

Review of corporate governance reporting

KPMG Board Leadership Centre

For the third year, the FRC has reviewed how companies have reported on their governance in line with the Principles and Provisions of the UK Corporate Governance Code (the Code). The new report, [Review of Corporate Governance Reporting](#), sets out that while there have been year-on-year improvements, there are few companies whose disclosures meet the highest standards throughout their report. The assessment, which comprised 100 randomly chosen FTSE 350 and Small Cap companies, supports the FRC's growing body of evidence on those areas where companies report well and where improvements could be made.

The FRC note that more companies are now offering greater transparency when reporting departures from the Code, but that some companies fail to provide an explanation, and many others give nothing more than boilerplate or vague explanations.

The FRC also looked closely for the disclosure of actions and outcomes resulting from governance policies, procedures and activities, noting that the better disclosures – the ones that included specific examples and case studies – were in the minority.

While the FRC note that reporting on workforce engagement issues and wider stakeholder engagement is generally of a good standard, they report that there is often insufficient narrative on the outcomes from the engagement, including feedback received, or commentary on whether the board acted on any of the issues raised and how decisions align with company strategy, or culture, purpose and values.

They also found minimal disclosure of specific board members' engagement with major shareholders, and the expected increase in the quantity and quality of reporting – in the light of significant numbers of votes against resolutions and renewed investor interest in ESG matters – was not evident. Indeed, where engagement was reported, it offered little insight.

The FRC also found that the majority of companies have met or are on track to meet external diversity targets. However, this progress has yet to translate into senior roles, for example, CEO and CFO roles where progress appears slow. Due to the lack of transparency in relation to diversity policies and targets, it is not clear how many companies strive to go beyond external targets.

Of particular note given the proposals to strengthen the UK internal control reporting framework, over half of the companies surveyed by the FRC provided a statement to confirm that their risk management and internal control systems are effective or that no weaknesses or inefficiencies have been identified. However, many of those companies do not explain how they assessed the effectiveness of these systems to justify the results of their assessment.

What do the FRC expect?

The review sets out the FRC's expectations across the five areas of the Code. For each area they set out their general conclusion, areas where reporting could be improved and examples of good practice along with expectations.

Code compliance

The FRC expects:

- Companies to make it easy for users of the annual reports to find whether the company has fully complied with all elements of the Provisions of the Code throughout the whole financial year; or in the case of departure from the Code, the Provision(s) it has not complied with and the explanation for non-compliance.

Further key messages include:

- High-quality reporting should show in a clear manner how the board has successfully applied the Principles of the Code to achieve effective outcomes for the company, shareholders and other stakeholders.
- In line with the Listing Rules, companies should be transparent about their noncompliance with the Code, by clearly acknowledging any departures from it.

Leadership

FRC expects companies to report not only on the outcomes from their culture assessment and monitoring activities, but also on the impact of any remedy initiatives to assess their effectiveness in the following reporting year. Further key messages include:

- Persistent reference to but non-disclosure of corporate values means that too many companies simply refer to principles of the Code without explaining how they applied them.
- Disjointed reporting on corporate purpose, values, strategy and culture, or reporting that lacks examples of impact gives the impression that a company is not fully leveraging the benefits that the alignment can have on its performance and stakeholders.
- It is important to have a continuous focus on culture rather than wait for a crisis.
- Good reporting on how the board ensured effective engagement with shareholders and stakeholders should include details of:
 - actions taken by the board: how the board engaged with the shareholders and stakeholders (methods of engagement, those involved, the frequency of engagement and topics discussed)
 - outcomes from the engagement: what was the feedback from the shareholders and stakeholders, and the impact it had on board discussions and decision making
- Engagement cannot be effective if shareholders and wider stakeholders do not get the opportunity to express their views or raise concerns
- Effective engagement with shareholders should allow them to express their views, ask questions and raise concerns.
- Regular engagement has a twofold purpose:
 - It gives the board a clear understanding of the views of shareholders.
 - It gives shareholders information on what impact their feedback has had on board decision-making, and as a result, on the company's strategy and governance, and social and environmental issues.
- Disclosures are informative if they go beyond general statements stating that a meeting/event occurred.
- Reporting on the feedback received from shareholders is an important indication of the effectiveness of the engagement.
- Good practice reporting would include an explanation of why the company has chosen their engagement mechanism and how they will monitor this to ensure that it is effective.
- Companies should provide appropriate cross-referencing to modern slavery statements in annual reports.
- Drawing internal expertise from across the organisation to inform modern slavery strategy ensures a joined-up approach which is strategically aligned to the business and its goals.

- By integrating modern slavery into existing strategies, companies can ensure that their modern slavery response is aligned with the business, including alignment with policies, KPIs and culture.
- The failure to report on outcomes of engagement on modern slavery was a missed opportunity by companies to demonstrate the effectiveness of their internal processes.
- Companies must assess the effectiveness of their engagement methods at identifying instances of modern slavery.
- Where companies do not provide all disclosures in full, we would expect, as required by the Listing Rule, an adequate explanation and an expected timeline for compliance.
- It is important that companies incorporate sufficient experience, expertise and knowledge of climate-related issues at board and senior management levels to help them better navigate these complex and increasingly material issues.

Division of Responsibilities and Board Composition

Key messages include:

- While we have seen an improvement in the disclosure of diversity policies, we continue to highlight that policies should include objectives and targets, and link to company strategy, along with actions taken to implement the policy and progress on achieving objectives. These elements form part of the reporting requirements in Code Provision 23.
- Companies should make clearer links on how their targeted diversity objectives and initiatives link to company strategy.

Audit and Risk and Internal Controls

The FRC expects companies to:

- Provide better reporting on their procedures to identify and manage emerging risks; and following an assessment, give an explanation of the emerging risks identified and actions to mitigate them.
- Explain how they have monitored their risk management and internal control systems throughout the year and any changes made to ensure their continuous efficacy.

Further key messages include:

- Good reporting on risk management procedures should give a detailed overview of the company's risk governance framework, the processes undertaken, and actions taken by the board during the year to review risks.
- Reporting on the steps taken by the board to review risk management and internal control systems provides the shareholders and other stakeholders with assurance that the company has taken active steps to assure the efficiency and resilience of these systems. It also increases confidence in the company's capability to identify and manage risks effectively.

- As stated in the [Guidance on Risk Management, Internal Control and Related Financial and Business Reporting](#): ‘The board should summarise the process it has applied in reviewing the effectiveness of the risk management and internal control systems. The board should explain what actions have been or are being taken to remedy any significant failings or weaknesses.’

Remuneration

Key messages include:

- Companies should look to provide specific explanations and directly refer to their corporate purpose and values when discussing their executive remuneration arrangements. Most of these statements fail to explain how the framework is designed to align with purpose and values, and what the benefits are.
- Effective engagement on remuneration allows shareholders to raise concerns and provide their views on the remuneration policy and the annual outcome.
- Good reporting on shareholder engagement should include information on:
 - Actions – how the remuneration committee or the board engaged with shareholders to consult on remuneration matters
 - Impact – what impact has such engagement had on remuneration policy and outcomes
- In line with Code Provision 41, the annual report should describe how the company engaged with the workforce to explain how executive remuneration aligns with wider company pay policy.

To improve disclosures, the FRC’s reporting recommendations include the following:

- Moving away from declaratory statements and providing specific disclosures.
- Providing clear and meaningful explanations when departing from the Code.
- Demonstrating how the company’s culture, is aligned to its purpose, values and strategy.
- Reporting on engagement with shareholders and stakeholders, and how their views have been considered.
- Making clear linkages in the report to policies or disclosures that relate to stakeholder matters.
- Reporting on diversity, including at a senior leadership level beyond the recommended external targets including objectives and targets.
- Explaining how the board or a committee has reviewed the effectiveness of the risk management and internal control systems.
- Reporting on how the executive remuneration arrangements align with the company’s purpose, values and strategy.

The KPMG Board Leadership Centre

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