KPMG

Wates corporate governance principles

2018 Corporate governance reforms
KPMG Board Leadership Centre

The Companies (Miscellaneous Reporting) Regulations 2018 introduced a requirement for very large private companies (and public unlisted companies) to make public a statement detailing which corporate governance code, if any, has been applied and how. The Wates Corporate Governance Principles for Large Private Companies (the Principles) – released in December 2018 – will assist companies in fulfilling this new requirement by promoting best practice corporate governance within large private UK companies.

For accounting periods beginning on or after 1 January 2019, all companies of a significant size will be required to include a statement within their directors' report (or alternatively in the strategic 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 also be published on a website maintained by or on behalf of the company, though this requirement can be discharged by publishing its whole annual report or the entire directors' report (or the strategic report where the statement is included there).

The new requirements 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.

For the purposes of these requirements the word 'code' should be interpreted broadly to include a framework, set of principles or code. With this in mind, *The Wates Corporate Governance Principles for Large Private Companies* are likely to become the default Code of choice for many companies.

The Principles for large private companies

The 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 Principles are therefore designed to provide sufficient flexibility by introducing a high-level approach to good-practice corporate governance that can be adopted by any large private company by allowing companies to explain, in their own words, how they have applied each Principle within the context of their specific circumstances. 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 or not* they have been applied.

By providing broad Principles with supporting Guidance, the intention of the Wates Principles is to move beyond a 'tick box' approach to describing and explaining how the implemented practices achieve the Principles and demonstrate the outcomes. This approach offers increased transparency for stakeholders and links to the other reporting requirements such as the new section 172 disclosures.

Companies should provide a supporting statement that gives an understanding of how their corporate governance policies and processes operate to achieve the desired outcome for each Principle. Where appropriate the statement may cross-refer to information reported under other legislation, for example, information which may be in the Strategic Report or another company document.

The six Principles are:

1. Purpose and leadership

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

2. Board 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.

3. Director responsibilities

   The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.

4. Opportunity and risk

   A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.

5. Remuneration

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

6. Stakeholder relationships and engagement

   Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

Subsidiary companies

Subsidiary companies meeting the tests set out in the Regulations are required to make a corporate governance statement.

Directors of subsidiary companies are subject to section 172 (duty to promote the success of the company for the benefit of its members as a whole, and in doing so have regard to various other stakeholders) like any other director, but it is recognised that parent companies may in some cases influence policies. For example, remuneration practices and policies may be set by the board of the parent company. In such cases, any explanation that demonstrates application of the Principles could refer to the parent company's corporate governance statement, if that report explains the governance procedures of the subsidiary.

Illustration

Consider Principle three - the board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge. Different companies could apply and explain this Principle in different ways:

- A large family owned company might seek to appoint an independent director to its board to introduce independent challenge. It could explain how the appointment of this director has delivered improved outcomes by identifying an example where the provision of independent challenge from the independent director has improved board decision-making.
- A private equity-owned company with a small shareholder board might appoint an external consultant to provide independent advice on its corporate strategy. It could describe the value that independent insight has had on refining the company's purpose.
- A large subsidiary of a UK-listed company may establish an advisory committee to seek independent, objective advice as to the effectiveness of the board's decision making. It could explain how this appointment demonstrates the directors' commitment to accountability and acknowledgement of their duties under the Companies Act 2006.

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