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Dear Kristy,

**BDO response to the consultation on 'The Wates Corporate Governance Principles for Large Private Companies (June 2018)'**

We are pleased to have the opportunity to comment on 'The Wates Corporate Governance Principles for Large Private Companies (June 2018)' (the Consultation Document).

We welcome the publication of the first corporate governance code aimed specifically at large private companies and agree that there should be improvements in transparency and accountability in this area. We also support a principles-based 'apply and explain' approach in relation to their corporate governance reporting. We do, however, have two main concerns:

- Firstly, legislation requiring large companies to disclose corporate governance arrangements and new voluntary guidance will not be effective in driving improvement in the corporate governance of large private companies unless there is an effective monitoring and enforcement system in place. In our view, any body that, as a result of recommendations from the independent review of the FRC led by Sir John Kingman, is ultimately given powers to monitor the application and reporting of the corporate governance arrangements adopted by the UK's listed companies should also undertake the same role for large private companies.
- Secondly, the Principles provide no clear guidance relating to the disclosure of corporate governance arrangements. In our view, an important aspect of good governance is transparency of governance arrangements; this helps inspire trust between a company and its stakeholders. An absence of guidance on disclosure will likely lead to a wide divergence in practice in terms of the nature and level of information that is provided by companies adopting the Principles making it difficult for external stakeholders to make informed judgements on a company's corporate governance arrangements.

Our detailed responses to the questions raised in the Consultation Document are set out in the appendix to this letter. If you wish to discuss any aspect of our response, please contact David Isherwood.

Yours sincerely,

BDO LLP



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**Appendix: Responses to the questions raised in the Consultation Document*****Question 1: Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?***

No, in our view the Principles do not address the key issues of the corporate governance of large private companies.

We acknowledge that poor corporate conduct by major businesses, which has disproportionately and adversely affected non-shareholder stakeholder groups, has been a major driving force behind the new legislation and the Principles. However, we are concerned that the draft Principles do not address the need for boards also to consider the views of shareholders.

Whilst the directors of large private companies will often also be major shareholders, this will not always be the case. Even where directors are also major shareholders, there may still be a shareholder minority that does not have formal board representation. In our view, if a board of directors is to manage a company for the benefit of its members as a whole, any corporate governance framework that it might seek to apply should include a principle encouraging meaningful engagement with the company's shareholders. This should include having regard to the wishes of minority shareholder groups whose interests are at risk of being overlooked if there is also a powerful major shareholder.

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

Yes, there two areas in which we consider the Principles could be more specific:

***Disclosure***

The Companies (Miscellaneous Reporting) Regulations 2018 introduce a requirement for a company within its scope to state in its directors' report how the company has applied any corporate governance code that it may have adopted or, if no corporate code has been adopted, what corporate governance arrangements have been adopted. The 'Q&A' published<sup>1</sup> by the Department for Business, Energy & Industrial Strategy indicates that companies will be expected to provide 'sufficient information to ensure that their corporate governance arrangements are explained' and goes on to state that if a company chooses to adopt the Wates Principles then they would expect a '...short supporting statement for each principle...'. The Principles themselves, however, provide no clear guidance relating to the nature and level of detail that might be considered best practice in respect of the disclosure of governance arrangements.

Whilst we accept the need for proportionate application, we would consider it helpful if the Principles set some expectations regarding disclosure. In our view, an important aspect of good governance is transparency of governance arrangements; this helps inspire trust between a company and its stakeholders. An absence of guidance on disclosure will likely lead to a wide divergence in practice in terms of the nature and level of information that is provided by companies adopting the Principles making it difficult for external stakeholders to make informed judgements on a company's corporate governance arrangements.

<sup>1</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/715740/corporate-governance-company-reporting-faq.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/715740/corporate-governance-company-reporting-faq.pdf)



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*Guidance for consideration*

The 'guidance for consideration' sections that follow the Principles explain the importance of the principle they follow; they provide little in the way of practical guidance on how a company might apply the principles. In our view, companies seeking to apply the Wates Corporate Governance Principles would benefit significantly from practical guidance on how that might be achieved.

The concept of a business model is used in the 'guidance for consideration' in both principles one and four. This makes it difficult to understand in what ways these two principles are intended to differ. Whilst it is inevitable that the concepts embodied in the principles will overlap to an extent, where this is the case, it is important that the accompanying guidance clearly describes how the principles differ.

Finally, we also found some of the guidance for consideration repetitions or unnecessarily wordy.

***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?***

Yes, in our view, the Principles do take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures.

Whilst the Principles and guidance have been drafted in language that reflects a more traditional ownership structure, the principles-based, high-level approach adopted by them will be easy to apply in a range of less common circumstances. In our view, attempting to address multiple ownership and management structures in these voluntary Principles would give rise to unnecessary complexity.

***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?***

As elaborated upon further in our response to question two above, the Principles provide no clear guidance relating to the reporting on corporate governance arrangements. In consequence, they cannot be relied upon to ensure that companies give key shareholders sufficient visibility of remuneration structures. If this is an objective of the Principles, then they must include an explicit disclosure requirement.

***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?***

In our view, this aspect of disclosure will be covered by the recently introduced "Section 172 Statement", guidance on which has been included in the FRC's recently revised Guidance on the Strategic Report. On this basis, we do not think the draft Principles should be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level; they should confine themselves to the nature of the corporate governance arrangements adopted by a company and the disclosure of them.

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

As noted in our response to question two above, and as elaborated upon further in our response to question nine below, the Principles provide no clear guidance relating to the reporting on corporate governance arrangements. In consequence, they cannot be relied upon enable sufficient visibility of a board's approach to stakeholder engagement. If this is an objective of the Principles, then they must include an explicit disclosure requirement.

***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?***

Yes, we agree with the 'apply and explain' approach adopted by the Principles. In our view, this approach is critical in ensuring that the Principles are capable of being applied to a range of companies, both large and small. We note that this approach is adopted by the Quoted Companies' Alliance's (QCA) Corporate Governance Code, which has also been drafted with a view to allowing it to be applied in companies occupying a wide range of stages of development and complexity.

A 'comply or explain' approach, as adopted by the FRC's UK Corporate Governance Code, would require the Principles to be supplemented by a list of explicit list of expectations relating to structure and process (ie "Provisions") against which compliance might be assessed. This would add considerably to the volume of material that is included in the Principles, increase their complexity, encourage a tick-box approach and, as the Principles have been principally drafted with a larger company in mind, deter smaller companies from adopting them.

A simple 'statement of compliance' approach would require the Principles to comprise a ridged set of expectations that must be applied which would, again, increase their complexity, encourage a tick-box approach and deter smaller companies from adopting 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?***

In our view, legislation requiring large companies to disclose corporate governance arrangements and new voluntary guidance will not be effective in driving improvement in the corporate governance of large private companies unless there is an effective monitoring and enforcement system in place. However, such a system is not currently in place for any category of entities; Public Interest Entities, other listed companies or large private companies. This is an issue that is the subject of significant debate in relation to the FRC's UK Corporate Governance Code in the listed company arena and not one that we consider relevant to the development of the Principles themselves.

The above point notwithstanding, however, we note that the remit of the FRC's Corporate Reporting Review powers and activities covers both listed and large private companies. In a similar way, it is our view that any body that is ultimately given powers to monitor of the application and reporting of the corporate governance arrangements adopted by the UK's listed companies should also undertake the same role for large private companies. The identity and powers of that body can only be determined by Government and will be significantly influenced by the outcome of the independent review of the FRC led by Sir John Kingman.



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***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?***

As noted in our response to question two above, unlike the QCA's Corporate Governance Code and the FRC's UK Corporate Governance Code and its associated guidance, the Principles provide no clear guidance relating to the reporting on corporate governance arrangements. The only indication of expectations relating to the public disclosure of corporate governance arrangements in unlisted companies is in the **Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended**. As the new legislation and the Principles have been introduced in order to address the criticism in relation to the lack of transparency and accountability in some large private companies, in our view the Principles could do more in terms of encouraging this transparency.

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

We have four additional comments on the Principles in addition to those made above:

***Extent of the Wates Corporate Governance Principles for Larger Private Companies***

It is not clear what information from the consultation document will be included within the final Principles. As an example, there is a discussion on page five of the Consultation Document in relation to the application of the Principles using an 'apply and explain' approach. This provides an example of how a company could apply and explain principle three but it is unclear whether this be included in the final document. In our view, the Principles would be enhanced with some preamble such as this.

***Code vs Principles***

We note that the legislation refers to the term 'code' of corporate governance whereas the Consultation Document is described as a set of 'principles'. As it is intended that the Wates Corporate Governance Principles for Large Private Companies are intended to represent a code for the purposes, we would consider it clearer to refer to the document as the Wates Code of Corporate Governance for Larger Private Companies.

***Principle five***

In our view, the guidance for consideration section of principle six should acknowledge the fact that, in some private businesses, there will be a lack of clear distinction between remuneration and investment returns for some director/shareholders. In some cases, the balance between the two will be influenced by tax considerations. This will inevitably affect the balance between the remuneration of directors and senior management and the wider workforce.

***Principle six***

Whilst we absolutely agree that, for a business to be sustainable in the longer-term, it must create and sustain long-term value for a variety of stakeholders, we do not consider it necessarily the case that it is the responsibility of a larger company to create and sustain long-term value for a variety of stakeholders. There are circumstances when a well-run company either may wish, or be forced, to take a shorter-term view.