For Information:
Updates on UK, US, EU and other International developments.

This paper provides a brief update on publications since the last Corporate Governance Committee meeting on 2 December 2019.

Corporate Governance

The FRC’s annual review of the Corporate Governance Code
This report covers reporting against the 2016 UK Corporate Governance Code, and also assessed FTSE 100 ‘early adopters’ of the revised 2018 Code. The FRC’s analysis found some good examples of reporting by companies who are increasingly using incentives relating to non-financial matters and are grounded in long-term strategy. Many companies are grappling with defining purpose and what an effective culture means with too many substituting slogans. There is insufficient consideration of the importance of culture and strategy, or the views of stakeholders. Following the FRC’s 2016 report on culture, companies should be commenting on culture and now explain how they are monitoring and assessing it. There has been limited reporting on diversity. Those companies that did report well had clear plans to meet targets beyond just gender and understood the long-term value of diversity. The use of engagement surveys was portrayed by many companies as an effective tool to achieve insight on employee engagement and culture. The FRC repeated its criticism that chairmen and women were outstaying their useful terms and companies were not properly explaining why they were staying beyond the nine years that it regards as the normal maximum.

Most UK companies’ approach to board ethnic diversity is unsatisfactory
The FRC has reported that over half of FTSE 250 companies (52%) fail to mention ethnicity in their board diversity policy, and most of the FTSE 350 do not set measurable ethnicity targets.

Compensation orders against disqualified directors-four years in the making
The aim of the UK’s compensation order regime is to make directors financially accountable for the consequences of their unfit conduct. The Secretary of State has the power to apply for a compensation order against a director who is either subject to a disqualification order or who has given a disqualification undertaking, and the conduct of that person has caused loss to one or more creditors of the insolvent company. CMS reports on the first order which was made against Noble Vintners Limited.

Understanding MSCI thematic indexing
Thematic investing is a top-down approach that has become increasingly popular with both institutional and retail investors, whether in terms of investment philosophy or product development. In this paper MSCI review the concept of thematic investing and discuss the differences between it and the factor and ESG investment processes. MSCI then lay out how they
model various themes in order to build a rule-based index methodology that represents the performance of companies exposed to a certain trend.

**Principles for Purposeful Business**
The British Academy have proposed a new formula for corporate purpose: the purpose of business is to profitably solve problems of people and planet, and not profit from causing problems. This independent report explains how this can be done, presenting eight principles for use in guiding lawmakers and business leaders, including reform of company law.

**Best Practices for Disclosing Executive Health Issues**
Muck, Bell and Dicke, Fenwick & West LLP, report that the death of Oracle CEO Mark Hurd highlighted a longstanding public company dilemma: whether and when to disclose the news that a senior leader has a serious health challenge. Not only is the topic sensitive from a personal and privacy perspective, but there is no specific rule or duty that requires disclosure of a CEO's or other executive’s adverse health information unless the executive is incapacitated.

**Corporate Political Spending Practices & Disclosure**
According to the annual CPA-Zicklin Index of Corporate Political Disclosure and Accountability which benchmarks S&P 500 corporate political spending practices and disclosure: (i) nearly half of companies require some level of board political spending oversight and nearly half disclose general board oversight; (ii) approximately 40% have a board committee that reviews direct contributions/expenditures and/or reviews the company's policy on political spending; and (iii) 35% have a board committee that reviews payments to tax-exempt groups.

**Worker Representation on US Corporate Boards**
Palladino of University of Massachusetts argues that workers should have representation on corporate boards of directors and explores the policy choices in the US economy of the 21st century to achieve the goal of worker representation on corporate boards. Effectively implementing such a reform requires consideration of key issues, including: how many corporate directors should represent employees; how they should be chosen and who counts as a worker when the choice is made; how they should meaningfully represent workers, and what information the board owes the workforce; how these choices are different in a unionised or non-union context; and the relationship between a worker’s role as director and employee, in terms of pay, time, and protection from repercussions at work.

**Companies' Anti-Fraternization Policies: Key Considerations**
Kohn, Park, and Sanamyan, Cleary Gottlieb Steen & Hamilton LLP, say that in recent years, numerous senior executives have resigned or been terminated for engaging in undisclosed consensual relationships with subordinates. Such relationships are gaining particular attention in the wake of the heightened scrutiny around workplace behaviour, because they raise concerns relating to, among other things, potential power imbalances and conflicts of interest in the workplace. It is increasingly important for companies to consider whether to institute policies governing close personal relationships, and what those policies might look like. The authors address a few key considerations to guide these decisions.

**Female Directors in California-Headquartered Public Companies**
There is new legislation intended to ensure that public companies headquartered in California have at least one female director. This law, known as SB 826, went into effect on January 1, 2019 and requires companies subject to this law to have at least one female director by December 31, 2019. Blake and Mathes, Wilson Sonsini Goodrich & Rosati, provide FAQs.

**Running the Risks: How Corporate Boards Can Oversee Environmental, Social And Governance Issues**
Ramani and Saltman, Ceres, reflect on how the risks from environmental, social and governance (ESG) issues such as climate change, water scarcity and human rights become more apparent, and with growing investor attention and action on ESG issues, the authors explain why it is
increasingly important for corporate boards to understand how these issues affect business strategy and performance.

**Does Money Talk? Market Discipline through Selloffs and Boycotts**

Gantchev, Southern Methodist University, Giannetti, Stockholm School of Economics, and Li, University of Alabama, think that while it is very important to understand whether and to what extent market discipline can be effective in improving firms’ ESG policies, evidence is scarce. Existing work simply highlights that large blockholders can engage with companies’ management and pressure for changes in policies, but it is silent on the effects of small investors and customers. The lack of evidence on the effectiveness of market discipline largely reflects difficulties in capturing changes in investors’ and customers’ discontent with firms’ ESG policies. In *Does Money Talk? Market Discipline through Selloffs and Boycotts*, the authors overcome this obstacle using a novel dataset, which monitors violations of internal policies and international standards for listed companies around the world. In particular, they use company-specific media coverage of potential risks and violations of internal or external sustainability standards to isolate environmental and social risks from broader firm governance risk, and focus on the former to capture a firm’s ESG vulnerability.

**Shadow Governance**

Niliu, University of Wisconsin, and Hwang, University of Utah, investigate non-charter, non-bylaw shadow governance documents and show how they influence corporate decision-making. They find that shadow governance documents are important and influential.

**The Plight of Women in Positions of Corporate Leadership in the United States, the European Union, and Japan: Differing Laws and Cultures, Similar Issues**

Schipani, University of Michigan, compares gender issues in corporate leadership among the United States, a sampling of countries in the European Union and Japan. There are multiple reasons for this selection of jurisdictions. First, all three jurisdictions reflect highly developed industrial powers with well-established corporate cultures. Second, each jurisdiction has a noteworthy history of tackling the problems of gender equality and more or less established recognition of women’s potential to contribute to the economic and social development of their countries. Third, women in these geographical areas belong to the most educated in the world and economically are self-sufficient. However, despite the industrial progress of these jurisdictions, none of them can boast of creating a sufficiently supportive environment for women to rise to positions of leadership.

**Board Diversity: Consider Globally Dispersed Directors**

The Board Travel Policy Conundrum from Pearl Meyer tackles the quandary of how to benefit from the valuable experience international directors can contribute to the board in the context of the challenges associated with director service by individuals in far-flung locations who may have to travel for days simply to attend a board meeting. In lieu of avoiding potentially great candidates due to their location, companies should consider practices that may better accommodate director service by geographically dispersed directors.

**Board Composition: Former Political Figures**

Directors & Boards reported on the prevalence, and upsides and downsides, of former political leaders assuming corporate directorships. Among the potential upsides is their experience, and associated ability to assist the board, in navigating the potentially critical political/legislative environment. Downsides may include increased media scrutiny and associated PR and reputational risks, and perceived conflicts of interest.

**Financial Services**

The architecture for regulating finance after Brexit

The International Regulatory Strategy Group (IRSG), in collaboration with Linklaters, have reported on the UK’s current regulatory framework, which is among the most robust in the world and is an
important competitive strength for the UK. However, the IRSG also points out that after Brexit the UK system will face important choices and will not have the same resources, oversight mechanisms or parliamentary scrutiny as exist within the European system.

Sustainability

**CalSTRS Green Initiative Task Force Annual Report**
Jenkinson, California State Teachers’ Retirement System, discusses the CalSTRS Green Initiative Task Force, the Green Team, which is focused on managing sustainability-related risks, including climate risks, and taking advantage of appropriate sustainability-themed investments, including those that support the transition to a low-carbon economy, while providing robust disclosure around our efforts and initiatives to members and strategic partners.

**PwC’s SDG Challenge 2019**
PwC’s research explores how far companies have embedded the SDGs into their strategy and operations through analysis of the corporate reporting of 1,141 companies from 31 countries and territories. The report assesses the level of integration of the goals into leadership, business strategy, management and reporting, as an indicator of whether business is on track to make its vital contribution to achieving the SDGs and governments’ stated commitments within the next ten years.

Auditing

**Audit Committee Effectiveness**
In 5 Key Factors to Enhance Audit Committee Effectiveness the International Federation of Accountants (IFAC) effectively characterises the audit committee as the default board dumping ground ultimately tasked with overseeing matters that are not otherwise being handled by the board directly and that don't fall within another committee's scope. Expressly acknowledging well-founded variations in responsibilities among audit committees worldwide, IFAC advocates good governance practices and suggests key areas of focus in lieu of prescriptive regulatory mandates to bolster the committee’s effectiveness.

**Audit Committee External Auditor Oversight: Disclosure Practices & Trends**
The Centre for Audit Quality (CAQ) and Audit Analytics annual Audit Committee Transparency Barometer reveals S&P 1500 voluntary audit committee disclosure practices. This including upticks in disclosure of considerations in (re)appointing and evaluating the external auditor, and dramatic increases in cybersecurity oversight-related disclosures.

**The Case for Individual Audit Partner Accountability**
Honigsberg of Stanford Law School, knows that theory suggests that regulatory oversight, private enforcement, and reputational risk, provide auditors with incentives to perform high-quality work. However, she explains why the current structure of regulatory oversight, private enforcement, and reputation risk are unlikely to induce socially optimal levels of audit quality, and she suggests that we reconsider the role of reputation. To date, the reputational incentives have focused almost exclusively on the audit firm, but recent disclosures make it possible for us to identify the name of the individual partner leading the audit. Using this information, along with additional information, Honigsberg suggests that it is possible to establish a market for individual audit partners’ brands and this market would hold individual auditors responsible for their mistakes.
Assurance of Non-Financial Information: Auditor’s Role Evolves

The Role of Auditors in Company-Prepared Information: Present and Future from the CAQ makes a strong case for auditors having the requisite skills and other tools to provide data assurance outside the traditional historical financial statements arena, including corporate sustainability, cyber risk management, and value creation. Notably, the CAQ posits that good disclosure by companies about what is being measured (and how), how the information will be used, and whether the information has been independently assured, can facilitate desired analysis and comparisons by investors across companies without imposing on companies a one-size-fits-all framework on information and data that does not lend itself to uniformity.

Audit Committee: Financial Reporting Oversight

PwC’s report approaching the 2019 year-end financial reporting season suggests audit committee considerations for each of eight key topics, e.g., new accounting standards, global tax initiatives, reference rate reform, CAMs, SEC comment letters, and audit committee disclosure.

Capital Markets

Moody’s: Governance Practices Have Credit Implications

On the heels of its recently released governance assessment framework, Moody’s report indicates that companies’ corporate governance practices and their credit quality are inextricably linked. The report provides a framework to understand the key governance considerations that Moody’s incorporates into its credit ratings and analysis, which, for private sector companies, are financial strategy and risk management; management credibility and track record; organisational structure; compliance and reporting; and board structure, policies and procedures.

The Global Sustainability Footprint of Sovereign Wealth Funds

Liang, Singapore Management University and Renneboog, Tilburg University, say that over the last 15 years and especially around the time of the financial crisis, interest in and attention to the investment policies of sovereign wealth funds (SWFs) have grown. According to the SWF Institute, global assets under management by SWFs have exceeded $8 trillion, and the Norway Government Pension Fund Global manages over $1 trillion of wealth. While SWFs have been in existence for many decades, they have only attracted attention in recent years, especially since the global financial crisis. The lack of transparency and political motivations lead host country governments and firms to react cautiously to SWFs’ investments. As SWFs are government-owned, they do not need to exclusively focus on financial returns, but can also add a stakeholder perspective to their investment goals.

Report on undue short-term pressure on corporation from the financial sector

ESMA has published a report, which it makes recommendations for action in key areas, such as disclosure of ESG factors and institutional investor engagement. The report draws on the results of a survey through which ESMA wanted to identify: areas in which existing rules may contribute to mitigating undue short-termism; and areas where the rules may exacerbate short-term pressures. The report forms part of forms part of ESMA’s work on sustainable finance and relates to the European Commission’s Action Plan on ‘Financing Sustainable Growth’.

Alternative performance measures

The European Securities and Markets Authority (ESMA) has published a report on the use of alternative performance measures (APMs) by EU issuers and on the level of compliance with its APM Guidelines. The Guidelines, which came into effect in July 2016, define an APM as being a financial measure that is not required as part of an issuer’s financial reporting obligations but which is presented voluntarily by an issuer as an aid to understanding the performance of its business. Examples include net debt, operating earnings and EBITDA. The purpose of the Guidelines is to
promote the transparency and usefulness of APMs contained in certain announcements and documents issued by listed companies. The report highlights that, whilst APMs are widely used, only a minority of issuers comply with all principles of the Guidelines. In light of its findings, ESMA encourages issuers to improve the transparency of disclosures provided in relation to APMs and sets out a number of recommendations (for example in relation to definitions and labels) to assist with compliance.

Tax

**International Tax Risks & Strategic Planning**

Deloitte's "International taxes: Seismic changes may be coming" explains the pending OECD international tax scheme initiative and the types of companies and business operations that may be impacted, and describes the associated risk and strategic planning implications. While the ultimate outcome of the initiative is subject to multiple influences and still uncertain, the briefing motivates management's active engagement with relevant industry trade groups and business organisations and suggests a number of sound considerations for boards that promote risk mitigation and informed strategic planning.

**Global Forum 10th Anniversary Report**

In 2009, the G20 Leaders declared that 'the era of banking secrecy is over’. The Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum) was called on to deliver this result. Ten years on, the Global Forum has nearly 160 member jurisdictions and has achieved massive progress in implementing the international tax transparency and exchange of information standards. With the strong backing of the G20 and the Organisation for Economic Co-operation and Development, the Global Forum has produced the most impactful international project against offshore tax evasion in history.

**Exchange of information and bank deposits in international financial centres**

This paper presents the results from new work to assess the impact of increasing tax transparency and exchange of information on cross-border financial activity using bank deposit data. The paper focuses on one aspect of international financial activity: cross-border bank deposits, using a dataset from the Bank for International Settlements, which provides bilateral data on bank deposits for up to 47 jurisdictions from 2000 to 2019.

Selected ICAEW CEO blogs since 2 December 2019

09/12/19 Extending and improving the trust register
14/01/20 A cohesive and sustainable world

**Related work across ICAEW**

**Fifth Anti-Money Laundering Directive**

HM Treasury has revised the Money Laundering Regulations to take account of the changes required by the Fifth Anti-Money Laundering Directive (5MLD). ICAEW has issued guidance on the areas which its members need to address in their policies and procedures, eg, when taking on a limited company or limited liability partnership as a client it is necessary to check that details of the Persons with Significant Control have been filed with the registrar (Companies House) and discrepancies need to be reported.
Communicating climate risk

There is growing pressure from investors for reliable information on an entity’s impact on the environment and assurance has an important role in achieving this. Yet assurance options can be difficult to understand. The Audit and Assurance Faculty has published A buyer’s guide to assurance on non-financial information, in collaboration with WBCSD. The guide explains assurance in simple terms and brings much needed clarity to those procuring assurance services on non-financial reporting, with an emphasis on ESG reporting. At the same time, efforts to achieve greater standardisation in sustainability reporting are gathering pace, under pressure from investors faced with proliferating approaches to accounting. We have been contributing to Accountancy Europe initiatives in this area.

Revised ICAEW code of ethics

ICAEW Council has approved the adoption from 1 January 2020 of a revised ICAEW Code of Ethics. It is based on the code issued in April 2018 by the International Ethics Standards Board for Accountants (IESBA) (the IESBA code). As a member of the International Federation of Accountants, ICAEW is committed to internationalisation of standards and to the adoption of at least the provisions of the IESBA code. ICAEW’s code comprises the IESBA code together with a significant number of additional paragraphs (signified in italics). This add-on material is included in the ICAEW code where the IESBA code is considered to offer insufficient discussion on a topic or, occasionally, its requirements are insufficiently robust.

Welcome outcome on probate fees

The Government had proposed to reform probate fees, using a statutory power to charge fees above cost recovery levels. Following complaints from ICAEW and others that the fees proposed were wholly disproportionate to the costs, these proposals have now been withdrawn. ICAEW will continue to be vigilant for similar attempts to raise revenues outside of the proper scrutiny to which tax would normally be subject.

Who will account for the internet of things?

At its heart accountancy is about ordering and presenting data. So as the profession looks to its future and role in the 21st century, the proliferating data produced by the internet of things provides a huge opportunity. The internet of things and accounting: lessons from China considers the implications of the increasing tendency to embed sensors in everyday objects and connect them to the internet.

Michael Izza’s reflections from Davos

In his blog Michael Izza, CEO of ICAEW, details his recent attendance at the World Economic Forum. The main themes this year were stakeholder capitalism and climate change. The idea that companies should be accountable to a wider group than just their shareholders has now fully come of age, ie, the health of the planet is the most important accountability of all. Michael spoke at the ‘Green Economy Coalition’ dinner, highlighting ICAEW’s work to help businesses transition to greener ways of working, and ICAEW’s support for various initiatives, in particular, the Natural Capital Coalition. Another theme high on the agenda this year was the transition to the digital economy and the changes that businesses are making and should be planning for. Artificial intelligence and automation will have significant implications for roles currently carried out by humans, and thus reskilling the workforce is widely regarded as a priority. There is a widespread recognition that governments cannot do this alone so businesses need to invest, and individuals need to embrace the changes. Equally, how we tax the digital economy – not just large tech companies but a shifting economy as a whole – was a hot topic. 137 countries are now working towards a new tax plan, but if the OECD cannot get agreement, there are 40 countries willing to
introduce their own national approaches, based mainly on turnover. You can hear more about Michael in Davos in a special podcast available on the 'More Than a Number' channel.