14 November 2014

**We asked governance and compliance professionals for their thoughts on the most prominent events and biggest challenges of 2014**

As we reach the end of a year which has brought significant developments in regulation and legislation, we take a look back at the events that have prompted discussion at board level in the past 12 months.

### Remuneration under scrutiny

The topic of executive pay has been rarely out of the headlines in 2014. Legislation introduced in the wake of public outcry and political debate requires companies to justify their strategy to shareholders. Leo Martin, Director of Business Ethics Advisers at GoodCorporation, tells us that the impact, 'is already being felt with discussions about the best way to structure directors' remuneration to ensure long-term success'. Mala Shah-Coulon, Director of the Corporate Governance Team at EY believes this has 'acted as a restraining hand on pay and bonuses'.

Executive pay at the largest UK listed companies has quadrupled over the past decade. Oliver Parry, the IoD's Corporate Governance Adviser, concedes that 'exceptional levels of pay may be justified in exceptional circumstances' but points out that there is often 'no clear link to company performance.' This does not help 'the reputation and legitimacy of the UK business community.' He reminds us that it may seem that regulators 'see this as low hanging fruit, a vote winner which will always gain approval from shareholders'. Yet he acknowledges that few were disciplined 'for the excessive risk-taking for short-term rewards which led to the 2008–2009 financial crisis.'

Companies face more scrutiny from shareholders on pay and board appointments. Ben Mathews, Group Company Secretary at HSBC Holding plc, feels there is 'still room for both the companies and their shareholders to improve their future communications [to] achieve a consensus that meets the interests of shareholders, employees and other stakeholders.'

Parry says that when companies do not comply with core elements of the UK

Corporate Governance Code they must 'supply better explanations, especially in light of greater shareholder examination.'

### Reporting

The change in UK corporate reporting for quoted companies has had a positive effect on corporate governance according to Mala Shah-Coulon with 'preparers, regulators and other stakeholders focusing more than ever on what good reporting looks like.'

Peter Swabey, Policy and Research Director at ICSA agrees and notes that they have allowed 'companies to focus much more on the issues that really matter to them.' Despite relatively little change to date, he believes that 'this will have a huge impact on the quality of corporate reporting.'
Shah-Coulon points out that initially there was an inevitable focus on compliance but 'there is now an increased expectation for companies to ensure that their annual reports are accessible for shareholders.'

### Code and culture

The FRC's updated UK Corporate Governance Code is 'one of the greatest pieces of legislation to come our way in recent years,' says Socrates Coudounaris, IRM board member and Senior Manager at PWC. The 'letter and spirit of the new requirements' ensure companies have 'the right boardroom risk management skills, leadership and tone,' he says.

John Smart, Head of Fraud Investigations and Disputes at EY agrees: 'There is a greater focus on establishing the culture, values and ethics of the company and the correct tone from the top.'
'The new importance placed on organisational culture … is a very significant step,' says Dr Ian Peters, Chief Executive of the Chartered Institute of Internal Auditors (IIA). 'We have been calling on boards in both the private and public sector to take steps to "audit" culture.'

### Auditing standards

Changes to the UK and Ireland's auditing standards require more detailed reporting, including description of significant risks and of how materiality was applied, which seems to resonate with investors, according to Shah-Coulon. 'We have been pleasantly surprised at the level of engagement,' she said.

Tim Copnell, Associate Partner and Director of KPMG's UK Audit Committee Institute, agrees that the new standards provide 'a robust framework for auditor independence and strengthen corporate governance'. He suggests that companies can and should go beyond focusing on key risks: 'The audit reports for Rolls-Royce Holdings plc and New World resources plc are truly innovative… [in] setting out under each audit issue, the risk, the response and auditor's findings.'

Other aspects of the legislation such as 'mandatory firm rotation combined with significant restrictions on non-audit services' may in fact reduce choice for shareholders, he points out.

Companies have also begun to feel the effects of the audit market reform driven by the EU. 'It places more emphasis than ever before on the procurement of audit and professional services with far reaching implications for companies and auditors alike,' says Mala Shah-Coulon.

Dr Ian Peters feels that internal audit is being taken out of 'its comfort zone' with boards demanding more information and assurance. A consequence may be that internal auditors will need new skills and competencies.

### Further developments

When we asked the team at the Competition and Markets Authority (CMA) what they saw as the most significant development in governance during the past 12 months, it is no surprise that they cited the creation of the CMA itself in April 2014. The authority's power to conduct compulsory interviews and impose financial penalties on businesses and individuals that fail to cooperate with investigations reflects, 'a step change in the authorities' appetite for enforcement of consumer and competition law, and stronger ability to meet that appetite.'

Leo Martin draws our attention to the UK Bribery Act which has prompted a number of sectors 'to set up compliance functions for the first time'. He feels 'general counsels are recognising that compliance has a set of specialist business skills which are not the same as legal knowledge or expertise.'

David Thompson, Senior Associate at FCA regulatory consultants Branko Limited, believes we should not overlook the Mortgage Market Review, which is a welcome addition for the financial industry. However, he concedes that 'some lenders may have been a little over enthusiastic in their interpretation of the new rules.' This has resulted in 'increased mortgage interview times and, often, contractors, freelancers and entrepreneurs being excluded from obtaining a mortgage.'

### Fines and penalties

Many of the changes that 2014 brought have had a positive impact on the corporate world, but there have also been a number of scandals that resulted in reputational damage and financial penalties.
The financial services industry has had a 'tough time' adjusting to regulation by the FCA and PRA, David Thompson says. This is evident by the number of companies that have faced 'fines or redress' including:

- Payday lender Wonga – £2.6 million to customers for unfair debt collection practices
- RBS/NatWest – fined £14.5 million for failings in advised mortgage sales
- Barclays – £37.7 million for failing to properly protect client custody assets
- Deutsche Bank AG London Branch – £4.7 million penalty for incorrectly reporting transactions
- Coop Bank – under investigations by the FCA regarding decisions and events up to June 2013

There is some uncertainty about what may be required to avoid such penalties. Leo Martin notes that corruption scandals in 'pharmaceuticals, engineering and defence' have prompted many companies to ensure they have adequate procedures. However, he points out that 'understanding what the SFO will judge as "adequate" is still a significant challenge.' This could lead companies to 'waste money putting in unnecessary controls, or worse, fail to put in place the controls that will actually protect the company.'

Results of a recent survey conducted by EY involving 2,700 executives across 59 countries 'paint a disturbing picture' according to John Smart. Reticence to engage in anti-bribery training – particularly in emerging markets – and assign adequate resources to compliance teams and internal audit are a concern.

### Looking ahead

Oliver Parry describes the amount of upcoming legislation that the banking sector in particular will face, from the EU and UK, as 'a tidal wave'. In addition, the corporate sector as a whole still has a way to go to restore its reputation. Peter Swabey feels that regaining 'public trust in companies' remains the biggest challenge. Mark Butterworth, Director at Condie Risk Consulting, believes that 'marketing and selling products that are fair and reasonable' and satisfy the regulators on conduct has become a 'juggling act'. It seems that the year ahead looks set to be an equally challenging one.

### Challenges for charities

It is not only the corporate sector that has faced challenges in 2014. Polls by the Charity Commission show that public trust in charities remains high but they have not escaped the scrutiny of media and government. Independent charity consultant Rosie Chapman reminds us of some of the challenges they are facing:

- The right to campaign
- Levels of CEO pay
- Fundraising methods

Administration costs

The sector has also 'seen its fair share' of new requirements introduced during 2014. This includes two new Statements of Recommended Practice (SORPs), which will apply from 1 January 2015. Although Chapman acknowledges that these requirements have 'ducked some of the more contentious issues – such as transparency of senior executive pay', they do indicate a move to make charities 'more transparent about how they manage and spend their money.'

One media storm from 2014 surrounded Academy Schools. Concerns were raised about a 'Trojan horse' of religious extremism following claims that hard-line Muslims were trying to impose their views on a school. Company secretary and author of ICSA's How to Run an Academy School, Katie Paxton-Doggett believes that: 'At the heart of the scandal was poor governance. What is necessary is an adequate system of oversight that fully takes into account all aspects of management of an academy.'

The controversy has resulted in 'a huge push towards ensuring that those appointed to academy bodies have the right balance of skills and experience.' Paxton-Doggett believes that this could have a positive impact if it attracts more suitable candidates who have 'the capacity and the time to ensure robust governance and oversight.'




## Discover more

Current magazine issue Features More news


## Have your say





Institute of Chartered Secretaries and Administrators
Saffron House, 6-10 Kirby Street, London EC1N 8TS, United Kingdom