



Association  
of International  
Certified Professional  
Accountants®

## Association of International Certified Professional Accountants Response to Financial Reporting Council Corporate Governance Code Review

28 February 2018

### Background

The Association<sup>1</sup> welcomes the opportunity to comment on the Financial Reporting Council's (FRC) proposal. CIMA submitted a response to the Government Green Paper in February 2017 and welcomed its response to this of August 2017. We recognise this code review as an important part of Government's corporate governance agenda. This response is given in the sole context of the UK market and, as such, does not relate to any other jurisdiction.

### Introduction

The UK's Corporate Governance Framework (Code) is widely admired around the world and is a continuing source of competitive advantage for UK business. For this reason, we fully support the continued promotion of the Code on a voluntary *comply-or-explain* basis. This promotes good practice but allows flexibility in a transparent manner and maintains its relevance. We also support the continued improvement of best practice in line with UK reporting requirements.

---

<sup>1</sup> The Association of International Certified Professional Accountants (the Association) is the largest professional accounting body in the world, combining the strengths of the American Institute of CPAs ([AICPA](#)) and the Chartered Institute of Management Accountants ([CIMA](#)) to power opportunity, trust and prosperity for people, businesses and economies worldwide. It represents 650,000 members and students in public and management accounting and advocates for the public interest and business sustainability on current and emerging issues. With broad reach, rigor and resources, the Association advances the reputation, employability and quality of CPAs, CGMA designation holders and accounting and finance professionals globally.

The ‘*comply- or- explain*’ regime, supported by the FRC allows companies to pursue best practice while, at the same time, deviating from this, where practical, and necessary for the benefit of the particular company.

## THE RESPONSE

The Association believes that the redraft of the code is an excellent opportunity to update its principles in relation to the latest corporate governance developments and thinking both from academia and in practice. It is also a chance to ensure that monitoring of the code remains effective. Based on this thinking it is our view that the following overarching priorities be addressed in this review -

### Trust –

We recognise that the driver for reform lies in the declining trust that society places, not just in business organisations, but in all institutions, both global and national. Trust is at the heart of much in life, and the reputation of an organisation is critical to its long-term strategic success.

Trust, or reputation, underpins whether investors want to invest in a company, whether customers want to do business with a company, whether individuals and suppliers want to work with a company, and whether society wants a company to continue to operate in their region.

In an increasingly complex and interconnected business environment where value is driven by intangible factors such as the quality of the customer experience and the strength of the brand, trust becomes ever more crucial as the foundation of commercial success.

The sobering lessons of Bell Pottinger and the Weinstein Company represent just two recent examples. Even in cases where customers still seem to like the product, such as Volkswagen cars or Ryanair flights, there is always a price to be paid somewhere from trust failures, such as regulatory penalties and management disruption.

We therefore welcome the inclusion of many of the findings of the Culture Report in the review of the Code as an important element of building trust.

It is our view that organisations need to assess, measure and report on the extent to which they are building trust through appropriate metrics. However, to be meaningful, it is essential that this is done within the context of the value drivers of the organisation.

**The code should highlight explicitly the need to focus on trust and on its link with value through the business model more fully.** We would suggest that this could be achieved through an explicit reference for the board to consider the extent to which the organization is building trust in Provisions 1 and 2, supported by an additional question for boards in the ‘Effective

The Helicon, One South Place, London EC2M 2RB, United Kingdom

T: +44 (0) 20 7663 5441

[aicpaglobal.com](http://aicpaglobal.com) | [cimaglobal.com](http://cimaglobal.com) | [aicpa.org](http://aicpa.org) | [cgma.org](http://cgma.org)

Board' section of the *Guidance on Board Effectiveness*, for example: To what extent is our organization trusted by our stakeholders, including society, and are we focusing sufficiently on building trust?

**The Association is currently undertaking a project, aligned with the current Lord Mayor of London's 'Business of Trust' initiative, on 'Managing the Trust P&L', which we will be publishing in Spring 2018.** This provides guidance for boards on how they can exercise their roles as guardians of trust and reputation of the organization. We would be very happy to share our thinking on this with the FRC to support the Code Review.

## **Long Term Value Creation**

The challenge for boards is to create and communicate the value of their organization's business model for all material stakeholders in an integrated manner. The focus for all organisations should be achieving success over time and a longer term focus as measured through appropriate value creation metrics.

We welcome the emphasis in Section 1 on long-term sustainable success. However, while we also welcome the wide-ranging nature of the review, we have some concerns that the board's role in relation to performance and strategy has become slightly lost relative to the focus on specific stakeholders and culture. As discussed below we would like to see this imbalance rectified through renewed emphasis on the board's entrepreneurial role.

In order to achieve this, we believe that a sound understanding of how value is created over time at board level is key in steering companies towards a sustainable long term future. Our recent consultation on business models shows value can be destroyed relatively quickly and a thorough understanding of how this can happen should underpin key business critical decisions.

We therefore believe that business model frameworks help boards to understand and oversee long-term value creation. **In our view Business Model Frameworks should be further embedded into the code as a critical governance decision-making tool**, to help avoid the serious strategic miss-steps that lead to corporate failures and undermine trust in businesses.

This could be achieved by including an additional 'Questions for boards' box in the Guidance on Board Effectiveness in the Leadership and Purpose section. We believe that this would redress the balance between appropriate focus on the one hand, stakeholders and culture and on the other, issues around strategy, performance, competitive pressures and innovation. These questions should cover value creation in an integrated way, link with the purpose of the organisation, and give appropriate consideration of customers and intangible assets as we explain below.

The Helicon, One South Place, London EC2M 2RB, United Kingdom

T: +44 (0) 20 7663 5441

[aicpaglobal.com](http://aicpaglobal.com) | [cimaglobal.com](http://cimaglobal.com) | [aicpa.org](http://aicpa.org) | [cgma.org](http://cgma.org)

Furthermore, we would note that there has been some loss of connectivity between the different sections within the code. The code should make it clear that the leadership, responsibilities, evaluation and remuneration sections link together in the context of the business model and that they are not isolated within a business. **We would recommend that the code should cross reference these sections so that it is clearly aligned with how a business operates in the real world.** We would also suggest that the code emphasise the competitive pressures that exist when boards are making key decisions, specifically around performance, remuneration and promotion of executives. The code should underpin sound reporting on remuneration so that this is clearly understood by all stakeholders and that the value created in the long term demonstrably links to the pay and performance metrics.

## Customer Focus

To achieve the creation of long-term value the organisation must meet the needs of their customers and other stakeholders including of society. Critically, we believe that the revised code should highlight the importance of the customer in generating value. The customer is ultimately the source of company value and we believe this importance does not come across in the revised code.

In order for an organisation to meet the needs of the customer and other stakeholders over time, the board needs to understand how it generates value through its strategy, operations and delivery. The board also needs to consider how the surplus generated should be shared with stakeholders and investors or reinvested in the business to maintain its long term success.

Our business model framework helps display this and in using it the organisation necessarily learns how its value is derived and whether its model has changed or become obsolete. This in turn ensures better decision making as well as improved reporting.

The code review is an opportunity for it to reflect how value is created today, **including** through intangible assets, intellectual capacity, relationships and service provision. The network of relationships that are needed to sustain a company are often where value lies and the code should emphasise this.

A sharper focus on the components of how value is created within the code would ensure that the board takes responsibility for understanding, prioritizing and balancing the needs of all its key stakeholders in a way that builds trust. **More specifically we would caution against the emphasis made in the consultation document on workforce as a stakeholder group** above others. In our view the essence of a sound board decision should consider all material stakeholders and the code as written may skew this approach unnecessarily.

Following our consultation in 2017, we will be publishing revised CGMA Business Model Framework guidance in spring 2018 and we would be happy to share this with the FRC to support the Code Review.

## **Corporate Culture**

Notwithstanding our comments about the need to emphasise the entrepreneurial role of the board in the section above, we welcome the focus of the revised code on the importance of Corporate Culture – where the Board should be accountable for setting the right culture at the top, ensuring that this permeates throughout an organisation in a way that is consistent with its purpose and values. We would also stress that, this culture should always be developed through activity which generates value for stakeholders in the context of the business.

Culture should also be tailored specifically to the company and market and does not exist in isolation to the market where value is being added. Culture, in our view is very much linked to the purpose of the business and is lived on a daily basis through the activities of the business and the behaviour of its representatives. Critically, we feel that the board should -

- Demonstrate that the board lives by the values that it sets.
- Ensure that bad behaviour is dealt with through transparent process.
- Ensure that measures are in place to support its desired culture and report on these as appropriate.

## **Risk**

One of the key elements to decision making at board level is an understanding of risk. Risk assessment helps preserve and maintain value and acts as the basis for a sound organisational strategy. We therefore support the code's continued focus on risk. We believe that there should be increased focus on robust risk management systems with disclosure focused on how these are implemented. Our view is that current viability disclosures have been too generic to be valuable and **we would suggest that the code places more emphasis on these.**

We note that the section on audit, risk and internal control is relatively unchanged and we would agree that this is appropriate given that this was a key area of focus in the last review. The viability statement is a recent introduction to the governance regime and we welcome the discussion in paragraphs 75-77 of the consultation document that provides additional guidance

The Helicon, One South Place, London EC2M 2RB, United Kingdom

T: +44 (0) 20 7663 5441

[aicpaglobal.com](http://aicpaglobal.com) | [cimaglobal.com](http://cimaglobal.com) | [aicpa.org](http://aicpa.org) | [cgma.org](http://cgma.org)

on how these should be prepared. We believe that there is some way to go on improving viability assessment and reporting and that the recent Financial Reporting Lab report on risk and viability reporting is an important first step. We would also point to the ongoing solvency work with the finance sector as a useful template.

**In the first instance, we would recommend placing paragraphs 98-101** on viability statements in the *Guidance on Board Effectiveness*. It would be better to keep all the risk and internal control guidance in one place and simply include a cross reference to it from the *Guidance on Board Effectiveness*. **We would furthermore suggest that the *Guidance on Risk Management* is amended to incorporate paragraphs 98-101 together with some of the discussion in paragraphs 75-77 of the consultation document, in particular the references to the FR Lab report and the comments about the need to analyse the sustainability of the business model.**

While the viability regime needs to evolve, recent events at Carillion have provoked some questions about the value of viability statements. At this stage, it is too early to make any considered judgment. However, **we believe that an initial step would be to place particular emphasis in the Code** on the importance of the risk assessment that underpins the viability statement. It will be crucial for lessons to be learnt from the Carillion case to ensure that the viability statement and the process involved in preparing it is not compromised. This can be done through boards ensuring that they have an understanding of how their business model creates value now and in the future. This understanding facilitates the identification of operational and strategic risks. **We would recommend that the board effectiveness guidance makes this link clear.**

## **Board Role & Composition**

We welcome the code emphasis on having the right mix of skills on the board as well as the emphasis on diversity of skills. However, we would recommend that the code emphasises that this should be in the context of the business and its needs rather than a generic requirement. We would also emphasise the importance of non-executive directors to this balance. **We would recommend that principle 1 is extended as follows:**

The board and its committees should have a balance of skills, experience, independence and knowledge that will best support the long term success of the company. It would also be useful to include guidance on this in Section 3 (Composition, Succession and Evaluation) of the *Guidance on Board Effectiveness*.

## **Code Structure**

The Helicon, One South Place, London EC2M 2RB, United Kingdom

T: +44 (0) 20 7663 5441

[aicpaglobal.com](http://aicpaglobal.com) | [cimaglobal.com](http://cimaglobal.com) | [aicpa.org](http://aicpa.org) | [cgma.org](http://cgma.org)

We welcome the revised code and the intention to make it clear and concise throughout. In particular, the focus on principles is welcome. We would also emphasise that the fair, balanced and understandable criteria on which disclosures should be based is of the highest importance and should be maintained.

Further to this we would also urge consideration of how the revised code dovetails with the reporting requirements of other bodies such as the IASB, FCA and LSE.

More specifically, we think that the new principles could be more concise than is currently the case with some of the supplementary text moving to the paragraphs below. Notwithstanding the need for legal clarity in some instances, we believe that concentrating on broad principles necessarily puts the emphasis of interpretation on the companies. In our view this is important as it means that boards can take, in a flexible manner, responsibility for their decisions around governance and reporting.

## **Conclusion**

In summary, we welcome the review of the code, and congratulate the FRC on its work. While agreeing with the direction of the review we would emphasise the need to balance broad principles which allow flexibility with rules that allow accountability.

We feel that our recommendations, particularly on strengthening focus on the business model, customer focus and risk management, would improve the code further and ensure that it remains relevant to UK business and its entrepreneurial culture.

We would be happy to provide any further information required and in particular discuss our work with you on the business model.

*Charles Tilley*

Charles Tilley

Executive Chairman CGMA Research Foundation

*Andrew Harding*

Andrew Harding

Chief Executive Management Accounting

The Helicon, One South Place, London EC2M 2RB, United Kingdom

T: +44 (0) 20 7663 5441

[aicpaglobal.com](http://aicpaglobal.com) | [cimaglobal.com](http://cimaglobal.com) | [aicpa.org](http://aicpa.org) | [cgma.org](http://cgma.org)