



RESPONSE TO FRC CONSULTATION
The Wates Corporate Governance Principles for
Large Private Companies

7 September 2018

Introduction

- 1 The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents over 21,000 members who advise and lead business across the UK and in almost 100 countries across the world.
- 2 ICAS's Charter requires it to primarily act in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and protect their interests. On the rare occasion that these are at odds with the public interest, the public interest must be paramount.

Key messages

- 3 Arrangements for monitoring and reporting the implementation and effectiveness of the principles and the new "apply and explain" approach should be confirmed. We believe that the FRC is best placed to do this. Without a clear view as to how this is to be policed it risks being ineffective. We note the background of the FRC review and constrained resources which makes this option of further concern.
- 4 The question of achieving appropriate challenge on boards to help ensure principles are applied in private companies unless there is good reason not to, needs further consideration.
- 5 To support the policy intention of building trust in business, behaviour is key. The role of ethics and integrity should have a higher emphasis within the Code.

Detailed responses

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

- 6 Some gaps have been identified. The ethical responsibilities of directors, integrity and leading by example should be promoted more clearly to ensure that this is included within the direction of travel. This is essential if the policy intention is to enhance trust in business.
- 7 We would prefer Principle One to be reworded to "leadership and purpose" to highlight the responsibilities of directors including setting an appropriate direction, their duty to promote the success of the company and the value of a longer-term perspective in decision making, as well as ensuring the implementation of values and culture.
- 8 Principle Six identifies the board's responsibility to present a fair, balanced and understandable assessment of the company's position and prospects. The financial statements are an important element of the annual report and audit performs a key role serving the public interest by underpinning transparency and integrity in business. Further guidance on the value of ensuring an independent and high quality audit, and directors responsibility for this should be included. Principle Six should also include a reference to ethical business behaviour with stakeholders.
- 9 We note the lack of a regulatory requirement to apply the principles and monitor compliance/effectiveness of the new Code. We believe that there would be benefit in the FRC setting up a monitoring group who can report on progress and facilitate the sharing of good practice to help promote the objectives of the new Code. The FRC Financial Reporting Lab is an example of how best practice can be shared.

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

- 10 See above.

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?

- 11 The Code should not assume tight ownership structures – there can also be diverse equity structures. Whilst it may be helpful to readers to disclose ownership arrangements, this is not straightforward as shareholder agreements are often subject to confidentiality (usually for valid reasons). Further consideration should be given to the governance implications of shareholders agreements and how this should be addressed in the Code.
- 12 Principle Six could acknowledge more clearly the importance of shareholders wishes in the ownership structure. While the Code seeks to reflect a move away from a shareholder centric view of the company, in doing so it must recognise the reality of company law. The need to reflect the Companies Act in this guidance should not be lost sight of. This is a two-way commitment and shareholders must also take some responsibility for promoting good and fair behaviour.

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?

- 13 Further clarification is needed of the purpose of this Principle being to avoid short term remuneration which is not aligned to performance or business purpose and the duty for supporting longer term, sustainable success. Changes to transparency requirements involving publication would indicate a significant change for this sector, we have understood that this Principle refers to internal transparency (shareholders and employees) not external publication.
- 14 Pushing private firms down the route of external publication could, as with the listed sector, have the reverse effect of driving remuneration inflation. The principles should be based on achieving greater fairness and equity in organisations. We are supportive of making sure companies align pay and conditions throughout an organisation and that there is transparency enabling key shareholders to see this is the case, but we do not support forcing publication of directors' remuneration in private companies.

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

15 No.

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

16 Yes.

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

17 Yes, agreed.

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?

18 We believe that the FRC is best placed to do this.

19 An approach would need some assessment and challenge similar to the Corporate Reporting Review which incorporates evidence gathered through the FRC's monitoring of annual reports and accounts and outreach to stakeholders. In terms of encouraging ongoing development, the FRC Lab work provides a safe environment for listed companies and investors to explore innovative reporting solutions that better meet their needs. Lab reports summarise observations on practices that investors find useful to their analysis and encourage companies to consider adopting the practices if appropriate.

20 Perhaps the scope of these existing FRC mechanisms could be expanded to include private companies to help generate wider adoption of good practice and facilitate innovative thinking.

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?

21 The balance is reasonable as a starting point to get the largest private companies moving in the right direction.

We welcome any commentary on relevant issues not raised in the questions above.

22 Overall the proposals indicate a direction of travel to encourage some progress. We understand the need to minimise regulatory burdens. Whilst this is a positive first step on the journey and should encourage boards to think and discuss the issues, it is not particularly stretching for the size of targeted company and will need developed over time to develop standards, align more closely and keep pace with good practice, and to meet the policy objective of enhancing public trust in business.

23 The threshold for targeted group of private companies is set high - only the very largest companies (the highest cited in the [BEIS response to consultation 2017](#)) whilst ICAS and other stakeholders suggested a lower bar would still capture very large privates and still be effective. This proposal is focusing on a very small minority of private companies which will ease implementation but will also have limited impact.

24 We suggest reviewing the thresholds at appropriate future points to broaden the application of good practice, where evidence exists that the new Code is effective and as the need to strengthen corporate governance and their disclosure gains wider acceptance across the sector.

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