



**Financial Reporting Council
Response to Consultation Paper on Revisions
to the Corporate Governance Code**

26 February 2018

Introduction

1. ICAS welcomes the opportunity to comment on this consultation. We are a leading professional body for chartered accountants with over 20,000 members working across the UK and internationally. Almost two thirds of our working membership work in business; others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.
2. ICAS's Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key Points

3. Overall, we are supportive of the proposed changes to the Code and direction of travel. We have also made suggestions on where forward-looking practice could be introduced in the supporting guidance.
4. An outline of interim findings from an on-going research project entitled 'Speak up? Listen up? Whistle-blow?' has been included in Annex 1 for your information as it contains observations which are relevant to the proposed revised code (provision 3).

Any enquiries should be addressed to Alice Telfer, Head of Business Policy and Public Sector, atelfer@icas.com

Specific responses to consultation questions

Introduction

1. Q1. Do you have any concerns in relation to the proposed Code application date?

For those adopting the Code for the first time, some may find the implementation timescale tight. Whilst the comply or explain method offers flexibility, expectations need to be managed. Awareness raising amongst investors and voting agencies would be useful for those engaging with companies beyond the FTSE 350.

2. Q2. Do you have any comments on the revised Guidance (Appendix B – Revised Guidance on Board Effectiveness)?

No.

3. Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

We recommend that the wording should be more flexible and less prescriptive. The second sentence could be moved to the guidance (see extract below) and "*would normally be...*" changed to "*could normally be*". Greater emphasis should be given to the need for a combination of approaches/different solutions to achieve the intention of improved workforce engagement and communication. An expectation should be set to raise the quality and standard of engagement rather than how to do this. The onus should be on the company to choose what is most suitable and explain it.

~~... This would normally be... a director appointed from the workforce, a formal workforce advisory panel or a designated non-executive director...~~

Provision 3 revised UK Corporate Governance Code

Section 1 – leadership and purpose

4. Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

Principle A includes the expectation that a successful company has a function to contribute to wider society. How well this is embedded and implemented should be seen before any further developments in the Code itself are made.

Whilst we do not believe that a specific reference to the UN SDGs should be in the Code, we recognise that there is growing stakeholder awareness and demand for business to respond to the global commitment to achieving the SDGs. The UN SDGs are a natural reference when considering this issue/benchmark for measuring broader sustainable success. There is potential to spread good practice and influence the direction of travel through modifying the Guidance on Board Effectiveness.

5. Q5. Do you agree that 20 per cent is ‘significant’ and that an update should be published no later than six months after the vote?

Agreed, although the level should be kept under review to ensure it remains appropriate. Further clarification of what happens when votes are withheld would be helpful. Our understanding is that withheld votes are not classed as a vote.

Wording should clarify that the 20% rule applies to total issued share capital.

More emphasis is needed that the updates (provision 6) focus on the effect, results and what is changing to keep reporting active (rather than boiler plate). It may also be appropriate to explain where dissent is focused in a small number of voters. This could be suggested in supporting guidance.

In view of the tight timescales between receiving the results, voting and the AGM, boards will need some time to consider how to react to a 20%+ dissenting vote and to formulate appropriate actions. This may only require an additional 2-3 weeks from the date of the AGM. The actions should be either reported in the Annual Report or signposted to the information on the company website.

Section 2 – division of responsibilities

6. Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

We do not believe that an external evaluation should be a requirement for companies below the FTSE 350 but would support it as suggested or recommended good practice. The comply or explain framework raises the bar so a clear statement of what the company *should* do encourages compliance. External board evaluations can be disproportionately expensive for smaller companies and there is no guarantee of a quality outcome as the value it offers will vary depending on the quality of the reviewers.

There is some inconsistency in the wording between the revised Code (provision 21) which says companies “*should have an externally facilitated board evaluation*” and the [Guidance](#) which says “*The Code recommends that premium-listed companies have externally-facilitated board evaluations at least every three years*”. This could create some confusion and we suggest wording is clarified to confirm this is recommended good practice for companies beyond the FTSE 350.

7. Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

Yes, for non-executives but not for chairs who are appointed from within the board as we are concerned that this may affect chair succession plans which is not in the best interests of the business.

As a suggestion, in the circumstances where a NED is appointed chair, a 12-year period could be applied.

8. Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

Setting an end date is appropriate.

Section 3 – composition, succession and evaluation

9. Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

Yes, and we agree that greater focus on the pipeline to supply boards is needed.

10. Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

Yes.

11. Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

Diversity is much more than gender and ethnicity. Background, education, personality, experience, diversity of thought etc. are also important. If reporting only certain aspects, then it suggests that the other aspects of diversity are less important. We have a concern that reporting percentages risks creating a tick box mentality and narrow focus at the expense of achieving diversity more broadly. Nonetheless, we are aware that greater transparency and insight offered into the Board's diversity can help to drive behaviour and lead to greater diversity in the future.

We suggest that companies should be encouraged to explain (in some detail) how they ensure that there is diversity in its broadest sense across their organisation. The more people think about this for their individual teams within an organisation (not just at Board level) the better companies are likely to perform. In our view, if we end up just looking at gender and ethnicity we will not be as successful.

Section 4 – audit, risk and internal control

12. Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

Yes.

13. Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

Yes.

Section 5 – remuneration

14. Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

We suggest that the wording in provision 33 is amended, as “oversee” indicates a significant expansion of the remit which strays into executive management territory.

It should ~~oversee~~ take account of remuneration and workforce policies and practices, ~~taking these into account~~ when setting the policy for director remuneration to ensure that there is alignment throughout the organisation.

15. Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

We suggest that the requirement for a short post-employment holding period should be strengthened.

We support the provision in Appendix A para 36 that remuneration schemes should promote long-term shareholdings by executive directors that support alignment with long-term shareholder interests.

A broader range of performance considerations could be encouraged in light of the increased interest in aspects of performance not measured in financial terms.

We also suggest that to support consideration of the wider sustainability agenda, the Guidance on Board Effectiveness could be expanded. It could suggest that executive remuneration is linked to achievement of strategic goals to enable long term value creation. This could include: improvement in culture; reduction of the gender pay gap; improved mechanisms to identify sustainable development risks and opportunities; and, evidence of responses to such risks and opportunities. To help achieve this, the questions for remuneration committees in Appendix B page 22 could include: How can executive remuneration reflect achievement of strategy which is designed to support long term value creation (which is not only measurable in financial terms)?

16. Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

Boards do try to exercise discretion when possible and where needed. The linkage and alignment with the pay policies of the wider workforce may help as it should highlight inconsistencies that require discretion to be exercised.

We support the shortening of the Code. To avoid losing sight of some of the good practice which is still relevant in certain deletions, perhaps this could be referenced in guidance. Examples include:

- Provision A.1.3
- Supporting Principle B.1
- Provision D.1.2
- Latter part of Provision D.1.3
- Provision D.2.3
- Provision E.2.1
- Provision E.2.4.

Stewardship Code

17. Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?

The provision of assurance should be included if the Stewardship Code and investor engagement is to have teeth. To make the assurance more useful and effective, the scope should be wider to avoid it being seen as a box-ticking exercise. Greater transparency and more disclosure about the scope and the results of findings should also be encouraged.

Other matters for consideration

We believe there would be value in encouraging companies to communicate how the company purpose, viability statement and sustainability join up. The Strategic Report would be an appropriate place to bring these themes together. The aim is to offer users further clarity and business insights to enhance understanding of the business model.

Speak up? Listen up? Whistle-blow? How ICAS members respond to ethical dilemmas – based on interim findings (relevant to the Code proposals provision 3)

These comments have been prepared by the researchers: Professor Catriona Paisey, Professor Nicholas Paisey and Dr Yannis Tsalavoutas.

The survey was completed by chartered accountants. They worked for a variety of organisations including, but not confined to, accounting firms and public interest entities.

We support the proposal to shift responsibility to the board rather than the audit committee as this provides a visible statement of intent at the highest level within the organisation and therefore more effectively sets the tone from the top. Our research shows that responsibility for whistleblowing and speak up arrangements currently rests in a variety of locations including the board, the audit committee, executive team, human resources and compliance departments. Specifying overall board responsibility, which the board may then delegate, provides consistency and clarity.

We agree that the board should be charged with establishing a method for gathering the views of the workforce and that the board should review this and ensure that arrangements are in place for investigation and follow-up action. Our findings show that a clear majority of respondents worked in organisations that had ethical policies, codes of ethics, sets of core values and policies covering speaking up and whistleblowing. Furthermore, the vast majority of respondents knew how to access speak up and whistleblowing mechanisms. However, our findings suggest that although arrangements may exist in organisations to deal with investigation and follow-up, they may not always be used, or may not be used effectively. A significant minority of our respondents had not received training in speaking up, how to deal with ethical matters reported to them or effective listening. Only just over half of respondents felt that their organisational speak up and whistleblowing policies were effective. Where our respondents had raised ethical concerns, whilst most were satisfied with how these had been dealt with, around a quarter of respondents stated that the matter had not been resolved and around one in twelve did not know whether the matter had been resolved. This contributes to our finding that, overall, a third were not satisfied with how the concern was resolved. **We therefore suggest that, in addition to the proposed wording, the proposed text should state explicitly that the board should also be required to periodically review the effectiveness of the arrangements that are in place and to report on the outcome of their periodic review to the extent possible without breaching any confidential information.**

We support the proposal to refer to the 'workforce' rather than to the 'staff of the company' as the former suggests employed staff whereas references to the workforce can include extended workforces, including self-employed and outsourced workers, thus better reflecting modern working practices. Our literature review shows that current UK legal protection for whistle-blowers, while very welcome, does not provide protection for all people who have concerns. For the avoidance of doubt, **we suggest that the term 'workforce' should be defined in the code and that this definition should be broad so that it encompasses groups such as self-employed and outsourced workers.**

We agree that the proposal to refer to 'concerns' rather than the wording in the current code of 'concerns about possible improprieties in matters of financial reporting or other matters' is preferable as the order of the currently existing wording gives precedence to financial reporting improprieties rather than other ones. Our research shows that our respondents had raised concerns not only about accounting irregularities but also about a wide range of other matters including auditing and tax issues, fraud, theft, bribery, corruption, bullying, discrimination and harassment.

We recognise that organisations may have a variety of channels for people to report issues of concern, and that the intention in both the current and proposed code regarding whistleblowing provisions is to provide a mechanism for capturing serious matters that do not fall within the scope of regular reporting lines or where the person making the report does not feel that they can use the alternative channels. In addition to actual concerns of such nature, there may be instances where people have a feeling of concern but do not possess sufficient information to know whether these represent an actual concern. It is important that there is a mechanism in place for people to be able to make enquiries in these circumstances as well as to report actual concerns as these enquiries may lead to the discovery of matters of actual concern.

Our respondents reported that two-thirds of their organisations permitted people to raise enquiries as well as allegations, which we regard as welcome. **We therefore suggest that the term ‘concerns’ be augmented by explaining that the ‘speak up’ channel may also be used for hunches or suspicions of an ethical nature which are either inappropriate for other communication channels or for where other channels have failed.**

We support the inclusion of anonymity, if the person raising the matter so wishes, as well as confidentiality. Our literature review had indicated the benefits of permitting anonymity though there can be downsides, particularly as feedback cannot be provided to the person raising the concern. Our research findings show that while around a quarter of respondents were in organisations that permitted concerns to be raised only confidentially, a clear majority permitted concerns to be raised both confidentially and anonymously. On balance, we believe that permitting both confidentiality and anonymity maximises the likelihood of people feeling able to raise concerns.