



7 September 2018

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Submitted via email: [corporategovernanceprinciples@frc.org.uk](mailto:corporategovernanceprinciples@frc.org.uk)

Dear Ms Merrick,

The Chartered Institute of Internal Auditors (Chartered IIA) welcomes the chance to respond to the consultation on the Wates Corporate Governance Principles for Large Private Companies.

The Chartered IIA represents internal audit professionals in organisations spanning all sectors in the UK and Ireland, and it champions the contribution internal audit makes to good governance, strong risk management and a rigorous control environment leading to the long-term success of organisations.

The Chartered IIA is happy to discuss any of the comments included in the response.

We are happy for our response to be published.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'IJP', followed by a long horizontal flourish.

Dr Ian Peters MBE  
Chief Executive

## **Response to the FRC consultation on the Wates Corporate Governance Principles for Large Private Companies**

The Chartered IIA represents 10,000 internal audit professionals in organisations spanning all sectors of the economy, including most FTSE companies, across the UK and in Ireland.

Internal audit is a function that sits within the governance structure but it must be independent of the areas it evaluates, and internal auditors must be free from undue influence from management, so that their judgments can be as objective as possible.

In 2017, the Chartered IIA produced a discussion paper for members, which covered three key corporate governance issues:

- the definition of corporate governance;
- corporate governance reform in the UK;
- and updating the UK Corporate Governance Code.

The feedback from this consultation has been taken into consideration when compiling this response.

### **Overall comments**

The Chartered IIA welcomes the Wates Corporate Governance Principles for Large Private Companies.

We are pleased to see that the Principles are short, sharp and not overly onerous for companies in the UK. The Chartered IIA believes that the Principles and the associated guidance are especially useful for companies to provide greater clarity for organisations on how they should promote good corporate governance in their companies.

In addition, the broad nature of the Principles highlights that there is not a one size fits all solution for good corporate governance.

We have, however, suggested some additional inclusions in the guidance to mirror key principles that currently exist in the UK Corporate Governance Code, which we believe to be integral to effective corporate governance.

The Chartered IIA welcomes the mention of internal audit in the guidance. This highlights the important role that internal audit plays in an effective corporate governance regime for all organisations, not just those that are listed. However, we believe that the wording of this mention could be enhanced to encourage large private companies to consider establishing internal audit functions.

We are pleased to see the inclusion of the importance of corporate culture in the guidance. Internal audit is a key mechanism for boards to assess their company's culture. Corporate culture is integral to effective corporate governance and the Chartered IIA believes that the reference to culture in the Principles will encourage boards to promote a positive 'tone from the top'.

## **The Wates Corporate Governance Principles for Large Private Companies answers to consultation questions**

1. Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?

The Principles address the key issues of corporate governance for large private companies. The Principles promote accountability and transparency which are essential to effective corporate governance.

We are pleased to see that the Principles are short, sharp and not overly onerous for companies in the UK. The broad nature of the Principles highlights that there is not one size fits all solution for good corporate governance.

The Chartered IIA welcomes the mention of internal audit in the guidance of *Principle Three – Responsibilities*. This highlights the important role that internal audit plays in an effective corporate governance regime for all organisations. However, we believe that the wording of this mention could be enhanced to encourage large private companies to consider establishing internal audit functions.

We are pleased to see the inclusion of the importance of corporate culture in the guidance. Corporate culture is integral to effective corporate governance and the Chartered IIA believes that the reference to culture in the Principles will encourage boards to promote a positive ‘tone from the top’.

2. *Are there any areas in which the Principles need to be more specific?*

Generally, the Principles are sound and provide an effective backbone for good corporate governance for large private companies. However, there are some ways in which they could be more specific and in turn, promote more effective corporate governance.

We have suggested these additional inclusions and changes in the guidance to mirror key principles that currently exist in the UK Corporate Governance Code.

### **Principle Two – Composition**

The guidance for consideration should additionally state:

- That there should be separation between the chair and chief executive; and
- That there should be transparent, rigorous and formal appointment procedures for directors.

Furthermore, the guidance currently refers to “directors” in the general sense. The Chartered IIA believes that the guidance would benefit from explicitly stating:

- The importance of having an appropriate balance of both executive and non-executive directors.

This would provide clarity for large private companies on how both executive and non-executive directors add value to an organisation.

### **Principle Three – Responsibilities**

The guidance for consideration should additionally state:

- That non-executive directors should have sufficient time to meet their board responsibilities and that non-executive directors should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.

We suggest that the final paragraph in section three could be amended. This currently states:

*In some cases, this will require the design and implementation of appropriate internal control systems (such as an internal audit function).*

The Chartered IIA suggests that this should be revised to:

*This will require the design and implementation of appropriate internal control systems (such as an internal audit function).*

The Chartered IIA feels strongly that all organisations require strong internal control systems and this may require an internal audit function.

### **Principle Six – Stakeholders**

The guidance for consideration should additionally state:

- That the board's approach to stakeholder engagement should be made available to material stakeholders on an annual basis.
3. *Do the Principles and guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?*

The broad nature of the Principles highlights that there is not a one size fits all solution for good corporate governance; therefore, the Principles take into account various ownership structures.

4. *Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken account in setting directors' remuneration?*

The Chartered IIA has no comments on this question.

5. *Should the draft Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?*

The draft Principles should not be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level. This is because one

of the benefits of the Principles is that they are broad, allowing companies of different size and structures to apply the Principles as is appropriate for their organisation. Any specific requirement here could become too onerous for those companies who sign up to the Principles.

*6. Do the Principles enable sufficient visibility of a board's approach to stakeholder engagement?*

The guidance on *Principle Six – Stakeholders*, should state that the boards approach to stakeholder engagement should be made available to material stakeholders on an annual basis. This would enable sufficient visibility of the board's approach to stakeholder engagement.

*7. Do you agree with an 'apply and explain' approach to reporting against the Principles? If not, what is a more suitable method of reporting?*

As the Principles are voluntary the 'apply and explain' approach is a suitable method for large private companies reporting against them.

It is reasonable to expect that companies that adopt the Principles are to fully comply with them and provide a supporting statement on how their corporate governance processes operate and are meeting the desired outcome.

*8. The Principles and the guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and guidance would encourage good practice?*

The Chartered IIA believes that any monitoring of the application of the Principles should be undertaken by the Financial Reporting Council (FRC). The Chartered IIA sees the role of promoting good corporate governance in public interest entities as part of the core work of the FRC. Therefore, the monitoring of the application of the Principles should logically sit with the FRC.

The FRC could take a sample of reports of those companies who have signed up to the Principles to ensure that they are 'applying and explaining' how they are adhering to the Principles and that their applications and explanations are adequate.

The Chartered IIA does not believe there should be any strict enforcement mechanisms if a company does not apply and explain the Principles. This is because good corporate governance in companies requires a cultural change and punishing those who may not be at this standard would not be beneficial to good corporate governance in the UK.

Furthermore, if there were tough sanctions for non-appliance then companies may not sign up to the Principles for fear of retribution.

9. *Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted versus publicly listed companies?*

The Chartered IIA believes that the correct balance has been struck between corporate governance arrangements for both listed and unlisted companies.

10. *We welcome any commentary on relevant issues not raised in the questions above.*

The Chartered IIA has no further comments.

ENDS

### **About the Chartered Institute of Internal Auditors**

Established in the UK and Ireland in 1948, the Chartered Institute of Internal Auditors (Chartered IIA) has 10,000 members. It is the only professional body dedicated exclusively to training, supporting and representing internal auditors in the UK and Ireland. We are part of a global network of 180,000 members in more than 170 countries. Members of the Chartered IIA work in all sectors of the economy: private businesses (including most FTSE 100 organisations), government departments, utilities, voluntary sector organisations, local authorities, and public service organisations such as the National Health Service. All members work to the same global International Standards and Code of Ethics, which are part of a globally agreed International Professional Practices Framework and have been recognised in the Financial Reporting Council's Guidance for Audit Committees and adopted as the basis of the Public Sector Internal Audit Standards in UK central government, local government and the NHS.