Ten Hot Topics for Company Secretaries – 2020

In this Prism Briefing, we take a look at ten key items that company secretaries need to be aware of as we enter 2020. Some of these are issues that have been developing over the past twelve to eighteen months. The 2018 UK Corporate Governance Code (the Code) has added its support to areas where Government and investors have been voicing concerns with new Code provisions that came into force from 1 January 2019. It will be interesting to see how compliance with these new provisions develops throughout the year.

1. **Section 172 and Stakeholder Reporting**
   Under Section 172(1) of the Companies Act 2006, directors have a duty to act in a way they consider would be most likely to promote the success of the company, taking into account a non-exhaustive list of factors such as the interests of employees, the need to foster relationships with suppliers and customers, the impact on the community and environment and the company's reputation. With effect from 1 January 2019 certain companies are now required to include a Section 172 statement within the Strategic Report. This statement should set out how directors have considered these matters when reaching their decisions. In a letter to Audit Committee chairs published in October 2019, the Financial Reporting Council (FRC) reminded companies of the guidance available to assist in drafting these statements and encouraged boards to disclose which issues and stakeholders they considered relevant, how they came to that view, the methods used to engage with stakeholders and how the company's decisions and strategies were affected by consideration of the issues raised.

   It should be noted that subsidiary companies falling within the definition of a 'large' company are also required to produce a Section 172 statement even if the parent company includes a statement in their annual report.

2. **Workforce engagement**
   The Code mirrors the requirement for companies to produce an s172 statement and goes further in terms of how to gather the views of employees. Recommended methods in the Code are one or a combination of: a director appointed from the workforce; a formal workforce advisory panel; and/or a designated non-executive director.

   If boards have not chosen one or more of these methods, they will need to explain what alternative arrangements are in place and how they are effective. Anecdotal evidence is that a large number of companies have chosen a designated non-executive director as the way of engaging with employees but this is a developing area and companies need to use ways that are suitable for their circumstances taking into account geographical spread and size of their workforce.

3. **Diversity**
   The start of 2019 saw further enhancements to diversity in the boardroom when the Code came into effect. The Code sought to further promote diversity by building upon recommendations of reports such as the updated Hampton-Alexander Review on gender diversity and The Parker Review on ethnic diversity.

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Section 3 of the Code requires appointments to the board to be subject to a formal, rigorous and transparent procedure and importantly both appointments and succession plans should promote, not only diversity of gender and ethnic backgrounds, but also of social, cognitive and personal strengths. The Code has also broadened the role of the nomination committee in promoting diversity. Provision 23 of the Code states: *"The annual report should describe the work of the nomination committee, including …the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the objectives…"*

It should be noted that the key proxy voting agencies such as IVIS, ISS, and Glass Lewis have hardened their position towards boards which do not have or show progress towards having diverse boards and this includes recommendations to vote against the nomination committee chair or other directors as appropriate where it is felt not enough progress has been made.

4. Executive Remuneration Reporting

Investor focus on remuneration is set to continue. The new Code (Provision 40) sets out six new considerations to be taken into account by remuneration committees when determining executive director remuneration policies and practices. Code Provision 41 contains expanded disclosure requirements that need to appear in remuneration reports for financial years beginning on or after 1 January 2019. Further requirements around executive remuneration reporting have also been introduced by the Companies (Miscellaneous Reporting) Regulations 2018 which highlights CEO pay ratio and share price appreciation. In addition, the Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 sets out additional disclosures, for example, the split of fixed and variable pay in a single total figure, and annual change in each executive directors pay versus employee which will be required for financial years commencing on or after 10 June 2019.

Of particular interest in the next year for investors will be how companies have tackled executive pension provision. The Investment Association has championed the cause to bring executive pension rates in line with that of the workforce. Its voting body, IVIS, has stated that it will red top the remuneration reports and/or remuneration policies of companies in certain circumstances where executive pension rates are felt to be out of step and there are no plans to bring them into line.

Finally, it is important for remuneration committees to review and consider the Investment Association's updated 'Principles of Remuneration', which highlight key areas of focus in 2020. These include alternative remuneration structures, pensions, levels of remuneration, pay for performance and post-employment shareholding guidelines.

5. Proxy Voting Guidelines

Several of the major proxy voting agencies and investor relation bodies have published their voting guidelines for the 2020 AGM season including Glass Lewis and Institutional Shareholder Services (ISS) and others are expected early in 2020. Those published so far mirror each other in terms of the areas of concern for investors such as board diversity and executive remuneration with their own individual slant on what they would like to see. For example, ISS expects remuneration committees to report on environmental, social and governance factors taken into account when deciding on remuneration

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outcomes whilst Glass Lewis wants to see remuneration committees using downward discretion where there has been an exceptional negative event even if targets have been met. Company secretaries need to consider those proxy voting agency guidelines of relevance to their shareholder base and ensure the board and relevant committees review the detail of these guidelines.

6. **Focus on the Audit Market**

One area where radical changes are expected in the short to medium term is that of the audit market and profession. Three major reviews over the last 18 months have considered and reported on different aspects of the audit market. The Kingman report, looking into the operation of the Financial Reporting Council (FRC), was published at the end of 2018 and made recommendations in relation to audit quality and regulation. The Competition and Market Authority's final report on the audit industry published in April 2019 made four main recommendations including mandatory joint audits for large companies, greater scrutiny of audit committees and an operational split between audit and non-audit audit practices for the biggest firms.

Most recently the review by Sir Donald Brydon into the quality and effectiveness of audit made 64 separate recommendations. These included the development of a new audit profession, additional reporting requirements for companies including a Public Interest Statement, and increased scope of the audit and materials that can be used by auditors in making their judgements. In addition, the report recommended that the risk report should be published by audit committees to allow shareholders to comment and to put forward areas that they would like to see in the audit plan.

The Department for Business, Energy and Industrial Strategy (BEIS) has also been busy in this area publishing a report into the future of audit which also made numerous recommendations. This included a requirement that auditors should make a presentation at the AGM to show how they have challenged to underpin their audit opinion and to raise any major issues.

If all of the recommendations from the various reviews and reports were put into effect it would mean a seismic shift for audit firms and the companies that they audit. It is now for the Government to decide on the extent of reform. Audit committees will need to keep abreast of proposals.

7. **Climate Change**

Environmental and climate change will continue to be an area of great focus in 2020. The expectations of investors and stakeholders around the reporting of the impact of climate change on their businesses have grown increasingly over the last few years, and are likely to continue to do so.

A number of publications were produced in 2019, including BEIS's updated environmental reporting guidance, 'Streamlined Energy and Carbon Reporting' (SECR) and its 'Green Finance Strategy'. The former sets out and elaborates on seven principles that companies should apply when reporting on environmental impacts. The Green Finance Strategy, launched on 2 July 2019, seeks to ensure that climate and environmental risks and opportunities are integrated into financial decision making and that finance supports the UK's commitments to climate change.

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The Financial Stability Board, an international body that monitors and makes recommendations about the global financial system, set up a ‘Task Force on Climate-related Financial Disclosures’ (TCFD), which published in 2017 recommendations on the disclosure of climate-related financial risks and opportunities. The Green Finance Strategy supports the TCFD guidelines by setting out the expectation that listed companies should disclose in line with the TCFD recommendations by 2022. The FRC Reporting Lab has also recently set out investor expectations for improved climate-related corporate reporting. Within this report, it recommends companies use the TCFD guidelines as a framework when reporting on climate change.

8. Going Concern

The FRC has recently published revisions to the International Standard on Auditing ‘Going Concern’ effective for audits of financial statements for periods commencing on or after 15 December 2019. The amendments were in direct response to a number of enforcement cases and corporate failures where auditor’s reports failed to highlight concerns about the prospects of companies that then collapsed. The new standards require more rigorous assessment by the auditors, improved transparency and for a clear, positive statement to be produced on whether management’s assessment is appropriate. If one of the recommendations of the Brydon Review is put into effect then companies will need in the future to produce a Resilience Statement that builds on the current Going Concern and Viability Statements.

9. A New Regulator?

The Kingman review of the Financial Reporting Council published in December 2018, made 83 recommendations in relation to the regulation of audit, corporate reporting, and oversight of corporate governance. The Government has supported the report’s recommendation for a new regulator, called the Audit, Reporting and Governance Authority (ARGA), although there is uncertainty around when this will happen. Implications for companies if this and other recommendations are put into force is that they can expect to see a tougher and expanded approach to the review of annual accounts and a stronger enforcement regime.

The Kingman review also proposed changes to the Stewardship Code and suggested if these couldn’t be achieved it should be abolished. The Financial Reporting Council has taken up the challenge and published in October 2019 the ‘Stewardship Code 2020’ with new principles for asset managers and owners and emphasis on greater transparency required from its signatories.

10. Brexit

Lastly, despite the recent Government elections, uncertainty remains in the political sphere, which will likely continue through 2020 until further details around Brexit and the new Government’s plans are confirmed. Boards need to keep abreast of developments and the ongoing trade negotiations.

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We would be pleased to receive any comments on these Ten Hot Topics. Email us at enquiries@prismcosec.com or contact us via Twitter (@PrismCosec) or LinkedIn (https://www.linkedin.com/company/726062/).

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Appendix:

Publications:

- The UK Corporate Governance Code (July 2018): (https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF)
- FRC: Year-end letter to Audit Committees and Finance Directors 30 October 2019 https://www.frc.org.uk/getattachment/71345784-8f60-438b-a474-fc7c79ace9e3/Year-end-letter-(003).pdf
- Glass Lewis – 2020 Proxy Papers Guidelines – An Overview of the Glass Lewis Approach to Proxy Advice (https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_UK.pdf)
- ISS – United Kingdom and Ireland: Proxy Voting Guidelines Benchmark Policy Recommendations (2019) (https://www.issgovernance.com/file/policy/latest/emea/UK-and-Ireland-Voting-Guidelines.pdf)
- The Kingman Review of the Financial Reporting Council: https://www.gov.uk/government/publications/financial-reporting-council-review-2018
- CMA Statutory audit services market study | Final Summary Report 18 April 2019 (https://assets.publishing.service.gov.uk/media/5cb74577e5274a7416b64f01/final_summary_report.pdf)
- The Brydon Report (December 2019) (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf)
- FRC | Developments in Audit 2019 (November 2019) (https://www.frc.org.uk/getattachment/5d176788-3330-4b62-b18e-276c678d3d2c/Developments-in-Audit-Final-Screen.pdf)
- BEIS Environmental Reporting Guidelines (March 2019) (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/850130/Env-reporting-guidance_inc_SECR_31March.pdf)
- BEIS Green Finance Strategy (https://www.gov.uk/guidance/green-finance#green-finance-strategy)
- FCA Climate Change and Green Finance: summary of responses and next steps (https://www.fca.org.uk/publication/feedback/fs19-6.pdf)
- ISA (UK) 570 Going Concern (https://www.iaasb.org/publications/international-standard-auditing-isa-570-revised-going-concern-3)
- UK Stewardship Code (https://www.frc.org.uk/investors/uk-stewardship-code)