

Stephen Haddrill
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By e-mail: effectivestewardship@frc.org.uk

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Dear Mr Haddrill,

Response to the consultation paper on Effective Company Stewardship, Enhancing Corporate Reporting and Audit

Smith & Nephew plc welcomes the opportunity to respond to the consultation paper on Effective Company Stewardship, Enhancing Corporate Reporting and Audit. Smith & Nephew plc is a UK FTSE 100 company, with a secondary listing on the New York Stock Exchange. We have around 22,000 registered shareholders and operate in over 30 countries across the world.

General Comments

Before commenting on the specific issues raised in the consultation document, we would have the following general points to make:

- 1) We note that the consultation paper makes the assumption that there is something wrong with the current system of corporate reporting and audit. We are not convinced that the current economic situation is due to any failure in corporate reporting and audit and we note that the paper acknowledges this.
- 2) We also note that there are currently a number of other initiatives elsewhere on closely related topics. Notably the BIS consultation into Narrative Reporting, the EC Green Paper on Audit Policy, and the expected EC consultation into Corporate Governance in Listed Companies. We would suggest that all these initiatives are co-ordinated so that, as far as possible, common conclusions may be drawn. One of the reasons that Annual Reports are long and unwieldy is that companies, particularly those with US listings, have to comply with many different laws, regulations and guidelines and this lengthens the report. Co-ordination between different bodies could assist in producing a more coherent set of requirements
- 3) There seems to be a tension in the consultation paper between a desire to cut down on excessive boilerplate, repetitive or unfocussed reporting by companies and at the same time a requirement to describe processes and activities in greater detail. It is not clear how these two aims can be reconciled.

- 4) We believe that in discussion about what should be included in the Annual Report, it is important to bear in mind the purpose of the Annual Report and the end user. Whilst the Annual Report is consulted and used by many different groups, including customers, suppliers, employees, the wider community and those with environmental or other CSR type concerns, the prime purpose of the Annual Report is to report to the shareholders of the company. Whilst (paraphrasing S172 of the Companies Act), Annual Reports should have regard to the interests of these other groups, the prime purpose should remain to report to shareholders. Other means may be used to communicate with other groups, which should mean that Annual Reports could be “de-cluttered”.

We have the following comments on the specific recommendations in the paper:

Recommendation 1: Directors should take full responsibility for ensuring that an Annual Report, viewed as a whole, provides a fair and balanced report on their stewardship of the business.

We believe that Directors already take full responsibility for ensuring that the Annual Report, viewed as a whole, provides a fair and balanced report on their stewardship of the business.

Recommendation 2: Directors should describe in more detail the steps that they take to ensure: the reliability of the information on which the management of a company, and therefore directors’ stewardship of the company, is based: and transparency about the activities of the business and any associated risks,

We do not believe that there is any need for additional processes and reporting. We would caution that further disclosure requirements would lead to boilerplate reporting with companies all writing much the same thing.

We also believe that there is a conflict between “describing in detail” and “transparency”. In many cases, greater transparency is achieved through less detail and more focus.

Recommendation 3: The growing strength of Audit Committees in holding management and auditors to account should be reinforced by greater transparency through fuller reports by Audit Committee and an expanded Audit Report.

We have a number of concerns with this proposal. It is not the role of the Audit Committee to hold “management and auditors to account”. This is contrary to the concept of a unitary Board. The key to an effective Audit Committee is the skills and independence of its members and the “tone at the top” set by the Chairman, Chief Executive and Chief Financial Officer. These issues are not addressed by requiring fuller Audit Committee Reports.

We would be concerned that the requirement for fuller Audit Committee Reports will lead to lengthier Annual Reports. We have all seen how the length of Remuneration Reports have grown in recent years, to the extent that many now call for more concise reports with less detail. We can see Audit Committee Reports following the same pattern. We also suspect that the wording in these reports will differ little from company to company resulting in more boilerplate reporting, which will be of limited use to investors, other than those who take a “box-ticking” approach to corporate governance.

We would not support the proposal that auditors be required to comment on the completeness and reasonableness of the Audit Committee Report. "Reasonableness" is a difficult concept to define and this will lead to further audit processes and higher fees. We also suspect that auditors will only sign off on "reasonableness" having previously obtained representations from the members of the Audit Committee, which frankly does not add very much to the assurances being given to shareholders and other users of the Annual Report.

We note that the auditors already review the Annual Report to ensure that it is consistent with the information contained in the financial statements.

Recommendation 4: Companies should take advantage of technological developments to increase the accessibility of the Annual Report and its components.

We fully support the recommendations to use technological developments to increase the accessibility of the Annual Report and its components. We would also support the proposals put forward elsewhere to use websites to store standing information about a company and to use the Annual Report itself to concentrate mainly on the information that changes from year to year. We do recognise that this would require a substantial change to the processes both within companies and by those who use the Annual Report and that this may not be welcome for all. We would therefore suggest that Companies should be encouraged but not compelled to take advantage of technological developments, in the early years.

Recommendation 5: There should be greater investor involvement in the process by which auditors are appointed.

Investors currently have the opportunity at every Annual General Meeting to vote for against the re-appointment of auditors. We do not believe that any further involvement from investors is required in the process. Shareholders delegate the management of the company and, with it, the appointment of the auditors to the Board. Shareholders are free to (and do) raise any issue they may have with the selection of a particular firm of auditors with the Chairman of the Board or of the Audit Committee.

Recommendation 6: The FRC's responsibilities should be developed to enable it to support and oversee the effective implementation of its proposals.

Our response to this particular question rather depends on the extent to which the other recommendations in the paper are implemented or not.

Recommendation 7: The FRC should establish a market participants group to advise it on market developments and international initiatives in the area of corporate reporting and the role of assurance and on promoting good practice.

We understand that there are already a number of cross market groups, for example, the KPMG Audit Committee Institute which consider market developments and international initiatives in this area and are not sure what more can be achieved by an additional forum.

If you would like to discuss any of these points further, we would be happy to do so.

Yours faithfully

Susan M. Henderson

Susan Henderson
Company Secretary