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Dear Kirsty

### **The Wates Corporate Governance Principles for Large Private Companies Consultation**

Moore Stephens LLP are writing in response to this Consultation Paper as invited.

Moore Stephens is a top ten accounting and advisory network, with offices throughout the UK. Our clients include individuals and entrepreneurs, large organisations and complex international businesses. Our Governance, Risk & Assurance group works with businesses in all sectors, advising on their governance structures, providing comfort on their control environments and helping to embed transparency and accountability.

The organisations we assist are increasingly required to demonstrate effective corporate governance to meet the high expectations of all their stakeholders and comply with best practices such as the UK Corporate Governance Code requirements. We believe effective governance is fundamental to the performance of any organisation and good corporate governance ensures that transparency, accountability and fairness are embedded in the decision-making processes of an organisation. Our team work in partnership with our clients to help develop an effective governance framework with strong procedures, leveraging our knowledge of best practice in similar businesses.

Our response to the Consultation Paper is therefore informed by the wide diversity of clients we work with from listed entities, financial services regulated entities, public sector organisations, charities and others including owner managed businesses and corporates, schools and sports governing bodies.

We are keen as a firm to contribute to this debate. If you have any questions on our response please contact Sarah Hillary ([sarah.hillary@moorestephens.com](mailto:sarah.hillary@moorestephens.com)) or Charles Portsmouth ([charles.portsmouth@moorestephens.com](mailto:charles.portsmouth@moorestephens.com)).

Yours faithfully



Moore Stephens LLP

## 1. INTRODUCTION

### 1.1. Background

Our Response to the Government's Green Paper on Corporate Governance Reform noted the key pillars of the UK's Corporate Governance framework including:

- a "robust framework of company and financial market law";
- a unitary board system under which directors are held collectively responsible for the decisions made by the board;
- the FRC UK Corporate Governance Code (UKCGC) setting out the principles and best practice on board issues which applies to leading listed companies on a "comply or explain" basis and its continuing evolution; and
- the FRC's Stewardship Code setting out the principles of effective investor stewardship.

We stated our belief that, generally, improvements in the UK's corporate governance codes probably now need to focus on the functions of governance rather than on the features of governance. A focus on the functions (what is the compensation package needed to attract and retain the talent we require to achieve our goals as an organisation?) rather than features (what is the total compensation package of the CEO and how does it compare to his or her peers?) will almost certainly yield more benefit to an organisation. The presence of a feature does not necessarily imply a function is being performed properly.

In designing governance systems, directors and other stakeholders be they government, regulators or investors now need to move beyond the simple decision of whether to adopt a governance feature, beyond mere compliance and instead tackle the more difficult - and fundamental - question of designing a governance system that adds value by encouraging the pursuit of corporate objectives and discouraging self-interested behaviour whilst respecting the spirit of the governance features.

There is an important role for laws and regulations to play in corporate governance, but all those interested in improving corporate governance should not lose sight of the fact that most companies are organisational entities and their oversight requires an organisational perspective. This means that effective governance solutions should take into account the realities that come with managing and monitoring groups of individuals, including personal and interpersonal dynamics, models of behaviour, leadership, co-operation, and decision-making.

Thus, we believe that corporate governance systems cannot be completely standardised because their design and effectiveness depends on the situation and the appropriate structure for organisations will differ depending on the context of each individual organisation.

## 1.2. Overall comments on the Wates Principles

Following its Green Paper, the Government has now extended the framework of company and financial market law through the new Companies (Miscellaneous Reporting) Regulations 2018 which include:

- A requirement for companies qualifying as large<sup>1</sup> under the Companies Act to include a new, separately identifiable Section 172(1) statement to be included in the company's Strategic Report and website; and
- A requirement for very large<sup>2</sup> UK registered companies to confirm which corporate governance code, if any, has been applied and if the company has departed from any aspect of the code which aspects and the reasons.

These requirements will apply to a large range of differing companies including family owned businesses, private equity owned companies and large subsidiaries of UK listed companies. It is imperative that such companies can have a flexible, proportionate but appropriate corporate governance code to refer to and to apply.

We note that the UK Corporate Governance Code which applies to all premium listed companies has been revised such that it is shorter and sharper, and renews the emphasis on applying the Principles of the Code as opposed to 'box-ticking' against the Provisions. There is more focus on high quality reporting and many premium listed companies will need to think carefully about how to adapt their reporting to focus on how governance has been applied, as opposed to listing out board and committee roles and responsibilities.

The revised UK Corporate Governance Code also reflects various themes including those addressed in the recent Government Green Paper, that have been well-established, such as:

- the importance of culture;
- the necessity of wide stakeholder engagement, particularly with employees;
- diversity on boards;
- the independence of non-executive directors (NEDs) and the chair; and
- the treatment and reporting of executive remuneration.

We welcome, therefore, the development of the Wates Principles and believe that these will be of assistance to a wide range of companies in complying with the new regulations but also will be of assistance to an even wider range of companies as they consider the effectiveness of their corporate governance arrangements and their responses to the increased emphasis now being placed on the provisions of s172 of the Companies Act.

Good corporate governance is particularly important to the shareholders and stakeholders of private companies. In most cases, shareholders will have limited ability to sell their ownership stakes, and are therefore committed to staying with the company for the medium to long term. This increases their dependence on good governance. The respect of stakeholders is also important in the current environment of increased scrutiny of the business world, and private companies need to devote attention to their wider stakeholder responsibilities to sustain and grow the necessity of public trust in

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<sup>1</sup> Companies meeting two of: a turnover of more than £36 million, or balance sheet total of more than £18 million, or more than 250 employees.

<sup>2</sup> Companies with more than 2,000 employees or with a turnover greater £200 million and balance sheet total of more than £2 billion.

business. The reputation and trust in business generally will benefit through increased transparency and accountability.

Our responses to the individual questions posed on the proposed revisions to the Code are set out in Section 2 below.

## 2. THE WATES CORPORATE GOVERNANCE PRINCIPLES FOR LARGE PRIVATE COMPANIES CONSULTATION QUESTIONS

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

As noted above the new legal requirements introduced by The Companies (Miscellaneous Reporting) Regulations 2018 will apply to a wide range of companies reflecting many differing ownership models including family owned business, private equity owned companies and UK subsidiaries of listed and unlisted companies.

The Principles, therefore, need to be both capable of being applied to a very diverse range of organisations and of reflecting their own particular circumstances. Thus, taking a high level approach to corporate governance is important such that both the Principles and the Guidance for consideration are capable of being applied in a flexible, proportionate and appropriate manner.

The current best practice guidance for unlisted companies is set out in The Institute of Directors Corporate Governance Guidance and Principles for Unlisted Companies in the UK which contains 9 Principles applicable to all unlisted companies and a further 5 Principles applicable to “large and / or more complex” unlisted companies. All the Principles are expressed as being principles that unlisted companies “should” meet and some are quite detailed in their coverage and are therefore quite prescriptive.

To be appropriate, the proposed six Wates Principles need to cover the same areas as the UK Corporate Governance Code but also to be stated at a level that is not overly prescriptive. As proposed they do cover the key areas required which in principle are no different to those covered by the UK Corporate Governance Code. The revised UK Corporate Governance Code subsumes the old Code’s provisions relating to shareholders within its reduced number of sections. However we believe it appropriate that the Wates Code maintains a separate principle (Principle Six) addressing wider stakeholder engagement. This emphasises the importance of wider stakeholder engagement reflecting the need for large private companies to reflect on their societal impact. It also links the Wates Principles to the Companies Act s172 provisions.

There are two areas which we believe could be covered further by the Wates Principles:

- Firstly, the governance and oversight of corporate reporting in terms of the financial statements, strategic report and other narrative reporting. The UK Corporate Governance Code contains the ‘fair, balanced and understandable’ requirement for the annual report and accounts. Boards of large private companies should be just as engaged in this activity.
- Secondly, the Wates Principles do not focus on effective CEO and board succession planning. An effective recruitment, retention and succession plan for the CEO and other directors is a key board role. For family owned businesses, a focus on governance can assist in enabling a smooth succession in terms of changes in ownership or management.

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

Wates Principle One addresses a company’s purpose and ensuring that its values, strategy and culture aligns with that purpose. We believe that the revised UK Corporate Governance Code, in its Principles A and B, expresses it better than the proposed Wates Principle One and we recommend that Wates Principle One should be revised to read:

“A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society. The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned.”

By using the language contained in the revised UK Corporate Governance Code there is better clarity and also importantly better alignment of the two Codes and linkage with the provisions of s172 of the Companies Act.

There may be other areas where such an approach is useful – see the response to Question 4 below (Section 2.4).

**2.3. 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?**

The proposed Principles and guidance are drawn widely to ensure that they are capable of being applied taking sufficient account of the differing ownership structures of private companies, and the differing role of the board, shareholders and senior management in these structures.

We recommend however that the guidance utilises the approach used in the revised FRC Guidance on Board Effectiveness with its use of “Questions for Management” and the like which will assist in bringing to life the expectations of the Principles and some of the considerations directors might seek to address which might vary for differing ownership structures.

**2.4. 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?**

We recommend greater alignment with the revised UK Corporate Governance Code on Remuneration structures and the consideration of the workforce and suggest the following wording for Principle Five:

“Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose, values and culture. Workforce remuneration and related policies and the alignment of incentives and rewards should be taken into account in setting executive director remuneration.”

We believe this revised wording provides better clarity and transparency in addressing this key issue for building public trust in business and also links better to the UK Corporate Governance Code and the s172 provisions of the Companies Act.

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

The Companies (Miscellaneous Reporting) Regulations 2018 apply to all companies qualifying as large under the Companies Act. A large company is defined as those meeting at least two of the following: a turnover of more than £36m; a balance sheet total of more than £18m; and, more than 250 employees. Subsidiaries of listed groups are also captured by these requirements if they meet the size criteria.

These companies will need to report (in a new, separately identifiable Section 172(1) statement to be included in the Strategic Report and on a website) on the issues, factors and stakeholders relevant in complying with s172 and why. They will also need to discuss their engagement methods and the impact on decisions and strategies during the year.

The Regulations apply to all companies who might be applying the Wates Principles and they are quite explicit. We therefore do not believe the Wates Principles necessarily need to be more explicit in the Guidance for consideration but they might benefit from the approach used in the revised FRC Guidance on Board Effectiveness with its use of “Questions for Management” and the like which will assist in bringing to life the expectations of the Principles and some of the considerations directors might seek to address and which might vary for differing ownership structures.

**2.6. Do the Principles enable sufficient visibility of a board’s approach to stakeholder engagement?**

See our response to Question 5 in Section 2.5 above.

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

As noted in our introduction, corporate governance systems cannot be completely standardised because their design and effectiveness depends on the situation and the appropriate structure for organisations will differ depending on the context of each individual organisation.

The Wates Principles are intended to apply to a wide range of differing ownership models and organisational structures. Using an apply and explain approach where boards of firms can apply a Principle and then provide a supporting explanation should assist in their adoption because this approach:

- Has the necessary flexibility and proportionality to enable its application to a wide-range of business models or organisational structure; and
- Should encourage a thoughtful and reflective approach focusing on how the Principle is met in the circumstances of that business rather than of compliance to a number of features or ‘box-ticking’ approach.

We note that the revised UK Corporate Governance Code also has more of an emphasis on applying the Principles whilst complying or explaining on the Provisions. This fits with our belief that corporate governance generally should be moving towards a focus on the functions of governance rather than on the features of governance (i.e. encouraging less ‘box-ticking’).

**2.8. 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?**

The purpose of the Government's implementation of The Companies (Miscellaneous Reporting) Regulations 2018 is to strengthen the corporate governance framework for private companies. It is appropriate that their implementation in practice should be monitored to ensure that they are effective in terms of their intended outcomes and ensuring that these meet the government's expectations. It is unclear how the application of these provisions will be monitored.

The Regulations provide that companies within scope must include in their Directors' Report a statement confirming which corporate governance code, if any, has been applied and how. Companies may choose the code that is most appropriate to their requirements. If the company has departed from any aspect of the code it must set out the respects in which it did so, and the reasons. If the company has not applied any corporate governance code, the statement must explain why that is the case and what arrangements for corporate governance were applied. The statement will also need to be published on a website maintained by the company.

The application of the UK Corporate Governance Code is partially monitored by active shareholder engagement with companies as encouraged by the Stewardship Code but is also monitored through the activity of the Financial Reporting Council (FRC).

The Wates Principles are intended to provide an appropriate, proportionate and flexible code to be applied by in scope companies. It is not clear how the wider stakeholders will engage with large private companies in terms of encouraging and challenging the adoption of the code and the related corporate governance practices. Therefore, it seems to be appropriate for there to be monitoring of the application of both the Regulations and the Wates Principles by an appropriate body.

The publication of regular reviews setting out examples of good and poor practice would also help to encourage good practices to emerge for all companies affected by the Regulations and not just those affected by the requirement to apply a corporate governance code. This activity might be carried out by the FRC if it had the appropriate remit but this will inevitably incur costs for the FRC and it is unclear how those costs will be paid for.

**2.9. 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?**

The higher level of expectation of the corporate governance practices of publicly listed companies arise from the fact that they are publicly listed and as such they have a diverse ownership model which needs to be addressed by both the companies and their investors. Publicly listed companies are therefore required to apply the UK Corporate Governance Code (or if they are AIM Listed another recognised governance code) which has only one ownership model to deal with. Unlisted companies have many different ownership models and, therefore, there is a different balance to be struck and a greater need to allow for a more flexible and proportionate approach to corporate governance.

The Wates Principles are seeking to apply the fundamental aspects of good corporate governance and therefore we generally agree with both the approach taken and the resulting overall balance that is contained within the proposals. However, we do believe it is important that wherever possible the Wates Principles and the UK Corporate Governance Code are linked



better by sharing wording wherever possible – as noted in our responses to questions 2.2 and 2.4 above.

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

We do not have any additional comments to make.