



the inside track #33

Highlighting Governance and CSR Issues of the moment

And they thought it was all over!

For those company secretaries that thought they had respite from legislative changes in company reporting because of BREXIT deliberations, three news items this November that may have revised their opinion that “it was all over” for the short term.

First were the 2016 amendments to the Companies Act 2006 (CA 2006). In 2014 the EU introduced its Directive on corporate disclosure of non financial and diversity information in annual reports (2014/95/EU), requiring national ratification by the end of 2016. The Commission introduced this Directive to harmonise company reporting (originally governed by the European Accounts Modernisation Directive of 2003) - significant disparities were seen in the quality of reporting with only a few, especially the UK, seen as leading on the quality of reporting.

In November 2016, the UK government ratified this Directive, introducing two new sections to CA 2006, to ensure compliance with the Directive. These sections are relevant not only to listed companies but also PIEs (public interest enterprises e.g. banks and insurance companies).

Essentially there are no changes in the main requirements for the content of the Strategic Report, as set out under the 2013 amendments to CA 2006, but additional reporting is required on:

- policies relating to non financial matters (including **the diligence process and a description of the outcome of these policies**);
- the principal risks relating to **non financial matters, and how these are managed**.

Also, the Directive required additional reporting on the diversity policy as it applies to the board. In the UK, these have been addressed for listed companies through the FCA amending its DTR (Disclosure Guidance and Transparency Rules) – FCA2016/70 – 7.2.8A. This requires a company’s corporate governance statement to contain:

- a description of the diversity policy applied to the board regarding aspects such as age, gender, or educational and professional backgrounds;
- the objectives of this diversity policy;

- how the diversity policy has been implemented; and
- the results in the reporting period.

Both the CA 2006 amendments and the DTR changes apply for financial years starting on or after 1st January 2017.

Also in November 2016, the government published its Green Paper on Corporate Governance Reform. This was initiated by the Prime Minister’s desire to “build an economy that works for everyone, not just the privileged few” and was prompted by corporate governance issues such as those experienced with BHS and Sports Direct. The Green Paper addresses three areas:

- shareholder influence on executive pay;
- measures to increase the connection between boards and stakeholders;
- extending listed corporate governance aspects to large private companies.

The intention is to bring large private companies’ governance to a similar standard as listed companies. Questions posed in the Green Paper include “What is the case for strengthening the corporate governance framework for the UK’s largest, privately-held businesses” and “Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business”.

The former question implies extending the UK Corporate Governance Code to large private companies (possibly modified for the sector), whilst the latter implies reporting on non financial KPIs, including mandatory carbon emissions.

Importantly for future developments, the Green Paper “includes support for the work to increase gender diversity in the boardroom and in senior management, and Sir John Parker’s work to consider how to improve ethnic diversity, both of which are relevant to the workforce and customer base”. The latter is “A report into the ethnic diversity of UK boards” – known as “Beyond One by 2021”. This report highlights clear business reasons for improving ethnic diversity in boards – not just social and ethical reasons.

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Given the consultation on gender pay gap reporting still awaits government feedback, the speed of these latest developments is somewhat surprising (although the Directive's ratification was at the time limit).

The CA 2006 policy effectiveness changes follow from the Modern Slavery approach. These require fuller explanation of processes supporting policies and measures to determine those processes' effectiveness. For example, many companies have health and safety policies on noticeboards. Most have measures such as Lost Time Accidents, but the latter can be the result of good luck, rather than good management. It is necessary to assess whether there is a health and safety culture in the company and companies need to assess employees' views about the company's attitude towards health and safety, and describe this assessment. This CA 2006 change involves more micromanagement of non financial matters than previously. Similarly the requirement to report on non financial risks and their management is not covered significantly in most annual reports, risks sections. Companies need to decide their material non financial areas and implement risk management of them with more detailed reporting – again more micro management.

The Green Paper addresses the anomaly that being listed has more onerous reporting burdens than private companies. Large private companies (such as UK companies like John Lewis, JCB and Brakes Group, and foreign companies' subsidiaries like Ford, Thames Water and Tata Steel) have more lenient reporting requirements (even though some of these do have high quality reporting). The biggest challenge for large private companies is the need to develop frameworks to comply with mandatory emissions reporting. Obviously the consultation's outcome may lead to changes before legislation.

But for listed companies, reporting on the board's diversity policy is challenging. Whilst companies may say they have been reporting on these matters in their directors' profile, the need to report in the corporate governance statement (with implicit auditability) means that there will need to be a due diligence process in assessing the evidence of directors' profiles. Our experience from a FTSE30 company is that whilst age was not a problem, evidence relating to education and experience was challenging - with some directors being "economical with the

truth"! Going forward companies will require a proactive diversity policy to be in place – and to be able to report on its management and outcomes.

Perhaps the most significant change comes from "Beyond One by 2021". Research in America shows boards with greater diversity have higher performance in creativity and problem solving - ethnic diversity offers business as well as social and ethical advantages.

The report comments that "UK citizen directors of colour" represented only 1.5% of the UK board population, against 14% of UK population. Given the success of the Davies Report on gender diversity in boards, companies should expect in time ethnic diversity in boards is likely to have as much support as gender diversity. This will result in wider ethnicity diversity in UK listed boards – and not just appointing foreign nationals as directors.

The report recommends that existing FTSE350 directors should mentor and sponsor people of colour within their own companies to be ready to assume senior management and director positions. This will require companies to establish leadership development programmes for people of colour in conjunction with key talent programmes, in the same manner as they have for female managers. In itself, this would send a positive message to all its stakeholders.

So BREXIT or not, for now things are not "all over" for company secretaries!

If you would like to know more about The Asesoría Group's work with clients on corporate reporting or developing key talent programmes, and would like an objective and impartial view, please contact one of our Directors, Melissa Kittermaster or Tony Hoskins via melissa.kittermaster@asesoria-group.com.