



Independent Intelligence

Insights for the independent director

Winter 2011



Introduction

FTSE350 and mid-market Independent director (ID) programmes

Today's ID programme must navigate a maze of regulatory and technical challenges, from financial reporting through to fraud.

We understand that the task of keeping up to date with these issues can often be difficult; this is where our ID programmes come into play. We provide comprehensive programmes throughout the UK.

To find out more information about our ID programmes please visit <http://www.ey.com/uk/independentdirectors>

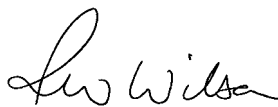
Welcome to the latest edition of Independent Intelligence – another packed edition. New to our usual format, we have an insightful interview with Vanda Murray, an independent director with an impressive portfolio of companies – many AIM listed. She shares her experiences on the new demands of being an ID as well as tips for those aspiring to the role.

The article on the FRC's latest thinking on the company stewardship is a good way to understand the recent outputs from the FRC and what the high level implications are for you as an ID. I would also urge those of you on remuneration committees to read InSights which addresses the four specific roles for audit committees around remuneration oversight – particularly important at a time when compensation issues are being increasingly scrutinised by media and shareholders alike.

In the rest of the magazine, we continue to look at macro economic and regulatory issues which are of interest to you in your role as an ID. The top 10 business risks and opportunities report explores the key drivers of growth, given tough market conditions. Meanwhile, the fifth capital confidence barometer gauges corporate confidence in the economic outlook and highlights key trends. Finally, the Fraud Survey continues to analyse the impact of a challenging business environment and increasingly stringent legislation on businesses and their anti-bribery policies and procedures.

I hope you enjoy this edition and if you wish to read any of the reports in full, please contact the team at neds@uk.ey.com.

Regards



Richard Wilson

Chairman, Ernst & Young Independent Director Programme and Co-chairman of the Audit Committee Chair Forum



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To be an independent director...

An interview with Vanda Murray

Vanda Murray

Independent Director



Vanda Murray, OBE has been an independent director since 2006. She has a portfolio of non-executive directorships including: Carillon plc, Chemring plc, VPhase plc and Manchester Airport Group plc. She is also Chair of Business Link North West and Deputy Chair of the North West Development Agency. Here, she talks to us about her experiences as an independent director and provides some tips for aspiring non-executives.

Q: How do you think the role of non-executive director has changed in recent years?

A: Companies are expecting more from their non-executives. The responsibilities of the role have increased, partly in line with corporate governance requirements. Developments like the Bribery Act in the UK have placed new burdens on board directors. But while the responsibilities have increased, fundamentally the role has remained the same. To me it's about four things: strategy; performance; risk and people. As a non-executive director, you should have a view on all of those aspects of a company.

The days when board members were all friends of the chairman have long gone. There are signs that companies are starting to cast the net more widely and that's very encouraging. But at the same time as boards are becoming more diverse, the role is also becoming more demanding. Today, it's a pretty lengthy process to be appointed as a non-executive director and it's a role that is closely scrutinised.

I also think that the type of person looking to hold non-executive directorships has changed. At one point it was something that you did at the end of your career. And, while that's still true for some people, who often have an enormous amount to contribute, there are more and more people who choose to become a non-executive at an earlier stage.

Q: What is the secret to being a good independent director?

A: A good non-executive asks the right questions and is not prepared to give up if they don't get the assurance that they're seeking. You need to oversee the performance of the company to make sure it's doing the right things, and provide the relevant level of challenge for the executive team to make sure that the business really understands the implications and risks of the decisions it is taking. That process improves a company's decision-making and will, I believe, drive the success of the business in the long term.

If you're going to perform the role well, then you need to do more than just turn up for board meetings. You've got to connect with the company outside the boardroom, engage with managers and people across the organisation so that you develop a good understanding of the company. Your commitment to the business has to be pretty solid and you have to be willing to spend more time if there is a particular issue or challenge that the business is facing.

One of the reasons why I enjoy the work is that, as a non-executive, you work across a range and variety of businesses with different challenges. You get to work at a senior level with interesting people and use your own experience and skills, hopefully to the benefit of that company.

Q: Is it appropriate for executives to take on non-executive roles, or will that place them under too much pressure?

A: There are times in your executive career when it's appropriate to take on an additional commitment and times when it isn't. If your own company is going through a difficult time, then that's clearly not the moment to go off and give more than 5%-10% of your time somewhere else. But if it is more stable, then as a personal development activity I would recommend becoming an independent director very highly. And looking at it from the other perspective, it's always good to have someone on the Board as a non-executive director who is also a serving chief executive.

Q: Should non-executives try to stay in the same industry or apply their skills and experience in other sectors?

A: It's always nice to use your skills in the industry where you've spent your executive career, but if you want more than one non-exec role then you're usually restricted because of conflict of interest issues. So if you want to take on multiple directorships, you will almost always have to step into another industry. That can be a positive thing, because you can come to the industry with no preconceptions. Again,

from the perspective of the board, it's good to have a mix of people who are industry specialists and those who might bring a fresh outlook.

Q: What would be your advice to someone who is seeking to build a portfolio of non-executive roles in future?

A: I would urge them to get experience on a not-for-profit board or in the public sector to get a feel for the non-executive role. This can also help you enormously in your executive career because it helps to build your experience. If necessary, go on courses and get the relevant qualifications. Once you've done that, you can visit the recruitment consultants and make sure that people know you're on the radar. Networking events can also be very helpful to raise your profile.

Turn risks and opportunities into results

Exploring the top 10 risks and opportunities for global organisations

Gerard Gallagher

Head of Markets for
UK&I Advisory



While risk continues to dominate the business agenda, competition is becoming just as dominant a feature. Market volatility, pricing pressure, variations in market performance, demanding stakeholders – all have contributed to a global economy that encourages competitive drive. And with that drive comes opportunity.

The seven sectors researched were:

Banking	Oil and gas
Government and public sector	Power and utilities
Health care	Retail and wholesale trade
Life sciences	

The top 10 risks for 2011, in rank order

1. Regulation and compliance

Unchanged from number one in the 2010 report

In four out of seven sectors we surveyed, regulation and compliance risks rank first. Furthermore, the two sectors that rate the impact highest see risk levels rising still further by 2013. (Forecast for 2013: no change from the current ranking.)

2. Cost cutting

Up four places from the 2010 report

Much of the pressure driving the rise of cost cutting appears to originate from government austerity programs. The most frequently reported mitigation strategy is process optimisation. (Forecast for 2013: falling from the current ranking.)

3. Managing talent

Up one place from the 2010 report

While never first, in almost all sectors human resources risks rank among the top four challenges. Many of the geographies where the risk is of particular concern are emerging markets. (Forecast for 2013: rising from the current ranking.)

4. Pricing pressure

Up 11 places from the 2010 report (where it was below the radar in fifteenth place)

Organisations in many sectors are facing mature markets and slow organic growth rates, and thus pressure on prices. Additionally, like cost cutting, national austerity programs seem to be a driver of this risk. (Forecast for 2013: falling from the current ranking.)

5. Emerging technologies

Up eight places from the 2010 report

The most frequently reported drivers in developing an innovation culture and uncertainties inherent in untested technologies. (Forecast for 2013: rising from the current ranking.)

6. Market risks

New this year

Market risks are a new entrant to the radar, combining issues such as commodity price shocks and real estate market volatility. Mitigation strategies based on active monitoring are most frequently reported. (Forecast for 2013: rising from the current ranking.)

7. Expansion of government's role

New this year

Another new entrant to the radar, expanding government ranks among the top four concerns of respondents from the world's two largest economies, the US and China. (Forecast for 2013: rising from the current ranking.)

8. Slow recovery/double-dip recession

Down five places from the 2010 report.

Economic risks have fallen, as expectations of recovery have risen. Still, 50% of respondents from Germany report concerns related to fiscal tightening, and 50% of US respondents report continued weakness in private demand. (Forecast for 2013: falling from the current ranking.)

9. Social acceptance risk/CSR

Unchanged from nine in 2010.

Oil and gas, life sciences and public administration respondents are most likely to report a rise in public pressures on their sector. The most frequently reported response is the integration of CSR into strategy. (Forecast for 2013: rising from the current ranking.)

10. Access to credit

Up eight places from the 2010 report.

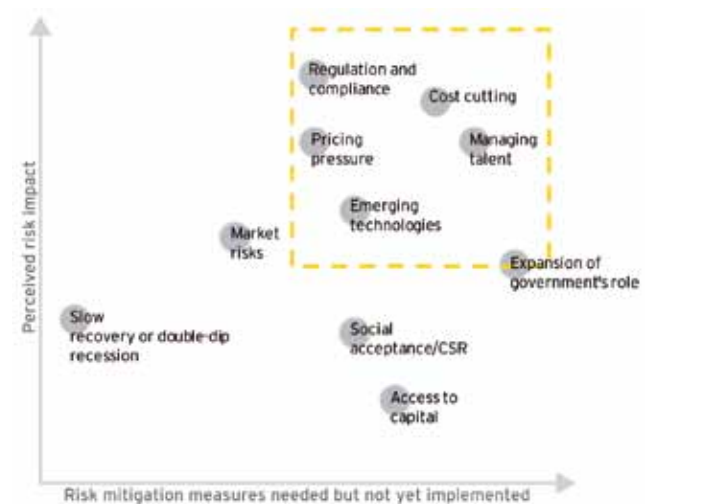
Concerns about access to credit have abated overall. Still, one in four organisations worldwide report ongoing struggles to obtain the credit they need. (Forecast for 2013: rising from the current ranking.)

Ernst & Young Sector Risk Radar

Top 10 global business risks



Ernst & Young Risk Heat Map



“In the last two years competitive advantage has come mostly from managing risks better than your competitors. There’s been a lot of focus on this, but it won’t be enough going forward. You also need to understand the opportunities resulting from the current business climate and execute these better than your competitors.”

Gerard Gallager

“A lot of companies talk about moving into emerging markets, but nowhere near enough actually do it. In many emerging markets, first-mover advantage is critical, so organisations should be developing and executing their expansion strategies now.”

Gerard Gallager

The top 10 opportunities in rank order

1. Improving execution of strategy across business functions

The most frequently cited successful response to this opportunity is to enhance strategic communication. Respondents located in China are more likely to emphasize the development of the strategic planning function as a key to success. (Forecast for 2013: no change from the current ranking.)

2. Investing in process, tools and training to achieve greater productivity

The sectors vary in the degree to which cost optimisation or staff developments are emphasized in seeking productivity. Overall, the banking and public administration sectors report the greatest barriers to productivity improvements. (Forecast for 2013: rising from the current ranking.)

3. Investing in IT

Across Europe and the US, investing in IT is typically either the top or second-highest priority for executives. In China, Russia, and India, however, IT tends to rank further down the list. (Forecast for 2013: falling from the current ranking.)

4. Innovating in products, services and operations

Respondents identified four key barriers to innovation success: lack of focus or investment, excessive conservatism, lack of sufficient expertise and inflexibility. Life sciences firms lead the way in incorporating innovation into core strategy. (Forecast for 2013: rising from the current ranking.)

5. Emerging market demand growth

One in five organisations surveyed reported scaling back in Asia, following setbacks there. Initial unrealistic expectations are being replaced by long-term commitments. (Forecast for 2013: rising from the current ranking.)

"We've noticed that our clients who are doing really well are very focused on delivering their core strategy, rather than allowing themselves to be distracted by perceived risks or continuing with 'deep recession' tactics, even after the economy has started to recover. Over the last two years another feature which is influencing confidence inside organisations, is what I call 'Homeland Pessimism', sometimes it is hard to see the upside and opportunities around the globe if your home market is struggling."

Gerard Gallager

6. Investing in cleantech

The opportunity from cleantech tends to vary depending on an organisation's country and sector. Respondents from China were the most likely to see the need to adapt corporate cultures and strategies to prioritise cleantech in coming years. (Forecast for 2013: rising from the current ranking.)

7. Excellence in investor relations

Although not the number one strategic initiative in any sector, banking and power and utilities respondents give particular priority to investor relations. (Forecast for 2013: rising from the current ranking.)

8. New marketing channels

New marketing channels include social media, web 2.0, email, mobile marketing, search and apps. These channels are notably of interest to executives in the US, China and Russia. (Forecast for 2013: rising from the current ranking.)

9. Mergers and acquisitions

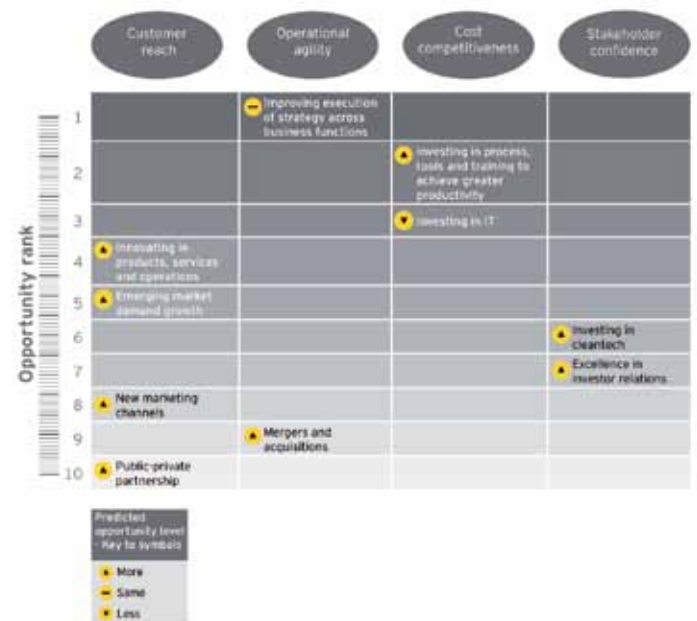
Lack of experience is the most frequently reported perceived obstacle to success in M&A, while the desire to enter new markets is the strategic goal most frequently pursued via acquisition. (Forecast for 2013: rising from the current ranking.)

10. Public-private partnership

Increasing government intervention in markets appears not only on our risk radar, but also on our opportunity ladder. This was due in part to significant interest from respondents in the health care sector. (Forecast for 2013: rising from the current ranking.)

For a copy of the full report, please visit www.ey.com/uk/id or contact neds@uk.ey.com

Ernst & Young Opportunity Ladder Top 10 global business opportunities



Ernst & Young Opportunity Heat Map



European fraud survey 2011

Recovery, regulation and integrity

Competitive success is proving elusive for many firms and pursuing the three fundamental drivers of organic growth – entering new markets, creating new products or services, and developing the new skills required to deliver enhanced or cheaper offerings – is becoming even harder.

At the same time, tougher anti-bribery legislation such as the UK Bribery Act, increases demands put on companies to re-evaluate ethical guidelines and understand the risk of bribery in all facets of the business.

So the incentives to commit fraud or act unethically remain high, while the potential risks of non-compliance with legislation have never been higher.

In summary, our findings are:

A fragile and slow recovery

While there is a general consensus that the worst has now passed, those interviewed for our current survey remain negative about the economic prospects for the next 12 months. For example, 64% expect more companies to get into financial difficulties in the coming year. This is an improvement on the outlook expressed two years ago, but clearly acknowledges the pressures that businesses face.

Businesses continue to focus on cost-cutting, which is seen as a major challenge by 60% of our respondents. This will, inevitably, place pressure on non-revenue generating functions such as Internal Audit and Compliance that are so critical in managing the risks of fraud, bribery and corruption.

The pressure to comply with regulations is seen as a significant burden by only about a quarter of our respondents. This response may be understandable given businesses' recent focus on their day-to-day survival. However, it fails to recognise the significant regulatory challenges and compliance risks that businesses are likely to face.

Unethical behaviour still tolerated

Companies must be prepared for the challenges posed by greater regulatory scrutiny. However, our survey indicates that a large proportion remains tolerant of unethical conduct across all levels of organisations:

- ▶ Almost one in five company employees, regardless of grade, consider it acceptable to pay bribes to win or retain business.

This is not new. This finding is similar to the results from our survey in 2009. It does, however, indicate that companies are not making progress in strengthening their ethical culture.

This internal change must come, of course, through the establishment of the proper tone at the top of each organisation.

The following responses indicate that this will be a major challenge:

- ▶ A quarter of our respondents do not trust their management to behave ethically.
- ▶ 59% of those interviewed expect management to cut corners in order to achieve targets, and half of management agrees.

Bribery and corruption still widespread

The fragile market conditions and the ethically challenged culture of companies may create an environment conducive to fraud, bribery and corruption.

- ▶ Two-thirds of those interviewed informed us that bribery and corruption are widespread in their country; a situation that, according to 40% of them, has become worse during the economic downturn.

However, our respondents are not as concerned about bribery in their sector.

- ▶ Three-quarters of our respondents do not believe that bribery and corruption is a widespread issue in their sector.

If employees believe that bribery is someone else's problem, there is a very real risk that such unethical behaviour will go unidentified and unchallenged.

Major gaps in the corporate response to fraud and corruption

Our survey indicates that many companies have a long way to go to address the challenges of fraud and corruption. Fraud remains a very real risk in the current environment, and companies are still failing to address this risk in a robust manner.

Fewer respondents think that their companies have anti-fraud measures in place than two years ago. Almost one company in 10 apparently has no anti-fraud measure in place at all.

This indicates a lack of attention to fraud and is a particularly concerning decline given its coincidence with a period of economic slowdown during which the risk of fraud, bribery and corruption is elevated.

- ▶ Only 56% of those interviewed are aware that their company has an anti-bribery policy.
- ▶ Only approximately one-third thinks that the policy contains clear guidance.

Anti-bribery training has declined at a time when there is increasing extraterritorial enforcement under anti-bribery statutes such as the US foreign corrupt practices act (FCPA) and the UK Bribery Act. This lack of employee training may expose more of these companies to prosecution.

Companies are failing to provide those individuals who potentially present the greatest bribery risks with appropriate anti-bribery training and communication.

- ▶ Almost a quarter of sales, marketing and business development respondents cannot see the relevance of their company's anti-bribery policy to them.

Integrity delivers business benefits

Our survey indicates that real business benefits can be achieved by companies that act with integrity:

- ▶ Two-thirds of our respondents agree that there are commercial advantages for companies with strong reputations for ethical behaviour.
- ▶ 45% would be unwilling to work for a company involved in a major bribery or corruption scandal.
- ▶ 53% of respondents state that they would be unwilling to hire suppliers or agents involved in a major bribery or corruption case.

Employees backing greater regulation

In the absence of an effective internal response to fraud, bribery and corruption, employees are looking to regulators to accomplish what their management has failed to do.

The proportion of respondents agreeing strongly that there should be more supervision by regulators has more than tripled since our 2009 survey, increasing from 13% to 45%. In addition:

- ▶ 68% believe that regulators are either unwilling to pursue convictions for bribery and corruption offenses or are ineffective in doing so.

These respondents recognise, however, that regulators face significant challenges in this area:

- ▶ 53% think that bribery and corruption is too widespread to be tackled.
- ▶ 30% believe that regulators lack the necessary legal powers.
- ▶ 28% believe that regulators lack the necessary resources.

In an environment of shrinking governmental budgets, this situation is likely to get worse.

Governments may be tempted to water down legislation or reduce enforcement for fear of damaging businesses in a weak economy.

Our respondents do not share this caution:

- ▶ 70% of our respondents think that new anti-bribery legislation would have little impact on economic growth: a positive message for companies and governments to note.

Summary

Our survey indicates that the corporate response to fraud, bribery and corruption continues to face serious challenges and clearly expose companies to heightened financial, regulatory and reputational risk.

There must be a response from audit committee and board level management to:

- ▶ Make ethical behaviour a priority for the business and demonstrate its commitment to achieving this objective.
- ▶ Conduct a fraud, bribery and corruption risk assessment and identify gaps in current policies and procedures.
- ▶ Where necessary, modify and develop policies and procedures.
- ▶ Implement changes pay particular attention to training.

For a copy of the full survey and more information on how your company can address these challenges, please visit www.ey.com/uk/id or contact neds@uk.ey.com

Four specific roles for audit committees in remuneration oversight

“The board as a whole is responsible for pay, but there has to be interplay between the committees who advise the board. The remuneration committee has primary responsibility, but it has to work with the other committees, including the audit committee, that are looking at major risks in the company and the company strategy.”

Investor

Audit committees have not traditionally played an active role in remuneration oversight. But there are signs that this might change in future. With executive compensation becoming a key area of reputational risk for companies, boards are paying closer attention to pay practices. For audit committees, there are now four specific areas where they can be involved as an advisor to the main board:

- ▶ Ensuring links between pay and risk are understood.
- ▶ Helping to link pay plans with the company's strategic goals.
- ▶ Providing insight into complex metric and accounting issues.
- ▶ Taking a broader review of remuneration disclosures.

These are the key findings of research commissioned by Ernst & Young among audit committee chairs, board directors, investors, regulators, audit executives, academics and other subject matter professionals across Europe. The research, undertaken by Tapestry Networks, set out to determine how leading audit committees are currently engaging in oversight of remuneration. Other key findings include the following:

Remuneration risk has been elevated on the governance agenda. Executive compensation has long been a key topic for discussion with investors but companies must now take a broader range of stakeholders into account. Regulators, in particular, have surpassed investors in driving reform of remuneration plans and disclosure, which creates its own risks for companies. Meanwhile, media coverage of pay packages has become a key source of reputational risk. This intense scrutiny and heightened risk has elevated remuneration to the top of the governance agenda and it is now often a matter for the full board.

Increased scrutiny and risk have led to specific audit committee roles in remuneration oversight. While the remuneration committee continues to be the primary oversight body, audit committee members can also play a prominent role. Their accounting and financial expertise means that they can help their boards to understand the linkages between pay and risk and ensure that performance metrics are aligned with the strategic goals of the company. Audit committees can also validate pay metrics and ensure that messages to the market are valid and consistent.

The role of the audit committee in remuneration oversight could become more formal over time. Although the role of audit committee in remuneration is not formalised, boards are ensuring that there are connections in place between audit and remuneration committees. This might include overlapping committee membership between the two or close partnership and cooperation between committee chairs. Over time, we may see audit committees playing a more formal role in remuneration oversight as regulators continue to seek ways to improve corporate governance in Europe.

For a copy of the full report, please visit www.ey.com/uk/id or contact neds@uk.ey.com

About Tapestry Networks

Tapestry Networks is a privately held professional services firm that brings leaders together to solve complex problems. Since 2002, networks convened by Tapestry Networks have tackled some of the most significant strategic challenges facing institutions and society, including raising standards in corporate governance in the United States, Canada and Europe, developing strategies for a more sustainable health care environment in Europe, and enhancing national security in the United States through public-private collaboration. Tapestry Networks convenes eight audit committee networks sponsored by Ernst & Young that collectively consist of chairs of more than 200 audit committees who sit on over 320 boards at some of the world's most admired companies. For more information, please visit www.tapestrynetworks.com

About this document

InSights is produced by Tapestry Networks to provide assessments of key issues of interest to audit committee members in Europe. It will be distributed by Ernst & Young and Tapestry Networks. Anyone who receives *InSights* may share it with those in their own network. The ultimate value of *InSights* lies in its power to help all constituencies develop their own informed points of view.

The views expressed in this document represent those of the individuals who participated in the research. They do not reflect the views nor constitute the advice of network members, their companies, Ernst & Young or Tapestry Networks.

Capital confidence barometer

A new paradigm?

Global M&A activity and volatility coexist

Our fifth Capital Confidence Barometer predicts a new paradigm: Corporate M&A activity and extreme market volatility coexisting. There is a surprisingly stable appetite to do deals over the next 12 months as top global corporates remain resilient to the market turbulence.

But why is that the case when we are in the midst of market upheaval and weakening global growth? Because this is not 2008 all over again. Leading corporates have spent three years focusing on reducing financial risk, operational fitness and learning to live with volatility:

- ▶ Balance sheets are stronger with less leverage.
- ▶ Companies have re-financed to improve their capital structures, reduced interest costs and extended maturities.
- ▶ Many companies can draw upon cash war chests.
- ▶ Earnings growth outlook is positive.

Consequently, the focus is now clearly on growth, with the fewest number of respondents since 2009 focusing on survival. We also see an increased consensus around asset values, resulting in a 30% rise in potential sellers coming to the table globally.

All of this is fostering a favourable environment for M&A – but some barriers do remain. Mounting regulatory pressures could potentially impede growth, and there is the fundamental question of the economy. While our respondents' M&A attitudes are remarkably robust given the current environment, a slump into a double-dip global recession or another banking crisis would mean all bets are off.

However, for the time being, our respondents have learned how to manage in volatility: they have the capability – and ambition – to do strategic deals in the current climate.

About this survey

The Confidence Barometer is a regular survey of senior executives from large companies around the world conducted by the Economist Intelligence Unit (EIU).

Our panel, the 'Ernst & Young 1,000' is comprised of selected Ernst & Young clients and contacts and regular EIU contributors.

This snapshot of our findings gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their capital agenda.

FRC's latest thinking on company stewardship

Andrew Hobbs

Associate Partner,
Regulatory and
Public Policy



In September 2011 the FRC issued a set of proposals in response to feedback on its earlier consultation paper: *Effective Company Stewardship: Enhancing Corporate Reporting and Audit, January 2011*. The output reflects lessons learned from the financial crisis, and provides a follow-up from last year's revisions to the UK Corporate Governance Code, and the introduction of the Stewardship Code for institutional investors. The paper is called *Effective Company Stewardship Next Steps, September 2011*.

It should also be noted, for future reference, that a second report was also published by the FRC in September. Called *Boards and Risk*, it summarises output from various discussion groups on risk management. Although this did not make any recommendations, it will be used to inform the FRC's future plans in regards to the Turnbull Guidance. For this reason we have chosen to focus this article on the stewardship report, and we will cover the outcome from the risk paper when changes to Turnbull are proposed.

David Parrish

Senior Manager
Regulatory and
Public Policy



Effective company stewardship

In essence, the new proposals seek to ensure that every aspect of the annual report and accounts are balanced and fair, including the narrative. To this end the FRC proposes that audit committees should satisfy themselves that the report and accounts meet this criteria, explaining their viewpoint in a committee report which is then attested by the external auditor prior to publication in the same annual report.

The FRC sought to develop these proposals because it reviewed a sample of reports and accounts and found that nearly two thirds fell short of its expectations in various areas, including the reporting of principal risks. The plan now is for the FRC to work closely with BIS, to help it develop its new reporting framework, whilst developing model standards for narrative reporting and hosting its new reporting lab. The lab is an environment where investors and companies can come together, to develop and test new reporting formats.

The FRC's stewardship proposals can be distilled into three main categories, each with the following aims:

Narrative reporting

- ▶ To help ensure that narrative reports focus on strategic risks rather than operational ones.
- ▶ To explore the feasibility of introducing standards for narrative reporting.
- ▶ To run a reporting lab and support the government's reporting framework.
- ▶ To update the Turnbull guidance on risk, and consider changes to the UK corporate governance code following the Sharman inquiry into going concern and liquidity risk.

Audit committees

- ▶ To extend the scope of the audit committee, so it assesses the fairness and balance of the report and accounts in totality.
- ▶ To require the committee to report to the whole board and, after its report is accepted by the board, to ensure its report is attested by an external auditor (for completeness and reasonableness) and then published in the annual report and accounts.
- ▶ To develop and consult on revisions to the UK Corporate Governance Code and related guidance for audit committees.

Audit

- ▶ To help ensure auditors show clearly that they have checked independently a company's financial statements (e.g., including the decisions, judgements and estimates) and they have checked to make sure that the report has been properly prepared and is fair and balanced.
- ▶ To encourage auditors to provide more insight into the audit process, to reassure users of financial statements that all material matters have been properly disclosed.
- ▶ To address the need for the contribution by auditors to be more transparent to the audit committee, with proposals to review and consult on revisions to the auditing standards governing reporting by auditors to audit committees (ISA (UK and Ireland) 260) and audit reports (ISA (UK and Ireland) 700).
- ▶ To require companies to put their audits out to tender at least once every 10 years, or explain why they have chosen not to do so.

This article provides a selective high-level summary of the FRC's proposals, and as such it is no substitute for reading the FRC reports in full. If you have not already done so, we strongly recommend that you to visit the FRC's website and read each report. The combined effect of these proposals could have a significant bearing on the future role of the audit committee.

Regulatory snapshot

FRC publishes proposals on corporate stewardship, to help increase transparency in corporate reporting

According to two new reports published by the financial reporting council (FRC), companies should improve the way they report to investors. The FRC's proposals seek to ensure that every aspect of the annual report and accounts are balanced and fair, including the narrative. To this end the FRC proposes that audit committees should satisfy themselves that the report and accounts meet this criteria (e.g., by only reporting on risks which are strategic and/or operationally significant).

The reports are:

- ▶ **Effective company stewardship: Next steps**, which is the FRC's response to over 100 submissions to its consultation published in January 2011.
- ▶ **Boards and Risk**, which summarises detailed discussions the FRC has held over the past six months with directors and specialists from listed companies.

UK government publishes proposals for a new corporate reporting framework

The Department for Business, Innovation and Skills (BIS) has published proposals aimed at improving the UK's narrative reporting framework. The consultation seeks to simplify the reporting requirements for companies with the introduction of a Strategic Report and Directors Statement. The former aims to cover strategy, results and risks. The latter is proposed as a replacement for the Business Review and Director's Report.

It is proposed that the directors disclose how they check and verify information used in the narrative report, and audit committees review the balance and fairness of the annual report in its entirety, and then publish their findings. The overall aim is to increase transparency and accountability in the investment chain to enable shareholders to get a real picture of what is happening to inform their investment decisions.

The Kay review

The Kay review raises questions about long-term decisions in the UK equities market. It recognises the importance of strong corporate governance and the need to emphasise long-term value creation. It will review ways in which the mechanisms of control and accountability provided by UK equity markets, and the behaviour of the agents in that process, affect the performance of UK businesses. The review will give particular emphasis to the ability of managers to focus on the actions needed to enhance long-term competitiveness.

About Ernst & Young

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