ICAS response to the FRC

13 September 2023

UK Corporate Governance Code

Introduction

About ICAS

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ICAS' diverse membership is made up of over 23,000 world class business professionals who work in the UK and in more than 80 countries around the globe. Members of ICAS are also known by the letters CA, an exclusive professional designation in the UK.

ICAS members operate at the forefront of ethical and sustainable business. Educated, regulated, and led by the highest standards of ethical leadership since 1854, they are at the top of their game. They are trusted professionals, that transform business and support one another for the greater good.

Acting in the public interest is the guiding principle of all that ICAS does and we continually work to maintain trust in the finance profession. That ethos is enshrined in ICAS' internationally respected Code of Ethics – which applies to all members, students and member firms, and is underpinned by our Royal Charter commitment.

ICAS is a member of the Chartered Accountants Worldwide Network, a global family that brings together the members of 15 leading institutes to create a community of over 1.8 million Chartered Accountants and students in more than 190 countries.

Any enquiries should be addressed to atelfer@icas.com.

Key Points

We strongly support the continuation of a principles-based comply or explain approach in the Corporate Governance Code. Overall, we are supportive of the principles and general Code changes but would highlight the following specific concerns:

a) Proportionate regulation has an important role to play in to making the UK an attractive place for business so any changes should support wider government objectives to grow the economy.

b) Increasing detailed disclosures could make annual reports even longer and increase regulatory burdens. This potentially undermines the need to keep corporate reports readable and relevant. To minimise the risk, we suggest that guidance stresses the need for reporting to focus on what is significant and meaningful content to meet the Code's principles and provisions.

c) The presumed widening of the audit committee remit in relation to narrative reporting – we believe that the Code wording should clarify that responsibilities are restricted to the annual report. Importantly, it is the board's responsibility to decide who is responsible for monitoring the integrity of narrative reporting in the annual report. Allocation of responsibilities should be left to the Board and the Code should enable this. The Code should not assume or assign specific responsibilities to the Audit Committee.

d) We strongly suggest removing a reference to "minimum" within provision 40 ("minimum circumstances in which malus and clawback provisions could be used") as this would be difficult to define.

e) There are strong concerns that companies could struggle to meet the broader scope directors' statement on the effectiveness of internal controls. Given the breadth of controls that need to be reviewed to implement this proposed change, it is believed that achieving the declaration will be more challenging than appears. Guidance will need to be clear on how to implement this consistently, proportionately and efficiently. If introduced, we think that a transitional period would help. We would also like clarification on how the UK would avoid the detail, complexity and onerous burdens which are causing concern.

f) We support introducing an explicit reference to ethics in the Code. In particular, we believe the Code should include a new principle highlighting the need for directors to:
   - Promote ethical leadership, and
   - Establish a code of conduct/ethics and for this code to be made publicly available.

Response to detailed questions

Board leadership

Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

We agree that the board should focus on governance activities and more outcome-based reporting but would stress that outcomes are difficult to identify, and some guidance would be helpful to support successful implementation.

It would be appropriate to include a definition of what is meant by outcome, as the term can be used interchangeably with impacts. Outcome can be interpreted as a separate step before impacts.

We also note that impact (rather than outcome) is a concept that is relevant for certain types of sustainability reporting so it may be preferable to change the Code to make specific reference to only impacts. This would better align the Code with the logic and language of the IFRS Sustainability Disclosure Standards[1] which are the standards being assessed by the government for use in the UK[2].

Q2: Do you think the board should report on the company's climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?

Yes, this is consistent with the direction of travel in reporting. Also, given the evolving yet often urgent positive and negative influence of climate change to businesses, it warrants separate disclosure.

Q3: Do you have any comments on the other changes proposed to Section 1?

Yes, there is continued frustration voiced by board members on efforts to engage shareholders, illustrated by the comment "you can lead a horse to water but you can't make it drink". More thinking is needed of how to improve traction and interest with shareholder, especially where chairs are actively trying to develop engagement with them. Committee chairs/ members should always be available to deal with any shareholder request for engagement. We believe that wording should remain as to "seek engagement" in paragraph 3 instead of "engage" to reflect this dual responsibility.

Division responsibilities

Q4: Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments an explicit part of board performance reviews?

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[1] IFRS - IFRS Sustainability Standards Navigator
[2] UK Sustainability Disclosure Standards - GOV.UK (www.gov.uk)

Yes, and we believe it would be appropriate to encourage good practice on this across other organisations, not just the listed sector.

Q5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

We support the listing of each significant director appointment but not adding a description of how each director has sufficient time to undertake their role effectively. There is a risk that the current wording may encourage boiler plate descriptions which will lengthen reporting for no real benefit. To reflect board responsibilities, we would prefer the Code wording to focus on a statement from the board that confirms they are satisfied that board appointment procedures have adequately reviewed and confirmed that the new director(s) have sufficient time for undertaking their duties.

To help to strengthen the board's ability to fulfil their duties (Section 3 principle J), we suggest including the upskilling of boards. The aim is to improve understanding, knowledge, experience and competencies in new areas, such as climate risk, as well as the current and emerging risks, and opportunities facing an entity.

Composition, succession & evaluation

Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

Yes, the proposals are reasonable.

Q7: Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?

Yes.

Q8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?

Yes, however this is quite a lengthy addition to the annual report. We suggest that how to streamline reports is given further attention and investigation.

Board performance

Q9: Do you support the proposed adoption of the CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?

Yes, however we note a trend of lengthening annual reports which is moving away from earlier attempts to streamline reporting (also mentioned in our response to question 8) and the UK government's agenda on smarter regulation.

Audit risk & internal control

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

We are supportive of an audit and assurance policy on this basis.

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?

We are generally supportive of the provisions but believe the following statements should be amended:

- The wording of provision 26 should state that the scope of narrative reporting and sustainability is restricted to the annual report.
- If there is a provision in the Code, "Promoting effective competition during the tendering for an external auditor, to support audit market diversity", it should not be at the expense of audit quality and Code wording should make this explicit.

We note the additional reference to engaging with shareholders. Our members report particular difficulties engaging shareholders on audit committee business and a lack of interest from shareholders, despite considerable efforts on behalf of the business. Please see our response to question 3.

Sustainability

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?

No, we believe the following points should be explicit in the Code:

- We do not consider it appropriate to extend the Audit Committee's responsibilities to cover non-financial reporting in other communications such as marketing materials. The scope of non-financial reporting needs to be tightly and clearly defined in the Code and restricted to the annual report.
- Importantly, it is the board's responsibility to decide who is responsible for monitoring the integrity of narrative reporting in the annual report. Allocation of responsibilities should be left to the Board and the Code should enable this, not default to the Audit Committee.

  A one-size fits all approach is not helpful and there may be a risk of duplication with other committees as companies may operate different committee structures (some focussed on ESG). As there may be an alternative to the Audit Committee better suited to the task, the Board is best placed to decide.

Risk management & internal control

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 directors providing a statement on the effectiveness of the companies' internal control over financial reporting. Extending the proposed statement to include all reporting controls, compliance and operational controls is likely to be more challenging. We believe that companies could struggle to meet the broader scope directors' statement on the effectiveness of internal controls.

Given the breadth of controls that need to be reviewed to implement this proposed section of the Code, there are strong concerns that achieving the declaration is more challenging than envisaged. There is nervousness about the extent of assurance required and potential need to increase external assurance to avoid a future legal challenge that wording was misleading.

This may have significant resource implications both for business and the attractiveness of the UK as a place to do business. The potential regulatory burden needs to be consistent with broader UK government policy to grow the economy, improve the attractiveness of listing in the UK and proportionate regulation. Business members would welcome further information on the expectations for proportionate implementation and cost benefit analysis to provide reassurance.

If introduced, we believe that a transitional period would be necessary but would also like further clarification on how the UK would avoid the detail, complexity and onerous burdens which is driving business concerns.

Guidance will need to be clear on how to achieve a consistent, proportionate and efficient approach to implementation. Companies will have different starting points and a high-level, rather than prescriptive approach to guidance is preferred.

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?

Applying the balance sheet date would be more consistent with the rest of the annual report. Our understanding is that the declaration would be based on internal control arrangements undertaken during the year, but the statement would be at the balance sheet date.

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?

Please see our response to question 13.

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?

Please see our response to question 13.

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?

No.

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

Further wording would help to clarify:

- how the Code interacts with SOX would help to avoid potential duplication by dual-listed companies.
- the integration of sustainability risks and opportunities in enterprise risk management (ERM) could support integrated thinking and an appropriate comprehensive assessment for board members.

Financial reporting and sustainability reporting must make sense when read together and provide a comprehensive understanding of the results and plans of an entity. Disclosure elements like the risks reported per the Code and the sustainability risks reported for example in a materiality assessment, should reconcile, as they will often not be identical.

Going concern

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.

Resilience statement

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

Yes.

Q21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?

Yes.

Remuneration

Q22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

The principles are reasonable.

Q23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?

No, we have some concerns about the interpretation and practical implementation of the statement "*minimum circumstances in which malus and clawback provisions could be used*".

Whilst a high-level intention on the use of malus and clawback may set out the board's commitment and objective to meet good practice principles, detailing minimum conditions in a fluid legal context is not providing meaningful disclosures and may hinder the decision-making process by the Remuneration Committee. Reporting on minimum circumstances cannot completely cover every eventuality and could be counter-productive, possibly leading to litigation. We suggest removing the word "minimum" and just offering some examples of circumstances when malus and clawback would apply.

Ultimately, if shareholders disagree with decisions or malus and clawback is not applied when they think it should, they can vote against those directors responsible for that decision as these are matters which will be raised at the AGM.

Existing interest and engagement on remuneration is comparatively high (unlike audit committee matters). Annual reports are getting longer and remuneration is already an area of additional disclosures so any further increases should be proportionate and balanced.

Quality of reporting

Q24: Do you agree with the proposed changes to Provisions 40 and 41?

Yes.

Q25: Should the reference to pay gaps and pay ratios be removed, or strengthened?

We agree with removing the reference to pay ratios and gaps. Given the wide range of situations and roles it is difficult to boil it down to a succinct and meaningful ratio. We agree with the objectives pay gap reporting is trying to achieve but existing disclosures are not the best fit.

We would support further discussions on how this might be developed in the future to help address weaknesses and inequities relating to pay gaps.

Other

Q26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence (AI)?

Organisations need to have appropriate governance procedure in place to ensure appropriate use of AI.

ICAS also believes that the need for ethical leadership should be emphasised within the UK's Corporate Governance Code.

It is vital that businesses maintain their reputation, public confidence and support. Businesses are significant as employers, as the providers of goods and services, and occupy a key role in our communities. There is a need for the leaders of organisations to engender an ethical culture where the integrity of the organisation's employees is seen to transcend all other business objectives and strategies.

We therefore believe that the Code at Principle B should highlight the need for directors to:
1. Promote ethical leadership.
2. Establish a code of conduct/ethics and for this code to be made publicly available.

The suggested changes to the UK Corporate Governance Code (in red) are as follows:
"The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are all aligned. All directors must promote ethical leadership, act with integrity, lead by example and promote the desired culture. The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. These should include that the company has a publicly available code of conduct/ethics which sets the standards of behaviour expected of all directors and employees."

CA House, 21 Haymarket Yards, Edinburgh, UK, EH12 5BH
+44 (0) 131 347 0100
connect@icas.com
icas.com

@ICASaccounting
ICAS – The Professional Body of CAS
icas_accounting
icas_accounting