GOVERNANCE: REPORTING AND DISCLOSURE

The meaning of transparency and disclosure

The directors of a company are responsible for running the company in the interests of its stakeholders, particularly its shareholders. In most large companies the major shareholders are not also directors, and it is therefore important that there should be good communications between the two groups. The shareholders need to be informed about how the company is performing, and the directors need to know the views of their shareholders. Transparency and disclosure are therefore key issues in corporate governance.

Transparency in stock markets and other financial markets means that information about conditions in the markets is clear and well understood. For example, transparency exists when investors understand about the financial situation of companies, and the future plans and prospects for those companies, so that they can make well-informed investment decisions. Investors need information about companies to make their investment decisions. Shareholders need information about the companies they have invested in, to assess the financial performance of the company and its future prospects, and to decide whether to hold on to their shares, sell them or buy more shares. Other investors need information about companies in order to decide which companies they should invest in, and how much to invest.

Disclosure means making information available, so that there is transparency. Companies have the main responsibility for disclosure in the stock markets. They provide regular reports to shareholders and other investors, and it is from these reports that investors obtain most of their information.

Corporate Governance: The Need for Transparency and Disclosure

The need for transparency and disclosures in the financial markets is recognised in codes and statement of principles on corporate governance. The code of Corporate Governance in Nigeria states that companies should engage in increased disclosure beyond the statutory requirements of the Companies and Allied Matters Act, 2004. The board should be guided by the principle of timely, accurate and continuous disclosure of information and activities of the company so as to give a balanced and fair view of the company including non-financial matters. The board should use its best judgment to disclose any matter not specifically required in the code but which it considers to be capable of affecting in a significant form the financial condition of the company or its status as a going concern.

What information should be disclosed?

There are three main categories of information that investors need from a company:

i. Financial information about the past performance of the company, its financial position and its future prospects.
ii. Information about the ownership of shares in the company, and voting rights associated with the shares. This is important for global investors, who may have problems with investing in companies where there is a majority shareholder, or where there is a complex structure of share ownership, or where some shareholders have more voting rights than other shareholders (for the same class of shares).
iii. Corporate governance information.

Principles of disclosure and communication

There are several basic principles for disclosure and communication of information.

i. **The information should be reliable**: Reliable information is information that is sufficiently accurate for investors to trust it when making their investment decisions. The OECD Principles, for example, state that information should be prepared and disclosed with high quality standards of accounting and high standards for both financial and non-financial disclosures.
ii. **Information should be understandable:** One of the criticisms of international financial standards (IFRSs) is that financial reporting in accordance with IFRSs can be very complex, and some investors might not properly understand the information that they provide. Many investors support the idea that companies should provide information about themselves in a narrative form, in addition to providing financial statements. Narrative statements are explained in more detail later.
iii. **Information should be timely:** In the financial markets, 'timely' often means 'communicated as soon as possible'. Information should be made available to all investors as soon as possible after it becomes 'public'. Efficient stock markets should ensure that information announced by companies is made available to everyone quickly after the

announcement. In the European Union, for example, one of the aims of the Transparency Directive (introduced in 2007) is to communicate information available quickly to investors as soon as companies make announcements to the stock market.

iv. **Access to relevant information in an equal, timely and cost-efficient manner:** When information is disclosed by companies, it should be equally available to all investors and users.

v. **Information should be made available by convenient channels of communication**: Companies should be encouraged to make it available in electronic form to investors who want to receive it in that form. For example, companies should use their web sites for making disclosures.

vi. **The opportunities for exploiting confidential information to make a personal profit should be minimised**: By making information available to investors quickly, opportunities for insider dealing should be reduced.

Requirements for Disclosures about Corporate Governance

Institutional investors expect to be given information about corporate governance by companies, because this information helps them to make their investment decisions.

In the European Union and in other countries, the principle of 'comply or explain' is applied. Major companies are required to comply with a recognised code of corporate governance, or explain their non-compliance. However, this on its own does not provide all the corporate governance information that investors want.

- In countries of the European Union, major companies are required to prepare a corporate governance statement each year. This is included in their annual report and accounts. In the UK for example, the Listing Rules require a statement in the annual report and accounts (of listed companies) relating to compliance with the UK Corporate Governance Code.
- In Nigeria, all public companies are required to state in their annual reports how they have applied the Code of Corporate Governance and the extent of their compliance with the code.
- Similarly, the Singapore Exchange Listing Rules require similar disclosures from listed companies, in relation to the Singapore Code of Corporate Governance.
- The OECD Principles call for disclosures by companies about governance issues.

The Content of ‘Best Practice’ Disclosures

Corporate governance statements by listed companies are often quite long. Typically, they fill five or six pages in the annual report and accounts. (In addition, UK listed companies include a lengthy directors’ remuneration report, in addition to their corporate governance report.) The specific content of a corporate governance statement may vary. In the UK, statements by listed companies are required to contain the following information.

i. A statement of how the board operates, including a high level statement about which matters are reserved for the board and which decisions are delegated to management. For example, a report might state: ‘The Board has set out clearly the Schedule of Matters Reserved for Board Decision in order to ensure overall control of the Group’s affairs. These include the approval of financial statements, major acquisitions and disposals, authority levels for expenditure, treasury policies, risk management, Group governance policies and succession plans for senior executives.
ii. Names of the chairman, CEO, senior independent director and chairmen of the nominations, audit and remuneration committees.
iii. The number of board meetings and board committees during the year, and the attendance record of each director at those meetings.
iv. The names of the non-executive directors that the board considers to be independent. Reasons should be given where this is appropriate.
v. The other significant commitments of the chairman, and changes in these commitments during the year.
vi. A statement about the performance evaluation of the board, and how this has been conducted.
vii. A statement about the steps the board has taken to ensure that the directors (especially the non-executive directors) are informed about the opinions of the company’s major shareholders. This statement might be quite brief. For example: ‘Shareholders are offered the opportunity to meet with the Senior Independent Non-Executive Director. The Board is kept informed of the view of major shareholders through regular updates.’

Somewhere within the annual report and accounts, the following information should also be provided.

i. A separate section describing the work of the nominations committee.
ii. A description of the work of the remuneration committee. (In the UK for example this is required as part of the Directors Remuneration Report Regulations, and is likely to be contained within the Directors Remuneration Report.)
iii. An explanation of the directors' responsibility for preparing the financial statements.
iv. A statement by the directors that the company is a going concern.
v. A report that the board has carried out a review of the company's system (and group's system) of internal controls.
vi. A separate section describing the work of the audit committee.
vii. If the company does not have an internal audit department, the reasons why it does not.
viii. If the company's auditors provide non-audit services to the company, an explanation of how the auditors' objectivity and independence are safeguarded.

Other information that should be provided by companies includes:

ix. The terms of reference for the nominations committee, remuneration committee and audit committee. These can be made available on the company's website.
x. The terms and conditions of appointment of NEDs (which can also be made available on the website).
xi. When papers are sent to shareholders for a general meeting where there will be a proposal to elect or re-elect a non-executive director, a statement by the board of why the individual should be elected. When a NED is proposed for re-election, the chairman should also confirm that the performance of the NED continues to be effective and the individual continues to commit the necessary amount of time to the company.

Mandatory and Voluntary Disclosures

Disclosures about corporate governance may be a mandatory requirement of the law or other regulations, or they may be provided as voluntary disclosures by a company. In practice, the disclosures by a company are likely to be a mixture of mandatory and voluntary items. The nature and amount of mandatory disclosures depends on the laws and regulations of the country.

- Some disclosures are required by law. For example, companies are required to prepare an annual report and accounts, and present these to the shareholders. Company law specifies what the directors' report and the accounts must contain, and in addition other regulations about content apply such as the requirements of financial reporting standards. In the UK, there is a legal requirement for quoted companies to include a directors' remuneration report in their annual report and accounts.

- Some disclosures are required by stock market rules. For example, as mentioned earlier, the UK Listing Rules require listed companies to provide information relating to corporate governance in their annual report and accounts. There are also stock market rules about other announcements by the company, such as profit warnings and announcements of proposed takeovers.

In addition to the mandatory disclosures required by law or regulation, many companies provide additional information, as part of their normal reporting cycle. Typically, these include:

a. a chairman's report describing the activities of the company and its different operating divisions: alternatively, an operating and financial review by the CEO;
b. a social and environmental report, or a corporate social responsibility report.

The Reasons for Voluntary Disclosures

Companies are not required to provide voluntary disclosures, but there are several reasons why they choose to do so.

i. Some voluntary information might be provided as a public relations or marketing exercise, to present 'good news' about the company to investors and other users of the company's published reports. For example, this might be the purpose of a chairman's report. It could be argued that social and environmental reporting has been used by some companies to promote their 'green' image and strengthen their reputation with customers.
ii. Providing information on a voluntary basis might persuade the government or financial service regulator that compulsory disclosures and regulation are not necessary.
iii. Companies might publish social and environmental reports out of a genuine ethical and cultural belief in the responsibilities of the company to society and the environment. If a company believes that it has social and environmental responsibilities, publishing a report on these issues is a way of making itself accountable.

iv. A company might use voluntary disclosures as a way of improving communications with its shareholders. By giving more disclosures to shareholders, companies might encourage shareholders to respond, and enter into a dialogue with the company about its strategies and plans for the future.