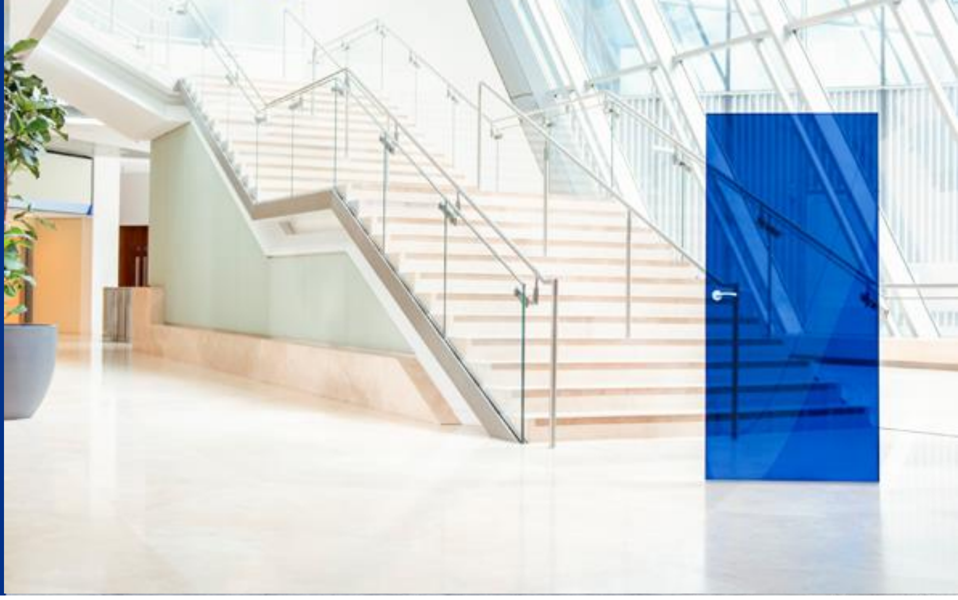
Review of corporate governance reporting

KPMG Audit Committee Institute



Following the first year in which UK premium listed companies reported on their application of the 2018 UK Corporate Governance Code (Code), the FRC's Review of Corporate Governance Reporting concludes that, overall, reporting does not demonstrate the high quality of governance that the FRC expects. In the words of Sir Jon Thompson (CEO, FRC), "*the review highlights many examples of excellent reporting but it's clear that some companies are continuing to take a formulaic approach to corporate governance driven by compliance, rather than focusing on outcomes, supported by high quality and transparent evidence.*" This new FRC review sets out clear expectations to address company reporting that is falling short, so that in future it can better meet the interests of not only shareholders but wider stakeholders too.

The FRC's analysis - made up of a random sample of 100 companies which included FTSE 100, 250 and Small Cap companies together with assessments by third parties - reports that the objective of too many companies is to claim full compliance with the Code and that this has led to 'tick-box' practices.

As part of their assessment, the FRC were looking for a high standard of reporting which demonstrated that boards had considered matters beyond process and reassessed issues such as company purpose, culture, and strategy, in order to set them at the heart of governance. And, whilst examples of good reporting were found, overall, the FRC were disappointed with the response to the new Code.

Pulling no punches, the review argues that too often companies who are not compliant with the Code, do not declare non-compliance but offer vague explanations, and continue this pattern year on year. This, in the FRC's view, is an approach that demonstrates a disregard for implementing good practice and questions whether the leadership of the company is fully committed to good governance and transparency.

A far better aim, it is argued, is to set out the approach to the company's application of the Code's Principles, explain why this approach is right for its individual circumstances and, if necessary, what actions it has taken to mitigate the impact of not following the Code. Explanations that demonstrate a thoughtful approach to corporate governance would be welcomed by the FRC – though they note that such an approach is unfortunately lacking from too many of the reports they have assessed.

These conclusions are very much in line with the findings of another hard hitting critique of corporate governance reporting – the FCA's recent report on Corporate Governance Disclosures by Listed Issuers which sets out how corporate governance disclosures could be improved, especially when disclosing how the Code Principles have been applied.

The FRC's Year end letter to CEOs, CFOs and audit committee chairs caries similar messages – specifically around reporting on section 172, workforce engagement and succession planning.

This latest FRC review goes on to note their surprise that in many cases corporate governance reporting was not coherent and cohesive. For example, many companies stated the importance of diversity and diverse boards but offered little explanation in the way of evidence to support their assertions, including: a lack of targets to improve diversity at the board and executive committee levels; little or no discussion of succession planning; and minimal reporting on how board evaluations are leading to the development of diverse talent pools. They also report that many companies refer to diversity and inclusion committees or LGBTQ+ networks but do not describe the impact of such groups on the company's long-term success.

On purpose and culture, the FRC note that reporting has improved, nevertheless, many companies continue to set out a purpose that is more of a marketing slogan and only a minority of companies set out in detail how they plan to assess their culture beyond the use of surveys and site visits.

Companies were better at commenting on stakeholder engagement, but the FRC remain concerned about the reliance on process and the lack of reporting on feedback received and outcomes. In many cases, it was not clear how issues were raised to board level, and how any discussions of such matters affected decision-making.

This lack of evidence of any feedback also manifested itself in relation to remuneration policies where despite many companies reporting that they had considered wider (workforce) remuneration when setting executive remuneration polices, there was almost no discussion of how the new policies had been debated with and explained to shareholders and wider stakeholders.

Reporting expectations

The key theme running throughout the review is that companies reporting against the Code are expected to move away from boilerplate statements towards a more meaningful narrative in support of their application of the Code's Principles and to report non-compliance with Provisions. The use of examples is strongly encouraged, to demonstrate application of any non-compliance with the Code. Recognising that no one size fits all, the Code should serve as a guide to good governance practice, which companies ought to use to tell their unique story.

Specifically, the Code puts greater emphasis on companies' relationships with their stakeholders, in line with s.172 of Companies Act 2006 and strategic reporting requirements. The FRC expects companies to report on their engagement efforts with their stakeholders, which should be conducted in an open manner. Reporting should also include a discussion on how any received feedback has informed company decisions and strategy.

As a result of this year's review, the expect improved reporting in the following ways:

- Companies to have a well-defined purpose and to clearly show the progress towards achieving it
- Discussion of the issues raised, topics considered, and feedback received during engagement with shareholders and employees
- Clearly show the impact of engagement with stakeholders, including shareholders, on decision-making, strategy and long-term success
- Increased focus on assessing and monitoring culture, including consideration of methods and metrics used
- Increased attention and better reporting of succession planning, diversity and board evaluation
- Clearly show the impact of engagement with shareholders on remuneration policy and outcomes
- Clearly show the impact of the engagement within the workforce in relation to executive remuneration policy

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

Learn more at www.kpmg.com/uk/blc.

Contact us

Timothy Copnell
Board Leadership Centre
T: +44 (0)20 7694 8082
E: tim.copnell@kpmg.co.uk