The Big Issue – or where next for the corporate governance debate?

by Peter Parry

The report that has recently been published by BEIS and the Work and Pensions Committee into the collapse of Carillion provides damning criticism of the Company and its directors, auditors and the regulators. It is essentially a report on a gross failure of corporate governance. The key question is, where do we go from here? I do not have the answers but I do have a few thoughts to throw into the debate. You may agree or disagree with them but hopefully they will at least help to stimulate further constructive discussion.

An omission from the report of the Work and Pensions Committee

One criticism of the Work and Pensions Committee's report is that it fails to make a single mention of the disenfranchisement of retail shareholders thanks to the perverse and iniquitous way in which nominee accounts function in the UK.

As all members will know, private investors have increasingly been corralled into investing through nominee accounts. Although the nominee is simply an intermediary, performing what is basically an administrative function, in UK law the nominee is the legal owner of the shares. The retail investor (the person whose money is at stake) is the 'beneficial owner' and enjoys none of the rights that normally attach to share ownership, including the right to receive information from the company and the right to attend and vote at the AGM.

The report on Carillion makes the point that a number of major investors approached the Carillion board in private in the period preceding its collapse and urged it to 'change its direction of travel'. Having failed to exert much influence, many of the large shareholders decided to sell their shares and walk away. A significant weakness of the report is that it fails to identify the hopelessness of this secretive and ineffective approach to shareholder oversight.

Those private shareholders who are able to access their shareholder rights often do attend AGMs, ask pertinent questions and make their views clear to boards very publicly. Private shareholders should be a key component of the effective corporate governance oversight that the report into Carillion identifies as lacking. With the amended Shareholder Rights Directive (SRD II) shortly to be transposed into UK law, the government has the opportunity to change the UK's perverse definition of a 'shareholder' and ensure that private shareholders are re-enfranchised and able to play a meaningful role as owners of the companies in which they have invested. The Beaufort Securities debacle, mentioned elsewhere in this issue, provides further compelling reasons for change.

A clear justification for shareholder committees

Members will be aware that both UKSA and ShareSoc have been calling for the implementation of shareholder committees. We put this idea forward in the response the green paper on corporate governance issued by BEIS in early 2016 only to see it watered down to become a 'stakeholder committee' before being quietly dropped. While the RBS campaign calling for the Company to implement a shareholder committee continues, the Carillion situation provides an opportunity to move the debate about shareholder committees 'centre-stage'.

The external auditors are supposed to look after the interests of the shareholders. In reality they are appointed by the board of directors and their sole interaction is with the directors. There is plenty to suggest that this relationship is too close, cosy and riddled with conflicts of interest. The shareholder committee concept has the potential to address this problem to a significant extent. An active and effective shareholder committee should play an active role in both the selection and appointment of the auditors (appointment to be ratified at the AGM). Furthermore, it provides the opportunity to re-establish a direct link between the auditors and those whose interests they are meant to serve. It also has the scope to apply greater direct shareholder oversight over the board instead of relying on the system of cosy chats behind closed doors between the company and the large shareholders – as mentioned above.

'This won't hurt'; a trip to the dentist for the regulator

There has been plenty of comment about the 'timidity' and 'toothlessness' of the regulators – criticism in this case aimed primarily at the FRC. One of the problems that regulators face is that they have to be very careful that they do not do or say anything which could prejudice those they regulate. This leaves far too much scope for companies to adopt approaches to reporting which are not strictly illegal but which are nonetheless misleading and unhelpful to shareholders. Carillion's reporting practices are proving to be a case in point.

It is completely wrong that regulators should be inhibited from raising their concerns publicly for fear that they will be sued by the company or the auditors. Regulators should be given immunity from being sued. We have to assume that regulators will not pursue frivolous or vexatious issues; they have better things to do. It is not the role of the regulator to tip-toe around making sure that they do not damage the standing or reputation of those they regulate. It is for the companies and auditors themselves to look after their own reputations and to make very sure that their own actions are not going to land them in trouble. This includes not only ensuring full compliance with what is strictly legal but also complying with what the investor on the Clapham omnibus would see as being fair, open and honest in respect of accounting and reporting practices. In a very few cases regulators may be required to work covertly. In all other cases their decisions to mount an inquiry or review of practices should be put promptly into the public domain. Similarly, the findings and conclusions of any review should be published as soon as possible once the review is complete.

…and finally

Don't forget that PWC is running an event for UKSA and ShareSoc on auditing at Embankment Place on ***Tuesday, 3rd July***. The event will start at 2.00p.m and will finish at about 5.00pm with drinks and canapés after the formal part of the afternoon. Topics covered will include the role and remit of the external auditors, internal audit and the audit committee. There will also be a session on the future of audit. PWC has managed to obtain input from senior auditors in the other 'Big Four' practices.

This promises to be a lively and interesting event. Some, I know, will want to shoot the auditor and perhaps for understandable reasons. The majority I hope will be coming armed with good, well-prepared questions with which to grill the auditors so that we are better placed to argue for the sorts of change in corporate governance that will best serve our interests in future.

You can sign up for this event by clicking on this link or e-mailing or telephoning the office.