Principles of Corporate Governance: Reporting and Disclosures

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The Organization for Economic Cooperation and Development (OECD) defines corporate governance principles as the non-binding key pillars or building blocks of sound corporate governance intended *to help policy makers evaluate and improve corporate governance's legal, regulatory, and institutional framework.* The rationale underlying the principles of corporate governance is that they provide a benchmark for good governance frameworks for corporations, ensuring consistency of the governance framework and enabling the corporations to achieve their economic objectives through greater investor confidence.

There are four primary principles of corporate governance, namely, transparency (TRP), responsibility (RSP), accountability (ACC), and fairness (FRN). Reporting and disclosures derive from the principle of transparency. The import of reporting and disclosures is that corporate governance frameworks should ensure mechanisms for timely reporting and disclosure of accurate, relevant and reliable material information to all stakeholders. Current corporate reporting and disclosure trends indicate a shift from mere financial reporting to providing more holistic information, including non-financial information. This article explores the substantive content of the principle of reporting and disclosures as derived from the principle of transparency, the rationale underlying the principle and its extension to non-financial matters, Kenya's regulatory frameworks on reporting and disclosures, and compliance with the principle in Kenya.

In most jurisdictions, listed or publicly traded companies are legally obligated to file annual reports and periodic disclosures. While only listed corporations are legally obligated to make public disclosures and publish reports, most non-listed organisations voluntarily report and disclose information on their performances to the relevant stakeholders. At a minimum, the listed companies are required to publish material information annually. However, they may be required to report and disclose periodically, e.g., quarterly or biannually.

What Does Reporting and Disclosures Entail?

Reporting and disclosure principle requires a company to provide financial and non-financial information to the stakeholders, mainly shareholders, in a comprehensible, accessible, and timely manner. However, the reporting and disclosure obligation is not absolute. There are some notable limitations and restrictions. Companies are not required to publish reports or make disclosures that could potentially hinder their competitive position. Such information may only be disclosed when it is required by investors to make sound investment decisions. Further, preparing the reports and making the disclosure must, in principle, not impose an undue administrative and financial burden on the organisation preparing it.

Corporate reporting and disclosure may be classified into financial and non-financial reporting. Financial reporting entails the publication and disclosure of information about an entity's financial position (statement of financial position), economic performance (statement of comprehensive income), and changes in financial position (statement of cash flows). Financial information also provides an overview of the management's stewardship of the resources entrusted to it. Financial reporting is mainly done in the form of annual financial reports. Non-financial reporting, on the other hand, refers to reporting and disclosure of information that is non-financial.

It is noteworthy that non-financial information is commonly referred to as Environmental, Social and Corporate Governance (ESG) information. This is because environmental and social performance constitutes core elements of measuring an organisation's sustainability. Non-financial information is multidimensional, and it includes information on environmental and social risk management, stakeholder engagement, regulatory compliance, human rights performance, labour and working conditions, occupational health and safety, training and education, diversity and equal opportunity, consumer protection, data privacy, carbon footprint assessment, and internal policies such as sexual harassment and anti-corruption policies. Non-financial reporting takes many forms, such as the non-financial declarations in the EU.

Rationale for Reporting and Disclosures

There is a significant informational asymmetry between a company's management and directors, on one hand, and external stakeholders, such as investors and the general public, on the other hand. This asymmetry tends to be exploited from time to time to the detriment of other stakeholders' interests. Against this background, reporting and disclosure are entrenched as a core benchmark of the sound corporate governance framework. Corporate reporting forms a link between a company, its investors, and other stakeholders. The reporting and disclosure of material information enable prospective investors to comprehensively assess a company's financial and non-financial performance to make investment decisions that are as risk-averse as possible. It also ensures transparency as the company's various stakeholders are empowered with relevant and reliable information to monitor its corporate health. Holistic disclosure is premised on the same reasoning underlying the concept of corporate social responsibility. Besides their economic obligations to investors and creditors, corporations have a larger responsibility to reduce their businesses' negative social and environmental impact.

Key Principles of Corporate Reporting

Non-financial reporting is a recent development in corporate reporting. Effectively, the principles or guidelines underlying non-financial and financial reporting are embedded in separate instruments. For example, the principles/guidelines on financial reporting are encoded in the IFRS Foundation's International Financial Reporting Standards. The guidelines on non-financial reporting are embedded in the GRI's Global Reporting Initiative standards. These principles or guidelines provide standards against which the quality and appropriateness of its reports and disclosed information is assessed. Despite the difference between financial and non-financial reporting, the principles/standards for the respective reporting are fundamentally similar. These may be summarised as follows:

a. Fair presentation. The disclosed and reported information must represent the company's performance, including positive and negative developments. It should be accurate and unbiased. The information must also be reliable.
b. Materiality. The materiality test should be employed to determine which information should be disclosed/reported. Material information is whose omission or misrepresentation would alter the stakeholders' decisions concerning the organisation. Only material information should be subject to reporting and disclosures.
c. Understandability. The information must be presented in a simple, clear and understandable manner, considering the key stakeholders' differences.

d. Comparability. There ought to be consistency in the company's subsequent reports and relative reports of other rival companies. This consistency enables comparison of the company's performance over time and relative to other organisations.
e. Completeness. The reported information should be sufficient to enable a comprehensive and holistic assessment of the organisation's impacts during the reporting period.
f. Timeliness. The organisation shall report information on a regular schedule and make it available in time for information users to make decisions.
g. Cost versus benefits. As a primary rule, the benefits derived from information should exceed the cost of providing it.

Regulatory Framework for Corporate Reporting

Corporate reporting is a legal imperative for publicly traded (listed) companies. Non-listed companies may also be obligated to report and disclose information to stakeholders per their constitution and investors' rights agreements. Regarding financial reporting, the Companies Act 2015 and the Companies (General) Regulations 2015 have important financial reporting and disclosure provisions. The CMA's Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 also has important provisions on the role of directors and the audit committee in financial and business reporting. Regarding non-financial reporting, various legal instruments include the Companies Act 2015, the Climate Change Act 2016, and the Consumer Protection Act. The Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 also imposes on the board of directors the obligation to furnish the stakeholders with relevant and to have the stakeholders' best interests while determining which information to consider the material for publishing. In addition to that, there are non-binding guidelines and footprints relevant to corporate reporting. These include Kenya's Vision 2030 development blueprint and the Nairobi Securities Exchange ESG Disclosures Guidance Manual (November 2021).

Key Steps in the ESG Reporting Process (~NSE)

In its ESG Disclosures Guidance Manual, the Nairobi Securities Exchange (NSE) has outlined seven key steps to prepare non-financial reports. The chart below provides an overview of those steps.

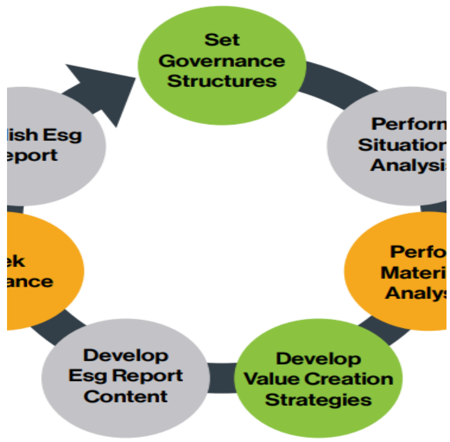

Figure 1. Key Steps in the ESG Reporting Process. Source: The Nairobi Securities Exchange ESG Disclosures Guidance Manual (November 2021)

Step 1: Governance over ESG reporting. This stage involves setting objectives for ESG integration & reporting and selecting an ESG reporting team.

Step 2: Situational analysis and stakeholder engagement. This entails analysing the organisation's positive and negative ESG impacts on the economy, environment, and society.

Step 3: Materiality analysis. This stage involves identifying and prioritising material ESG issues and planning responses.

Step 4: Value creation. This stage involves developing value-creation strategies around risk and opportunity management for assessed topics.

Step 5: Content development. This involves collecting, compiling, reviewing, signing off and reporting data externally and using an adopted reporting standard or framework for ESG reporting.

Step 6: Assurance. In this stage, the organisation builds credibility over the public ESG disclosures through internal & external audit processes and quality assurance.

Step 7: Publish the ESG report. The stage involves publishing the final ESG report on its website and social media and/or availing printed copies to stakeholders.

The Status of Corporate Financial and Non-financial Reporting and Disclosures in Kenya

According to the CMA report, Kenyan issuers registered a positive performance on the principle of reporting and transparency. The average aggregate performance by all issuers for the financial year 2019/2020 was 71.24%. There was a commendable upward trend in reporting and disclosure of risk management processes, frameworks and corporate activities, board charters, the board committee's terms of reference, and the environmental impact of companies' operations. CMA also noted that the issuers are increasingly developing and disclosing their codes of ethics and conduct. The CMA report also flagged some areas that need improvement. There is a need to ensure that the information reported is current, timely, accessible, and user-friendly taking cognisance of the stakeholders' diversity. There's also a need to highlight the issuers' policy and stakeholder relations strategies. Further, there's a need to disclose insider dealings and related party transactions and introduce an integrated reporting system for consistency and standardisation.