value for shareholders. We believe that NEDs should be remunerated on the basis of the time they devote and the experience they bring to the company. We do not believe that stock based remuneration is appropriate for non-executives, certainly not in listed companies.

Insurance provision

Recent corporate debacles should have alerted all directors to the risks associated with that position. NEDs, however, can feel particularly vulnerable as they are not full time in the business and may have limited access to information. Their core role, however, should ensure that they ask the right questions and obtain the information needed to assess whether risks are properly controlled. In this respect they should have as good, or better, an overview of risk as other members of the board.

Recent events have also highlighted the risk issues confronting NEDs. For example, how can NEDs have equal responsibility or, as some would suggest, greater responsibility for ensuring corporate or management probity when they have no management duties and work part time? We note that, fortunately, the courts take into account the skills and experience of a director in assessing personal liability. Consideration should be given, however, to whether the law should be clearer about how directors' liability is apportioned. It would be wrong, however, for any director, NED or ED, to rely on insurance as an alternative to making him/herself aware of risk and ensuring that the risk is being properly and effectively managed.

C: DO EXISTING STRUCTURES AND PROCEDURES FACILITATE EFFECTIVE PERFORMANCE BY NEDS?

The Combined Code

Although the Combined Code has worked very well, and many other codes around the world have been influenced by the UK model, it is now time to review it. We believe that our proposals are best implemented through revisions to the Code itself, rather than through any statutory route.

We also believe that a review of the Combined Code should take into account recent developments such as the new South African King Code. This code contains principles and guidance on role of the board, the review of board performance, internal control and risk management. In addition, the King Code deals directly with the issues of corporate social responsibility and sustainable development.

Many commentators on corporate governance have adopted a tick box approach when reviewing companies' compliance with the Combined Code best practice provisions. We suggest it is equally, if not more, important to assess corporate governance performance as a whole. To enable this, we recommend that the present 'comply or explain' basis for disclosure be amended so that companies also report how they have met the best practice provisions as well as explain where and why they have not 'complied' with any provisions. Shareholders, and other stakeholders, would then be better informed about their company's corporate governance performance.

Audit committees

The intense debate over the role of the external auditors and the increasing focus on other corporate governance issues may mean that the audit committee is in danger of becoming overburdened. As noted above, it is likely that governance considerations will expand, in the future, to embrace issues such as

corporate social responsibility, which could add further to the work of audit committees.

The role of many audit committees has already expanded well beyond what is presently outlined in the Combined Code. There are a number of governance oversight functions which need to be exercised in listed companies and these should be clearly identified in a revised Combined Code. Companies, however, should be able to decide if they want the audit committee or another committee to carry out these functions.

We believe that, at a minimum, the chair of the audit committee should be an independent NED.

We also believe that it would be helpful if responses to this review of the role and effectiveness of NEDs were to be integrated into the outcomes of other concurrent reviews, so that the result would be a better understanding of the role and of corporate audit committees. We note that the Financial Reporting Council has been asked to consider the operation of audit committees and that the Financial Services Authority is reviewing the listing regime.

Company and board performance

Many organisations have found a process of facilitated self-assessment helps the board to review its objectives and its effectiveness in achieving its objectives. This process can also be used to assist, and be integrated with, the risk management process. Reviewing and reporting upon board and company performance should be made an explicit part of the Combined Code.

D: DO EXISTING RELATIONSHIPS WITH SHAREHOLDERS OR OTHERS NEED TO BE STRENGTHENED?

Shareholders - particularly large institutions - need to demonstrate more involvement in, or concern for, the quality of corporate governance procedures within their investee companies. Without this external stimulus, there is no motivation for boards to improve their practices.

Historically, it is probably fair to say that institutional intervention into internal governance matters has been limited. This problem can be partially addressed by improving disclosure and giving shareholders the opportunity to ask questions and obtain answers. We propose that at AGMs, NEDs should formally report to shareholders on their role, be open to questions and able to provide answers.

Institutional investors say they have little contact with NEDs. Small shareholders probably have even less. There should be other mechanisms to improve communication on governance matters between NEDs and shareholders, not only institutional shareholders. Consideration should be given to involving NEDs in investor relations presentations and including NEDs in meetings between EDs and shareholders. It is of course necessary to ensure that price sensitive information is not carelessly disclosed.

Since the Company Law Review rejected the so-called 'pluralistic' view of directors responsibilities, it does seem that institutional investors are now the main focus of attention.

We believe, however, that the NED community also has an important role to play in protecting the interests of:

- smaller investors
 - employees
- and
- the general public.

Each of these interest groups has suffered in the wake of collapses of companies such as Enron, WorldCom and Marconi, and we need to recognise that the impacts of poor corporate governance are felt far wider than the offices of institutional investors.

We believe that NEDs should act as the 'Corporate Conscience' in respect of CSR issues. As the issue of CSR rises up the business agenda, we believe that it is appropriate for NEDs to accept a responsibility for ensuring that social, environmental and sustainability issues receive an appropriate degree of board level attention. This will become particularly significant if the proposed mandatory Operating and Financial Review Statement becomes law in the near future.

E: HOW CAN NEDS BEST BE SUPPORTED TO PERFORM THEIR ROLE?

NEDs can be supported either through the active involvement of shareholders (see section D above) or through resource-based mechanisms which enable them to do their jobs more efficiently.

Training

There is much support at present for the idea that board members should receive some formal training regarding their roles and responsibilities. NEDs should not be exempt from this innovation - especially given the sensitivity of their role on the expanded accountability debate. Insistence on formal qualifications for all directors would not, in our view, be appropriate.

Access to information from management and physical resources

NEDs should have access to any information and explanations they require. In practice, NEDs may need to be more prepared to challenge and investigate. Consideration should be given to allowing NEDs the same rights to information and explanation as auditors. NEDs should be able to call on a dedicated staff resource of a sufficiently high level of seniority and competence to provide them with the information they require.

Independent advice

Individual NEDs should be able to take independent advice at the company's expense on matters of probity. The Combined Code (in A1.3) states that there should be a procedure agreed by the board for directors in the furtherance of their duties to take independent professional advice at the company's expense. The Combined Code should make it clear that any NED or ED can take independent advice without recourse to any other director.

F: IN WHAT WAYS IS THE POSITION DIFFERENT FOR SMALLER LISTED COMPANIES?

In smaller listed companies there are more likely to be knowledge and skills gaps in the board and their employees. This means the potential contribution by NEDs is greater. Such companies, however, may find it more difficult to recruit NEDs of suitable calibre.

Our research into the role of NEDs in SMEs highlights the importance of the strategic role of NEDs. Related to this is an advisory or mentoring role which may help fill knowledge and skills gaps of management.

It follows that any changes to the Combined Code aimed at enhancing the monitoring role of NEDs should not be so prescriptive that smaller listed companies forfeit the strategic benefits that NEDs can bring. Likewise, any proposed statutory amendments regarding the role of NEDs should be designed so as not to impact adversely on smaller, unlisted companies.

We note that research by organisations such as PIRC (Pensions Investments Research Consultants Limited) regularly reveals that the extent of compliance with the full Combined Code decreases as one moves down through the FTSE all-share index. Some of this relates to the availability of resources, and some to the fact that certain issues - such as dealing with large institutional investors - are of lesser importance for the smaller listed company.

It is likely, therefore, that proponents of a stricter NED regime will have to accept that resistance to change will be higher - and compliance with best practice lower - in the smaller listed company realm.

**G: WHAT CAN WE LEARN FROM INTERNATIONAL EXPERIENCE?
POSSIBLE ISSUES FOR COMMENT:****International experience**

We are in favour of the unitary board system as it operates in the UK at present. It seems likely, however, that, in future, NEDs will have a more defined role and that UK boards will demonstrate a clearer distinction between EDs and NEDs. This could potentially divide the unitary board and result in UK boards beginning to resemble two-tier boards. It is important, therefore, to learn from German and Dutch experience, for example, before changing the way UK boards function.

Some countries have developed corporate governance codes which are worth study. The new South African Corporate Governance Code (sometimes referred to as King 2) for example provides useful information on the role of the board, review of board performance, internal control and risk management and corporate and social responsibility.

Disclosure is the best means by which shareholders and other stakeholders can assess the quality of corporate governance within an organisation. It is clearly desirable to have some global consensus on disclosure. The United Nations, through UNCTAD-ISAR is developing a set of guidelines on corporate governance disclosure. We are directly involved in this development ourselves as are representatives of the UK Department for International Development.

Research conducted by ACCA of CFOs supports ACCA's view that a global code of governance is required. Such a code would concentrate on disclosure of corporate governance practice and enable the international financial community to make meaningful comparisons of corporate governance in companies around the world.

Appendix 2: Duties of the Board

The following duties should apply to all boards:

- At all times act in good faith in the long-term interests of the company.
- Determine strategic direction.
- Identify and monitor key risk areas and key performance indicators and take appropriate action.
- Define and monitor the information needs of the board.
- Retain full and effective control over the company, and monitor management in implementing board plans and strategies.
- Ensure that the company complies with the substance as well as the form of relevant laws, regulations and codes of business practice.
- Reserve specific power to itself and delegate other matters with the necessary written authority to management. These matters should be monitored and evaluated on a regular basis.
- Provide sufficient information to shareholders regarding proposed board appointments, remuneration and other matters to be decided in general meetings.
- Record the facts and assumptions it relies on to conclude that the business will continue as a going concern in the financial year ahead or why it will not.

- Ensure that there is effective and timely communication between the company and its internal and external stakeholders.
- Encourage attendance at general meetings, at which the chairman of the board's audit committee and remuneration committee are present.
- Find the correct balance for its business between conforming with governance constraints and performing.
- Assess periodically whether the board is effective.
- Ensure that board succession is planned.

[Source: King Report (amended)]

TECH-CDR-211



The Association of Chartered Certified Accountants

29 Lincoln's Inn Fields London WC2A 3EE United Kingdom

tel: +44 (0)20 7396 7000 fax: +44 (0)20 7396 7070 www.accaglobal.com