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Accountants in Business

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Value-added governance

Mark Wearden MSc FCCA FCG

Corporate purpose – recognising success

The current governance and audit reform debate

Aligning strategy, risk and control

Sceptically challenging the metrics

The financial viability pulse

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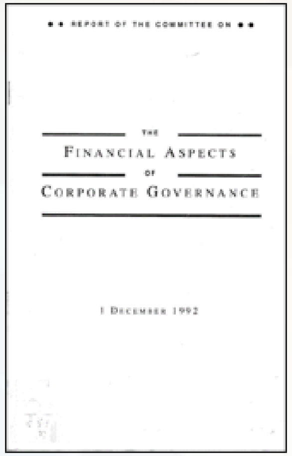
Corporate purpose – recognising success

The Financial Aspects of Corporate Governance 1992

- Corporate governance is the system by which companies are directed and controlled.
- Boards of directors are responsible for the governance of their companies.
- The board's actions are subject to laws, regulations and the shareholders in general meeting
- The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship.


REPORT OF THE COMMITTEE ON

THE

FINANCIAL ASPECTS

OF

CORPORATE GOVERNANCE

1 DECEMBER 1992

Companies Act 2006 section 172

A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.

and in doing so have regard (amongst other matters) to —

a) the likely consequences of any decision in the long term,

b) the interests of the company's employees,

c) the need to foster the company's business relationships with suppliers, customers and others,

d) the impact of the company's operations on the community and the environment,

e) the desirability of the company maintaining a reputation for high standards of business conduct, and

f) the need to act fairly as between members of the company.

UK Corporate Governance Code 2018

- A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.

- The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.

- The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed.

the significant decisions taken during the year and how they link to the company's purpose and strategic priorities, and for each significant decision:

– how the board or management reached the decision, including information used to back it up and any long-term considerations;

– how stakeholders were considered in reaching the decision, including consideration of feedback and engagement activities, and the impacts of the decision on different stakeholders;

– the difficulties or challenges in making the decision, including how different stakeholder needs or concerns are balanced, and any short-term negative consequences which are offset by long-term benefits; and

– the expected and/or actual outcomes of the decision, including how they are reflected in current performance and metrics, and the long-term implications on the company.

Milton Friedman (1970)

A corporate executive is an employee of the owners of the business, with direct responsibility to those employers, to conduct business in accordance with their desires, which will generally be to make as much money as possible while conforming to the basic rules of society – law and custom.

SHAREHOLDER

Colin Mayer (2018)

The sole pursuit of profit drives bad business and bad outcomes:

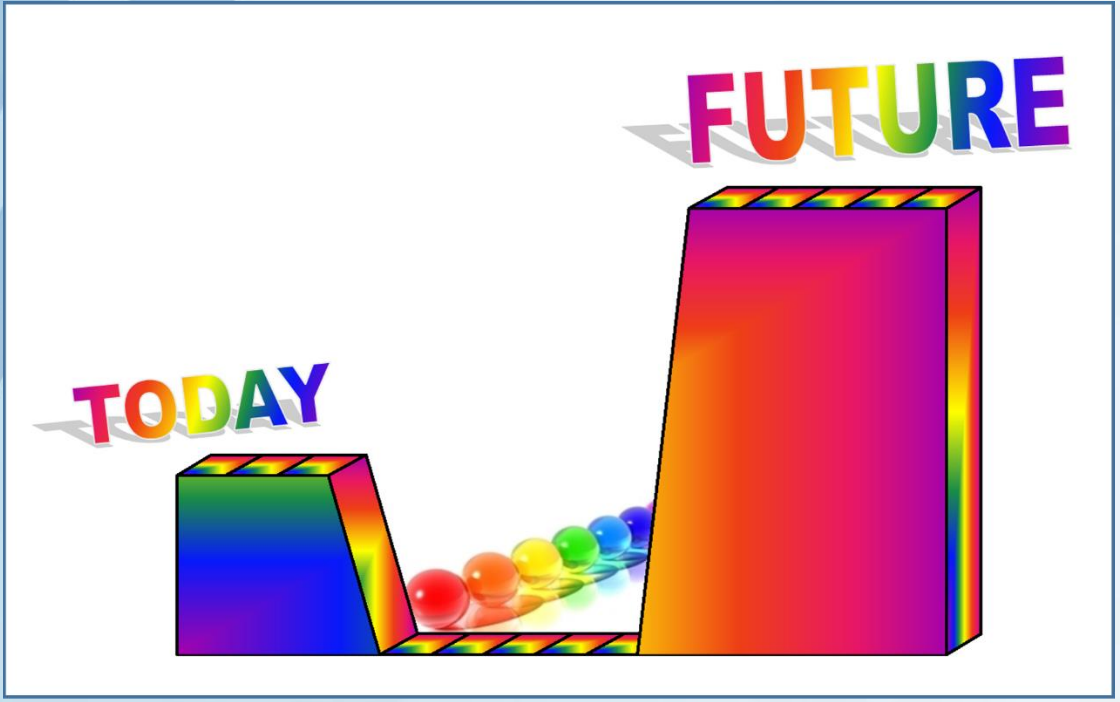
- Profit is a condition of achieving a purpose, not a purpose in itself;
- The agglomeration of capitals within a company should drive long-term commitments;
- All stakeholders are at risk from the opportunistic behaviour by shareholders.

STAKEHOLDER

Purpose and success measures

•Achieving a target market share	GROWTH
•Maintaining position	SURVIVAL
•Creating an ever-expanding empire	CONTROL
•Satisfying the shareholders	WEALTH
•Maximisation of profit	RETURN
•Repayment of gearing	CASH
•???	???

Strategic thinking



FUTURE

What needs to change?

Are timeframes realistic?

How will we recognise success?

PAST

What can we learn?

What has been achieved?

How has it been measured?

PRESENT

What are today's values?

What are the driving forces?

Do we understand our viability?

Corporate purpose

Customers are at the heart of everything we do and guide every decision we make. We push ourselves to improve for our customers — and that is embedded in our core purpose of serving shoppers a little better every day, doing what is right for our customers, communities and the planet.

Unilever

Purpose-driven performance

One in three people around the world use our brands every day. With this reach comes responsibility – and opportunity. That's why we've made it our purpose to make sustainable living commonplace. To help people live well within the limits of the planet. This isn't just something we say – it steers our decisions and shapes our actions, at every level of the business.

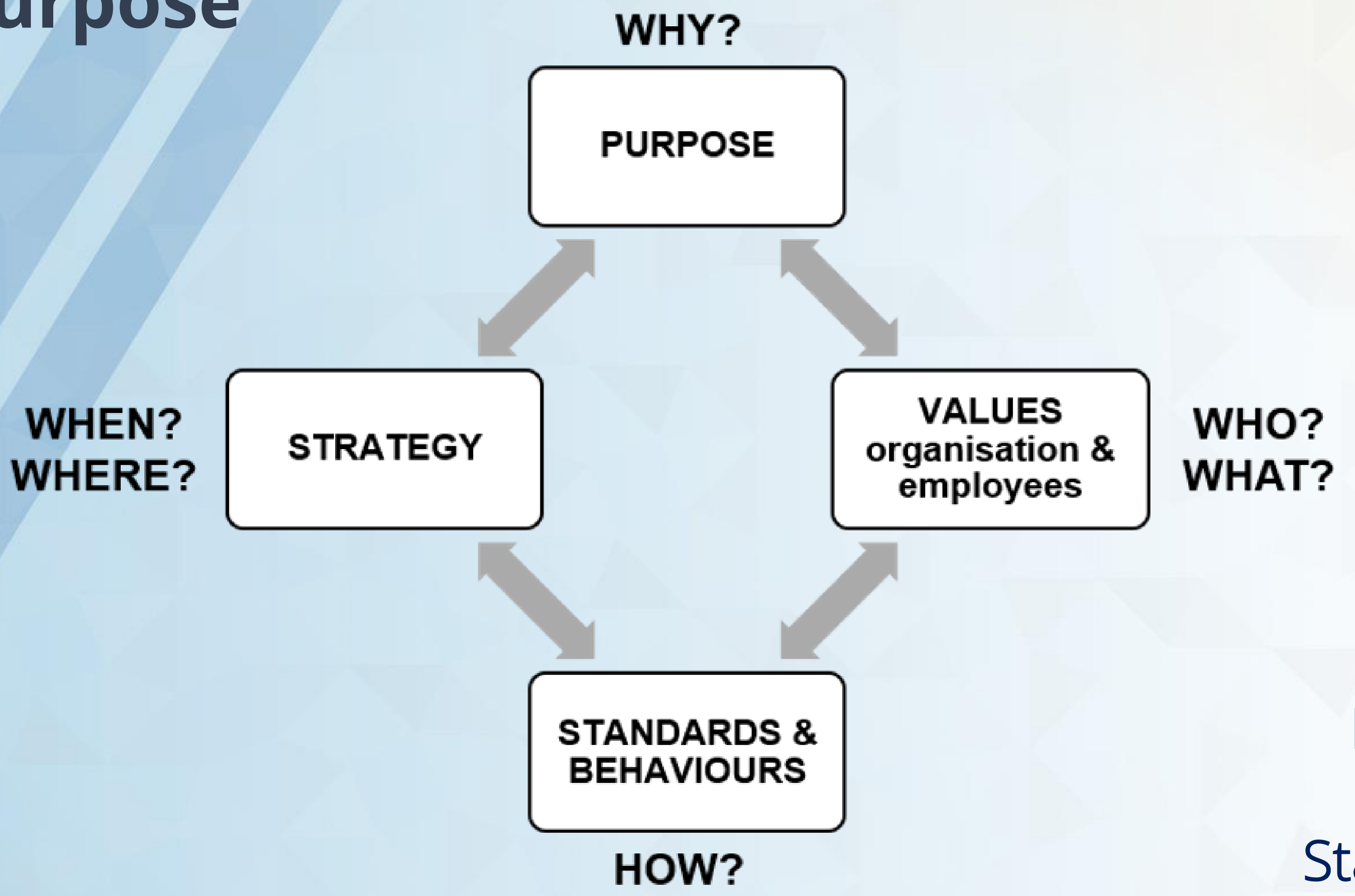
Our focus on purpose goes back to the days of one of our founders, William Lever, well over 100 years ago. It's part of Unilever history, and it's integral to our future. This is why we want all our brands to take a stand, and act, on the big social and environmental issues facing the world. We believe we'll be a better and more successful business by following this path.

Defining purpose

Viability

Reputation

Sustainability



Investors

Directors

Stakeholders

Consider the following two companies. Imagine in each case, you are the finance director.

How will the corporate purpose and the stakeholders differ?

MTP Limited – Large private company

- Head office and 2 factories in Leeds
- Specialist in machine-tooled-parts for vehicles
- 38 individual family shareholders (from 1% to 26%)
- CEO (3rd gen. family); CFO (external); Chair (2nd gen family); 5 family directors; 1 INED
- Multi-national customer base
- Manufacturing continued throughout UK lockdown
- Financial snapshot
  - 2019: £385m revenue; 40% gross margin; 15% PBT
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  - Dividends paid at continuing rate
- Supply-chain issues at both ends
- Company (family) culture is *"jobs = CSR"*
- Annual report is tick-box and ignores ESG

Open-door plc – AIM listed company

- Head office in London
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The current governance and audit reform debate

Reaction to failure

carillion

BHS
BRITISH HOME STORES

House of Commons
Business, Energy and Industrial Strategy Committee

Competition & Markets Authority → **Competition and resilience** → **Audit market & services**

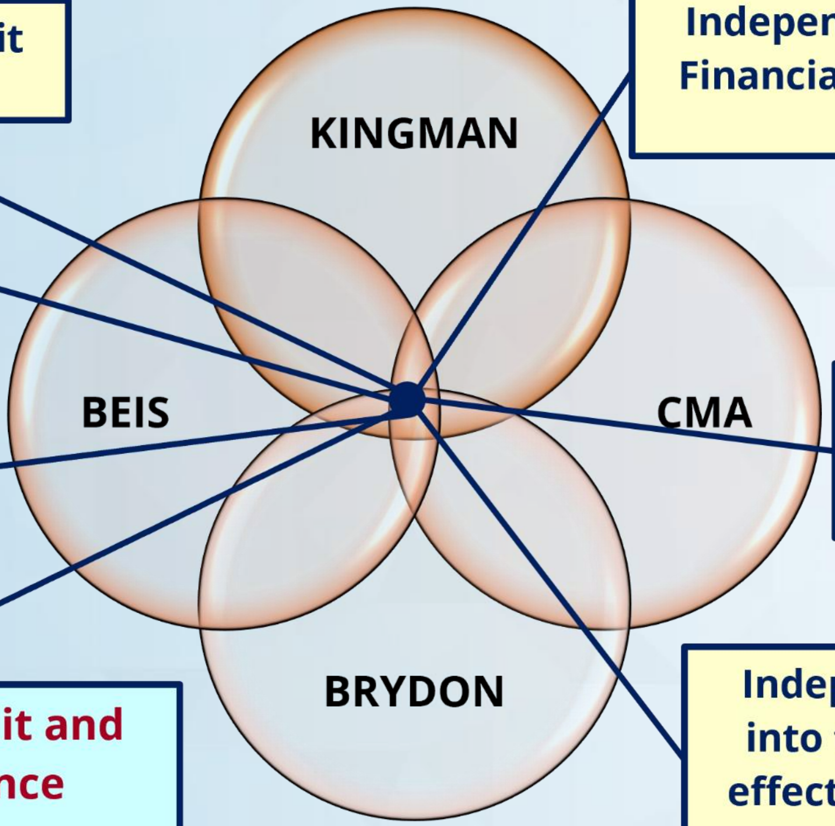
Brydon → **Scope of AUDIT Reporting** → **Purpose Scope Quality**

Kingman → **Regulation** → **ARGA The new regulator**

Kingman	CMA	Brydon
New regulator – ARGA Audit Reporting and Governance Authority • Accountable to parliament • Statutory levy • Forward looking • Robust intelligence • Independence • Viability focus	Recommendations to UK Government • Regulatory oversight of audit committees • Mandatory joint audit for FTSE350 • Operational split within Big Four auditors – audit vs non-audit • Five-year review of progress by ARGA	Audit process and Audit product • Assess, Assure and Inform • Improve audit quality and effectiveness • Redefining audit • The Corporate Auditor

A plethora of consultation documents!

- **The Future of Audit** — *99 pages*
- **Consultation on Kingman** — *51 pages*
- **Consultation on CMA** — *28 pages*
- **Restoring trust in audit and corporate governance** — *232 pages*
- **Independent review of the Financial Reporting Council** — *95 pages*
- **Statutory audit services market study** — *219 pages*
- **Independent review into the quality and effectiveness of audit** — *138 pages*




Department for Business, Energy & Industrial Strategy

Restoring trust in audit and corporate governance

Consultation on the government's proposals

March 2021

Closing date: 8 July 2021

CP 382

1. The Government's approach to reform
2. Directors accountabilities
3. New corporate reporting
4. Supervision of corporate reporting
5. Company directors
6. Audit purpose and scope
7. Audit committee oversight
8. Competition, choice and resilience
9. Supervision of audit quality
10. A strengthened regulator
11. Changes in the regulator's responsibilities

Value-added governance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1. What are the government hoping to achieve?
2. Directors need reminding of accountabilities.
3. We need additional reporting, but what ?
4. Hang on, that reporting will need more supervision.
5. Directors need to be held to account.
6. If we have to have an audit, what is the purpose?
7. We can build some brick walls for audit committees to climb over.
8. We can solve audit by spreading the risk amongst the firms.
9. Hang on, that additional audit will also need more supervision.
10. We have to give the new regulator teeth and a big stick.
11. We must increase regulatory power and the areas of control.

How might this impact you?

- **Listed companies + PIEs + ?**
- **Increased regulation and oversight (partly size dependent)**
- **New auditor profession and professional standards**
- **Enhanced CEO and CFO accountability – internal controls**
- **Additional reporting (partly size dependent)**
- **CA2006 s172 – enhanced transparency in reporting**
- **ESG agenda – enhanced reporting and accountabilities**
- **???**

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Aligning strategy, risk and control

UK Corporate Governance Code 2018

Principle O

The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

Strategy → Risk → Control

The heart of value-added governance

Strategy:

- what are we trying to achieve?

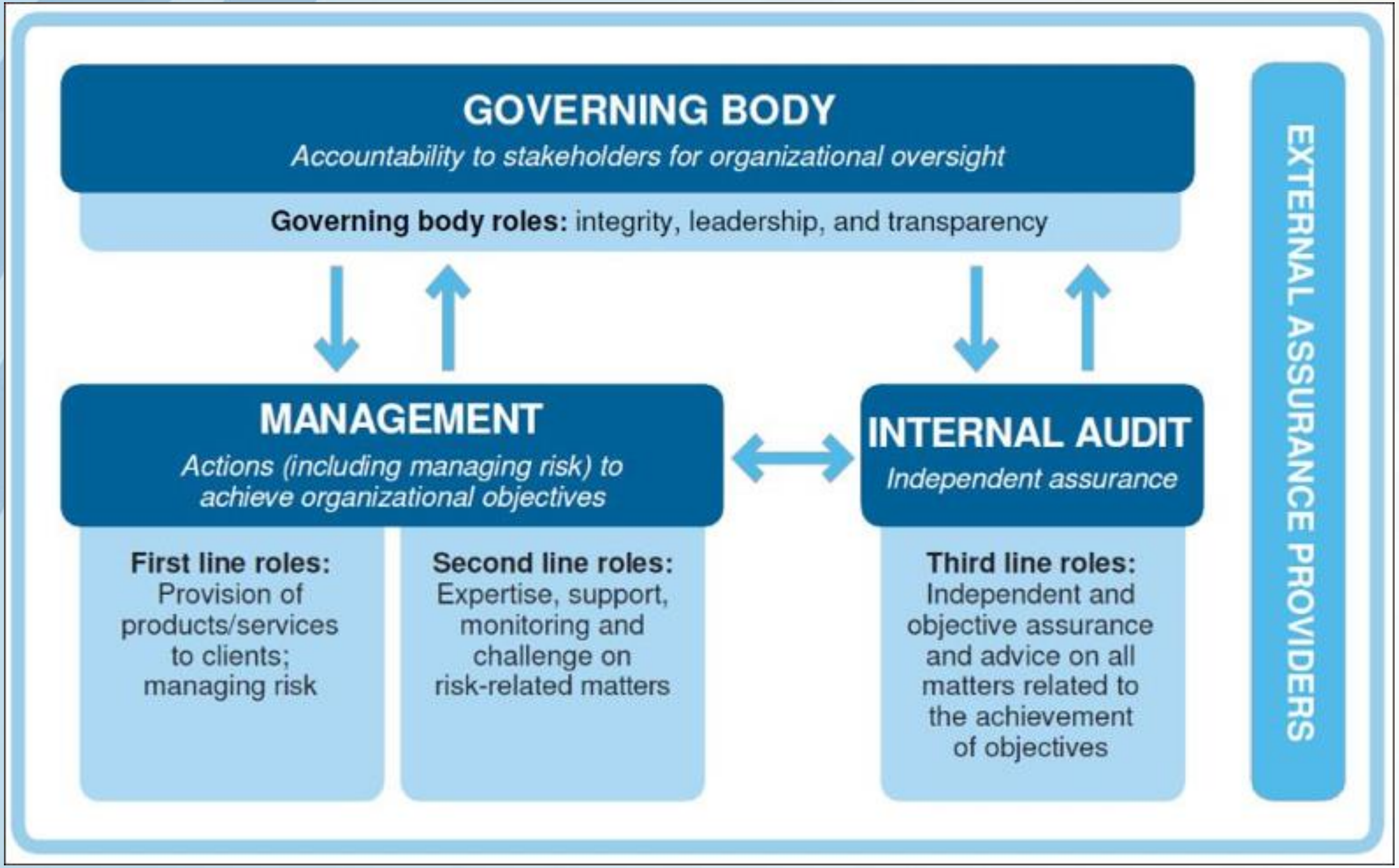
Risk:

- what are the perceived dangers in trying to achieve the strategy?

Control:

- how do we, as accountants and/or directors, fulfil our legal and ethical obligations by trying to ensure appropriate and adequate mitigation is in place to protect the assets of the company (monetary and people) whilst combatting the risks (forces) that will challenge our ability to achieve the strategic objectives (purpose)?

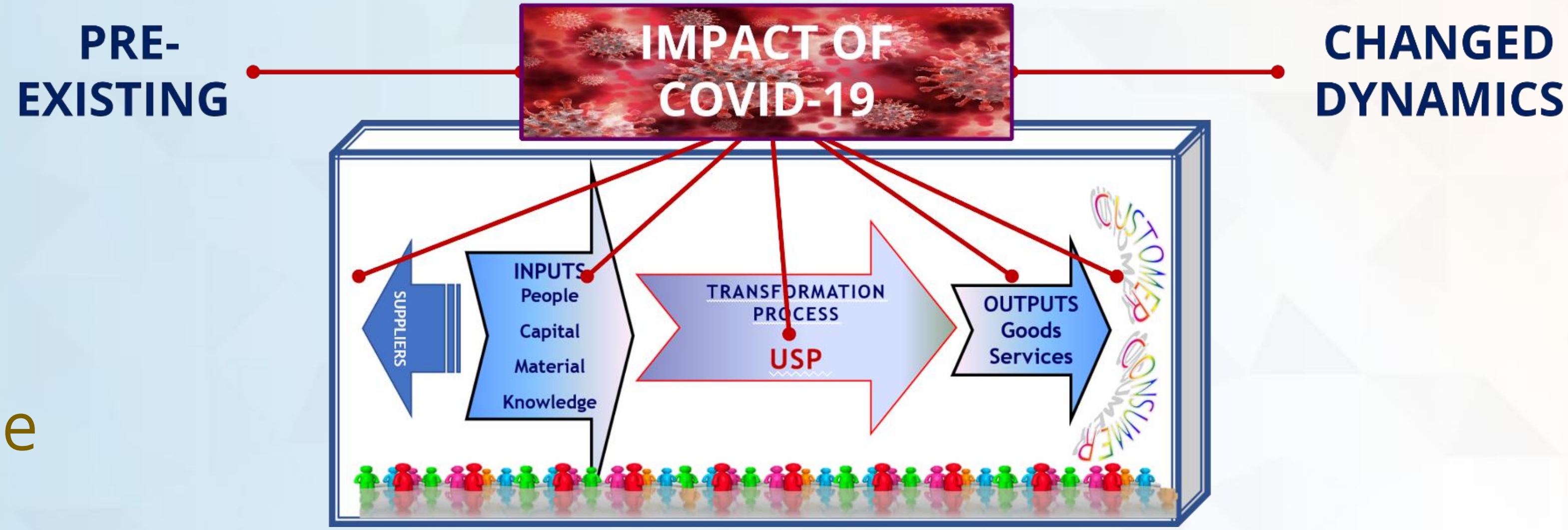
Three lines


GOVERNING BODY
Accountability to stakeholders for organizational oversight
Governing body roles: integrity, leadership, and transparency
MANAGEMENT
Actions (including managing risk) to achieve organizational objectives
First line roles: Provision of products/services to clients; managing risk
Second line roles: Expertise, support, monitoring and challenge on risk-related matters
INTERNAL AUDIT
Independent assurance
Third line roles: Independent and objective assurance and advice on all matters related to the achievement of objectives
EXTERNAL ASSURANCE PROVIDERS

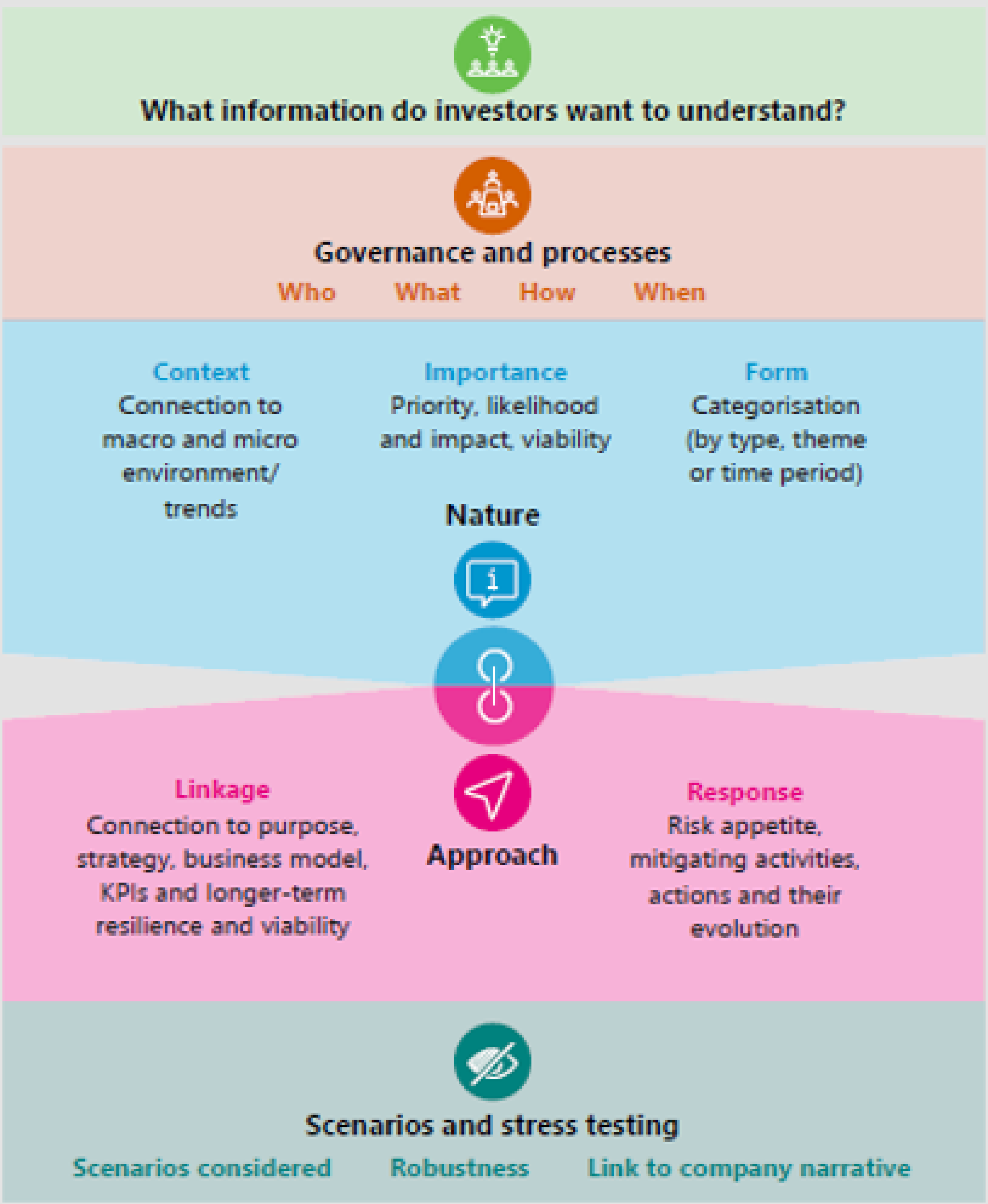
Supply-chain thinking

Differentiate between

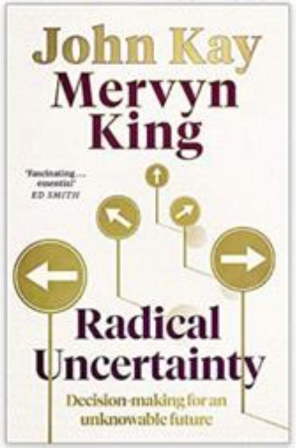
- Situations which need to improve or change
- Complexities which need managing
- Issues which need tackling
- Difficulties which need to be overcome



Value-added governance



Radical uncertainty versus risk



Risk

- range of definable outcomes to which probabilities can be applied

Radical uncertainty

- we simply do not know
- obscurity; ignorance; vagueness; ambiguity; unknown unknowns; Black Swans

Resolvable uncertainty

- can be resolved or mitigated through research, learning and/or inquiry

1 strategic objective for each company aligned to risk and control

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Sceptically challenging the metrics

FRC expectations from accountants/directors

- insight and information;
- integration into strategic planning;
- metrics and monitoring;
- uncertainties and scenario analysis;
- fair, balanced and understandable reporting;
- in-company and in-board competence and expertise; and
- public policy approach

Finding the right level of metric

DIRECTORS

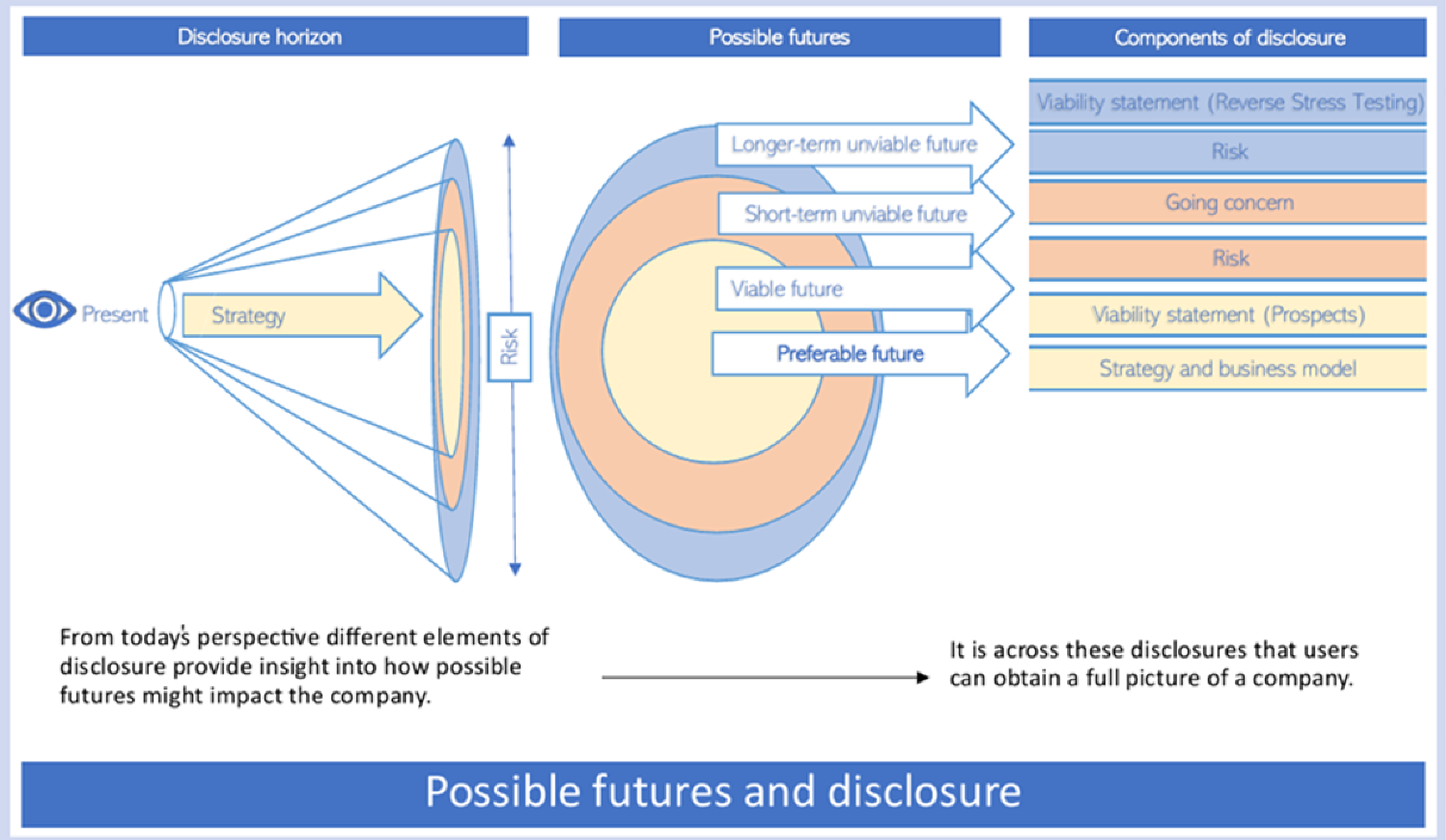
AUDITORS

REGULATORS

STAKEHOLDERS WILL HAVE

DIFFERING REQUIREMENTS & EXPECTATIONS

Determining the focus and timeline



Building aligned metrics

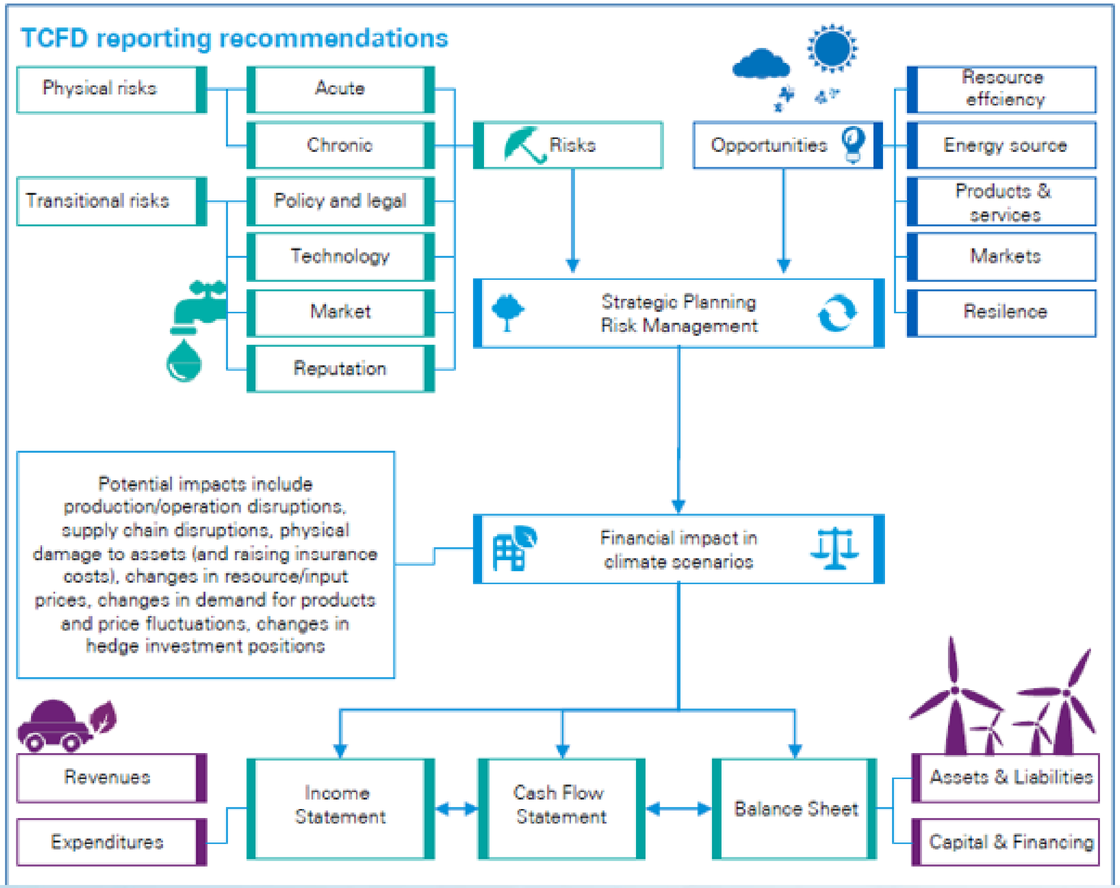
Aligned to strategy

Transparent

In context

Reliable

Consistent



Who sets the tone?

Who captures the data?

Who refines the data?

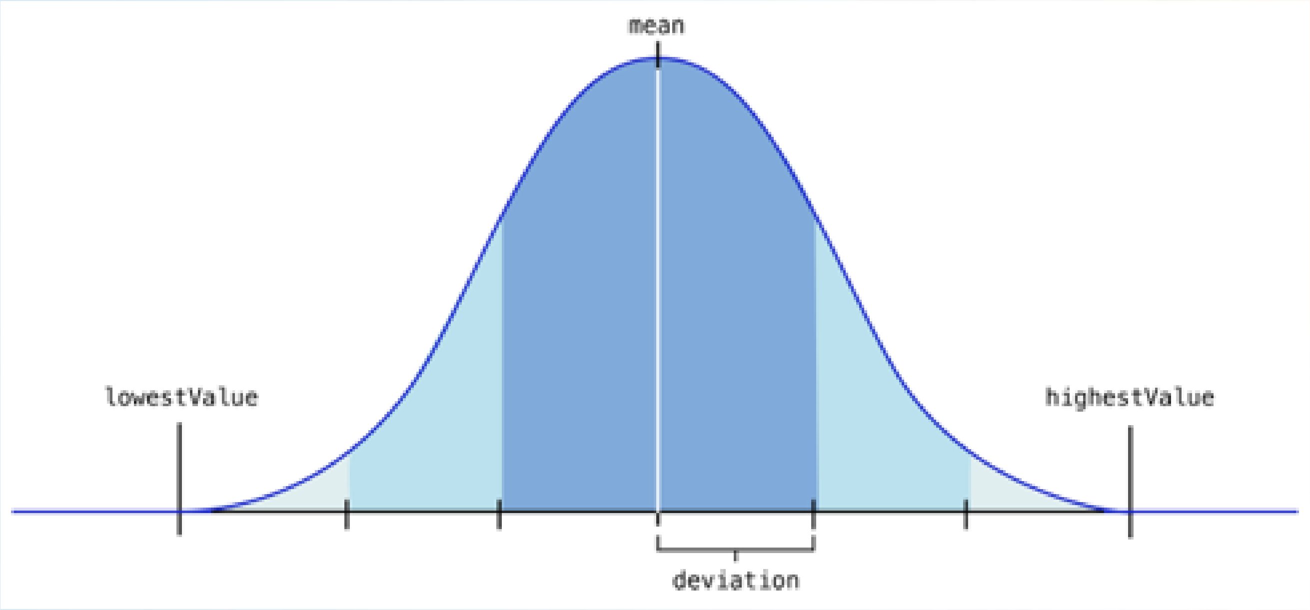
Who measures the impact?

Who writes the report?

Who listens for response?

Who decides on the true and fair metric?

- **Relevance – *data and impact***
- **Quantitative - *measurable KPIs and targets***
- **Accuracy – *reduce uncertainties***
- **Completeness – *holistic sources***
- **Consistent – *identify changes***
- **Comparable – *generic measures***
- **Transparent - *credible and coherent***



Value-added governance

Although a number of companies reported risks that related to excessive awards, most of these companies failed to explain their plans to mitigate these risks.

While most companies now show evidence of linking individual awards with the delivery of strategy and long-term performance, fewer companies provided evidence that they did not reward poor performance in their remuneration policies.

While the majority of companies show evidence of clarity in their engagement with shareholders, this was lower when discussing their engagement with the workforce.

Many companies used non-financial KPIs in executive pay formulas, but often did not explain why these were chosen or how they were formulated.

Many company reports were similar, simply using the wording from the Code, often boilerplate, and lacking detail in the way the application of the Code's Principles and Provisions related to remuneration were described.

1 financial APM and 1 non-financial APM for each company

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The financial viability pulse

Value-add 1: independence and scepticism

- **A director must exercise independent judgement**

- **Each director is present on his or her own merits and must maintain an independence of thought; there must be no subordination of power to the will of others. Governance codes and concepts place a high significance on the concept of independence in an attempt to bring a wider objectivity into organisational thinking and decision making.**

- **The reality is that in many situations a director is appointed through external influence**

- **A constant independent and sceptical mind-set is essential**

Value-add 2: recognition of accountability


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The Government proposes to give the regulator investigation and enforcement powers to hold company directors of public interest entities to account.
Section 5: Company directors

Directors' responsibility statement

1. Directors should be required to acknowledge their responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting.

Annual review of internal control effectiveness and new disclosures

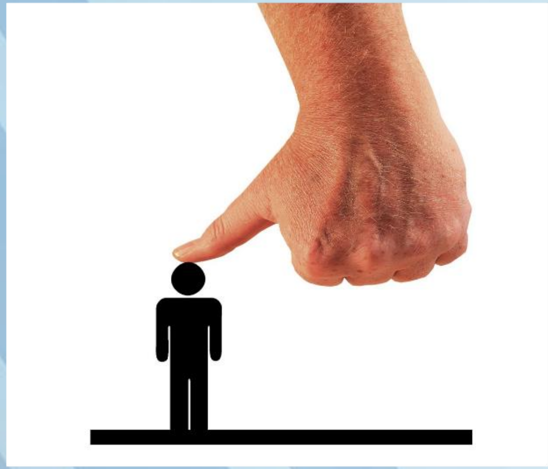
2. Directors should be required to:

- carry out an annual review of the effectiveness of the company's internal controls over financial reporting;
- explain – as part of the annual report and accounts - the outcome of the annual review, and make a statement as to whether they consider the systems to have operated effectively;
- disclose the benchmark system that has been used to make the assessment; and
- explain how they have assured themselves that it is appropriate to make the statement.

3. If deficiencies have been identified, these should be disclosed and the directors should set out the remedial action that is being taken and over what timeframe.

PERCEPTION

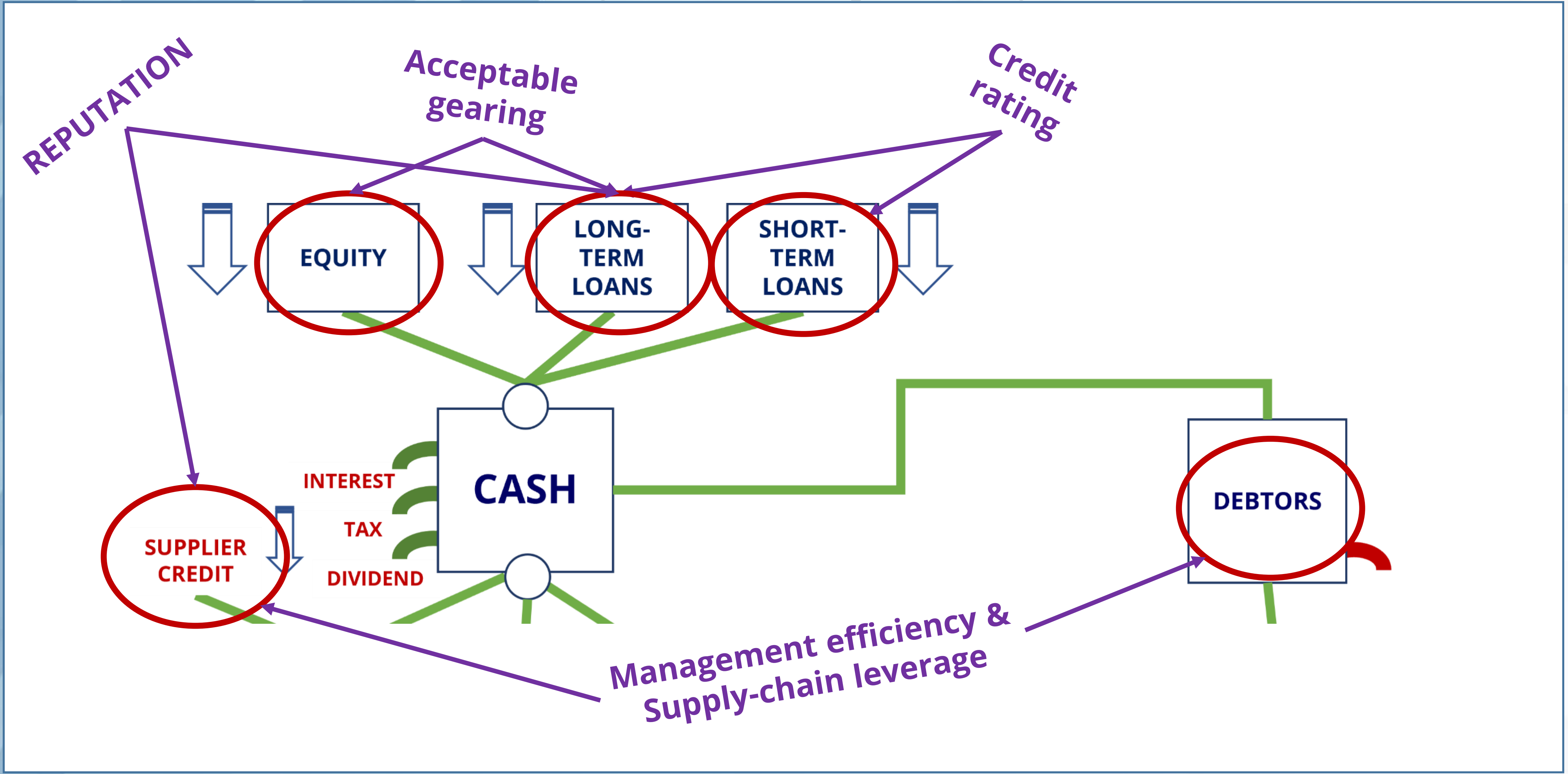
Integrity
Objectivity
Independence



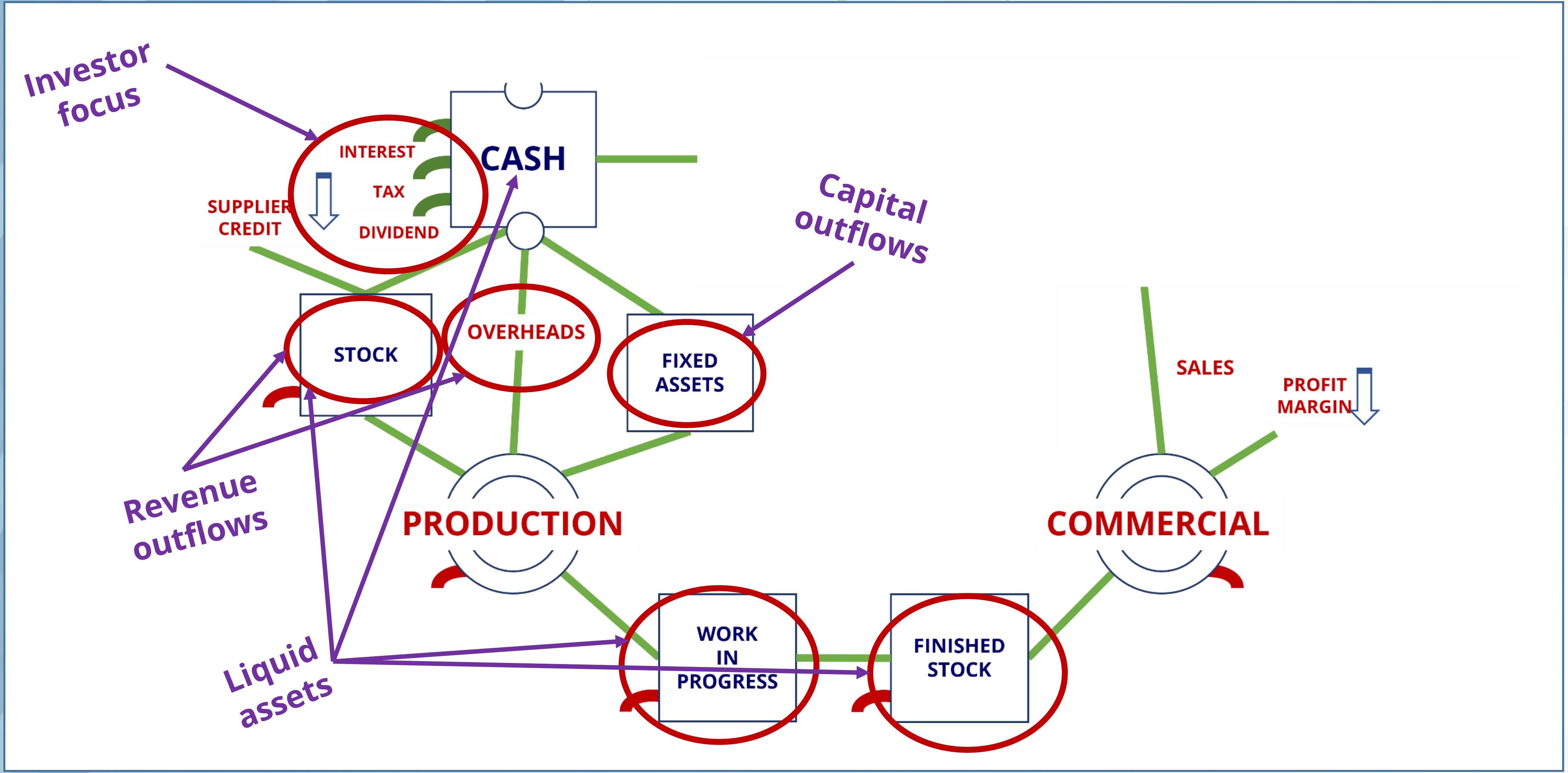
REPUTATION

Attitude
Bias
Challenge
Depth
Engagement

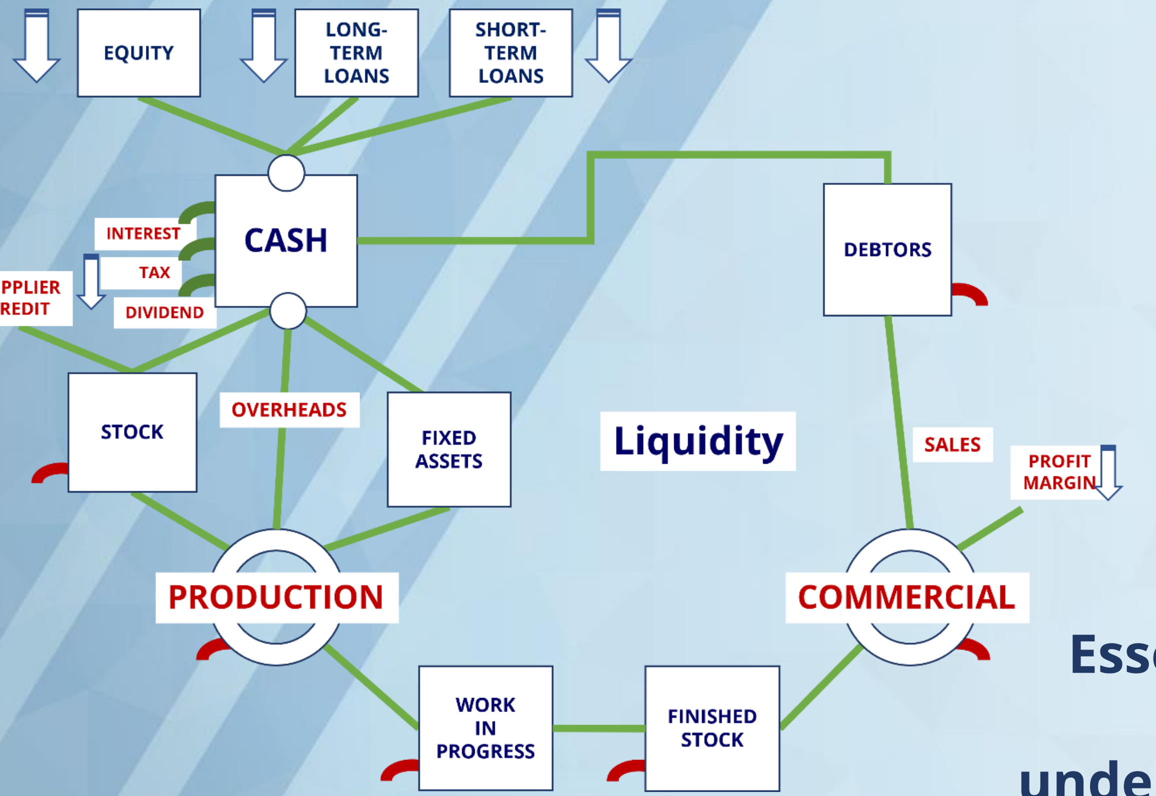
Value-add 3: viability and liquidity (A - inflows)

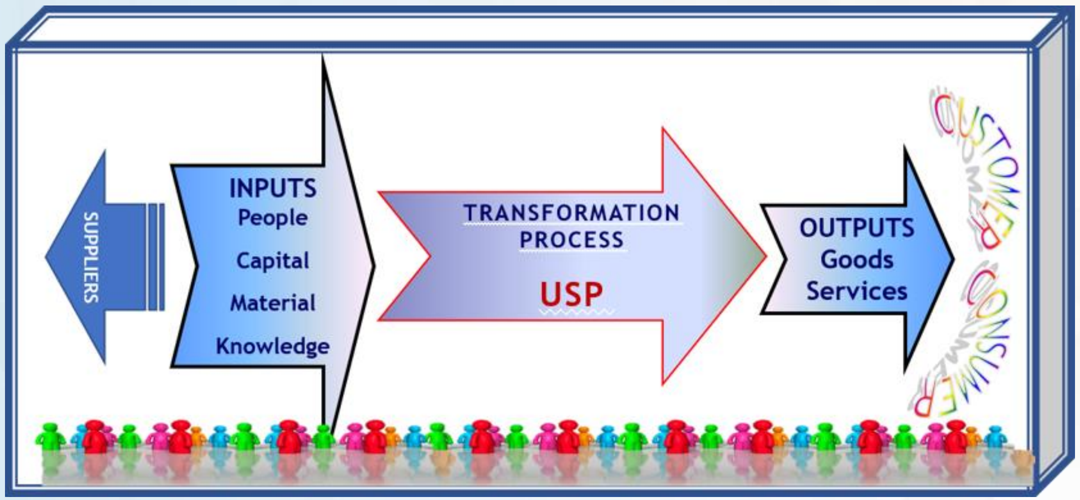


Value-add 3: viability and liquidity (B - outflows)



Value-add 3: viability and liquidity (C - alignment)





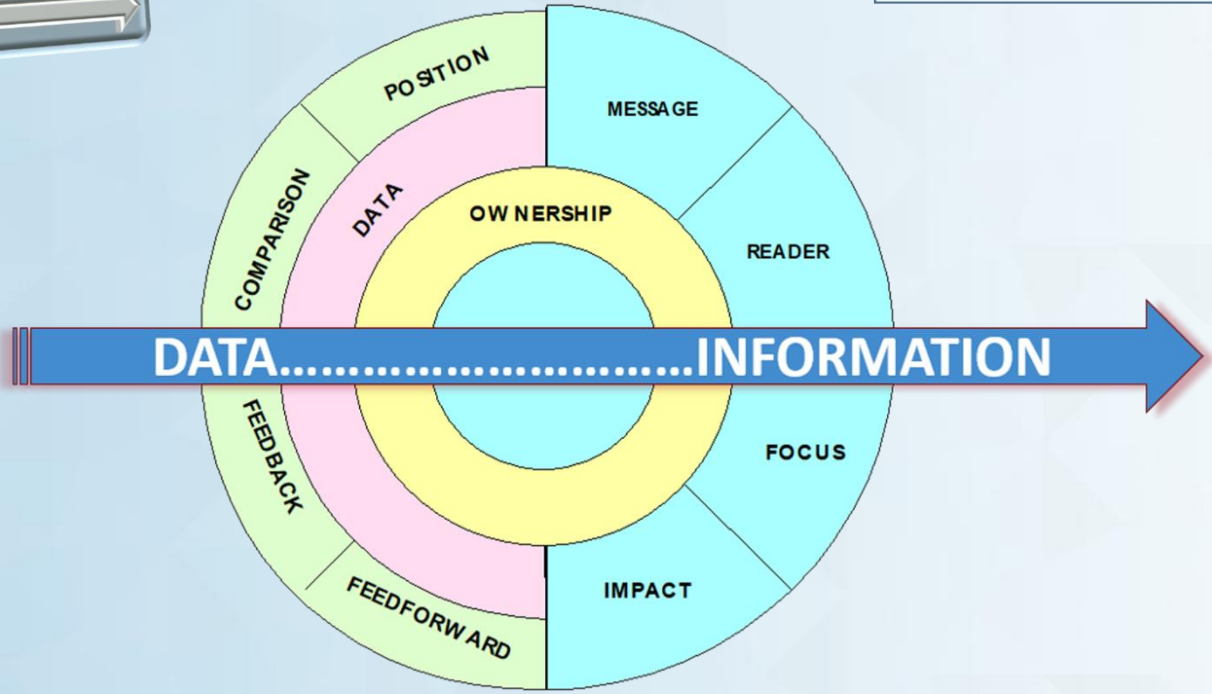
Essential for ALL DIRECTORS to have clarity of understanding of the operational business model and the liquidity that drives it

Value-add 4: maintaining reputation

Accuracy

Integrity

Traceability



Challenge

Impact

Knowledge

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Thank you

Mark Wearden