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# Beginners Guide to Corporate Governance and Smaller Companies

## What is it and Why?

Corporate governance is a great bit of jargon...what it really means is that every responsible business (and every responsible company director) needs to have a set of policies, processes, attitudes and values. The practices, principles and values that guide a company and its business every day, at all levels of the organization. These policies will hopefully aid the business and its directors in maintaining a high standard of ethical and businesslike behaviour.

Another definition is that it is the rules and practices by which a board of directors ensures accountability, fairness, and transparency in the firm's relationship with its employees, suppliers, customers, and anyone else involved with the business.

Should every business do this – well, Yes, But. But the smaller the business, the smaller the number of people involved in it, then the smaller the need. But equally, every business that has a management structure should think about how the values of the business can be expressed.

Corporate governance arose as a result of the excesses of various generations of company directors. But as a separate concept it did not exist in the UK until the Cadbury report of 1990s, this was followed by the Combined City Code in the UK and Sarbanes-Oxley legislation in the USA. Big corporate behavioural failures like Enron at the turn of the 21<sup>st</sup> century or the global banking crisis of 2009 have all taken their toll – and increased awareness of Corporate Governance and the political need to apply it to business generally.

## What rules are there?

Unless you operate a publicly listed company then the rules are just suggested guidelines – but they are obviously considered to be best practice. For publicly listed companies and their subsidiaries they are part of the legal framework and you need more information than is contained in this brief Beginners Guide.

The Institute of Directors has defined 14 points that constitute what corporate governance is for privately



held or unlisted companies, points 1-9 are for every company and 10-14 for larger or more complex businesses. Those 14 points are in the appendix... and as you would expect from such an august and influential institution make pretty boring reading. My executive summary is:

- ⇒ Have a written set of policies stating how the shareholders want the company to operate and what values the directors are to apply in operating the company.
- ⇒ Have a long-term plan for the success of the business and for management succession
- ⇒ Have a system of internal control and risk management to safeguard the assets of the company
- ⇒ Have meaningful board meetings
- ⇒ Have good communications with any external shareholders and, if you have family shareholders, don't let family squabbles interfere with the running of the business.

## CAVEAT

This Beginners Guide is no substitute for proper specific professional advice and no liability can be accepted for any acts or omissions taken as a result of reading it. Tax law is complex, changes frequently and much will depend upon your individual, precise and detailed circumstances.

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## APPENDIX: The IoD Corporate Governance guidance for unlisted companies:

- Principle 1:** Shareholders should establish an appropriate constitutional and governance framework for the company.
- Principle 2:** Every company should strive to establish an effective board, which is collectively responsible for the long-term success of the company, including the definition of the corporate strategy. However, an interim step on the road to an effective (and independent) board may be the creation of an advisory board.
- Principle 3:** The size and composition of the board should reflect the scale and complexity of the company's activities.
- Principle 4:** The board should meet sufficiently regularly to discharge its duties, and be supplied in a timely manner with appropriate information.
- Principle 5:** Levels of remuneration should be sufficient to attract, retain, and motivate executives and non-executives of the quality required to run the company successfully.
- Principle 6:** The board is responsible for risk oversight and should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.
- Principle 7:** There should be a dialogue between the board and the shareholders based on a mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. The board should not forget that all shareholders have to be treated equally.
- Principle 8:** All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.
- Principle 9:** Family-controlled companies should establish family governance mechanisms that promote coordination and mutual understanding amongst family members, as well as organise the relationship between family governance and corporate governance.
- Principle 10:** There should be a clear division of responsibilities at the head of the company between the running of the board and the running of the company's business. No one individual should have unfettered powers of decision.
- Principle 11:** All boards should contain directors with a sufficient mix of competencies and experiences. No single person (or small group of individuals) should dominate the board's decision-making.
- Principle 12:** The board should establish appropriate board committees in order to allow a more effective discharge of its duties.
- Principle 13:** The board should undertake a periodic appraisal of its own performance and that of each individual director.
- Principle 14:** The board should present a balanced and understandable assessment of the company's position and prospects for external stakeholders, and establish a suitable programme of stakeholder engagement.

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