QUOTED COMPANIES ALLIANCE

UHY Hacker Young
Chartered Accountants

Corporate Governance Behaviour Review 2016

Quoted Companies Alliance & UHY Hacker Young

Establishing trust and confidence with investors.

Our fourth annual Corporate Governance Behaviour Review is set within a changing political landscape where there is an increased focus on issues of corporate governance. Those who advocate good governance will welcome political support for what they do; however, there is a risk that politicians are raising this issue with different agendas in mind.

The ongoing scrutiny by the regulator, the Financial Reporting Council (FRC), continues to shine a spotlight on reporting by small and mid-size quoted companies as further improvements are sought in the quality of reporting. The new status of the FRC, as the UK's competent authority under the Audit Directive, provides the structure and powers to facilitate this ongoing improvement.

As in previous editions, in our review we have benchmarked the corporate governance disclosures made from a random selection of 100 small and mid-size quoted companies taken from the Main List, AIM and ISDX. We have compared these against the minimum disclosures set out in the Quoted Companies Alliance Corporate Governance Code for Small and Mid-Size Quoted Companies 2013 (the QCA Code).

Our results have been discussed with a group of institutional investors at a roundtable discussion. We have reflected on their comments and feedback to give you the top five recommendations that companies can follow to improve the way they address corporate governance disclosures.

We have also included some quick reporting wins as a result of the discussions.

The QCA Code is structured in a way which enables quoted companies to adopt appropriate corporate governance arrangements. The Code requires adopters to provide clear explanations that convey the approach and ethos of their corporate governance arrangements. Effective corporate governance reporting is achieved when investors have a clear understanding of the corporate governance arrangements in place and an appreciation of the culture established by the company directors. With this information investors can appreciate how the company's strategy is being managed and developed through the business.

Our annual review of governance disclosures sets out to identify key areas for improvement for company directors as they seek to enhance the quality of their annual reporting and connect more effectively with their stakeholders. The report provides an opportunity for both self-reflection as well as benchmarking against peers with a view to encouraging companies to make changes for the 2017 reporting season.

The top five governance reporting recommendations

Demonstrate clear links between strategy, performance and remuneration

Keep your reporting concise and transparent - tell your story

Demonstrate that you understand your shareholders' and other stakeholders' interests

Publish the results of shareholder votes on your website

Describe and explain how board performance is evaluated

EXECUTIVE SUMMARY

In so far as is practicable

Establishing a corporate governance culture that is appropriate and proportionate is a challenge for companies that do not have large investor relations and reporting infrastructure. As such, the QCA Code is constructed on the basis of broad and accessible principles. There is also a set of minimum disclosures that are considered to be appropriate for both companies that are at an early stage of development and organisations that are more established.

All too often, phrases such as 'in so far as is practicable' are used to convey the fact that not all the specific requirements and procedures have been addressed, but without any analysis of what may be practicable. To a reader of the annual report and accounts this creates uncertainty and confusion. No reader of such phrases can determine what is practicable, relevant or appropriate without adequate explanation. Such a report loses impact and fails to build trust between a company and its existing and potential investors.

The broad principles and the minimum disclosures required by the QCA Code encourage companies to set out why they do what they do, and explain why it is the best approach for the company and its stakeholders at this point in its business lifecycle.

Discharging responsibilities

Investors are increasingly interested in how company boards set about discharging their responsibilities and evidencing the same. The complexity of today's business environment, both in terms of the digital developments and the globalisation of businesses, provides a challenging environment for company directors to navigate.

Good corporate governance behaviours

In order to secure the trust and confidence of investors and other stakeholders it is incumbent on the board to establish good corporate governance behaviours. Such behaviours will provide for proportionate risk appraisal and management, prudent decision making and open communication. Regardless of the size of the company or its development stage, the combination of applying a "comply or explain" approach with a set of principles facilitates the creation of a corporate culture of high standards, which will help to secure investment necessary for the long term success of the business. It should go without saying that good corporate governance behaviours can only be recognised by investors if such behaviours are properly reported.

Annual reporting is your opportunity

Small and mid-size companies increasingly have fewer opportunities to meet and share information with the wider investment community. The FRC's recent project on smaller company reporting highlighted that the annual report and accounts represents a particularly important communication medium. The annual report and accounts provides the board with a unique opportunity to communicate its process, culture and objectives. It is an opportunity to showcase the company, telling the business story in an engaging and informative manner.

Small and mid-size companies will have made the decision to go to the market for any number of reasons, but fundamentally the essence of the decision is to attract and retain capital and facilitate the long-term growth of the company. As such, it is important that the members of the board take full advantage of the opportunity presented and articulate with care and consideration the ethos of the company through the behaviours of its leadership and to link this information to the company's strategy and ambition.

For investors to understand the business objectives, the strategy in place to achieve those objectives and to get an idea of the competence of the management team, the quality of the narrative explanations provided in the company's messages to the market is paramount. The key media for small and mid-size quoted companies is the annual report and accounts and the corporate website. If companies get this right, then trust is built between the company and its investors. With investor confidence comes a lower cost of capital.

Yet again, the glaring result is that companies do not seem to be effectively linking corporate governance into business strategy. We would be interested to hear from companies on why this does not seem to happen, what stops them from being able to do this and if this affects perceptions of investors. Please submit any comments to Colin Jones at c.jones@uhy-uk.com.

Facilitating conversations

Today's business environment grows ever more complex. Explaining the business model and the key performance measures in straightforward and concise terms enhances the understanding of investors. Companies can improve their reputation and credibility further by constructively engaging with investors and facilitating interaction and dialogue through producing high quality reports full of clear narrative. The value of this should not be underestimated.

Easy reporting wins

Information received by the board (Disclosure 11 of the QCA Code)
Include a summary of information received by the board and by individual committees.

Independent directors (Disclosure 6 of the QCA Code)
Explain fully why a particular director is considered to be independent. Length of service or a standard biography is not enough.

Performance evaluation (Disclosure 10 of the QCA Code)
Include more detail on the performance evaluation procedures undertaken in relation to each member of the board and the board as a whole, with a focus on the results and agreed actions arising.

OUR TOP FIVE GOVERNANCE REPORTING RECOMMENDATIONS

Demonstrate clear links between strategy, performance and remuneration

For small and mid-size quoted companies the issue of remuneration can be a key discussion point between companies and shareholders. Shareholders want to understand the links between the company's strategy, its performance, and how executives are being incentivised and rewarded for executing the strategy effectively. Investors want a frank and open engagement so that they can see how the company is building goal congruence between the appointed directors and the company.

Clarity and transparency in matters of remuneration are important foundations upon which trust between companies and shareholders is built. Establishing well-structured remuneration arrangements indicates good governance. However, this can be fully appreciated only if the arrangements are articulated effectively to all shareholders.

The regulations governing the disclosures to be made in relation to remuneration are detailed and extensive, particularly for listed companies. However, such regulations do also cause confusion and concern from an investor perspective. It is important therefore to be mindful when addressing the necessary compliance to ensure that consideration is given to the materiality and proportionality of the disclosures.

Crucially, it is the objective of any disclosures to ensure a proper understanding of the nature and amounts involved. The reader must be able to appreciate the connection between the company's strategy and performance and how executives are being rewarded for their contribution to the success of the business. Readers may find it useful to consider the practical approach to good remuneration disclosures as set out in the recent QCA Remuneration Committee Guide (2016).

Keep your reporting concise and transparent – tell your story

For the small and mid-size quoted company, the annual report and accounts is often the key piece of information available to shareholders and other stakeholders. As such, it is vital that time and resources are applied to producing a report that provides a clear and concise narrative around the company's activities over the past reporting period. It represents a vital first impression. Consideration should be given to the key performance indicators, describing the business model and conveying the company's strategy and its implementation in a transparent and honest fashion.

Each company should demonstrate that it can clearly articulate the business story and the company's ambition and purpose; this will enhance the quality of engagement with all interested parties: the shareholders, other stakeholders and potential investors. Focusing the narrative and explanations on the areas that are critical to the company's business will provide a better understanding of the issues faced and thereby manage expectations of future performance.

Demonstrate that you understand your shareholders' and other stakeholders' interests

Digital communication, particularly social media, is increasingly used by businesses and stakeholders. Easy access to information and discussion forums has increased stakeholder expectations considerably. This provides a real challenge to small and mid-size quoted companies as they seek to implement the strategy of the company, whilst managing the expectations of a range of stakeholders with different levels of understanding.

Acknowledging and addressing the issues and concerns of shareholders and other stakeholders builds trust and creates confidence in a board's ability to manage the business and deliver long-term success for the benefit of all stakeholders.

Effective boards do not shy away from addressing the concerns of stakeholders. Instead, they take specific actions or provide clear descriptions and explanations about a particular situation. This enables stakeholders to better understand the company's approach.

Publish the results of shareholder votes on your website

Investors believe strongly that the results of shareholder votes should be disclosed by all companies. Building on the requirements of AIM Rule 26 (which requires certain information to be readily available on the company's website); investors question the reluctance to provide this information, or to be selective in its provision. The information is gathered in preparation for company meetings and is therefore readily available. Investors find it difficult to understand why a company would choose not to set this out on the company's website.

The lack of publication of information considered to be readily available only serves to undermine the trust and confidence of shareholders in the management of the company.

Describe and explain how board performance is evaluated

An effective board will have procedures in place to evaluate its own performance on a regular basis and will have developed an action plan for addressing areas identified for improvement. Simply stating that there is a process of evaluation does not provide sufficient information. It does not tell shareholders the outcome of any assessment or the objectives and targets set as a result of the process. Companies need to be clear about the criteria set for board performance and how these are applied. This will provide comfort to shareholders that there is an appropriate culture of contribution and challenge within the boardroom environment and that there is a desire to seek continual improvement.

Investors want to know how the procedures around performance evaluation have evolved year-on-year. They want to know that a plan of action for improvement has been identified, how that plan has progressed and whether it was successful or whether there is further work to be done.

Disclosures on board evaluation provide a good opportunity to convey a sense of the operational culture within the business. It helps to demonstrate how that culture influences the behaviours of all those involved with the company. The impact and value of such disclosures in establishing confidence and trust should not be underestimated.

OUR ANALYSIS

This section details our measure of corporate governance behaviour by showing the percentage of the sample that included the minimum disclosures of the QCA Code.

*when assessing item one, we have excluded Main List companies given that they are required to adopt the UK Code, therefore, cannot adopt the QCA Code. However, we have included item two to indicate companies that reference compliance with a corporate governance code.

> The role of an independent non-executive chair needs to be more clearly defined so that a healthy separation exists between the senior management team and themselves to avoid potential conflicts.

Sid Chand Lall,
Hargreave Hale

CHAIRMAN'S GOVERNANCE REPORT

No	Disclosure	2016	2015	2014	2013
1	The narrative reporting of the company should include a report by the Chairman of how the QCA Code is applied (see note*).	26%	31%	22%	20%
2	There was reference to the application of a corporate governance code.	82%	68%	83%	81%
3	The report should include how such application supports the company's long term success and strategy for growth.	4%	7%	1%	3%

AUDIT COMMITTEE REPORT

No	Disclosure	2016	2015	2014	2013
4	An audit committee report should explain the major tasks undertaken and demonstrate an independent oversight of both management and external auditors.	53%	41%	36%	20%
	It should include details of the significant issues considered by the committee in relation to the financial statements and how these issues were addressed.	48%	32%	-	-
5	There should be an explanation to shareholders of how audit objectivity and independence is safeguarded, particularly if the auditor provides significant non-audit services.	49%	37%	35%	31%
6	The audit committee also acts as the committee focused on risk if there is no designated risk committee and, as such, the committee should indicate how this role has been undertaken.	43%	30%	28%	17%

REMUNERATION COMMITTEE REPORT

No	Disclosure	2016	2015	2014	2013
7	A remuneration committee report should explain how the company's remuneration policy and practice align with the company's strategy.	68%	55%	61%	68%

DETAILS OF DIRECTORS

No	Disclosure	2016	2015	2014	2013
8	The identity of all the directors, their roles and committee memberships must be disclosed.	93%	94%	79%	93%

RELEVANT SKILLS AND EXPERIENCE

No	Disclosure	2016	2015	2014	2013
9	The relevant skills and experience that the executive and non-executive directors bring to the board should be described.	99%	92%	73%	91%

INDEPENDENT DIRECTORS

No	Disclosure	2016	2015	2014	2013
10	Those directors considered to be independent should be identified. The reasons for their independence should be explained and particular attention given to circumstances where the status of independence may be impaired.	19%	30%	33%	43%

> Remuneration packages, especially LTIPs and options, need to be clearly disclosed. The effect of performance on the quantum and on the impact on dilution of share capital are just two of the factors that we need to see. It's not just about going through the motions of disclosure.

Katie Potts,
Herald Investment Management Ltd

COMMITTEES

No	Disclosure	2016	2015	2014	2013
11	There should be a brief description of the work of each board committee and its role.	92%	94%	75%	95%
12	Committee responsibility and accountability should be explained.	73%	75%	67%	87%

MEETINGS AND ATTENDANCE RECORDS

No	Disclosure	2016	2015	2014	2013
13	There should be disclosure of the number of meetings during the year of the board and of the committees.	77%	47%	57%	70%
14	The attendance records of each director should be provided.	69%	44%	51%	67%

RISK MANAGEMENT AND INTERNAL CONTROL

No	Disclosure	2016	2015	2014	2013
15	There should be a summary of the systems of risk management and internal control and the uncertainties facing the business.	91%	84%	89%	73%
16	An explanation should be provided of how risks align with the strategy of the company, as well as linking into key performance indicators, remuneration policies and corporate responsibility activities.	50%	63%	51%	38%

PERFORMANCE EVALUATION

No	Disclosure	2016	2015	2014	2013
17	There should be a description of the performance evaluation procedures for each director, the whole board and each committee focusing on their objectives and outcomes.	44%	34%	27%	14%
18	Include a summary of how evaluation procedures have evolved from the previous years, the result of the evaluation and action taken or planned as a result.	3%	11%	10%	2%

INFORMATION SUMMARY

No	Disclosure	2016	2015	2014	2013
19	There should be a summary of information received by the board and by individual committees.	5%	3%	2%	5%

SUMMARY OF STRATEGY

No	Disclosure	2016	2015	2014	2013
20	There should be a clear articulation of the strategy of the company.	87%	92%	41%	56%

“In the report and accounts we need to see a clearly outlined strategy and the performance against this. The same applies to the disclosures regarding the work of board committees and remuneration outcomes. Companies should tell the story in their own words – boilerplate disclosures add no value.”

Nathan Leclercq, Aviva Investors

DESCRIPTION OF ROLES

No	Disclosure	2016	2015	2014	2013
21	There should be a description of the roles and responsibilities of the chairman, chief executive and, if applicable, the senior independent director.	33%	30%	48%	65%

MATTERS RESERVED FOR THE BOARD

No	Disclosure	2016	2015	2014	2013
22	There should be a list of the types of decisions reserved for the board.	38%	46%	39%	32%

NON-EXECUTIVE APPOINTMENT TERMS

No	Disclosure	2016	2015	2014	2013
23	Terms and conditions of appointment of non-executive directors should be stated.	23%	20%	4%	12%

TERMS OF REFERENCE: AUDIT AND REMUNERATION COMMITTEES

No	Disclosure	2016	2015	2014	2013
24	Terms of reference of the audit committee and the remuneration committee should be included.	46%	35%	42%	41%

TERMS OF REFERENCE: NOMINATION COMMITTEE

No	Disclosure	2016	2015	2014	2013
25	Where there is a nomination committee, the terms of reference of the nomination committee should be included. If there is no separate nomination committee, there should be an explanation of the processes by which the whole board determines nomination and senior appointment matters.	40%	30%	33%	29%

ROLE OF EXTERNAL AND INTERNAL ADVISORS

No	Disclosure	2016	2015	2014	2013
26	An explanation should be given of the role of any external advisors to the board or its committees (in particular, the remuneration committee) and any internal advisory responsibilities, such as the roles performed by the company secretary and the senior independent director in advising and supporting the chairman. Where the company secretary is also a director, the company should provide an explanation for this.	11%	12%	4%	6%

PUBLISHED MATERIAL

No	Disclosure	2016	2015	2014	2013
27	The annual report and other governance-related material should be on the website.	100%	99%	100%	98%
28	Notices of all general meetings over the last three years should be on the website.	49%	58%	53%	63%

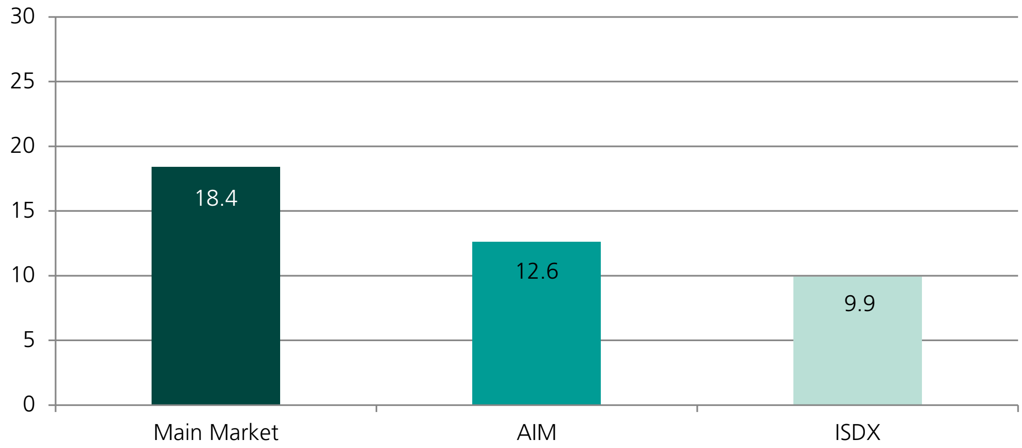
> Investors see a huge number of annual reports. We can tell very easily when a company has used boilerplate or failed to go into enough detail when explaining how it meets the corporate governance standards that we expect. It is paramount that companies report openly and effectively.

Anthony Marsden, Henderson Global Investors

RESULTS OF SHAREHOLDER VOTING

No	Disclosure	2016	2015	2014	2013
29	Voting decisions should be posted on the company website.	37%	54%	33%	65%
30	Where votes at a general meeting are by show of hands, the votes by proxy received by the company, including abstentions or votes withheld, should be reposted as soon as practical after the meeting. Where votes are conducted on a poll, the actual votes, including votes withheld or abstentions, should be reposted as soon as practical after the poll.	27%	14%	18%	65%

AVERAGE NUMBER OF CORPORATE GOVERNANCE DISCLOSURES



Market	Number of companies in the sample	Average number of disclosures	Minimum number of disclosures	Maximum number of disclosures
Main Market companies	54	18.4	3	27
AIM companies	39	12.6	5	22
ISDX companies	7	9.9	4	18

METHODOLOGY

The analysis was conducted on 100 annual reports and accounts and the corporate websites of small and mid-size companies with equity securities admitted to trading on a London market (the Main Market of the London Stock Exchange, AIM and the ISDX Growth Market) across all sectors in July and August 2016. Note that the sample of companies analysed in prior years is different to those analysed in 2016.

UHY Hacker Young assessed these annual reports and accounts and governance disclosures on their corporate websites against the minimum disclosures of the Quoted Companies Alliance Corporate Governance Code for Small and Mid-Size Quoted Companies 2013.

The assessment was completed on a straightforward binary measure: did the company disclose the requirement or not. We have not sought to judge the qualitative nature of the disclosure.

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