

SOCIETY FOR THE ENVIRONMENT

**SUBMISSION ENVIRONMENT TO THE INQUIRY ON CORPORATE GOVERNANCE BY THE
PARLIAMENTARY COMMITTEE FOR BUSINESS, INNOVATION AND SKILLS**

SUMMARY

1. The Society for the Environment submits that there will be benefits in comparing the Good Governance Codes of all sectors to identify best practice. In doing so, there may well be value in producing a Common Code of Best Practice. This would define a legal framework in which good behaviour can flourish and into which existing or evolving Codes can fit.
2. In doing so the Society has examined the relationship of culture and legislation recognising that the correct culture is required to work alongside regulation
3. Our principal interest is sustainability but we submit that the behaviours necessary for sustainable growth of a company are the same as this necessary to exercise environmental stewardship.
4. The Society is also taking this opportunity to reiterate that the concept of sustainability as applied to natural resources is missing for current codes, and if we do not get this right the consequences will be more serious than the collapse of individual companies. We wish to see this added to any changes made in governance.

INTRODUCTION

5. The Society is a partnership of 24 professional bodies representing individuals practicing in environmental and natural resources management, ranging from chemists and engineers to ecologists and biologists, from front delivery to the very highest levels of leadership. We have access to some 500,000 individual members. Our Royal Charter provides us with the responsibility to oversee the award of the status of Chartered Environmentalist, of which there are over 7,000.
6. The Society has extensive experiences of governance in other corporate sectors which may be of some assistance to the Inquiry.
7. One particular point of concern is the lack of governance relating to the sustainable use of natural resources. Whilst the impacts of corporate failure on matters such as company collapse may be tragic and unacceptable in the short term they are by their very nature rectifiable in one way or another. Whereas failure of governance in environmental matters may not be immediately tragic or even perceptible, the long term consequences may be tragic and irreversible. So we are using this submission to further advocate that company governance is extended to include sustainability.
8. We are providing some insights on the broader issues thus allowing the committee to extract whatever it considers will help answer the questions posed. We have focussed on

director's duties and board composition.

WHAT IS THERE AVAILABLE ON GOOD GOVERNANCE?

Companies

9. Unlisted companies are expected to comply with Guidance issued by the Institute of Directors in 2011, which largely incorporates the UK Corporate Governance Code issued by the Financial Reporting Council (FRC). Companies with premium listing of equity must comply with the Code which was updated in April 2016. This includes guidance on board effectiveness, the role of audit committees and risk management, internal control, the growing concern basis of accounting and the board's longer-term viability statement. In July the FRC issued a report on Corporate Culture and the Role of Board; the so called Culture Coalition.ⁱ The key findings were
 - Recognise the value of culture
 - Demonstrate Leadership
 - Be Open and Accountable
 - Embed and Integrate values and behaviours
 - Align Values and Incentives
 - Exercise Stewardship

10. All Directors registered with Companies House must comply with the requirements of the Companies Act 2006:
 - only exercise powers for the purposes for which they were conferred
 - promote success of the company,
 - exercise independent judgement,
 - exercise reasonable skill, care and diligence,
 - avoid conflicts of interest, not accept benefits from third parties,
 - declare interest in proposed transactions and or arrangements
 - Other Organisations

11. Since the 1990s there has been a series of reports and Codes running in parallel between public sector organisations and companies and these are not dissimilar in intention. In 1995 The Nolan Report defined the standards to be followed by office holders in public life:ⁱⁱ
 - Selflessness
 - Integrity
 - Objectivity
 - Accountability
 - Openness
 - Honesty
 - Leadership

This includes people who are elected or appointed to public office, nationally and locally, and all people appointed to work in:

- the civil service
 - local government
 - the police
 - the courts and probation services
 - non-departmental public bodies
health, education, social and care services
12. They underpin Good Governance defined in particular sectors, such as the Cabinet Office Guidance for Ministerial Appointments to Public Bodies 2015,ⁱⁱⁱ the Monitor NHS Foundation Trust Code of Governance 2014^{iv} and the Code of Governance for the Voluntary and Community Sector^v, produced by a coalition of organizations and supported by the Charities Commission in 2010. Earlier this year Sir Gerry Grimstone reported to the Cabinet Office on a review of public appointment processes, and in March the Cabinet announced that it is working on the consequences a Governance Code with Public Appointment Principles, it is still waited. The Society has proposed that it that it will include reference to sustainability.
13. It is notable, but perhaps not surprising, how similar the required behaviours are but a question has to be posed – why are there differences?

Convergence of Codes

14. Amongst the individual membership of our constituent professional bodies we have a wide experience of leadership at executive and non-executive levels in charitable trusts, arms length bodies, private and public companies. We are aware that there have also been governance criticisms of arms length bodies and charities even in 2016 beyond those criticisms of companies which triggered this Inquiry. These senior members report to us that the responsibilities of leadership are now very similar irrespective of the kind of organisation, although the detailed executive may differ, for example in whether or not Board meetings are held in public, or the handling of commercially sensitive decisions. Indeed, cross Board membership is encouraged and NEDs of companies may be appointed as NEDs of public bodies and they will expect similarity of governance.
15. As a specific point we have noted that sustainability and the use of natural resources is missing from all Codes and hence the Society has been advocating that a behaviour for public appointees should be added to Public Appointment Principles expressed something like ‘seeking to maintain and enhance the sustainable use of natural resources’ in the exercise of the functions of the body to which the individual has been appointed so far as consistent with the proper exercise of its functions. Wales has already introduced this as part of its Environment Act 2016. The Society now submits that this ought to be added to all governance codes.
16. It is clear from a comparison of all these codes and reports that it is recognised that regulation and culture must sit alongside one another in order to deliver success. This recognition chimes well with the challenges we face in sustainable use of natural resources and as a green cultural leader, the Society has expressed this in the statement ‘mankind cannot be green by regulation alone’. A crucial decision for the Inquiry will be to determine the best boundary between culture and regulation

THE BOUNDARY BETWEEN CULTURE AND REGULATION

17. The boundary is one which has been recognized for many years. The origin is a leading case in English law *Entick v Carrington* [1765] establishing the civil liberties of individuals and limiting the scope of executive power. It is famous for the dictum of Lord Camden: "If it is law, it will be found in our books. If it not to be found there, it is not law." He ruled that the State may act lawfully only in a manner prescribed by statute. A citizen may do anything but that which is forbidden by law; this is about behaviour. So a very important decision in the need for any changes of contributions of some Company directors has to be in the determination of what might be called the Camden boundary. This boundary is between regulation (statute) and behaviour (non- statute) and both sides contribute to the overall delivery of good leadership.
18. The boundary is moved either way by changes in statute, but this has become complicated because the delivery of aspiration can be achieved by providing choice to individuals. For example, the State has the power to levy a tax, and an individual can chose to continue with an activity and pay the tax, or desist. The use of plastic bags and sugar in drinks are examples of how the boundary has moved towards regulation, but is not regulated in the sense of Lord Camden.... After all we have 250 years of additional complexity to overlay on his ruling. We now have corporate entities in the place of individuals and corporate law including economic regulation and these are one step removed from individual/ State interface but affect individuals. We have the complexity of statutory targets such as for waste recycling which affects behaviours on the non-statute side of the boundary
19. But if the boundary moves away from State regulation we must be vigilant in understanding why; it might be a different way of delivering the same aspiration or it could be can be a lowering of standards or stopping regulation of activity completely. Either way the regulated envelope shrinks. A good example of how the State can decide that good behaviour can be a companion in delivery, is the notion of self-regulation or self-monitoring (such as the role of audit, ISO 9001^{vi} or 14001^{vii} in place of direct regulation), and we must act responsibly in embracing that opportunity. Paradoxically statute is often provided to put these systems in place. The State can also influence behaviour through education and awareness campaigns (which are really an extension of education)
20. General culture itself determines where the boundary is set. Politicians and policy makers can be susceptible to changes in culture. For example, mainstream politics in Wales has attempted to reflect the growing greenness in community attitudes.
21. Also on the non-statute side of the interface with the State, there are voluntary sector bodies in which individuals work together. Professional bodies present an accumulation of individual contributions. They provide sound evidence, to UK governments, policy makers, regulators and so on. So they are influential advisers on regulation. But again the evidence is affected by the cultures of the members of those bodies.
22. But on the other, non-statute, side of the boundary, professional bodies, can act as well advise. They have the power to change attitudes and behaviours in our communities, if they get communications right.

23. We have tried to summarise all of this in a simple Figure

Individual/Organisation	State
Good behaviour	Direct Regulation e.g. Companies Act
Working together in professional bodies, providing advice, awareness campaigns setting good examples	Regulation which affects behaviour e.g. taxation, Codes of Practice, Statutory targets
Providing sound evidence to the State	Initiatives which seek to influence behaviour e.g. education, awareness campaigns

A GENERAL APPROACH

24. It is clear from the evidence we have provided, that there is a case for a more integrated, but not necessarily unified, approach in the principles so good governance. And as the nature of the UK economy changes, it will be essential that governance is good. But we must be mindful administrative burdens on enterprises were an issue during the EU Referendum debate and so any changes must be as effective and focussed as possible. This forms a key part of the Society's six-point response to Brexit.^{viii}
25. We do not have any special competence on the current state of Company governance, as perceived from the events of 2016, except to say that it might be appropriate to see what benefits the FRC Coalition Culture brings. The Camden model, we have described, focusses the decisions on what is left to personal behaviour, enabling legislation and prescriptive legislation with associated penalties. It would appear that the current boundaries are not enough to constrain behaviours, particularly in privately owned companies. The Society recognises that the Camden boundaries will be different across sectors, sizes and ownership of organisations
26. We suggest that there is a case for a multi-body review of all governance codes to determine if there is a common best practice which can be applied universally. If this is possible it would make inappropriate behaviour by one sector even more difficult. Such best practice might set the core requirements for all directors but also require that sectoral and even local organisational requirements are defined clearly in addition. We pose the question; if there is an intention to produce Public Appointment Principles, why not have, say, Company Appointment Principles and Health Trust Appointment Principles, for example, drawing on a common approach? It would be good to share wisdom across sectors for the greater good. The challenge would be in agreeing the 'common thread' in such a diversity of organisations, yet the need is self-evident. This could cover the issues identified by the Inquiry and more.

27. There is a clear issue of compliance in the existing approach, but before considering any changes, the review should ask, as indeed the Inquiry is seeking to do, is the legislation wrong or is its implementation weak?

Duties and Responsibilities of Directors

28. Duties are often confused with responsibilities. Responsibility defines who does what. The Society has observed in organisations of different types, that there is sometimes confusion on who is responsible for what. There are often different concepts and syntax, for example, the use of 'Terms of Responsibilities' rather than 'Terms of Reference' brings sharper focus for committees. A matrix of responsibilities starting from the top, be it a minister or shareholders going through Chairs, Boards, Board committees, Executives and staff with the insertion of clear objectives derived from strategies and plans, as appropriate, is beneficial. It certainly addresses the issue of the relative roles of non-executive and executive directors

Transparency

29. The greatest disparities would occur within transparency, for example ranging from public bodies with triennial reviews, board meetings in public, and responsibilities under the Freedom of Information Act, to those in which the only source of information is a slim Annual Report. But apart from what should be contained in the Annual Report, there are some common requirements such as board self-assessment and audit reports which can provide re-assurance to interested parties. The Inquiry might like to consider what should be added to the Annual Returns to Companies House and what should be made public by external auditors on mandatory audits of governance. And if such audit reports are unfavourable what sanctions would be imposed. So the common core of information on performance should be defined in best practice

HOW WILL BEST PRACTICE BE EMBEDDED?

30. It might well be that a Common Code of Best Practice should be produced which will not require major changes in primary legislation but will add value to that legislation and to current practice. As with other Codes of Practice, a breach in itself would not be an offence, but if an offence is committed under other legislation, the level of adherence to the Code would be a matter for defence or prosecution. Once in place the content of this Code could be embedded as sectoral guidance, for example as Appointment and Performance Principles. Thus There would be value in finding ways in which the Code of Practice could be given statutory status.

ANSWERS TO SOME SPECIFIC QUESTIONS ON THE ROLE OF DIRECTORS NOT COVERED BY THE NOTION OF A CODE OF BEST PRACTICE

Composition of Boards

31. Cross sector knowledge sharing brings benefits. There have been big strides in the public sector and there are lessons which can be transferred. As the complexity of decision making increases, there is evidence from life in general and in the performance of ALBs that diversity in the decision making is beneficial.

32. Whilst the issues of greater diversity of gender, ethnicity, age, sexuality, disability, experience, socio-economic background must be addressed, it is more important that the skills and competences of board membership are defined clearly and then Board Members recruited on a matrix basis. The ability to deliver must come first and if it is not possible to meet the diversity criteria as well, all organizations have a responsibility to work with the supply pool of potential directors to ensure that the balance of available talent evolves to make diverse recruitment easier. Thus working with the education system is going to be key and co-operating with programmes like 'Come on Board' with CIPFA will contribute. A key competence in a diverse board is the ability to 'think out of the box' or at least to accept that kind of thinking, but aligning it with understanding tradition. It is also crucial that understanding risks and the 'law of unintended consequences' are part of good decision making, so it is good to have a diversity of risk appetites on the board so that all aspects can be considered, but not to the point of disharmony. The idea that fresh blood to board membership brings new creative thinking has value but this must not be at the expense of deep knowledge of the organization being led. Recruitment must be transparent and on the basis of the matrix, and not by some other means.
33. The presence of Executives at board meetings varies. The basic premise that the Chief Executive is a Board Member, but other Executive Directors may just attend for presentations. It is important that all Directors are One Team with One Vision and hence may be present as full Board Members or 'in attendance'. But if too many Executives are full Board Members it makes challenge that much more difficult even when practiced in an exemplary fashion, and can dilute the benefits that independent NEDs bring in a vote. There are benefits of course in that Executive Board Members do bring their knowledge of the business not only to the discussion, but to the vote. This can be complicated if Directors hold substantial equity. The Inquiry might like to consider best practice.

ⁱ <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Corporate-Culture-and-the-Role-of-Boards-Report-o.pdf>

ⁱⁱ <https://www.gov.uk/government/publications/the-7-principles-of-public-life/the-7-principles-of-public-life--2>

ⁱⁱⁱ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/411262/10032015_Departmental_Guidance_2015_PDF.pdf

^{iv} https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/327068/CodeofGovernanceJuly2014.pdf

^v <http://www.governancecode.org/wp-content/uploads/2012/06/Code-of-Governance-Full1.pdf>

^{vi} http://www.iso.org/iso/iso_9000

^{vii} <http://www.iso.org/iso/home/standards/management-standards/iso14000.htm>

^{viii} <http://c.yimcdn.com/sites/socenv.org.uk/resource/collection/56A0E3EA-050C-4F03-B2BC-B2906C3B9A1F/Society%20for%20the%20Environment%20Brexit%20Framework.pdf>