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**UK Corporate Governance Code Consultation**

Dear Sir or Madam

Thank you for the opportunity to respond to the FRC's consultation regarding revisions to the UK Corporate Governance Code; our response focuses on the questions linked to Audit, Risk and Internal Control.

We support the overall objective of strengthening risk management and internal control systems. These are essential components of effective corporate governance and play a vital role in safeguarding stakeholders' interests. In this regard, it is encouraging to see that the proposed amendments aim to address these areas.

That being said, we do have some comments about the proposed amendments to the code, in summary:

1. We acknowledge the intention to strike a balance between strengthening risk management and internal controls while avoiding undue burden on companies. However, the proposed approach seems to allow companies complete discretion over how to implement these measures. Without a concerted effort to "set the bar" at an appropriate level, it is likely that the outcome of these reforms will not enable stakeholders to assess the effectiveness of risk management and internal control systems across companies with confidence.

2. While we note that operational and compliance controls both featured in the previous iteration of the Code, this is an area we feel would benefit from further clarification and guidance regarding the scope and expectations. Companies outside highly regulated sectors have, until now, tended to focus efforts on financial controls and applying the

same rigour across all three control categories would likely require significant investment.

3. The extent of the scope proposed by the FRC, covering Reporting, Operations and Compliance, goes significantly further than even the US regulator's requirements. There is a risk that this could be viewed as an unnecessary barrier for companies listing in the UK.

   Furthermore, "Reporting" is an area of significant change e.g. ESG reporting. As the standards and expectations surrounding non-financial reporting continue to develop, it is important to consider the practical implications and potential challenges of extending the scope to cover all "Reporting" controls at once. Companies will need more time to ensure the necessary resources, expertise, and frameworks are in place to achieve this level of coverage. As a minimum, a phased approach would facilitate a smoother transition for organisations as they adapt to the changes in this area.

Our detailed comments are provided in the attached annex. If you have any questions or would like to discuss the points in this letter further, please do get in touch with me. Otherwise we look forward to the outcome of your consultation and further clarification of the changes and their implications.

Yours faithfully

[redacted]

## ANNEX – COMMENTS ON PROPOSED CHANGES TO AUDIT, RISK AND INTERNAL CONTROL REQUIREMENTS OF THE UK CORPORATE GOVERNANCE CODE

*Q10: Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?*

Yes. It would be logical to introduce this for all Code companies rather than just PIEs given the potential confusion associated with having listed entities that are below the PIE threshold complying with different requirements than those above. The AAP can also be a useful tool in providing clarity on the assurance approach across the company's risks.

*Q11: Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?*

Yes. We would encourage simplification and avoidance of duplication wherever possible and consider this will be helpful for all users of these documents.

*Q12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?*

We do not have any specific objections to this proposal.

*Q13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?*

We support the overall objective of strengthening risk management and internal control systems. These are essential components of effective corporate governance and play a vital role in safeguarding stakeholders' interests. In this regard, it is encouraging to see that the proposed amendments aim to address these areas.

The regulator's emphasis on enhancing reporting, particularly through the declaration of the effectiveness of risk and internal control systems throughout the reporting period, is commendable. Transparency in this area allows stakeholders to make more informed decisions. However, we recognise that a key challenge lies in the absence of a consistent framework to support companies in achieving this statement. Without a standardised approach, there is a concern that comparing companies' annual reports becomes challenging.

One concern we have is the lack of a common basis for making the declaration of effectiveness. While reported financial results are supported by accounting standards and undergo rigorous audits, the same level of scrutiny will not be required over financial controls. This disparity may limit the usefulness of the proposed reforms, as the reliability and comparability of the reporting would depend on what each company determines to be material and thus worthy of being reported. There is a strong possibility that companies will take a conservative approach to limit reporting on control failures.

We acknowledge the intention to strike a balance between strengthening risk management and internal controls while avoiding undue burden on companies. However, this approach raises questions about the whether the reforms will achieve the desired impact. The proposed approach will undoubtedly encourage companies to look again and in more detail at their risk management and internal control systems but the lack of a standardised framework is likely to prevent stakeholders assessing the effectiveness of risk management and internal control systems across companies with confidence.

Turning to operational and compliance controls, while we note that these were covered in the previous iteration of the Code, this is an area we feel would benefit from further clarification regarding the scope and expectations. Whereas many boards previously relied on assurance over operational and compliance topics from internal audit and others to conclude on the effectiveness of the risk management and internal control systems, it is far from clear that such an approach would be satisfactory under the current proposals.

Take for example, a company which has until now been SOX compliant. That company would clearly meet the new requirements in relation to internal controls over financial reporting; however, extending their programme to provide consistent coverage of operational and compliance controls would require significant investment in documenting the processes and controls, capturing evidence to support their effectiveness and testing.

In addition, "operational" controls – the definition of which is not clear – are potentially all-encompassing and could conceivably cover everything from customer services through to procurement, production, product testing, project management and beyond. For "compliance" controls, most companies outside highly regulated sectors (such are pharmaceuticals, financial services, and utilities) lack a dedicated compliance function and to identify and monitor the controls with any kind of rigour would again require significant investment.

In conclusion, we would question whether the same approach is needed across all types of control, i.e. financial (reporting), operational and compliance, given this scope extends far beyond that required by even the US regulator. There is also the possibility that the proposed scope could be viewed as both too onerous and an unnecessary barrier for companies listing in the UK. As a minimum we would propose more meaningful guidance on the regulator's expectations with regard to operational and compliance controls and the framework for assessment.

*Q14: Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?*

We believe that a balanced approach is necessary to ensure transparency and accountability while allowing for remediation of controls during the period.

We support the notion of regular monitoring throughout the reporting period up to the balance sheet date as it enables a more comprehensive assessment of risk management and internal control systems. It provides the board with a more complete view of their effectiveness over time and could assist with identifying any emerging issues promptly. This approach enhances the company's ability to proactively address potential weaknesses and reinforces the importance of ongoing risk management.

We also recognise the practical need to allow for controls to be remediated during the reporting period and feel that it is important to allow control weaknesses to be resolved by the balance sheet date without an automatic need to report these. This flexibility acknowledges that organisations may encounter temporary challenges that can be rectified in a timely manner without adding to the burden of reporting on transient issues that do not impact the overall effectiveness of the control environment. Furthermore, it encourages a proactive approach to remediation while ensuring that any significant control issues are adequately addressed by the end of the reporting period.

We do not agree that monitoring should take place up to the date of the annual report. We feel that this would be impractical and would result in significant additional cost to implement properly.

*Q15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?*

We understand the logic in proposing to change "financial" to "reporting" to capture controls on narrative as well as financial reporting. The inclusion of controls over narrative reporting aligns with the evolving landscape of corporate reporting, which now encompasses various non-financial aspects, including environmental, social, and governance (ESG) considerations. Incorporating non-financial controls into the code acknowledges the importance of transparent and reliable reporting in all areas.

However, we note that this is an area currently undergoing significant change, particularly with the development of requirements on ESG reporting. As the standards and expectations surrounding non-financial reporting continue to develop, it is important to consider the practical implications and potential challenges associated with expanding the scope from "financial" to "reporting" at this time.

In addition, while other regulators have focused on internal controls over financial reporting (ICFR); the UK, in expanding its scope to cover not only operational and compliance controls but also narrative reporting, is at risk of making its requirements onerous and out of sync with rival markets. This comes against a backdrop of the loss of high-profile IPOs to other markets.

We would advocate for further consultation on the adoption of this measure and whether it truly adds value in relation to other reporting regimes. This delay would provide time to properly evaluate the impact of developments in areas like ESG and to understand the expectations of stakeholders regarding the necessity of including these controls.

As a minimum we think more time should be allowed for implementation, to provide companies with a period to ensure the necessary resources, expertise, and frameworks are in place to effectively implement, test and report on these controls. This phased approach would facilitate a smoother transition for organisations as they adapt to new requirements in this area.

*Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?*

We acknowledge the importance of providing guidance to companies on methodologies or frameworks for assessing the effectiveness of risk management and internal control systems. Such guidance plays a vital role in promoting consistency, clarity, comparability and best practices in corporate governance.

While including example methodologies and frameworks in the guidance may be helpful as a starting point, there are potential limitations in relying solely on examples. Not least that it could lead to challenges in comparability between companies and potentially hinder the effectiveness of the proposed reforms.

Ideally we would like to see the emergence of a minimum standard in the guidance. This would establish a baseline that companies must meet in terms of assessing the effectiveness of their risk management and internal control systems. Companies would then have a clear benchmark to work towards, ensuring a more consistent level of reporting across the board.

We acknowledge that a one-size-fits-all approach may not adequately address the specific needs and nuances of different organisations and that some companies may already go beyond a “minimum requirement”, especially if they are already compliant with regulations such as the Sarbanes-Oxley Act. Allowing companies to exceed the minimum requirement would provide flexibility for organisations with more advanced control practices. This approach would accommodate varying degrees of sophistication and maturity in risk management and internal control systems.

*Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?*

Consistent definitions for these terms are crucial to drive consistency and comparability in the reporting of risk management and internal control systems across companies. Currently, there is a lack of consensus on how these terms are defined, which hinders effective comparison. Therefore, we would support the establishment of standard definitions to promote clarity and uniformity in corporate reporting.

An alternative approach could be to require each company to disclose the definitions they are choosing to apply, ideally with reference to an established framework.

To ensure robust and widely accepted definitions, we propose engagement with industry bodies that have expertise and experience, particularly regarding the practical application of definitions in this area. Organisations such as COSO (Committee of Sponsoring Organizations of the Treadway Commission), the IIA (Institute of Internal Audit), ICAEW (Institute of Chartered Accountants in England and Wales), ACCA (Association of Chartered Certified Accountants), audit firms and others possess valuable insights and knowledge on risk management and internal control practices. Consulting these industry bodies would enable a comprehensive and inclusive approach to developing consistent definitions that align with best practices and can be easily applied.

*Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?*

No additional areas to those noted above.

*Q19: Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?*

Yes.

*Q20: Do you agree that all Code companies should continue to report on their future prospects?*

Yes.