

Chris Shaw – Committee Clerk  
Business, Innovation and Skills Parliamentary Committee  
House of Commons  
London  
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21 October 2016

## CIMA Response to Business, Innovation and Skills Parliamentary Committee Inquiry on Corporate Governance

Dear Mr Shaw,

CIMA is the world's leading, and largest, professional body of management accountants with over 100,000 Members globally. We are incorporated by Royal Charter and headquartered in London. As a provider of world class research and educational content to our profession CIMA takes a keen interest in the development of corporate governance best practice both in the UK and globally. CIMA welcomes the opportunity to contribute to your inquiry.

Having considered the terms of reference for the inquiry we would like to highlight the following points-

The Companies Act 2006 Section 172 currently sets out directors responsibilities to the company itself and to wider society. However, we are of the view that these responsibilities are not always fully understood or acted upon by those who make corporate decisions. Purpose is often understood in narrow financial terms rather than broader societal ones, even though there is no legal reason that this should be the case. In particular, we would note that the long term sustainability of the company should be at the heart of any key decisions rather than short term gain. The Act embeds the principle of the long term in law. However, we are not aware of the Act ever actually having being tested in court or used against those who have violated this principle. We would therefore urge consideration of why this might be the case. In our view the power to enforce this provision could potentially be extended beyond investors and clarity could be given by government around how enforcement action could be undertaken. We would also propose consideration of how the duties already legislated for can be communicated more widely.

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Building on the theme of long term success, our latest research into company culture highlights the importance of building trust from Board level downwards. Part of what undermines this trust in our view is that the level of executive pay in the UK has become disproportionate when considered in the context of average pay levels. While it is important that value adding success is rewarded it is equally important that this success is demonstrable to all stakeholders and in line with the long term sustainability of the business. An important transparency measure would therefore be to ensure that rewards and incentives are clearly linked to value adding performance over time. This value may not always be observable immediately in financial terms.

Another topic that we would emphasise as important is that the composition of boards should have the diversity of skills to effectively govern, develop and implement strategy. While the recent report from Lord Davies on diversity is encouraging we believe that business should seek to strengthen boards through any mechanism which ensures that the skills and competences needed for value creation are available to it. It is the duty of the board in our view, to engage all stakeholders and to ensure its members have knowledge of all value drivers in the business. Ultimately the board should understand how its stakeholder's needs are being met, typically through extensive consultation.

Further to the above, CIMA would recommend the following practical steps to address some of the issues outlined -

- Including within the scope of FRC oversight private companies whose activities are in the public interest, potentially using the same test as used for calling in cases against individuals.
- Widen the scope of the FRC financial reporting review to include the strategic report addressing whether it is fair, balanced, and understandable. This would address promoting the long term success, the interests of material stakeholders, and transparency of material matters.
- Setting out the basis of selection of board members to meet the skills required to be included in the governance report.

Whilst aware of the public pressure for action in this area CIMA would however, caution against politically expedient measures. Any regulatory change should be founded on demonstrable evidence and should not unnecessarily impact on the attractiveness of the U.K. as a place to do business, or needlessly increase cost and bureaucracy. It is also important to give recent changes to corporate governance codes and legislation time to be able to assess the impact. This includes changes regarding executive remuneration, the viability statement, and the recent report on culture. The Government imperative in this area is well understood and we believe

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that a collaborative approach with UK business would be the best way of ensuring a positive policy outcome.

Ultimately it is our view that businesses themselves need to develop clarity around their business model, and understand how value is created and shared with stakeholders. A well described business model addresses company objectives, values, connectivity, opportunities and risks. It links remuneration to performance, and skills. It also provides a basis for strategic reporting and assurance and helps put sound governance at the centre of corporate decision making. Government can help to build this mind set and change culture rather than regulation.

Finally, in terms of the role of professional bodies, we would note that many directors of companies are not members of professional bodies and that this can lead to significant gaps in understanding. It is therefore important that the value of a professional qualification is recognised throughout the business community and promoted through Government education policy.

Should you require any further information from us or require us to attend the inquiry in person please do not hesitate to contact me.

Yours sincerely,

*D.J.Hackett*

David J Hackett  
Policy & Technical Manager

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