



## Governance in Brief

### Your summary of the latest corporate governance developments

#### Headlines

- The provision of non-audit services by auditors – the debate continues
- ICSA publishes updated guidance on improving board effectiveness for consultation
- BIS issues a consultation on the future of narrative reporting
- Major investors call for caution on the new annual re-election of directors provision of the UK Corporate Governance Code
- Significant increase in director disqualifications this year

#### The provision of non-audit services by auditors – the debate continues

**In Brief:** Further to an Auditing Practices Board (APB) consultation in October last year on whether there should be a prohibition on auditors providing non-audit services to the entities that they audit, the FRC has published for consultation updated guidance to audit committees on determining whether a company's auditor should be permitted to provide particular non-audit services.

The APB's October consultation followed a report last year by the House of Commons Treasury Committee which proposed a ban on the auditor providing non-audit services. The consultation generated a substantial number of responses from all APB's stakeholder groups, in particular, including the views of a range of investors.

The overwhelming view of respondents (irrespective of the constituency involved) was that there should be no outright prohibition on non-audit services.

APB says, however, that a perception remains that auditor objectivity and independence is adversely affected by the provision of non-audit services and that improved transparency and governance would address these concerns. The APB is therefore proposing changes to the APB Ethical Standards for Auditors and amendments to the FRC's Guidance on Audit Committees.

Issuing the consultation paper Baroness Hogg, FRC Chairman, said:

"We believe that audit committees can help by having a clear framework for assessing when it would be appropriate for the auditor to provide other services, and are consulting about how to make this more transparent."

The proposed changes include the following:

- more prominence to be given to the importance of non-audit services in the assessment of the objectivity and independence of the company's auditor;
- new policy and procedure guidance relating to the practice of seeking specific approval from audit committees for particular categories (and values) of non-audit services to be supplied by the auditor;
- additional guidance to help the audit committee distinguish between those non-audit services which are closely related to an audit and which give rise to a very low threat to auditor objectivity and those where the threats need more careful consideration;

- guidance to assist audit committees on the judgement as to the cost and efficiency benefits and the real or perceived threats to auditor independence which are associated with the auditor providing services which fall outside the audit and audit related services;
- proposed prohibition related to restructuring services for entities in distress, non audit services performed on a contingency basis and conflicts of interest; and
- improved disclosures on the nature of services provided by the auditor and an outline of the reasons why the audit committee decided to purchase non-audit services, other than audit related services, from the auditor rather than from another party.

A key issue raised by APB is whether the changes will result in increased cost. This is particularly relevant as the CBI, the Hundred Group and over 60 companies have written expressing concern about the impact of prohibitions on business costs.

Deloitte strongly supports enhanced transparency but has concerns that further prohibitions may impede the ability of distressed companies to survive and make it more difficult for AIM, small cap and private equity companies to enter into transactions. The deadline for comment is 23 October 2010 and the comments put on the public record from the previous consultation can be accessed via [http://www.frc.org.uk/apb/publications/consultation\\_responses.cfm](http://www.frc.org.uk/apb/publications/consultation_responses.cfm)

**Date:** 23 July 2010

**Source:** Financial Reporting Council

**Deadline for comment:** 23 October 2010

**Further info:**

<http://www.frc.org.uk/apb/press/pub2326.html>

### **ICSA publishes updated guidance on improving board effectiveness for consultation**

**In Brief:** A well-designed decision-making process is one of the most important hallmarks of a strong board, according to draft guidance launched for public consultation by the Institute of Chartered Secretaries and Administrators. ICSA states that when making decisions, boards should guard against the effects of a dominant personality, the existence of “no go” areas for non-executives and a poor line of sight to significant risk.

ICSA was asked to develop the guidance by the Financial Reporting Council to complement the new UK Corporate Governance Code which was issued in May. It will submit a final text later in the year for adoption by the FRC as a replacement to the existing Higgs Guidance.

The guidance is entitled “Improving Board Effectiveness”. It has been drafted by a Steering Group chaired by Sir John Egan, recent chair of Severn Trent Plc, and takes account of an initial consultation involving investors, chairmen, directors, company secretaries and professional advisers operating in UK boardrooms.

The exercise revealed overwhelming support for short, non-prescriptive guidance to help improve board effectiveness. Key issues covered by the draft guidance are:

- more emphasis on the role of the chair as critical to building an effective board;
- the importance of the board’s role in creating a high-performance culture which maximises the opportunities for value creation and minimises risk;
- the need to create an environment of challenge in the boardroom;
- the value for companies of well-informed and high-quality board decision making;
- board composition and diversity as major factors in delivering an effective board;
- the advantages of a good training and development programme designed to improve directors skills, experience and knowledge;
- the benefits of regular board evaluation to explore how well the board is functioning.

It is intended that the completed draft guidance will be submitted to the FRC in November. The FRC intends to publish the final guidance by the end of 2010.

**Date:** 29 July 2010

**Source:** Institute of Chartered Secretaries & Administrators

**Deadline for comment:** 14 October 2010

**Further info:** <http://www.icsa.org.uk/policy-guidance/consultations/improving-board-effectiveness/draft-consultation>

## **BIS issues a consultation on the future of narrative reporting**

**In Brief:** Further to the Coalition Agreement commitment to “reinstate an Operating and Financial Review to ensure that directors' social and environmental duties have to be covered in company reporting and investigate further ways of improving corporate accountability and transparency”, the Department for Business, Innovation and Skills (BIS) has issued a consultation on the future of narrative reporting.

The objective of the consultation is to look at ways to drive quality of company reporting to the level of the best and thereby enable stronger and more effective shareholder engagement. The consultation paper is open in exploring all options – regulatory and non-regulatory – to achieve the objectives. The consultation focuses in particular on the business review provisions of the Companies Act 2006, but as part of its exploration of wider narrative reporting, it also looks at issues relating to the Directors' Remuneration Report. The consultation asks a number of questions including:

- Are company directors providing useful and relevant information on the company's forward-looking strategy and principal risks and uncertainties?
- Does the information provided reflect the issues discussed by the directors in board meetings?
- Would a statutory reporting standard help to improve the quality of reporting?
- Should there be a shareholder's advisory vote on the Business Review?
- Are there non-regulatory solutions to increasing quality through better guidance or publicising excellence in business reports?
- Do the current disclosure requirements provide clear and usable information about the process by which directors' remuneration is decided?

In addition, it should be noted that the FRC will be looking at other aspects of corporate governance, narrative reporting and auditing over the next twelve months. For example, the FRC will be carrying out a review of the Turnbull Guidance on internal control, beginning in the second half of 2010.

If changes are proposed as a result of these reviews they will be subject to separate consultation.

**Date:** 2 August 2010

**Source:** The Department for Business, Innovation and Skills

**Deadline for comment:** 19 October 2010

### **Further information:**

<http://www.bis.gov.uk/Consultations/the-future-of-narrative-reporting-a-consultation>

## **Major investors call for caution on the new annual re-election of directors provision of the UK Corporate Governance Code**

**In Brief:** Three major investors, Hermes, Railpen and the Universities Superannuation Scheme have written to the chairman of 700 UK companies urging them to ignore the new UK Corporate Governance Code provision on annual re-election of directors on the grounds such a move could lead to a short-term culture and undermine collective decision-making.

The letter states: “We do not believe that the new requirement within Provision B.7.1, that all directors be re-elected annually, will increase accountability of boards in the way that long-term asset owners consider necessary. Indeed we are concerned that it will have the opposite effect, and will engender a short term culture with the risk of well-performing boards being distracted by short term voting outcomes with too great a focus on the annual voting process.”

The three investors will consider carefully explanations as to why a company does not consider it appropriate to comply with provision B.7.1. As long as the explanation is reasonable, the investors would hope to support the majority of companies adopting this position.

**Date:** 29 July 2010

### **Further info:**

<http://www.proxywatch.com/uploads/2010/HermesUSSRailpenAnnualElectionsLetter.pdf>

## Significant increase in director disqualifications this year

**In Brief:** Wedlake Bell, the law firm, has published research based on data from the Insolvency Service which shows that the number of director disqualifications has seen a year-on-year rise of 17%. In the year to 31 March 2010 the number of disqualification proceedings totalled 2,169 compared to 1,852 proceedings in the prior year. Reasons for disqualification range from underpaying tax; failing to keep correct accounting records; theft and fraud; or for continuing to trade whilst the company is insolvent. It can be seen that the authorities are not accepting the harsh economic environment as a reasonable defence for such behaviour.

**Date:** 19 July 2010

**Source:** Wedlake Bell

### Time to take action

- Consider existing governance processes in relation to the provision of non-audit services and compare to the new proposals on procedure and disclosure
- Review the messages in the updated ICSA guidance and determine whether improvements could be made within your own board
- Consider the issues raised in the BIS consultation on narrative reporting in light of your latest annual report. Is there scope and appetite for making improvements?
- Take the earliest opportunity to discuss director re-election as a board and with your major shareholders to determine views and agree on the most appropriate arrangements for your company

### On the horizon

- Review of Turnbull Guidance on internal control

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.co.uk/about](http://www.deloitte.co.uk/about) for a detailed description of the legal structure of DTTL and its member firms.

Deloitte LLP is the United Kingdom member firm of DTTL.

This publication has been written in general terms and therefore cannot be relied on to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this publication. Deloitte LLP would be pleased to advise readers on how to apply the principles set out in this publication to their specific circumstances. Deloitte LLP accepts no duty of care or liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

© 2010 Deloitte LLP. All rights reserved.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

Designed and produced by The Creative Studio at Deloitte, London. 5464A

Member of Deloitte Touche Tohmatsu Limited