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Submitted electronically to: corporategovernanceprinciples@frc.org.uk

7 September 2018

Dear Ms Merrick

Coalition Group consultation: The Wates Corporate Governance Principles for Large Private Companies

The Ethics and Governance Committee of Chartered Accountants Ireland (EGC) welcomes the opportunity to respond to the invitation from the Chairman of the Coalition Group for comments on the proposed draft principles and guidance contained within The Wates Corporate Governance Principles for Large Private Companies.

Chartered Accountants Ireland is the largest professional accountancy body in Ireland, with in excess of 26,000 members located in Ireland, the UK and internationally, of which approximately 5,700 are based in the UK. Chartered Accountants Ireland is a member body of the International Federation of Accountants (IFAC). We have considered this consultation both for the perspective of Chartered Accountants Ireland members who work in Northern Ireland and the rest of the UK as well as with an awareness of the many members located in Ireland and elsewhere that work with and for UK large private companies and their related entities.

EGC welcomes the approach the Coalition Group has taken with the proposed principles and guidance and acknowledges the background that has led to their development. We are also conscious of the importance for the principles to take a high level approach in order to be sufficiently adaptable for application within any large company. While aware that the proposed principles and guidance in the code are not be mandatory, we expect that, if not specifically adopted, they will establish a measure of best practice that will be used by many large private companies in the UK.

EGC is very supportive of initiatives, such as these principles and guidance, that promote consistent and better governance for the benefit of not only the businesses that apply them, but also their wider stakeholders, including employees, suppliers and customers, and wider society. While supportive of the draft code we do have concerns regarding the lack of prominence in relation to principles such as accountability and integrity, given the issues that have led to recent corporate failures. In our response, we propose that Principle Five, *'Remuneration'*, should be included as part of *'Stakeholders'*, given the context of the principle and guidance around workforce pay and conditions, and that Accountability and Integrity should prominently feature together as principles in their own right. We outline our views on this and the other matters in our specific responses to questions asked in the attached appendix.

If you would like to discuss this response further please contact me at +353 1 637 7382 or niall.fitzgerald@charteredaccountants.ie

Yours sincerely

Níall Fitzgerald
Head of Ethics and Governance

Appendix

Question 1
Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?

Accountability is a principle that encourages responsible behaviour which includes acknowledging, reacting appropriately and reporting instances of irresponsible behaviour or negative outcomes. The introduction to the code refers to the events of large scale corporate failures and the public outcry for transparency and accountability. This was echoed in the House of Commons' Business, Energy and Industrial Strategy Committee's Corporate Governance Report in April 2017. However, in the proposed principles and guidance, while the concept of accountability may be addressed within Principle Three, *'Responsibilities'*, and to a certain extent within Principle Four, *'Opportunity and Risk'*, we believe it's importance as a corporate governance principle warrants prominence as a principle in its own right. Responsibilities may be perceived in the corporate environment as a narrower definition already arising from statutory and fiduciary duties in existence and already applicable to directors of companies.

Furthermore, we recommend that the principle of accountability be joined with integrity. Integrity has a central importance in ensuring that any principled approach to accountability is taken in a forthright manner and with a rigour that ensures public trust is earned and maintained through honest actions and behaviour.

In all other respects, we believe the principles are sufficiently broad to reference many of the key issues of corporate governance and sufficiently accommodate the diverse management and ownership structures in large private companies.

Question 2
Are there any areas in which the Principles need to be more specific?

While acknowledging the challenge to be sufficiently broad to encourage widespread adoption by large private companies, there are a number of areas that would benefit from being more specific as follows:

<u>*Principle One, Purpose:*</u>

i. If the purpose of an organisation is considered to be a destination, then the values of the organisation are an important part of the journey to achieving purpose. We recommend consideration be given to renaming Principle One to *'Purpose and Values'* and embed the importance for an effective board to promote not just the purpose of the organisation but also its values and ensure that the strategy and culture align.

<u>*Principle Two, Composition:*</u>

i. This is a very important given the critical role of the board in any large private company. The reference within the principle to the capacity of directors to discharge their duties is welcomed, however the guidance would benefit from further emphasis on capacity.

ii. The principle would be further strengthened by providing a guidance on what is "independent" and also an indication of how frequently individual directors should be evaluated.

iii. In relation to size, further guidance would be welcomed on the minimum size of board of a large private company, including maximum tenure, but with provision to explain why a particular director has been kept on beyond that level.

iv. Acknowledging the balance of broad application of the code to various types of large private companies, either inclusion or cross reference to elements of earlier guidance on composition provided in points 18 and 19 under "*Application of the principles – 'Apply and Explain'*" would provide greater context for various types of large companies, e.g. large private owner managed companies.

Principle Three, Responsibilities:

i. This principle provides good guidance around the concept of establishment of "advisory or board committees". For clarity, we recommend clarification that while specific tasks may be delegated to, or recommendations sought from, advisory or board committees, the board retains overall responsibility for decisions made.

ii. In addition, our comments to question 1 above refer insofar as the separation of accountability and integrity into a separate principle would be beneficial by allowing for greater consideration of these important principles in their own right.

Principle Four, Opportunity and Risk:

i. While the principle refers to *'Opportunity'* and *'Risk'* it includes guidance that focuses predominately on 'risk'. Consideration should be given to expanding the guidance to address board's responsibility in relation to opportunity, e.g. "establishing mechanisms or processes for the identification of future opportunities".

ii. The principle includes a useful list of responsibilities of the board in relation to risk management. Given the increasing importance of speaking up policies and procedures, including protected disclosures, for identification of malfeasance within the organisation, we recommend its inclusion in the aforementioned list.

iii. We note that the principle itself refers to the "long term success of the company" whereas the guidance makes reference to "how the company creates and preserves value of the long term". We recommend consistent reference to 'how the company achieves long term success', which allows flexibility in acknowledging that success comes in many forms.

Principle Five, Remuneration:

i. While we agree overall with the inclusion of a principle around remuneration we recommend consideration to incorporating this as part of stakeholders, as the main part of the principle is in relation to justification of executive pay in the context of a key stakeholder, the company's workforce. We present our comments on this in greater detail as part of question 4 below.

ii. While acknowledging that the requirements for disclosure of executive and non-executive remuneration originate within company law, with requirements varying depending on the structure of the company, we would expect to see some reference to disclosure of both executive and non-executive remuneration in addition to policy.

iii. The guidance does not place sufficient emphasis on the governance considerations associated with the relationship between executive pay and that of the wider workforce, its interrelationship with the values of the company, nor on its impact on the long term sustainability of the business.

Question 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?

We believe the guidance is very concise in their guidance and the principles are sufficiently broad to apply to the various ownership structures of large private companies.

We believe that at an early stage in the code, e.g. either as part of Principle One or Principle Two, it is important to make the distinction between the role of the board and the role of management. This reference should be further enhanced and clarified with the inclusion of the benefits of independent oversight with potential inclusion or cross reference to points 18 and 19 under "*Application of the principles – 'Apply and Explain'*", which provide some examples of how independent challenge can be introduced to various structures of large private companies.

Our comments in relation to areas that require greater specifics are outlined in response to question 2 above.

Question 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?

The guidance, as it is currently drafted, does not set out how workforce pay and conditions should be taken into account in setting directors remuneration. The last paragraph of the guidance should be extended to accommodate this.

The principle of remuneration, as it is currently written, has a key focus on the equity of executive pay in the context of that of a key stakeholder in the company, the workforce. Given the significance of the workforce as a key stakeholder in many large private companies we recommend inclusion of this principle and guidance as part of Principle Six, *'Stakeholders'*.

Question 5
Should the draft Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?

EGC considers the principle to be very clear, but that the alignment of the principle and the guidance could be improved. The principle refers to the board having regard to discussions with stakeholders when making decisions, however the guidance is more focused on the impact on stakeholders and transparency to stakeholders rather than the influence of stakeholders in decision making.

There is also a potential for ambiguity around what is meant by "material" stakeholders, given various connotations around the concept of materiality in other areas, e.g. audit, and perhaps reference to "key" stakeholders would be clearer.

Question 6
Do the Principles enable sufficient visibility of a board's approach to stakeholder engagement?

EGC considers that it is not clear to whom the visibility of stakeholder engagement is intended. The principles provide for and encourage meaningful stakeholder engagement but it is the engagement, rather than the visibility of, that is important to the company and stakeholders success.

In keeping with the objective of being sufficiently broad to apply to the various ownership structures of large private companies the guidance is at a high level. In relation to the workforce as a key stakeholder there are areas, highlighted in our response to question 2 above, which could benefit from being more specific. We suggested inclusion of a reference to speaking up policies and procedures under the list for Principle Four, *'Opportunity and Risk'*. This in addition to including under Principle Six the importance of promoting a safe and effective organisational culture and some examples on what decisions the workforce are likely to be invited to contribute will encourage and promote meaningful stakeholder engagement.

Principle Six, *'Stakeholders'*, currently includes a reference to the company making an assessment of the company's position and prospects available to stakeholders on an annual basis. The timeliness of such an assessment or when it is made available is less important than actually engaging with the stakeholders in meaningful way. We would recommend that reference to timing, i.e. annual basis, be replaced with "on receipt of reasonable request".

Question 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?

We agree that the 'apply and explain' is an effective means of achieving the objectives of the principles. It recognises the wide diversity of companies to which the principles may apply and provides the flexibility necessary to demonstrate effective and meaningful implementation. If 'Accountability' and 'Trust' are key objectives, as set out in the UK Governments Green Paper, Corporate Governance Reform (2016), then, while acknowledging additional disclosure requirements will be involved for large private companies, 'apply and explain' promotes a transparent approach towards achieving them.

Question 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?

Primary responsibility for the application of the code will rest with the directors of the large private companies to which it applies. However the challenge of monitoring application is greater given that the companies are private. Periodic review of the application of the principles by the FRC with public commentary on the outcome of those reviews would help encourage good practice.

As this is not a mandatory code the emphasis needs to be on promoting the benefits of application, rather than enforcing application, in order to assist large private companies to comply with the forthcoming legislative requirements of the Companies (Miscellaneous Reporting) Regulations 2018.

Other initiatives, such as governance awards for large private companies, may also assist in encouraging good practice.

Question 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?

Subject to comments above, the principles themselves appear to achieve an appropriate balance between requirements for listed and large unlisted companies. The extent of disclosure required by the “apply and explain” approach may however result in a burden on large private companies which is proportionately greater than for public companies which follow a “comply or explain” approach.

Question 10
We welcome any commentary on relevant issues not raised in the questions above.

Except as noted above, EGC has no other comments at this time.