Think Ahead ACCA

Corporate Governance inquiry

A public consultation issued by the House of Commons Business, Innovation, and Skills (BIS) Select Committee.

Comments from ACCA to the House of Commons Business, Innovation, and Skills (BIS) Select Committee.
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The Association of Chartered Certified Accountants (ACCA) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA has 188,000 members and 480,000 students in 181 countries and works to help them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 100 offices and centres and more than 7,110 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure the accountancy profession continues to grow in reputation and influence.

The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; pensions; education; and corporate governance and corporate social responsibility.

Further information about ACCA's comments on the matters discussed here can be requested from:

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ACCA welcomes the opportunity to comment on the proposals issued by the House of Commons Business, Innovation, and Skills (BIS) Select Committee. The ACCA Global Forum for Governance, Risk and Performance has considered the matters raised and their views are represented in the following.

SUMMARY

Long-term success of the company is the fundamental purpose of corporate governance
ACCA supports the position that the directors' duties should be to deliver the long-term success of the company. This position is clearly set out in main corporate governance principles internationally and is widely accepted. It is also underlined in Companies Act 2006, which however needs to be applied within the wider context of the UK corporate governance framework including the UK Corporate Governance Code and other non-mandatory guidance among others.

Transparency and disclosure facilitate accountability
ACCA supports transparent and clearly presented information as this helps companies communicate better with internal and external stakeholders. This in turn should encourage these stakeholders to scrutinise and challenge companies' strategic decisions and the thinking behind, complementing the existing, formal mechanisms of corporate governance without regulatory burden.

Ethics and culture, not regulations, improve governance
Importantly, we noted a marked absence of discussion on corporate ethics and culture. In many examples of corporate failings, there are frequently issues with the lack of leadership, dysfunctional corporate ethics and culture that negatively affect individuals' behaviour. ACCA has worked on the subject of corporate culture since 2012, and under the initiative **Channelling culture into corporate behaviour**, we have accumulated important insights that can help to address these gaps. We are happy to provide a brief on the existing work as well as the final paper about this important issue to be published before the end of this year. Ethics cannot be legislated; but the existence of intelligent principles might be effective in sometimes making people think and behave differently.

More time for debate to explore views
The comment period of one month is insufficient to explore the depth and breadth of fundamental corporate governance issues. Considering the debate on the Companies Act 2006 ('the Act') took no less than 10 years, we would have liked that the Committee had allowed at least three months for more thorough debate, also by reaching out to a wider range of stakeholders.

ACCA's commitment to facilitate better corporate governance practices
We would very much like to be involved in further debate on issues arising from this Inquiry particularly in relation to diversity. Based on our UK and international UK reach, we bring real expertise in this area by convening stakeholders to collate a breadth and depth of experience to inform the debate.

AREAS FOR SPECIFIC COMMENT:

Directors Duties

Is company law sufficiently clear on the roles of directors and non-executive directors, and are those duties the right ones? If not, how should it be amended?

Yes. We consider that Companies Act 2006 is sufficiently clear on the roles of directors and non-executive directors. We do not believe that company law requires amendment at this moment.

ACCA cautions against excessive focus on the effectiveness of company law or similar legislation, particularly in isolation. Legislative means can become either too generic to enable practical implementation or unduly detailed and complex which reduces applicability: it is not easy to strike the right balance. Furthermore, legislation can be inflexible and resistant to change once enacted, and its binding nature can lead to unintended consequences such as administrative burden and cost.

The effectiveness of corporate governance should be assessed based on a wider framework consisting of non-legislative as well as legislative means. For example, the World Bank adopts this framework-based approach when assessing the standard of corporate governance internationally in its *Reports on the Observance of Standards & Codes*. In the UK, we should take account of the Premier Listing Rules, the UK Corporate Governance Code (the Code), non-binding guidance and established good practice.

Is the duty to promote the long-term success of the company clear and enforceable?

Yes, the duty to promote the long-term success of the company is clear. However, in our view, that duty to promote the long-term success is not suited to enforcement.

As evidenced during the debate over the Sharman Inquiry on ‘going concern’, the concept of time, such as ‘long-term viability’, in a corporate life-cycle is fundamentally subject to judgement and cannot be determined externally. The directors need to communicate the basis of judgement to the shareholders and other stakeholders including shareholders, because their judgement underpins the model and strategy of the business.

Furthermore, the long-term success depends on many factors, from the quality of strategic decisions to a healthy corporate culture. As much as there is no single reason for a company failure, it will not be feasible to identify all relevant factors for the long-term success and enforce them.

How companies aim to deliver the long-term success is therefore up to individual companies. The directors’ duty is that they communicate how they have reached key strategic decisions and how they have implemented them to its stakeholders in unambiguous terms so that the latter may make informed economic decisions in turn. An attempt to define and enforce the duty is likely to lead to an unreasonable expectation gap among shareholders and other stakeholders.

How are the interests of shareholders, current and former employees best balanced?

There is no single way to prescribe how to best balance the interests of different stakeholders. As discussed under the previous point, directors are responsible for delivering the long-term success of companies by making the best possible decisions within given constraints. Balancing the interests of different stakeholders is one of the decisions that directors have to make and reassess on a regular basis.

This can be a challenging task in any time as the resources are always finite. Under financially stressed situations, this can be particularly difficult. The on-going debate on the pension deficit at failed businesses has highlighted that this flexibility can subject relatively vulnerable stakeholders, namely former employees, to disadvantage. While the existing legal basis provides a number of safeguards such as the Pension Protection Fund, we call for Government to monitor the situation to ensure that some form of protection should be in place.

How best should the decisions of Boards be scrutinised and open to challenge?

Scrutiny and challenge should start within the boardroom. The corporate governance debate since the 2007/2008 financial crisis has primarily focused on this point, including the diversity debate, driven by frustration that there is not sufficient rigour within boardroom discussion. The recent trend to examine corporate culture and ethics and the proposal to bring worker representation on boards are the outcomes of this debate and ACCA supports this. Our aforementioned study to examine the link between corporate culture and behaviour was also triggered by this very concern.

Since the introduction of the Financial Reporting Council (FRC)'s Stewardship Code in 2010, the role of shareholders in corporate governance is closely observed by many interested parties, such as firms of accountants, providers of information and voting advice, and the Regulator. This trend has further intensified with new global developments including the negotiation over the European Commission's Shareholder Rights Directive and the United Nations Principles for Responsible Investment (UNPRI)'s report on *Fiduciary duty in the 21st Century*. ACCA supports these developments and believes these contribute to enhance shareholder stewardship.

Calls for transparency on corporate information that clearly communicates a complete picture of business performance, supported by the speed and reach of traditional and social media, have been leveraging the impact of public opinion on public policy. We note that this is an emerging mechanism of corporate scrutiny and challenge that, while less structured and lacking a legal definition, can form a broad consensus on best practice as well as having the potential to influence regulatory and political developments.

Should there be greater alignment between the rules governing public and private companies? What would be the consequences of this?

We support greater alignment between principles but not rules governing both public and private companies. Principles of good governance should be consistent across organisations of all forms of capital structure.

The Code and the OECD Principles of Corporate Governance have provided benchmarks of good corporate governance for decades. This is evident from the fact that a wide range of organisations from the public sector to universities, as well as smaller unlisted companies, has adopted one of these documents to develop their own code of governance. An example of this is *Corporate Governance Guidance and Principles for Unlisted Companies in the UK* published by the Institute of Directors and EcoDa (2010).

Reflecting on the fact that this has taken place without enforcement by rules, we oppose the use of regulations and rules in this regard. Such a task is likely to be complex due to the diversity of the sector and could result in major cost implications for private companies.

Should additional duties be placed on companies to promote greater transparency, e.g. around the roles of advisors. If so, what should be published and why? What would the impact of this be on business behaviour and costs to business?

Disclosure of information should be determined based on how it benefits the decision-making of users of information and not for the sake of transparency as such. The board should exercise judgement when deciding what is useful for understanding the businesses position, performance and future prospects and should take account of the needs of shareholders whilst avoiding producing boilerplate disclosures.

We have noted the reference to transparency over the role of advisors in the question. The use of professional advisors is prevalent today and it is generally considered useful. We do not consider the use of them should allow the directors to shift their responsibility to deliver the long-term success. Therefore, introducing the duty to disclose the use of advisors will only add to administrative cost with little or no benefit.

How effectively have the provisions of the 1992 Cadbury report been embedded? How best can shareholders have confidence that Executives are subject to independent challenge?

In our view, the 1992 Cadbury report established the standard for what we now perceive as good corporate governance practice. While originally developed with listed companies in mind, its recommendations are adopted beyond public companies thanks to its principles-based approach.

ACCA believes that only certain aspects of the effectiveness of the UK Corporate Governance Code, which evolved on the back of the Cadbury report, are suited to objective measurement. Many aspects of corporate governance are qualitative and dynamic, and how each company adopts principles creates a huge variety in practice. We consider that Grant Thornton's annual survey on listed companies' compliance with the Code, and the FRC's *Developments in Corporate Governance and Stewardship* represent useful examples in this regard.

Should Government regulate or rely on guidance and professional bodies to ensure that Directors fulfil their duties effectively?

No. All companies with a Premium Listing of equity shares in the UK are required under the Listing Rules to report on how they have applied the Code in their annual report and accounts. We do not envisage that there are many other areas that could be subject to regulation.

Regarding the role of professional bodies in ensuring that directors fulfil their duties, we do not agree that this can present a generally applicable way forward. While many directors could be affiliated to professional bodies or associations, this is not a requirement. We do not believe that it should be compulsory either as it may stifle the board pipeline.

As a professional body of accountants, professional ethics is of fundamental importance to ACCA and its members. Principles that underpin our Code of Ethics are required of our members who work in business in all positions. It is imperative for us to support them in delivering their responsibilities in a satisfactory manner that may indirectly support Government objectives. Our recent revision of the ACCA qualification enhances training on ethics to a higher level.

Executive pay

What factors have influenced the steep rise in executive pay over the past 30 years relative to salaries of more junior employees?

There is a body of research conducted by think tanks, advisors, major accountancy firm and academics (for example, The State of Pay by High Pay Centre, Into Focus by EY, Form Over Substance? An Investigation of Recent Remuneration Disclosure Changes in the UK by Cambridge Judge Business School and King's College London).

The findings from the research should provide a detailed account of different factors that have influenced the rise in executive pay relative to salaries of more junior employees. One of the main reasons may be that the method of calculation for executive pay is significantly different from that that is used for more junior employees as executive pay is intended to be linked to the long-term success of the company.

How should executive pay take account of companies' long-term performance?

Executive pay should take into account the company's long-term performance in the context of the overall duty of directors to promote the long-term success of the company.

There are a number of mechanisms available and have been tried. This includes performance related pay based on a matrix, bonus schemes, share options and long-term incentive performance arrangements. There probably is no 'one size fits all' answer to pay arrangements. This is because each company's business model and the likely contribution of executives to achieving long-term performance will be different.

When assessing the long term success of a company, it is desirable that a range of indicators and benchmarks are used that are not exclusively based on financial performance, but also reflect their performance in developing the other forms of capital that are critical for longer-term value creation. Even in financial terms it is better to use measures that capture the more complete picture of performance - for example closer to profit before tax than earnings before long-term costs such as depreciation and pension provision.

Companies should disclose both the mechanisms and the measurement of long-term success that should be chosen in a transparent way should also be subject to development by the remuneration committee and the scrutiny of shareholders. The regulatory authorities should encourage good practice and hold directors to their fundamental duty in relation to remuneration rather than to set them by legislation.

Should executive pay reflect the value added by executives to companies relative to more junior employees? If so, how?

We do not think this would be feasible. The value added by individuals can be a very subjective concept, depending on the nature of work employees perform. It may be relatively straightforward where performance is measurable solely on the quantitative basis. In any other situations, this is likely to be more challenging. Directly linking executive pay with the value added either in the short or long term is unlikely to present a meaningful solution to the on-going pay debate.

What evidence is there that executive pay is too high? How, if at all, should Government seek to influence or control executive pay?

ACCA believes that the communicability of pay disclosure is fundamental to enhancing the value of the pay disclosure and we welcome the Governments role in encouraging companies to do so. We do not agree that Government should directly control executive pay otherwise.

Shareholders have a mechanism to demonstrate their views on executive pay at AGMs. Many of them follow the advice issued by proxy and voting advisors that in turn are informed by a number of remuneration principles issued by bodies that represent pensions, investors and other stakeholders as well as the Code. Their recommendations clearly encourage simpler and clearer pay structures better linked to the long-term performance.

In achieving this, it is important that the board, particularly the remuneration committee vigorously challenge whether and how the executive pay structure aligns with the long-term performance of the company before presenting it to shareholders for approval.

Recent high-profile shareholder actions demonstrate that the current framework for controlling executive pay is bedding in effectively? Should shareholders have a greater role?

We believe that it is premature to conclude on whether the current framework is effectively bedding in. Available information on the impact of shareholder actions is still limited, as the relevant framework came into effect relatively recently. It is important that we monitor shareholder actions and encourage initiatives to promote their stewardship.

Composition of Boards

What evidence is there that more diverse company boards perform better?

In principle, ACCA is of the view that board diversity can contribute to the diversity of thinking in companies. Generally, independent mind-set and different experiences can help directors to challenge constructively each other, leading to robust board discussion, fending 'group-think' and enabling better decision-making.

However, this cannot be achieved simply by bringing in individuals with different backgrounds to the boardroom. Boards need to review their membership in the light of challenges that the business faces, and introduce members who are capable of helping the business to address these challenges.

How should greater diversity of board membership be achieved? What should diversity include, e.g. gender, ethnicity, age, sexuality, disability, experience, socio-economic background?

Boardroom diversity is a means to an end in achieving the long-term success of the company. Companies need to explore the board composition that is most likely deliver their overall strategy. In doing so, companies also need to consider other means to obtain wider stakeholder views because no board can accommodate representatives from all stakeholder groups.

The recently introduced EU Non-Financial Reporting Directive requires the disclosure of the level of diversity of the board of directors. This requirement should help companies to communicate how they have approached the challenge and has come to the conclusion.

Companies need to do more to maximise the benefit of having diversity in the boardroom. For example, empowering board members with sufficient induction and regular training, complemented by monitoring and review of their effectiveness can help facilitate robust discussion. Board diversity alone cannot improve the effectiveness of the board without these other efforts.

Should there be worker representation on boards and/or remuneration committees? If so, what form should this take?

This depends on a number of factors. We revert to our earlier observation that the purpose of diversity is to increase the rigour of boardroom discussion. Worker representation on boards should be considered in this light. Whether a board member is a worker or not, the responsibility of the board is to collectively deliver the long-term success of the company.

There have been examples of workers being represented on boards both in the UK and internationally. For example, the OECD Principles of Corporate Governance (2015) refers to various models of employee participation in corporate governance including but not limited to employee representation on boards. In the UK, there were examples of workers on boards, following the Bullock Report (1977). Furthermore, continental European countries furthermore provide a range of board structures with worker representation.

Again, ACCA is of the view that the decision to build a board that delivers the company strategy should come before that on an appropriate form of worker representation.

What more should be done to increase the number of women in Executive positions on boards?

ACCA believes that this has to be addressed by growing the pipeline of talent, and offering mentoring support. ACCA also recommends that the scope of the successful initiative 'Women on boards' led by Lord Davies, that has until recently focused on gender diversity on boards, should be extended to women in executive positions.

In this area, ACCA has promoted the position of women in executive positions through research publications such as the 2013 report: *Paving the way to opportunities: women in leadership across the Commonwealth* which lists six recommendations to achieve diversity in boardroom and senior leadership positions.

Another ACCA publication: *Women in Finance: a Springboard to Corporate Board Positions?* explores whether having a financial background or qualification affects the likelihood that senior women will obtain a FTSE 100 board directorship.

More recently, Helen Brand, ACCA Chief Executive, spoke at an Asian Federation of Exhibition and Convention Associations Conference on ways to promote gender equality in the boardroom and ACCA has also publicly supported initiatives such as International Women's Day.

ACCA also has almost half a million students around the world studying to become professional accountants. Currently 54% of this number are female, a percentage that is growing year-on-year. Clearly, when it comes to increasing diversity in business, the pipeline of motivated, ambitious young women is extremely healthy. The next step for ACCA is to do everything in our power to ensure the path to the top is clear and open for our female students.