KPMG

Governance in private companies

2018 Corporate governance reforms
KPMG Board Leadership Centre

In its response to the 2016 Green Paper *Corporate governance reform*, the Government concluded that the case had been made for strengthening the corporate governance framework for the UK's largest private companies, noting "*the conduct and governance of large companies, whatever their legal status, has a sizeable impact on the interests of employees, suppliers, customers and others*".

Disclosure of governance arrangements

Amendments to the *Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* have been laid in Parliament with the intention to require all companies of a significant size to include a statement within their directors' report that details which, if any, corporate governance code the company applies, and *how* the company applies that corporate governance code.

If the directors decide not to apply an existing code or framework they must explain their reasons for not doing so and explain what corporate governance arrangements they have in place for that financial year. This statement must be published on a website maintained by or on behalf of the company.

For the purposes of this requirement the word 'code' should be interpreted broadly to include a framework, set of principles or code. With this in mind, the final approved *Wates Corporate Governance Principles for Large Private Companies* (see below) will assist companies in fulfilling this new requirement by promoting best practice corporate governance within large private UK companies.

The new disclosure requirement will apply to UK companies required to publish a directors' report, with 2,000 or more employees globally. If companies do not meet this employee threshold, but do have a turnover of more than £200 million and a balance sheet of over £2 billion, they will also be within scope of the new requirement.

Subsidiaries of listed companies which meet the above thresholds will be within the scope of the new requirements.

It is expected that the new reporting requirement will apply to financial years beginning on or after 1 January 2019.

Extract from The Companies (Miscellaneous Reporting) Regulations 2018

26.(1) The directors' report must include a statement (a "statement of corporate governance arrangements") which states:

(a) which corporate governance code, if any, the company applied in the financial year,

(b) how the company applied any corporate governance code reported under subparagraph (a), and

(c) if the company departed from any corporate governance code reported under subparagraph (a), the respects in which it did so, and its reasons for so departing.

(2) If the company has not applied any corporate governance code for the financial year, the statement of corporate governance arrangements must explain the reasons for that decision, and explain what arrangements for corporate governance were applied for that year.

Wates Corporate Governance Principles for Large Private Companies

In January 2018, the Secretary of State for Business, Energy and Industrial Strategy appointed James Wates CBE to chair a Coalition Group charged with developing corporate governance principles to enhance transparency and accountability in large private companies.

The Coalition Group - which includes representation from the Financial Reporting Council, the Confederation of British Industry, the Institute for Family Business, the Institute of Directors, the Institute of Business Ethics, Tomorrow's Company, the British Private Equity and Venture Capital Association, the Investment Association, the Climate Disclosure Standards Board, ICSA: The Governance Institute, and the Trades Union Congress – issued a consultation draft of The Wates Corporate Governance Principles for Large Private Companies in June 2018.

The draft principles recognise that due to the variety of different management and ownership structures employed by large private companies, a 'one size fits all' approach to corporate governance in large private companies would be inappropriate. The draft principles are therefore designed to provide sufficient flexibility by introducing a high-level approach to good-practice corporate governance that can be applied by any large private company by allowing companies to explain their application and the relevance of the principles to their corporate governance arrangements. In essence, this is an 'apply and explain' model rather than the familiar 'comply or explain' model applicable to listed companies. The emphasis is therefore very much on *how* the principles have been applied rather than *whether* they have been applied.

A company that adopts the principles is expected to apply them fully and provide a supporting statement for each principle that gives an understanding of how their corporate governance processes operate and achieve the desired outcomes. The principles are supported by non-exhaustive guidance that helps companies apply the principles in practice.

The draft principles can be found here. The consultation period closes on 7 September 2018.

The six principles

Purpose – An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.

Composition – Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.

Responsibilities – A board should have a clear understanding of its accountability and terms of reference. Its policies and procedures should support effective decision-making and independent challenge.

Opportunity and risk – A board should promote the long-term success of the company by identifying opportunities to create and preserve value and establish oversight for the identification and mitigation of risk.

Remuneration – A board should promote executive remuneration structures aligned to sustainable long-term success of a company, taking into account pay and conditions elsewhere in the company.

Stakeholders – A board has a responsibility to oversee meaningful engagement with material stakeholders, including the workforce, and have regard to that discussion when taking decisions. The board has a responsibility to foster good relationships based on the company's purpose.

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