



Association
of International
Certified Professional
Accountants®

Association of International Certified Professional Accountants Response to the Corporate Governance Principles for Large Private Companies Review by James Wates

6 September 2018

Dear James,

Please find below our response to the above consultation.

Our response is in two parts. Firstly, we outline our general comments around the proposed principles and secondly we give specific responses to the ten questions that you have raised.

We would be very happy to provide any further evidence to support this submission and look forward to working with the review team on next steps.

Yours Faithfully,

A handwritten signature in black ink, appearing to read 'Andrew Harding', is positioned above the typed name. The signature is fluid and cursive, with a long horizontal stroke at the end.

Andrew Harding FCMA CGMA

Chief Executive Management Accounting

Background

The Association¹ welcomes the opportunity to comment on the Wates proposal. CIMA submitted a response to the Government Green Paper in February 2017 and welcomed its response to this of August 2017 in terms of reviewing governance of private companies. We recognise this 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. However, as noted in the Government's Green Paper of August 2017 there has been an increasing trend for large companies to trade without publically listing, as well as in delisting, in recent years. There is also a perception that while enjoying the benefits of incorporation such as limited liability organisations do not fully accept the consequent accountability to the public interest that this entails. While most of these companies may nevertheless comply with high standards of governance it is undoubtedly the case that these requirements are less burdensome than for public companies bound by the Code. This imbalance and the consequent loss of public trust as evidenced in the annual Edelman Trust survey², is what the Wates Review seeks to address and we very much welcome this initiative. The Association believes that the review is an excellent opportunity to bring together those large private companies who will be affected by the principles to ensure that they have as larger buy in as possible. It is also crucial that the new principles address how private companies consider stakeholders beyond their immediate owners.

¹ 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.

² [Edelman Trust Barometer 2018 - UK Findings](#)

The Response

Our response seeks to address the questions raised in the Wates Review in two parts. The first part gives general reflections on the status and operation of the principles while the second part answers directly the questions posed by the Review.

The Association believe that The Corporate governance principles for private companies (the Principles) as outlined provide a good basis to underpin private corporate governance. They are current and comprehensive and based on practical expertise from within the Governance field.

Furthermore we would encourage the take up of the principles to be made under a '*comply- or-explain*' regime, which allows companies to pursue best practice while, at the same time, deviating from this, where the individual circumstances of a particular company make this necessary. This works well for listed companies and so it would seem sensible to ensure that private companies adopt these principles on a parallel basis with explanations geared towards wider stakeholders. Their adoption should also form part of the annual report governance statement in line with other initiatives of this type. It would also enable a smooth transition should a private company wish to list.

We would also emphasize the need to ensure that they achieve adoption amongst the 2000 or so firms that they would apply to. This should be done through the communication of their value and their purpose as well as the promotion of detail on how their adoption is monitored and incentivized. This could be done either through adding an introductory paragraph to the principles document itself, as well as through wider publicity by the Financial Reporting Council (FRC) and Companies House. In our view their adoption should be based on a public interest test that is transparent and objective. This would allow all those involved to clearly identify why the principles are important. Without this in place, there is the possibility that the principles will not achieve their stated objectives.

In terms of communication we feel that the draft text is well laid out and concise. The principles chosen also align well with our research into what is important and effective governance. Additionally, evidence of the value of good governance supported by case studies would be very helpful in cementing support.

Remit

For the Review to have maximum credibility we would encourage the Review team to seek formal status as Guidance under Secondary legislation within Company Law for the principles. In our view it is critical that although voluntary, organisations should understand the importance that the Government and the public at large place on their compliance. We would question whether the remit of the principles, covering employers with over 2000 employees is the right level. EU legislation, used as a yardstick continent wide, typically categorizes large companies as having over 500 employees and so we would recommend that this level is more effective and

would bring in a wider range of businesses. This would ensure that a key stakeholder group is not marginalized. We would also suggest a test which includes turnover in addition to employees. This may be justified as larger businesses are increasingly employing less people while still having large societal impacts. The turnover figures used to mandate a public audit would be a good figure with which to align (currently around £10.2 Million). Furthermore, the review should consider how the size test may be avoided. This could be by restructuring which will potentially introduce complexity and inefficiency into the corporate structure or lead companies to relocate some activities out of the UK which is not in the best interests for UK society.

Furthermore, we would argue that the principles may be of interest to the non-profit sector in light of recent malpractice identified in the charitable sector. The sector is a critical part of civil society and brings many benefits. However, many charitable trustee roles are part time or voluntary and as such the risk to governance is greater. In the UK high profile charities have come under increasing scrutiny in terms of transparency and probity and their business models mean that public trust is paramount. We therefore feel that the principles could usefully be applied to this sector on a voluntary basis.

Measuring Success

In our view the Review should consider what may constitute success in terms of the principles. Failure to improve governance in the eyes of society, particularly as reported by the media and reacted to by politicians, will have a negative impact on the reputation of the Principles and the Coalition that developed them. Conversely, wide take up and endorsement should help foster greater cooperation and trust between the public and business community. This could be highlighted through the annual return process which in turn would improve the credibility of the new principles.

Funding

It is essential that the review consider funding options for the principles to be enforced. It is critical that business takes ownership of the principles and for this reason it seems sensible for funding to come from business itself. However, the review should not seek to create additional regulatory cost on UK companies at this time. With this in mind one option may be to level an additional filing fee through Companies House in order to support this initiative.

Integration

One of the key challenges facing all organisations is developing their strategy and its implementation on an integrated basis. This is supported by recent research by the Association of International Certified Professional Accountants, the International Integrated Reporting Council, and Black Sun: Purpose beyond profit.³ The Principles should therefore emphasize the

³ <https://www.cgma.org/content/dam/cgma/resources/reports/downloadabledocuments/purpose-beyond-profit.pdf>

importance of integrated thinking and Integrated management information addressing how value is created for all the company's principal stakeholders through their business model.

At present the Integrated Reporting Council Framework highlights the importance of the six capitals as a basis for understanding. These capitals emphasize the need to consider wider value rather than purely financial value. This is consistent with the aim of these principles. We therefore urge the Review to reference within the principles the need to understand the importance of integrated reporting when applying them.

Appendix One: Consultation Questions

Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?

Yes. The principles are broadly the rights ones although we feel that further consideration should be given to principle three. It is far less concise than the other principles and would benefit from focus on accountability. This focus is important as organisations need to consider wider stakeholders and accountability is key to this. Without accountability to investors private companies may have greater freedom to operate. However, they should be no less accountable to the wider public or may be affected by their operations to their benefit or otherwise.

Are there any areas in which the Principles need to be more specific?

As highlighted above the principles would benefit from drawing on and encouraging integrated reporting in practice and the wider integrated thinking agenda.

Do the Principles and guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?

Yes. If private companies need further guidance they can then refer to the FRCs UK Corporate Governance Code and supporting documentation.

Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken account in setting directors' remuneration?

Yes. Companies can provide further information if they consider appropriate and we would encourage the goal of being concise.

Should the Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?

Identifying principal stakeholders and business partners is a key issue in achieving a sustainable business. Developing an evidence base of best practice and its contribution to value creation will be an important factor in achieving adoption.

Given the importance of stakeholders, consideration should be given to it being Principle 2 rather than Principle 5. Arguably the main purpose of the principle is to shift

organizational decision making away from pure focus on the owners and on to impacts on wider stakeholders. We therefore wish to see this principle promoted.

Do the Principles enable sufficient visibility of a board's approach to stakeholder engagement?

See above

Do you agree with an 'apply and explain' approach to reporting against the Principles? If not, what is a more suitable method of reporting?

The 'comply or explain' basis would be most appropriate as this is used for listed companies. In order to maintain a level playing field it would be better to adopt this approach.

The Principles and the guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and guidance would encourage good practice?

See principal comments above regarding communication, compliance and incentivization to adopt the principles. Undoubtedly the FRC or equivalent body would be best placed to perform this role.

Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted versus publicly listed companies?

Yes. For companies wishing to adopt corporate governance best practice, then they can reference the UK Corporate Governance Code. Although this is written with the investor in mind many of its provisions would still apply.