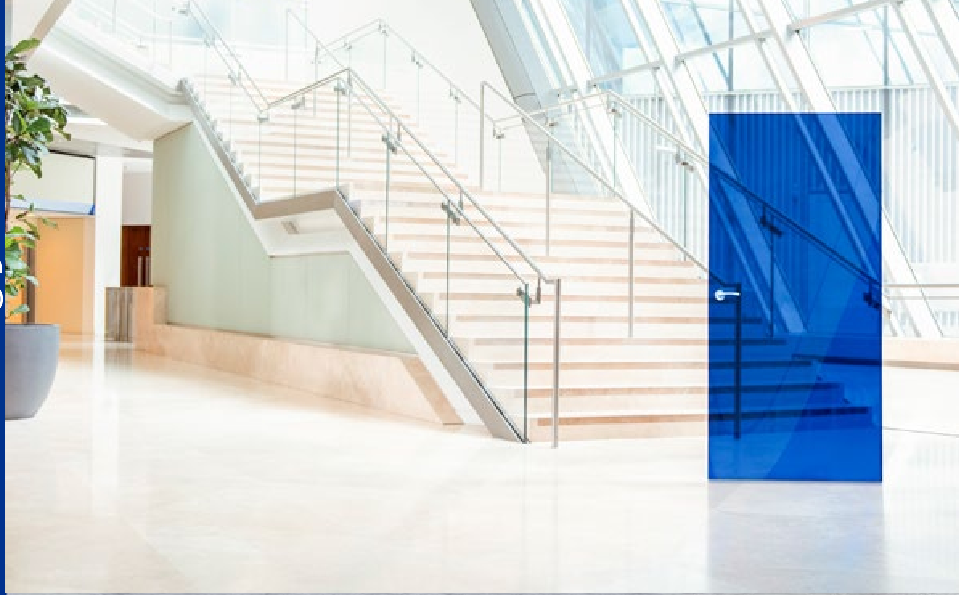
KPMG

Embracing the Wates Principles

KPMG Board Leadership Centre



The Financial Reporting Council (FRC) has issued the first in-depth assessment of the quality of reporting from private companies who have chosen to follow the Wates Principles. The report, which was conducted with the University of Essex, shows that the Wates Principles are the most widely adopted corporate governance code used by large private companies and that "companies are using the principles as a tool for self-reflection and improvement, and seeing the yearly governance reporting as an opportunity, not a burden."

It is relatively early to draw too many conclusions, with some companies still having completed only their first cycle of reporting against the Wates Principles, but the research provides a timely and rigorous analysis of the extent to which companies are grasping the spirit of the Wates Principles in their governance reporting. Many are using the principles as a tool for self-reflection and improvement, and seeing the yearly governance reporting as an opportunity, not a burden. Also, many are seeking not just to tick boxes but to communicate to their stakeholders relevant information about how they are governed, with an appropriate level of detail, using clear and understandable language.

The research

The research project was commissioned by the FRC to identify which companies within the scope of The Companies (Miscellaneous Reporting) Regulations 2018 ('the Regulations') provided a corporate governance statement for financial years beginning on or after 1 January 2019, and of those that did, how many applied the Wates Principles and how many applied an alternative corporate governance code or approach.

For companies applying the Wates Principles, the research also sought to assess the quality of reporting in terms of extent of disclosure, and to identify examples of good practice.

The findings

Out of the 1,206 companies analysed, 410 companies did not provide any information about their corporate governance arrangements, while the remaining 796 companies either included a statement of their corporate governance arrangements in their annual reports (770) or discussed their corporate governance practices but did not prepare a specific statement regarding corporate governance (26).

Of the

796

companies that published a corporate governance statement or discussed their corporate governance in other sections of the annual report,

454

had applied a corporate governance code

Of the 796 companies that published a corporate governance statement or discussed their corporate governance in other sections of the annual report, 454 stated they had applied a corporate governance code. Most of these (98%) referred to the application of one main corporate governance code, while a small number (2%) reported they applied more than one corporate governance code.

77%

of those adopting one corporate governance code followed the Wates Principles

The Wates Principles were by far the most widely adopted corporate governance code, with 348 companies adopting them (i.e. 77 percent of those adopting at least one corporate governance code). Some companies chose to refer to more than one code: ten companies referred to two codes, and one referred to three. Of those companies that did not apply a recognised corporate governance code, very few provided a rationale for non-application.

Other codes that were followed included the UK Corporate Governance Code (19 percent), industry specific codes (4 percent), other national corporate governance codes (1 percent), the Quoted Companies Alliance (QCA) Code and the Institute of Directors' Corporate Governance Guidance and Principles for Unlisted Companies in the UK.

Reporting on the Wates Principles

The vast majority of companies that used the Wates Principles provided some form of explanation of how each Principle was applied.

The research found that companies have been providing good levels of disclosure in terms of general information about their formal policies but relatively lower levels of disclosure when it came to how such policies are applied in practice. Also, when considering the narrative companies used to explain their application of the six Wates Principles, the research found that the highest average levels of disclosure were in relation to Principles Four and Six, while Principles One and Two received the lowest scores. Overall, the assessment concludes that there is room for improvement.

Principle One (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.

Principle One had the lowest disclosure score among the six Principles. The research found that companies disclosed on average less than one fifth of the recommended disclosure elements. In particular, the first area of interest – 'Purpose' – presents the lowest score.

- Only 45 percent disclosed their stated purpose
- Only two companies discussed the processes in place for the board to incorporate shareholder and stakeholder views into its decision making process on the company's purpose
- Only 51 percent of companies explained their culture
- Only a few companies explained what their values mean and how information relating to culture is passed to the board.

Examples of good disclosures cited included EDF Energy Customers Limited (July 2020) for 'Purpose', Dyson Technology Limited (November 2020) for 'Culture', and Ageas Insurance Limited (April 2020) for 'Strategy'.

Principle Two (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.

Out of the four areas identified within the guidance for this Principle, there was a relatively greater extent of disclosure related to the chair of the board, but less on the size and structure of the board, and substantially less discussion about the balance, diversity and effectiveness of the board.

- More than half of the companies (58 percent) disclosed some information about the board chair
- Most companies disclosed some general information about the board's size and structure
- Very few companies (only 2 percent) disclosed information about the procedures in place to guarantee directors' objectivity

Examples of good disclosures cited included Heathrow Finance Plc (February 2020) for 'Chair', Nomura International Plc (March 2020) for 'Balance and diversity', and Yorkshire Water Services Limited (March 2020) for 'Board effectiveness'.

Principle Three (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.

Around

80%

of the companies disclosed at least some general information related to the accountability of their directors

Examples of good disclosures cited included Cabot Credit Management Limited (December 2019) for 'Accountability', Dyson Technology Limited (November 2020) for 'Committees', and DPD Group UK Limited (December 2019) for 'Integrity of information'.

Principle Four (Opportunities 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.

The overall disclosure score for Principle Four was the highest among all six Principles. Of the two main areas covered by the principle – opportunities and risk – there was significantly more disclosure provided for opportunities than for risks.

— General information about corporate opportunities was disclosed by 74% of Wates Reporting companies

— A significant number of companies provided information about the internal channels used to communicate information on principal risks and risk appetite

Examples of good disclosures cited included Western Power Distribution Plc (March 2020) for 'Opportunities' and Allianz Holding Plc (December 2019) for 'Risk management'.

Principle Five (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.

Principle Five can be broken down into three main areas – remuneration policies, delegating remuneration decisions, and subsidiary companies. The research shows that companies provided more information about the delegation of remuneration decisions and, if a subsidiary, on the remuneration practices adopted by the parent company. Generally, remuneration policies were not widely disclosed, with only around a quarter of the companies using the Wates Principles reporting on this.

Most subsidiaries disclosed whether they relied on their parent's remuneration policy

Good disclosures cited for Principle Five included Yorkshire Water Services Limited (March 2020) – specifically for 'Remuneration policies'.

Principle Six (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.

The overall level of disclosure for Principle Six was in line with that of the other Wates Principles. Of the two main areas – stakeholder engagement and workforce – slightly better disclosure was provided in relation to workforce than stakeholder engagement.

— A very high number of companies provided details about who their key stakeholders are, but only 20% of them discussed the dialogue that the board had with such stakeholders.

— The lowest level of disclosure in relation to workforce engagement was about how the dialogue with the workforce had impacted board decision-making.

Examples of good disclosures cited included Lloyds Bank Plc (December 2019) for 'Stakeholder engagement and Ageas Insurance Limited (December 2019) for 'Workforce engagement'.

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.

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Contact us

Timothy Copnell
Board Leadership Centre
T: +44 (0)7801 520802
E: tim.copnell@kpmg.co.uk