

CORPORATE GOVERNANCE IN PRACTICE

THE VIEW FROM THE BOARDROOM

Helen Bradley, Robert Adam and Ron Kirschner of Baker & McKenzie LLP look at the key corporate governance requirements for boards, and consider the views of board insiders and industry experts on how to deal with them.

Recent years have seen an increased public, political and regulatory focus on the area of corporate governance, partly driven by prominent corporate failures and high profile criticism of some corporate cultures and decision-making. Companies are also facing increasing involvement and pressure from shareholders, which is encouraged by the Financial Reporting Council (FRC) in its Stewardship Code.

This article does not attempt to cover every aspect of corporate governance, nor every principle under the UK Corporate Governance Code (the Code), but rather focuses on some issues that have been recently identified as particularly concerning boards. These include:

- Conducting board evaluations.
- The increased focus on the remuneration committee.

- Diversity (in the boardroom and beyond).
- Succession planning and the role of the nomination committee.
- Shareholder engagement.
- Audit tenders.

These are only some of the issues currently being faced by companies, and with a constantly changing environment there are more issues on the horizon. Market practice will develop to deal with these and those advising companies will need to continue to watch this space.

CORPORATE GOVERNANCE RULES

The UK corporate governance rules have been designed to be flexible and adaptable to the business needs of companies,

without imposing standards that may be impracticable or overly restrictive. The rules have been designed to encourage more effective company leadership and better risk management, ultimately leading to better performing companies.

There are clear benefits of adopting good corporate governance and, conversely, evidence of under-performing companies exhibiting bad corporate governance. The key to applying the corporate governance regime successfully is to find the right approach and application of the rules to suit each company.

While some view the increasing regulation of corporate decision making as an unnecessary burden, and others fear that the regulations are a “Christmas tree” on which stakeholders can hang their favourite policies, the general view is that the codification of corporate

governance principles has been a positive development.

UK listed companies are increasingly complying with the Code, with 57% of FTSE 350 companies stating in 2013 that they are in full compliance with the Code (up from around 51% in the previous three years) and 85% of the remainder complying with all but one or two of the Code's 53 provisions (*Governance steps up a gear; Grant Thornton, December 2013, www.grant-thornton.co.uk/Documents/FTSE-350-Corporate-Governance-Review-2013.pdf*) (2013 Grant Thornton report).

The quality of reporting and explanation, however, remains an issue, especially among FTSE 250 companies (less so among FTSE 100). The application of the Code tends to be more difficult for smaller or recently listed companies, with the latter often having operated very differently before listing. However, it is recognised that the Code sets out best practice and that companies should use the Code as a basis on which to develop a corporate governance regime that best suits them. As one general counsel put it, "companies should use corporate governance to enhance, rather than distract from, their business".

BOARD EVALUATIONS

Board evaluations are designed to provide a way for the board to develop by recognising its strengths and addressing its weaknesses. The Code currently provides that the board should undertake a formal and rigorous annual evaluation of its own performance and of its committees and individual directors, and that FTSE 350 companies should arrange an external evaluation at least once every three years (*Code provision B.6*).

The board evaluation process focuses the board's attention on its own workings, something that it may not do naturally. It provides an opportunity to raise concerns that directors may otherwise feel uncomfortable raising, particularly where there is a powerful personality on the board or a general lack of questioning and feedback. However, one director we spoke to thought that annual evaluations could be burdensome and are held too frequently, leaving directors with insufficient time to address identified issues between evaluations.

Some directors are also nervous that the board evaluation may turn into a personal

assessment of individual board members. While the evaluation is an opportunity to identify issues, which in some cases may focus on certain individuals, the main purpose of the evaluation is assessing how the directors, whether executive or non-executive, operate together as a board.

As Bob Lawson, chairman of Genus plc and Barratt Developments plc explains, "It is the role of the chairman to make sure that the board understands from the start that the evaluation is of the board, and its decision-making process, and not of the individuals". Nicola Snook, Company Secretary of British American Tobacco plc, put it another way: "The role of the non-executive directors is to challenge, and the role of the executive directors is not to take it personally", and the board evaluation process should be taken in this spirit.

In planning the board evaluation, the essential elements to consider include: who should conduct the evaluation; how to ensure that it is effective; and how results should be communicated, both to the board and to stakeholders (primarily through the company's annual report). The key to a successful board evaluation is to get engagement from the directors, and it is the chairman's role to achieve this (*see also box "The external evaluator's view"*).

Internal evaluations

Internal board evaluations almost always involve written questionnaires. Some companies use a similar set of questions each year in order to track progress. Other companies prefer to change at least some of the questions to introduce greater variety, inspire new thoughts and feedback, and to discourage respondents from repeating their answers from the previous year.

The completed questionnaires are often then discussed at face-to-face meetings with the company secretary, the chairman or the senior independent director. While individual meetings are more time-consuming, they are generally seen as being worthwhile because they give directors an opportunity to express their views more openly and candidly, in a way that they might not be comfortable doing in writing. The findings of the internal evaluation are generally summarised in a report, often written by the company secretary, and discussed by the board.

A major benefit of internal evaluations is that they can be very specifically tailored

to the needs of the company. The person conducting the evaluation (usually the chairman, senior independent director or the company secretary) will generally already know the board well, and can more easily identify in advance the potential areas for development, allowing for a more focused process.

One company that we sampled, however, asked a newly appointed non-executive director to conduct its internal evaluation, allowing him to bring his skills and experience from other companies to the process and giving the board a fresh perspective.

External evaluations

When the requirement to conduct an external evaluation was first introduced it was met with some scepticism. There were questions about how useful an external review could be, and boards were nervous about allowing an external facilitator into the boardroom and the board process. However, as more companies began to undertake external evaluations, many realised the value of them, especially if effectively combined with the internal processes being conducted in other years.

External evaluations can range from the use of a simple online questionnaire to a full psychological assessment of each board member (increasingly, boards are also using personality profiles, such as the Myers-Briggs framework). In choosing the form of evaluation, boards should also consider whether to allow the external evaluator to attend and observe board and committee meetings.

There may be concern that allowing an external evaluator into the boardroom could create an artificial atmosphere and change the usual dynamic of meetings. However, in practice this does not seem to be the case, with many saying that they found them unobtrusive and soon forgotten (especially as there is so much material to cover during meetings). It also tends to help the evaluator to add context to the information obtained in the questionnaires and interviews.

There has been much discussion about the choice and quality of board evaluators. In 2013, Practical Law reported that 51 different external evaluators were appointed by FTSE 350 companies (*Annual Reporting and AGMs 2013: What's Market Practice?; Practical Law; November 2013, www.practicallaw.com/5-*

The external evaluator's view

Dr Tracy Long, of Boardroom Review Limited considers the key elements of a board evaluation:

Purpose

The purpose of a board evaluation is very simple: to assess the board's contribution, individually and collectively, to the health and success of the company. There is no single template for an effective board or its evaluation. The approach taken will partly depend on why the evaluation is taking place; whether on the grounds of compliance, to respond to external pressure or regulation, to benchmark the board's performance, to facilitate change, or to enhance the board's long-term efficacy. Factors including business complexity, board size and contribution, the number of participants, the board's timetable and the available budget will all influence the design and impact of the evaluation.

Internal evaluations

In internal evaluations, confidential responses to quantitative questionnaires or internal interviews are collated to provide the basis of discussion. Individual confidentiality should be protected and explained, and questions will require careful phrasing: to encourage thoughtful responses, so that respondents interpret them in a similar way, and to avoid repetition. Internal evaluations are quick and cheap to conduct, provide a basic understanding of the board's strengths and weaknesses, can involve a large number of people, and can be compared year on year. However, directors are often reluctant to write down confidential views and concerns, there are no independent perspectives or recommendations to consider, and the board cannot benchmark itself against others.

External evaluations

External evaluations vary in format from the use of an online questionnaire to an in-depth psycho-analytical assessment. It is important that chairmen choose, in consultation with colleagues, an appropriate methodology for the board and the company, taking into account: specific board requirements; levels of engagement; required skills and competences (from the evaluator); and necessary outcomes. Experience, skill and chemistry are important; the chairman has to be comfortable that an evaluator will be able to maximise the long-term benefits of an evaluation for the board, and be satisfied that the evaluator can conduct the work with sufficient objectivity and independence.

It is also important that all the directors are supportive of the process; good communication with the board on the approach and purpose, the process and the time commitment, with the necessary level of candour and feedback, will enhance the quality of input and level of engagement. An external evaluation will take more time to organise and conduct than an internal evaluation, and the chairman will need to plan the process to suit the board's calendar.

The use of interviews

Interviews can produce high-quality evidence and tend to work well on a semi-structured basis; this is where the interviewer has a framework of topics to be covered (and therefore a basis for comparison between directors), but enough flexibility to vary the emphasis. This framework should be discussed with the chairman at the beginning of the review. To maximise the relevance of the questions and understand the context of the answers, the interviewer should know enough about the company, the director's background and role on the board, and the external environment; for example, the impact of changing regulation, a fast-moving competitive landscape or a sector in decline. The interviewer may require a separate briefing from the chairman and CEO, as well as a review of the company's documents, such as the annual report and analysts' reports, before the evaluation begins.

Observation

Observation of the board, committee meetings and strategy days can help an evaluator to form a dispassionate view of the board, provide a context for the evidence given during the interviews, and prioritise the board's strengths and weaknesses. Observation also helps to develop important perspectives; for example, on the physical characteristics of the boardroom, the interplay between directors, and the relationship between the information provided to directors in advance of the meetings, and the related discussion. It is important to have the confidence to trust the evaluator with highly sensitive information; confidentiality is paramount, and the chairman should have assurance that the information will be used only within the context of the evaluation.

Communication

Although written documents are an important reference point for the board, a collective discussion provides a better catalyst for directors, allowing issues to be raised within a confidential forum. Confidential feedback to individual directors can also be helpful if issues arise; for example, relating to contribution and approach or the effectiveness of delegated committees.

549-2085) (2013 What's Market report). In addition, the FRC noted in a 2013 report that some companies have raised concerns about the variable quality of service provided by board evaluators (Developments in Corporate Governance 2013: The impact and implementation of the UK Corporate Governance and Stewardship Codes; Financial Reporting Council, December 2013, www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Developments-in-Corporate-Governance-2013.pdf) (2013 FRC report). Complaints often include the quality of reports; for example, often too generic and not providing tailored or practical conclusions.

There are a couple of practical ways to try to address these issues: seeking a recommendation (directors who have experienced evaluations at other companies are a particularly good source for these); and asking the evaluator for an anonymised copy of a recent report, to give a flavour of their style and quality of reporting.

Executive search firms are also entering the board evaluation market. As one director explained, the advantage of using an executive search firm for board evaluations is that the firm already knows the board and the company well and therefore could work more effectively with the board. It would also then be able to more efficiently assist the board in finding new directors, as it would have identified the relevant skills needed by new directors.

Others, however, are concerned about lack of independence, with the board evaluation being used as a platform to cross-sell executive search services, and conflicts; for example, as firms may be evaluating directors that they recently placed.

Reporting to the market on evaluations

Following the board evaluation, the board should state in the company's annual report how performance evaluation of the board, its committees and its individual directors, has been conducted (*Code provision B.6.1*). There is a growing trend among companies to disclose in their annual report a summary of findings, a list of action points and a timeframe for achieving specified results.

While the quality of reporting varies, and some companies are reluctant to make disclosures for reasons of confidentiality, others see it as

Remuneration consultants

The remuneration consultancy industry has developed significantly in recent years; at least 25 different remuneration consultants were appointed by FTSE 350 companies in 2013. However, the market share of these consultants is highly concentrated, with the most frequently appointed remuneration consultant being appointed by one-third of the FTSE 350 companies reviewed in the Practical Law What's Market 2013 report on AGMs, and 79% of the FTSE 350 companies appointing the three top providers.

The way in which companies use these consultants is varied. Some use them only to provide comparative data on remuneration of similar companies, while others use them to give the board guidance and advice on how best to design the company's remuneration structure in light of the company's business and shareholders' expectations. Some companies split this advice, getting comparative data from one consultant, while using another, often more specialised, to provide bespoke advice on the company's own remuneration structure.

There is a view that the relationship with remuneration consultants should be similar to that which a company has with its auditors. Over the years, auditors have become better at knowing each individual company and offering tailored advice, voicing a view on certain topics and guiding the board. Some feel that this quality has not yet fully developed among remuneration consultants. Others, however, seem satisfied with receiving comparative data and using this to design their own remuneration structure, or have found a specialised consultant who the board is happy with. Since the industry is relatively young, especially in comparison to the audit industry, this area is likely to develop and potentially consolidate.

an opportunity to demonstrate that they are following best practice in this area and that their boards are taking active steps to improve their effectiveness each year. In relation to external evaluations, the quality of disclosure in the annual report may partly be linked to the quality of the external evaluator's report; where the evaluator's report makes specific and constructive recommendations it is easier for the company to reflect these in its annual report.

REMUNERATION COMMITTEES

Director remuneration has received considerable attention over the last few years from the press, shareholders and legislators. Under this spotlight, and with increasing regulation such as the requirement for shareholder votes on the remuneration policy and the remuneration report, the burden on remuneration committees has increased (see feature article "*Directors' remuneration reports: the final picture*", www.practicallaw.com/3-540-4886). As one director put it: "in the past the chairmanship of the audit committee was considered to be the poisoned chalice: today it is the chairmanship of the remuneration committee".

The increased focus on remuneration has had a number of measurable effects on remuneration committees. Firstly, they tend to meet more often than they did in the past. The 2013 Grant Thornton report notes that there was an average increase of 6.5% in the number of meetings across the FTSE 350 from 2012 to 2013. Secondly, the pressure felt by chairmen of the remuneration committee is evidenced by the increased reporting by them in the annual report. The 2013 Grant Thornton report states that 70.5% of chairmen provided personal commentary in their committee's annual report in 2013, a significant increase from the 48% that did so in 2012. Finally, companies are increasingly turning to remuneration consultants for advice (see box "*Remuneration consultants*").

The shareholders' view

While the increased attention on remuneration issues is challenging many remuneration committees, shareholders may not be as focused on this area as companies may think. Apart from certain high-profile cases, the vast majority of companies have not been receiving a substantial vote against their remuneration reports.

With institutional investors receiving a growing amount of information from companies, they tend to be focused only on companies criticised in the past or with unique, or particularly lucrative, remuneration structures. They simply do not have the resources to wade through the large number of drafts they receive and some institutional investors reported that, with the annual re-election of directors, they feel that they have sufficient leverage without the need to vote down the remuneration policy.

DIVERSITY IN THE BOARDROOM

The Code provides that the nomination committee should set out in its report: the description of the board's policy on diversity (including gender); any measurable objective that it has set for implementing the policy; and progress in achieving the objectives (*Code provision B.2.4*). The FRC's 2011 guidance on diversity states that it is important to consider the diversity of personal attributes among board candidates and that diversity of psychological type, background and gender is important to ensure that the board is not composed solely of like-minded individuals (*FRC: Guidance on Board Effectiveness; Financial Reporting Council, March 2011, www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Board-Effectiveness.pdf*).

Areas of diversity

Over the last few years there has been quite much discussion of gender diversity on boards, especially following the publication in 2011 of Lord Davies' report "Women on Boards" (see *News brief "Women on boards: targeting diversity"*, www.practicallaw.com/8-505-3051). However, gender is not the only criterion for diversity and it should be considered in a broader context. As Susan Swabey, company secretary of Smith & Nephew plc, explained to us: "diversity of personality and experience is just as important as gender and ethnicity".

As well as preventing "group-think", diversity is also important to ensure that the board of a company reflects the diverse nature of its business and the direction in which the business is developing. This may include, for example, considering the nationalities of the board members and how these reflect the company's international operations and geographical expansion, or how the age and background of the board members allows

them to understand the company's target market.

But when it comes to nationality and ethnicity, companies and their shareholders should beware of trying to "tick the box"; a director who was born in a particular country but has spent most of their academic and professional life in the UK might make the board seem more diverse on paper, but may not introduce as much diversity as a director with broad international experience.

One area of diversity that is not in focus at the moment, but that will increasingly present a challenge, is the age of directors, in particular non-executive directors. According to the 2013 Grant Thornton report, the average age of a chairman of a FTSE 350 company is 64, and the average age of a non-executive director is 60.

While the relatively senior age of directors is understandable, as a certain amount of experience is required for a seat on the board, some companies are beginning to consider that younger directors may better equip the board to deal with challenges being faced by the company. One example is the increasing importance of technology across the business, from the way the company interacts with its customers, the use and effect of social media, to growing concern around cyber security. As Dr Tracy Long of Boardroom Review explains "a few years ago boards felt that their knowledge gap was understanding Asia, now it is understanding technology". Some boards are trying to alleviate this by hiring younger non-executive directors who have more experience and a better understanding of technology.

Executives serving as non-executives

A challenge to lowering the average age of non-executive directors is that skilled and ambitious individuals tend to stay in executive roles until a certain age. An increasing trend that is helping with this, however, is the appointment of executives as non-executive directors in other companies.

Historically, companies have been reluctant to allow their executives to serve as non-executive directors, due to concerns about potential conflicts and the time commitment required. But more and more companies are recognising that allowing their executives to sit on other boards brings certain benefits, as it broadens their experience and helps them to appreciate the role of the non-executives

in their own companies. As Nicola Snook explains "We encourage our executives to take up one non-executive role at another company as this leads to cross-fertilisation of ideas, benefiting both companies. However, the choice has to be right".

If an executive serves as a non-executive director of another company, it does raise certain issues, the primary one being the increasing time that non-executive directors are expected to dedicate to their role. It is generally accepted that an executive should not have more than one non-executive position and that a non-executive role is not appropriate for every executive. The choice of the non-executive position is crucial, and several factors need to be considered, including:

- The business sectors of the two companies.
- The dynamics of the boards.
- The skills the executive is likely to develop.

There are also the practical considerations including the location and frequency of board meetings, and the likelihood of emergencies arising (for example, if the company is in financial difficulties or is a likely takeover target). Executives may also find it more convenient to take on non-executive positions in companies with a different financial year end to their own company.

Another concern relates to executives serving on the remuneration committees of other companies. The Secretary of State for Business, Innovation & Skills, Vince Cable noted in 2012 that in the FTSE 350 about 6% of remuneration committee members are executives of other companies. He stated that there was a perceived conflict, as those individuals have a personal interest in maintaining the status quo in pay-setting culture and in pay levels, and that the government was looking at mechanisms to limit that.

The FRC was then asked to examine this issue, but concluded that there was virtually no support for a recommendation against executive directors serving as non-executive members of a remuneration committee of another listed company (see *News brief "Corporate governance: the FRC's consultation"*, www.practicallaw.com/2-569-

0063). The FRC's data shows no correlation between the presence or otherwise of these individuals and the levels of dissent on remuneration resolutions. As a result, the FRC did not recommend any changes to the Code to prohibit an executive from serving on the remuneration committee of another company.

SUCCESSION PLANNING

Diversity is often linked with a discussion on succession planning and the role of the nomination committee, with the view that good succession planning should lead to a more diverse board in the long term. According to the Code, it is the role of the whole board to satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, as this will help to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board (*supporting principle to B.2, the Code*). For some companies, succession planning is within the remit of the whole board, while others make this a particular focus of the nomination committee.

Longer term succession planning

Succession planning also means different things to different companies. Some boards focus mainly on the company's directors, looking at when board positions are likely to become vacant and regularly considering the board's composition. Others take a wider view of senior management, regularly examining potential internal candidates who may one day make it to the board and what the company is doing to develop those individuals. One company secretary we spoke to explained that their nomination committee regularly looks at every individual in the company's senior management team and considers who may be able to replace them, both in the long term and also in the event of an emergency.

Overall, boards are taking a more strategic view of succession planning, perhaps because of the increased focus on diversity. Identifying and developing talent at an early stage, coupled with an organisation-wide drive for diversity, helps to increase diversity at board level in the long term.

One example of this is where candidate directors in multinational corporations are required to demonstrate international

experience in the key markets for the company. Identifying talent early, and therefore providing opportunities to travel and work in these markets as early as possible, means that potential candidates would be able to gain international experience at a time when they are likely to be more flexible to travel and spend time overseas.

However, one non-executive director noticed a limitation with succession planning efforts, commenting that smooth succession is often more down to circumstances than planning: a talented candidate is unlikely to wait for a position to become available within their existing company; and timing talent development with availability of positions is often difficult, especially for smaller companies that do not have a wide variety of senior positions.

Chairman succession

While board appointments are generally the responsibility of the nomination committee, the task of replacing the chairman of the board is often led by the senior independent director. Given the close working relationship that often develops between the chairman and the senior independent director, and that a key part of the senior independent director's role is to act as a sounding board for the chairman, it is important for companies to consider and plan the order in which the chairman and the senior independent director approach retirement and replacement.

Ideally, the chairman would retire one year before the senior independent director retires. The senior independent director, who should be familiar with the needs of the company and the culture of the board, should then be able to lead the search for a new chairman. Once the new chairman is appointed, the senior independent director can retire, leaving the new chairman to lead the appointment of the new senior independent director, ensuring that they can work closely and openly together.

Looking ahead

With accounting and audit receiving considerable attention following the accounting scandals of the early 2000s, and the recent focus on remuneration, there are some who feel that succession planning is not getting the right amount of attention at board level and that this is about to change.

The 2013 Grant Thornton report notes the low profile of nomination committees, in contrast

to audit and remuneration committees, and suggests that many companies could improve non-executive and executive director succession planning. Similarly, the FRC has noted that the quality of succession planning has been highlighted as a cause for concern in many contexts during 2013 and that unless they are planning over the medium to long term for both executive and non-executive positions, boards will struggle to ensure that they have the mix of skills and experience they need as the company evolves (*2013 FRC report*). The FRC therefore intends to undertake a project to look at succession planning and the activities of the nomination committee.

ENGAGING WITH SHAREHOLDERS

Engaging with shareholders has always been a cornerstone of the Code: companies are required to engage in a dialogue with shareholders based on the mutual understanding of objectives (*Code provision E.1*).

But over the past few years there has been increasing pressure on shareholders, as well as on companies, to increase engagement levels, in particular following the FRC's publication of the UK Stewardship Code in 2010 and the Kay Review of UK equity markets and long-term decision making in July 2012 (www.practicallaw.com/0-502-8720; see *News brief "Kay review of UK equity markets: impact on UK quoted companies"*, www.practicallaw.com/0-521-0776).

Increasing the levels of dialogue has become more important as shareholders have gained more say in companies' affairs; for example, with the introduction of annual re-election of directors and a binding vote on remuneration policies. However, this trend is not without its pitfalls and risks.

Inappropriate disclosure

Historically, the main form of investor engagement, other than at the AGM, has been by way of investor presentations and roadshows held shortly after the release of financial results. This has generally provided relatively safe ground for directors, as all material financial information would have just been announced and presentations are scripted and rehearsed.

While shareholder engagement is nothing new, the increase in ad hoc meetings increases the risk of inappropriate

disclosure of confidential and potentially “inside” information, especially if the company is contemplating a major transaction, the announcement of which is being legitimately delayed. Most seasoned directors are generally familiar with the restrictions and limitations to which they need to adhere, although newer directors may be less experienced. General counsels and company secretaries should, therefore, consider the composition of the board and provide refresher training as necessary. Similarly, disclosure policies should be kept up to date with best practice, which includes that:

- To the extent possible, meetings and presentations should be scripted in advance, with scripts being reviewed by the company’s in-house legal team and brokers.
- Investors should be asked to provide questions, or at least agenda items, before meetings.
- Meetings with individual shareholders should focus on receiving the shareholder’s views on specific items; for example, the company’s planned remuneration policy.
- No meetings should be held during close periods or in the run-up to announcements.
- All meetings should generally be attended by more than one representative of the company, be it another director, the company secretary, general counsel or the company’s brokers or investor relations consultants.
- Contemporaneous notes should be kept of meetings.

Investors with differing views

A frustration commonly voiced by companies is that each institutional investor does not necessarily speak with one voice. It is not unusual for executive directors to attend a meeting with front-office representatives of the investor who seem happy with the company’s performance and strategy, while the chairman and company secretary will attend a meeting with back-office representatives of the same investor and receive criticism for the company’s compliance and reporting. Although this phenomenon is not new, it is likely to increase as the recent

Practical tips for an audit tender process

There are several practical tips that companies can consider when tendering their audit work:

- **Group-wide involvement:** consulting the CEO and chairman at an early stage for their views on the company’s strategic opportunities and challenges and what they expect from the auditors. Companies with significant international operations should consult individuals from other countries on the potential auditor candidates in their jurisdictions.
- **Planning ahead:** as well as disclosing the intention to audit in advance, companies should try to avoid the audit tender process clashing with other significant events; for example, changes of senior management or significant M&A transactions.
- **Controlling access to individuals:** the Financial Reporting Council suggests the use of procurement specialists, internal or external, to assist with running the process. Thought should also be given to which individuals within the company may be contacted, when, how and for what purposes. Companies should consider the level of internal resources available and ensure that access levels do not place excessive strain on them.
- **Controlling access to information:** when providing information to potential auditors (either directly or through the use of a virtual data room), a company should consult with its lawyers and brokers on whether any information is sensitive and should be excluded, redacted or whether additional undertakings from firms are required. Issues may arise relating to inside information, privilege, data protection or competition law (particularly over details of current or historic audit fee levels and breakdown).
- **Transition plans:** as part of the tender process, companies could ask firms to submit some form of transition plan; for example, asking how would they manage the first 100 days should they be appointed?

changes to reporting standards (such as the requirement for a strategic report) are implemented.

More engagement required

Since the introduction of the UK Stewardship Code in 2010, the FRC has been monitoring its effectiveness and reporting this on an annual basis. In the 2013 FRC report, it notes that investors are finding that companies are generally engaging with them earlier, especially on areas that are potentially contentious, and are more pro-active and flexible in their dealings with shareholders.

However, there seems to be a difference between the engagement of larger companies and smaller ones (starting at the lower end of the FTSE 100), with smaller companies voicing frustration that their requests for engagement are sometimes rebuffed. This is partly due to the stretched resources of investors, who therefore tend to focus on their larger investments.

The Collective Engagement Working Group was formed in April 2013 to try to alleviate this, encouraging investors to engage together with a particular company on a particular issue. In the past, some investors have been concerned that participating in collective engagement could mean that they are considered to be acting in concert with other participating investors. This concern has lessened since the European Securities and Markets Authority issued a public statement in November 2013, that there will be no presumption of acting in concert in respect of activities such as making representations to the company’s board about company policies, practices or particular actions (*Public Statement: Information on shareholder cooperation and acting in concert under the Takeover Bids Directive; European Securities and Markets Authority, November 2013, www.esma.europa.eu/system/files/2013-1642_esma_public_statement_-_information_on_shareholder_cooperation_and_acting_in_concert_under_the_takeover_bids_directive.pdf*).

AUDIT TENDERS

Several new laws and regulations are being proposed, or have already been introduced, imposing requirements for listed companies to periodically tender their audit work. In its 2012 update of the Code, the FRC introduced a new provision requiring FTSE 350 companies to put their audit out for tender every ten years (*Code provision C.3.7*) (www.practicallaw.com/5-521-9557).

This area has also been reviewed by the Competition Commission in 2013 and also the European Commission, which published Directive (2014/56/EU), which amends the Statutory Audit Directive (2006/43/EC) in May 2014 and proposes a requirement for some companies (with longer standing audit relationships) to change their auditors, as well as re-tendering the work (www.practicallaw.com/8-549-7755; www.practicallaw.com/3-568-9648).

The requirement to put audit out to tender has been identified by many companies as one of the key challenges in the corporate governance sphere that will give rise to several practical issues to be addressed by boards at each stage of the process: planning for the tender; running the tender process; and effecting the transition to the new auditor.

Some guidance on how best to run a tender process has been developing, with both the FRC and the Institutional Investor Committee (IIC) publishing papers on this (*Audit Tenders: Notes on best practice*; *Financial Reporting Council*, July 2013, www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Audit-Tenders-Notes-on-best-practice.aspx; *The Audit Tendering Process: The expectations of UK institutional investors*; *Institutional Investor Committee*, May 2014, www.iicomm.org/docs/IIC_The_Audit_Tendering_Process.pdf). However, the task remains a daunting one for companies, particularly for company

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secretaries who tend to run the process on a day-to-day basis (see box "Practical tips for an audit tender process").

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