The 2024 UK Corporate Governance Code

Summary of changes with references to supporting guidance

Updated April 2024

Introduction

Much awaited, the 2024 UK Corporate Governance Code (the Code) was published by the Financial Reporting Council (FRC) on 22 January 2024 following consultation in summer 2023.

While the rest of the audit and corporate governance reform agenda has disappointingly stalled, the Code, together with the new failure to prevent fraud offence[1] represent important enhancements to corporate transparency and accountability for in-scope companies and their directors.

This document provides a summary of the key changes introduced by the 2024 Code, supplemented with insights from the supporting guidance (the guidance) issued by the FRC.

Text in grey boxes denotes reference to relevant paragraphs in the guidance. The original version of this summary was published in January 2024 shortly after the FRC issued the Code and guidance. It was updated in April given the FRC re-issued the guidance on 6 March 2024. References to the guidance are therefore current as at April 2024, but given the FRC's ability to update the guidance quickly we advise readers to check the FRC's website for latest updates.

[1] introduced by the Economic Crime and Corporate Transparency Act 2023.

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1. Overview

- The 2024 Code is not a wide-ranging overhaul of the 2018 Code. It addresses key policy issues asked of the FRC by the Government.
- The FRC has kept changes to the Code to a minimum as it is conscious that the expectations for effective governance must be targeted and proportionate and reporting burden be minimised. As signalled in its policy update in November 2023, it has hence dropped many of the proposals it consulted on – the role of audit committees (AC) on environmental, social and governance issues; expanding diversity and inclusion expectations; over-boarding provisions, and expectations of committee chairs to engage with shareholders.
- The biggest change relates to risk management and internal control (RM and IC) in Section 4 (Audit, Risk and Internal Control). The requirement for malus and claw back provisions in director contracts has been added to Section 5 (Remuneration). All other changes are relatively minor.
- There is a staggered application date – accounting years commencing on or after 1 January 2025, with a further year for the Provision (29) related to RM and IC.
- Non-prescriptive guidance to support companies and to assist them when considering the application of the Code was first issued on 29 January. This guidance is not part of the Code and should not be seen as a requirement. It is intended to stimulate thinking on how boards can carry out their role most effectively and to aid them with their actions and decisions when applying the Code. The FRC will keep the guidance under regular review and is able to update it quickly as evidenced by revisions made on 6 March 2024.
- The structure of the Code i.e., its five sections, and its overall approach i.e., that companies must apply the Code's Principles, and comply or explain against the Provisions that support these Principles, remains unchanged, although there is a specific new Principle (C) to emphasise the importance of clear explanations where there are departures and for reporting to be focussed on outcomes of board decisions. Para 2 references the FRC guidance *Improving the Quality of Comply or Explain Reporting* for further information; outcomes-based reporting is discussed in paras 33 and 45, the former focussed on decisions and the latter on outcomes of engagement.

2. Summary of changes compared to the 2018 Code

Where pertinent, commentary comparing against the FRC's consultation has been included.

2.1. Risk management and internal controls

2.1.1. Overall objective of the changes

- The FRC has devised a principles-based approach which makes clear the board's accountability for effective internal controls – through a declaration – yet reflects the need for flexibility, proportionality and consideration of the particular circumstances of individual companies. The FRC hopes the Code will provide a stronger basis for companies to evidence the effectiveness of their internal controls, thereby enhancing transparency and investor confidence.
- The existing expectations of the 2018 Code remain i.e., for directors to monitor the company's RM and IC framework; at least annually review its effectiveness; and for the monitoring and review to cover all material controls (as judged by the directors).

2.1.2. What is new?

Provision 29 in the 2018 Code	Provision 29 in the 2024 Code
The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.	The board should monitor the company's risk management and internal control framework and, at least annually, carry out a review of its effectiveness. The monitoring and review should cover all material controls, including financial, operational, reporting and compliance controls. The board should provide in the annual report: ▶ a description of how the board has monitored and reviewed the effectiveness of the framework; ▶ a declaration of effectiveness of the material controls as at the balance sheet date; and ▶ a description of any material controls which have not operated effectively as at the balance sheet date, the action taken, or proposed, to improve them and any action taken to address previously reported issues.

- The reference to material controls in the 2024 Code is not new. It previously covered financial, operating and compliance controls. It now also includes "reporting".
- Under the 2018 Code, directors are encouraged through guidance to set out what the review of RM and IC systems entailed, now they will be required by the Code to do so (and also describe the monitoring that was undertaken).
- Under the 2018 Code, directors have to confirm they had conducted a review of the effectiveness of RM and IC systems, now they will have to provide an outcome based on this i.e., a declaration on the effectiveness of material controls as at the balance sheet date.
- Under the 2018 Code, directors are encouraged to set out actions undertaken to address failings or weaknesses; now they will be required to describe those material controls that were not operating effectively and the actions (taken or proposed) to improve them and any action taken to address previously reported issues.

2.1.3. Analysing the requirements further

Monitoring and review of the RM and IC framework

- Principle O includes the reference to the RM and IC framework, previously referenced within Principle C. It now references not just the need for boards to establish, but also to maintain this framework and no longer refers to it as prudent.
- Para 217 notes that boards "could use a recognised framework or standards as part of its process for designing and maintaining the effectiveness of the RM and IC framework (e.g., COSO, ISO, COBIT, etc.)" Para 227 notes that the roles and responsibilities of all key functions and individuals in respect of RM and IC should be made explicit. Para 293 recommends that the board should describe the main features of the framework.
- Boards are required to monitor and at least annually carry out a review of the effectiveness of the RM and IC framework.

- Boards are required to describe how the effectiveness of the RM and IC framework was both monitored and reviewed.
- We interpret monitoring as referring to regular activities, and the review to mean a discrete exercise conducted at least as at the balance sheet date.

- Para 260 notes that monitoring and review of the RM and IC framework is intended, amongst other things to allow the board to conclude whether the framework is properly aligned with strategic objectives; and identify and evaluate areas for improvement in the design, implementation and operation of the framework. Para 261 emphasises the need for an effective framework to be responsive and adaptable to changes.
- Para 269 sets out what the board may want to consider as part of its monitoring activities when reviewing reports during the year. Importantly, according to Para 262, significant issues identified in respect of the framework should be reported to the board, even if they have been remediated, including action(s) taken.
- Para 279 points out that the review should cover the effectiveness of the processes for ongoing monitoring of the framework, with para 284 setting out what is important to consider when carrying out a review.
- Emphasis from the previous guidance on risk appetite remains; in addition, para 250 notes that controls implemented should be appropriate to maintain principal risks within the defined risk appetite.
- There is no requirement or expectation that companies obtain external advice or assurance over the effectiveness of the material controls (para 274). The AC should however discuss what information and assurance it requires in order to properly carry out its roles (Para 188).

Declaration on the effectiveness of material controls

- Made by the entire Board, not solely by the executive directors or by the AC.

- Para 225 suggests that the AC should review the company's internal financial controls… as part of its expected roles and responsibilities in the Code.

- As at the balance sheet date, as opposed to throughout the period and up to the date of the annual report and accounts (ARA) as had been consulted on.
- The declaration is over the effectiveness of material controls (not over the risk management and internal control framework as consulted on).
- It is for the Board to determine what level of maturity is right for its business and their own levels of required assurance in relation to the effectiveness of material controls.

- Para 296 notes that the board can only provide a reasonable conclusion regarding the effectiveness, based on the work carried out and evidence obtained. The guidance does not specify the expectations around the evidence. Para 298 adds that "When the board has been unable to determine the effectiveness of a material control and/or provide a declaration on its effectiveness", the board may wish to utilise the 'comply or explain' nature of the Code.

- There is no reference to material weaknesses in the Code (to avoid confusion with requirements under US SOX), rather the disclosure requirement relates to "any material controls that have not operated effectively as at the balance sheet date".

- Para 297 indicates that "If a material control is not operating effectively at the date of the balance sheet, the board should disclose this in the annual report together with any action taken, or proposed, to improve controls. This could form part of a declaration which is in line with Provision 29 of the Code." It adds however that boards should not just consider the effective operation of a control, the design and implementation also need to be considered.

- The guidance does however refer in several places to significant failings or weaknesses in internal control and deficiencies in a control, with no definitions provided. Para 250 suggests that in agreeing controls, boards should determine what constitutes a significant control failing.

- Where instances of material controls not operating effectively are identified, remedial actions need to be discussed, although no timeframe for implementation needs to be set out. The annual report will also need to provide a summary of how the board has addressed previously reported issues.

Material controls

- The concept of material controls is not new; it already existed under the 2018 Code.
- These now include, amongst others: financial, operational, reporting and compliance controls (reference to 'reporting' added compared to the 2018 Code, reference to 'financial' added compared to the consultation).
- It is for boards to determine what should comprise material internal controls and they will be company-specific.

- While a definition of material is controls is not included, the following may be helpful:
  - In its "mythbuster" the FRC describes these as "controls most material to the long-term sustainability of the company".
  - Para 271 suggests that in identifying material controls, boards should consider how a deficiency in a control could impact the interest of the company, shareholders and other stakeholders.
  - Para 272 states that these could include, but are not limited to, controls over:
    - Risks that could threaten the company's business model, future performance, solvency or liquidity and reputation (i.e., principal risks).
    - External reporting that is price sensitive or that could lead investors to make investment decisions, whether in the company or otherwise.
    - Fraud, including override of controls.
    - Information and technology risks including cybersecurity, data protection and new technologies (e.g., artificial intelligence).
  - Para 285 notes that given the dynamic nature of risks, material controls will need to adapt to changes in risks over time.

2.2. Remuneration

- In line with the consultation, a requirement has been added for director contracts or other related agreements to include malus and clawback provisions. These need to be described in the ARA along with an explanation if they have been used in the last reporting period. The proposal consulted on to set out their use in the last five years has not been taken forward. Provision 37 of the 2018 Code requires that "Remuneration schemes and policies should … also include provisions that would enable the company to recover and/or withhold sums or share awards and specify the circumstances in which it would be appropriate to do so." Therefore, the key change is for director contracts and related agreements to contain such provisions and for the disclosures noted above to be made in the ARA.
- In line with the consultation, Provision 40 of the 2018 Code has been removed. This referenced the need for the remuneration policy and practices to consider clarity, simplicity, risk, predictability, proportionality and alignment to culture.

- Remuneration-related guidance has remained largely unchanged, other than additional considerations regarding non-executive directors' remuneration set out in para 322.

2.3. Diversity, board composition and board performance reviews

- Reference to specific characteristics of diversity (when making board appointments) i.e., gender, social and ethnic backgrounds, cognitive and personal strengths have been removed and replaced with a broad reference to "promoting diversity, inclusion and equal opportunity".

- Para 16 (carried forward from the FRC's previous guidance on board effectiveness, hence not new) notes that "diversity of skills, background and personal strengths is an important driver of a board's effectiveness, creating different perspectives among directors, and mitigating any risk of 'group think'.

- The nomination committee's report (in the ARA) should set out not just the policy but also any initiatives on diversity and inclusion the company may have – linking these to strategy, setting out how they have been implemented and what progress has been made in achieving their objectives. This reference to initiatives had not been included in the consultation.

- Para 154 includes examples of how companies can continually support diversity and inclusion; paras 156 and 157 reference external initiatives that support diversity and inclusion.

- References to board evaluation have been replaced with references to board performance review, as had been proposed in the consultation. This change had been proposed on the basis that the term 'evaluation' contributed to the erroneous perception that externally facilitated reviews are intended as a backwards-looking assurance function, whereas the value of such reviews is in informing a continual process of self-improvement for boards. The guidance has remained largely unchanged.

2.4. Other changes

Culture

- The board needs not only to assess and monitor culture but also how the desired culture has been embedded.

- Para 22 notes that boards will need periodic assurances from management – either conducted internally or externally, that values, attitudes, ethics and behaviours which support a positive culture have been effectively embedded in operational policies and practices. Para 57 encourages boards to keep a record on the number and type of incidents raised through whistleblowing arrangements to foster transparency, accountability and trust; para 59 emphasises the importance of the timely implementation of any actions arising from the analysis of employee survey results.

The work of the AC

- The content on the roles and responsibilities of the AC and reporting thereon has now been cross referenced to the "Audit Committees and the External Audit: Minimum Standard" (hereafter "The Minimum Standard") in an effort to streamline and reduce duplication. The AC is required to disclose the matters set out in the Minimum Standard* and also provide an explanation for the absence of an internal audit function, if relevant. This doesn't represent a change in substance for companies.

- According to para 8 (under the heading 'Audit, Risk, and Internal Controls'), Code companies should follow the Minimum Standard on a comply or explain basis; para 208 notes that the AC section of the ARA should include an explanation of how the AC has followed the Minimum Standard.

Successful management of board committees

- Section 2 of the guidance brings together foundational information relating to the make-up and general approach to board committees. Despite the fact that the Code does not stipulate any requirement for companies to have risk and sustainability committees, the guidance includes information relevant to them, in cases where they exist.

Relations with suppliers

- Guidance regarding engagement with suppliers has been added in paras 61-65. This includes reference to aspects such as payment terms, modern slavery considerations and methods of engagement.

Emerging risks

- Whilst the proposal to require companies to detail their emerging risks was not taken forward, there is increased emphasis on the importance of continuous monitoring of these risks to allow the company to adapt or develop appropriate actions.

** The Minimum Standard was issued in May 2023 with the primary objective of enhancing the performance and consistency of approach across FTSE 350 ACs in relation to the external audit. It covers the AC's i) overall responsibilities in relation to the external audit ii) Detail on its role in appointing external auditors in a tender process iii) Specific responsibilities overseeing external auditors on an ongoing basis iv) Reporting responsibilities in respect of the above and other related matters. When issued, the Standard was viewed as voluntary until such time that legislation could allow its enforcement, but it has now been brought into the Code via a cross reference. Companies which are not within the FTSE 350 index are not technically required to apply the Minimum Standard.*

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EYSCORE 000596-24-UK

UKC-032544 (UK) 01/24. Creative UK

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