



Evaluating Board Reviews

‘With Board Reviews now seemingly such an established part of the board’s annual cycle – and given the commitment of time and resources that a board is undertaking when embarking on a Review exercise – it is incumbent on all of those working in this space to focus on moving the practice forward.’

Philip Sydney

Governance of large private UK companies

‘I find the Wates Principles refreshingly simple and uncomplicated. They provide scope for each company to clearly articulate their enterprise processes and attitudes that add value to their business, help build its reputation and ensure long-term continuity and success. That is the essence of good governance and if companies cannot clearly articulate that for themselves that should be a red-flag.’

Vanessa Jones

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Governance of large private UK companies

Vanessa Jones takes a detailed look at the new Wates Principles on the governance of large private companies in the UK which the FRC issued for consultation last month.

Since the Government's 2016 Green Paper on Corporate Governance it feels as if we have been waiting a long time for a code of governance for large private companies. The House of Commons Business, Energy and Industrial Strategy Committees published its corporate governance report in April 2017 and considered the need for improved transparency and accountability for large private companies. The Committee recommended that the Financial Reporting Council (FRC) and others develop an appropriate corporate governance code with which the largest private companies would be expected to comply. So in November 2017, the FRC established a Coalition Group for developing corporate governance principles for large companies and in January 2018 James Wates CBE was appointed as Chairman of the Coalition Group.

On 13 June the FRC published a consultation on the long awaited Wates Corporate Governance Principles for Large Private Companies (Wates Principles). Just a couple of days before on 11 June 2018, amendments to the 'Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008' were laid in Parliament by way of a draft Statutory Instrument (The Companies (Miscellaneous Reporting) Regulations 2018) and accompanying FAQs document.

This new reporting requirement applies to all companies that satisfy either or both of the following conditions:

- more than 2,000 employees;
- a turnover of more than £200 million, and a balance sheet of more than £2 billion.

The Government's regulatory requirement will require companies to include a statement within their directors' report that details which, if any, corporate governance code the company applies and how the company applies that corporate governance code. So this is an 'apply and explain' framework and not a 'comply or explain' framework which is the reporting model used for the UK Corporate Governance Code for premium listed companies. This is a key difference and perhaps the most significant development in the Wates Principles. This new reporting requirement will apply to financial years from and beginning 1 January 2019.

Additional disclosures

If companies meet the relevant thresholds above (there is useful guidance on this in the FAQs document), companies will be required to make additional disclosures regarding:

- how the directors have had regard to the matters in section 172(1) of the Companies Act 2006;
- how the directors have engaged with employees;
- how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others;
- which corporate governance code (not necessarily the Wates Principles), if any, has been applied and how.

Large private companies and unlisted PLC's will need to make their section 172(1) statement and their corporate governance statement available on a website as soon as reasonably practicable.

What are the Wates Principles?

The Wates Principles are voluntary principles intended to assist companies in this new reporting requirement. The Wates Principles are currently under consultation and have already been through a robust process of the Coalition Group (made up of representatives from a wide and diverse range of industry, representative and professional bodies). Responses to the consultation are requested by 7 September 2018 and the final principles and guidance may be published later in 2018. The Wates Principles consultation is seeking feedback as to whether the principles are aimed at a sufficient level that enables fulsome application by large private companies, or areas where this could be improved. So it is well worth contributing to this consultation as things are not yet cast in stone.

There are six principles and each principle is supported by guidance:

1. *Purpose*: An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.
2. *Composition*: Effective board composition requires an effective Chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.
3. *Responsibilities*: A board should have a clear understanding of its accountability and terms of reference. Its policies and procedures should support effective decision-making and independent challenge.
4. *Opportunity and risk*: A board should promote the long-term success of the company by identifying opportunities to create value, and establishing oversight for the identification and mitigation of risks.

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5. *Remuneration*: A board should promote executive remuneration structures aligned to the sustainable long-term success of a company, taking into account pay and conditions elsewhere in the company.
6. *Stakeholders*: A board has a responsibility to oversee meaningful engagement with material stakeholders, including the workforce, and have regard to that discussion when taking decisions. The board has a responsibility to foster good stakeholder relationships based on the company's purpose.

The guidance is not intended to encourage a 'tick-box' approach and reporters under the Wates Principles will be encouraged to demonstrate, through a written explanation in their directors' report and on their corporate website, how the application of the Wates Principles has resulted in improved corporate governance outcomes.

So the new reporting requirements are real and the Wates Principles are in consultation mode currently to help support the new reporting requirement by adopting best practice corporate governance within large private UK companies.

Apply and explain

The UK Corporate Governance Code works on the principle of 'comply or explain' meaning that a company need only go into detail when there has been non-compliance within a particular year. However, with the Wates Principles, as currently drafted, if a company wants to state that they have complied with the Wates Principles it is not enough simply to state 'we comply with each of the Wates Principles'. The company must provide supporting statements for each of the six principles that explains and gives an understanding of how their corporate governance processes operate to achieve the objective of each of the Wates Principles. It seems to me that this is a much higher standard than currently prevails in the UK Corporate Governance Code 'comply or explain' approach.

So under the Wates Principles large private companies will be encouraged to apply all six principles and provide an explanation as to their application. This approach will make the drafting of the corporate governance statement an interesting and possibly challenging exercise which should encourage boards to really think about their approach to governance.

This is a refreshing attempt to move away from the 'box-ticking' of the listed sector and it will be interesting to see how our large private companies approach the drafting of these statements. I sincerely hope that it will not spawn a 'cottage industry' of consultants who may offer their drafting services to the relevant companies because for these governance statements to have real meaning they must come from, and speak for, the companies themselves in their own voice and language. In view of the fact that private limited companies are

no longer required to have a company secretary it remains to be seen who will be drafting these governance statements. I do hope that it will not be left to service providers to pull together boiler-plate statements.

The consultation is open until 7 September 2018 and feedback is sought on whether the Wates Principles are set at the right level to ensure that they are meaningful and robust, while at the same time enabling widespread adoption by large private companies. The consultation also aims to identify areas where this could be improved.

So there is ample opportunity for everyone to have their say and as these Wates Principles are intended to apply to such a wide and diverse sector of the business community it will be interesting to see what the various ownership structure entities will think of them. Simply taking the Wates Principles at face value it is hard to come up with significant objections as they are so widely drawn that well run enterprises should have little issue with any of the tenets sitting behind them. That in my opinion makes them an attractive proposition as drafted.

I find the Wates Principles refreshingly simple and uncomplicated. They provide scope for each company to clearly articulate their enterprise processes and attitudes that add value to their business, help build its reputation and ensure long-term continuity and success. That is the essence of good governance and if companies cannot clearly articulate that for themselves that should be a red-flag.

The Wates Principles seem to me to provide greater scope for a company to explain their own governance strategy and therefore allow these privately owned companies greater scope to define their own governance strategy depending on their particular circumstances. Less prescription is more challenging than over prescription.

The Wates Principles are uncluttered and easy to grasp and should be simple to apply. They should not build in any additional bureaucracy for private companies if applied intelligently. The Wates Principles provide a broad framework within which each enterprise will have the freedom to choose an appropriate and proportionate approach that is right for their enterprise. This will afford these large private companies a real opportunity to embed corporate governance practices that actually add value (rather than tick a box) to the organisation and provide assurance to stakeholders and gain competitive advantage. That is what governance should be concerned with at its heart.

Code of choice?

Large private companies have a choice of which corporate governance code they wish to apply so there is scope for widely diverging practice. However, the Wates Principles have

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been drafted specifically with the new Regulations in mind so are likely to be the corporate governance code of choice for many companies subject to the Regulations. But the beauty of the new Regulation is that companies will have the flexibility of applying other codes such as the UK Corporate Governance Code or the Quoted Companies Alliance Corporate Governance Code aimed at smaller listed companies if they so choose. Time will tell. It should be noted though that both of these are more prescriptive in their approach and therefore less likely to be the first choice for companies seeking to apply a code for the first time.

Action to be taken now

We are some way away from 2020 when we shall see the first annual reports that are required to comply with this new regime. However, we shall be there before we know it so large private companies need to work now on:

- establishing if the new rules apply to them;
- responding to the Wates Principles consultation before 7 September 2018;
- review and work on, if necessary, their corporate governance framework and supporting process and policy documents in readiness for the new reporting regime.

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Vanessa Jones is a Director of Corporate Legal Solutions a consultancy working in corporate governance, risk management and internal control, company secretarial practice and compliance. She has a keen interest in all company law developments, corporate governance, disclosure and transparency, public policy and issues of strategic importance to company boards.

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