AICPA & CIMA
Together as the Association of International Certified Professional Accountants

UK Corporate Governance Code
Consultation Response

Introduction

Over the last five years the UK's regulatory landscape has been largely focused on initiatives which were designed to improve audit quality and enhance audit market competition. However, this reform agenda was never just about the establishment of a new regulatory framework for the audit profession, but rather it was an opportunity to promote public and investor confidence in business. Audit is not the first stage of the corporate ecosystem. It is the last.

The Government's "Restoring Trust in Audit and Corporate Governance" policy proposals introduced the critical reforms that could recalibrate the corporate ecosystem: a focus on good governance and strong corporate reporting as the foundations of a well-run company. In general, we very much welcome the changes being made to the UK Corporate Governance Code, and the recent legislative reforms proposed over the summer, which are designed to enhance the UK's reputation for world class corporate governance. These are another step towards securing the long-term attractiveness of the UK capital markets.

The policy proposals relating to the future governance and corporate reporting of Listed Companies and Public Interest Entities companies (as applicable), including the prospective introduction of enhanced requirements over internal controls, will help to promote greater transparency and accountability of those companies which are significant to the UK economy and the capital markets.

We would wish to share some insights on the redrafted Code, which we hope are helpful and constructive.

Comply or Explain

The UK Corporate Governance Code provides a tried and tested mechanism to introduce new requirements for in-scope companies, and offers flexibility for future refinement. However, whilst government considers that the "comply or explain" basis provides for transparency and accountability to investors, there is a risk that it may not deliver the desired levels of consistency of corporate governance over the short term. As is highlighted in the consultation response, the FRC has seen a reduction in the number of companies claiming full compliance with the Code (27% of selected companies on the most recent review cycle, compared to 58% of selected companies for the previous year).

Comply or explain is a strength of UK corporate governance but, given the importance of some of the new measures being introduced via the Code, it is important that companies embrace these new requirements (particularly those relating to enhanced internal controls).

If this is not the case then we would hope that the FRC will engage and take steps to ensure that there is an acceptable level of consistency, in the public interest. Where there are departures from the Code there should be an expectation that the requisite explanation will consider both impact and outcomes.

A well-defined regulatory landscape
Stakeholders will recognise the challenge of trying to introduce a number of new governance requirements via the existing Code, in addition to recent FRC Guidance for Audit Committees and the new legislative requirements which were laid before Parliament at the end of July. The recent publication of the Companies (Strategic Report and Directors' Report) (Amendment) Regulations 2023 will have been welcomed by many stakeholders, and offered clarity on the matrix of requirements that are being introduced for companies, and directors. Nevertheless, the framework of legal and regulatory requirements is growing increasingly complex.

There is an evident interaction between the revised Code, the new legislation and pre-existing guidance. It may not be viable to enshrine everything in the Code, not least because of the tiered application of many of the requirements, but it would offer the simplest approach. Guidance will be critical. We would encourage the FRC to reflect on how best to simplify the navigation for companies that are in scope.

Strong Internal Controls
It will come as no surprise to learn that AICPA & CIMA welcome the introduction of enhanced internal controls, on which companies may seek external assurance (or otherwise set out their reasons for not doing so within the scope of the Audit and Assurance Policy).

We note that the original government proposal related to the introduction of a specific statement from the board about their view of the effectiveness of the internal controls system (financial, operational and compliance systems). We commend the FRC for recognising the increasing importance of non-financial information and narrative reporting, which has clearly influenced the proposed revised wording. It was always the expectation of the profession that the introduction of enhanced internal controls over financial information would, in time, lead to similar requirements over non-financial information. With the global developments in relation to sustainability reporting over the last two years, it is appropriate for the Code to recognise the pace and direction of recent changes in corporate reporting. Boards and audit committees are shifting focus to sustainable value creation beyond financial value. The changes proposed in the Code will acknowledge good practice in this area and ensure that stakeholders are better informed on how information is assured. This should, we hope, give investors greater confidence in the information that organisations are disclosing.

In our response to the earlier reform consultations, AICPA & CIMA strongly supported the introduction of enhanced internal controls over financial information, and the introduction of a directors' statement. Drawing on our experience of the implementation of the Sarbanes-Oxley Act in the US, via the insights of the membership and practice community of AICPA, we know first-hand the many benefits that can be gained from making improvements to a company's internal control system.

The evidence clearly demonstrates that the availability of more reliable, better quality corporate reporting, audit and assurance has outweighed any initial perceptions of additional burdens on business. A focus on a stronger internal controls environment has also led to less company re-statements, better financial management, and fewer expected corporate failures.

As the FRC looks to develop guidance to support the new Code, we would welcome the opportunity to share some insights into how to best develop the UK arrangements.

We have previously called for regulatory adoption of the framework of internal control provided by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) Internal Control-Integrated Framework (ICIF) (the "COSO Framework"). This framework is well regarded and widely used. However, we understand the UK Government view that this may not work effectively in the context of the UK market, and/or the hesitation of companies who are keen to avoid a costly road to compliance. For now, we can support the more nuanced focus in the Code Review on ensuring prudent and effective controls and in particular the new requirement for evidencing their effectiveness, but the FRC's guidance for companies within scope will be critical to ensuring that the spirit and intent of these new provisions are embraced.

Material Weakness

The Code requires Boards to provide a description of any material weakness or failure identified, the remedial action being taken, and over what timeframe. We commend the FRC for providing an extract from its draft guidance on the expected interpretation of "material weakness". Consistent interpretation of this requirement is critical to the reporting regime.

Board Composition

Board composition is paramount. Our profession has an important role to play in preparing the pipeline for the future. Many executive and non-executive board members are initially trained within the global accountancy profession. The knowledge, skills and (most importantly) the values of the accountancy profession can influence board culture and behavior in the future. We take this responsibility seriously, and are committed to training individuals from diverse backgrounds who can demonstrate high technical and ethical standards. Access to the accountancy profession is important. They may be our students today, but they are the business and profession leaders of tomorrow.

Against this background, we would like to offer some thoughts on the board governance provisions.

Most critical is the recognition of board diversity, and we support the proposed inclusion of protected and non-protected characteristics. People are shaped by their experiences, and as a profession we recognise that cognitive and personal strengths are often important characteristics for ensuring boards embrace robust discussion and constructive challenge. We welcome this express change to the Code.

The new sustainability reporting landscape will require Boards, more than ever before, to be open to new skills in areas such as environmental management, human rights due diligence and data analytics.

The board and its committees should have a balance of skills, experience, independence and knowledge and it is particularly timely to extend this to the Audit Committee given its role over sustainability reporting is set to expand.

In terms of the number of board appointments which could, or should, be held by one individual, we would wish observe that those individuals who are capable and competent to seek appointment to such a senior board position, are sufficiently experienced to assess their capacity to give the role their fullest attention.

Enhanced role of the Audit Committee

Alongside the impending legislative reforms, the revised Code introduces an enhanced role for members of the Audit Committee. Ensuring that such Audit Committee roles remain attractive for senior non-executive directors needs to be a focus for the FRC, as the succession planning for audit committee roles will likely be a prominent consideration for the future. We would hope that the FRC is engaged with the Audit Committee Chairs Independent Forum, as it will be a key stakeholder. We would also wish to recognise the role that internal audit will play in many companies as these new requirements are rolled out and embedded for the future.

Investor engagement with Audit Committees is an obligation which sits with the committee, and we would hope that the FRC continues to encourage investors to pay sufficient heed to the audit committee process, and the new requirements which are designed for their benefit.

Wider ESG & Corporate Reporting

The wider responsibilities of the board and audit committee for reporting beyond financial reporting are to be welcomed. The new provisions will increase the necessity for organisations to consider sustainable value creation through integrated thinking and its application to reporting. However, the FRC should ensure that the Code does not introduce any provisions that are not complementary to the new International Sustainability Standards. The Code should also ensure that stakeholders, other than investors, are considered in the decision-making process.

Resilience

Considering recent geopolitical challenges, including the pressure on supply chains that many organisations have felt, we welcome the focus that the Code puts on resilience and in particular the Resilience Statement. The previous provisions around a viability statement, in our view, led to rather generic reporting which added limited clarity to investor decision-making. The new Code provisions, which will supplement the impending legislative changes, will ensure that organisations consider in greater depth, and in a more integrated way, their approach to resilience. The proposals to streamline requirements in this section are also to be welcomed as this will minimise the regulatory burden on business. Ideally, the Code should emphasise the need for Boards to have a complete picture of how resilient their business model might be in light of potential risks, through the use of a business model framework. In any event, Management Accountants will play a key role in performing the scenario testing that are part of the resilience statement. We would recommend greater Management Accounting involvement in helping with, testing and reporting on the resilience of an entity via the Resilience Statement to the benefit of all stakeholders.

Corporate Reporting and Technology
Accountants in business and those in professional services roles are embracing and using technology every day. Our profession works in a technology driven market-place. Companies' decisions are data driven. At some point the role of AI and technology will need to be expressly recognised within the Code.

As AICPA & CIMA, we firmly believe that it is time to advocate for adding accounting to the list of STEM subjects taught in the UK, to signal to the public that the accounting profession is ready and qualified to assess the technology and business needs of their clients, and employers. We also believe it would strengthen the attractiveness of the profession, and that being recognised in this way would help future generations of students to understand the limitless possibilities of an accounting career, and equip the UK's future workforce with the skills it needs to drive a modern, entrepreneurial and productive economy. CIMA acts as Secretary to the All Party Parliamentary Group for Accounting for Growth, which has recently issued a Call for Evidence on this important issue. We hope that companies and professional services firms alike will engage with this milestone review, the outcome of which could hold important developments for business and finance professionals.

Closing remarks

We trust that our comments have been constructive and please do not hesitate to contact us should you require any further assistance.

Contacts:

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About the Association

The Association of International Certified Professional Accountants® (the Association), representing AICPA® & CIMA®, advances the global accounting and finance profession through its work on behalf of 696,000 AICPA and CIMA members, students, and engaged professionals in 192 countries and territories. Together, we are the worldwide leader on public and management accounting issues through advocacy, support for the CPA license, the CGMA designation and specialised credentials, professional education, and thought leadership. We build trust by empowering our members and engaged professionals with the knowledge and opportunities to be leaders in broadening prosperity for a more inclusive, sustainable, and resilient future.

The Chartered Institute of Management Accountants® (CIMA) is the world's leading and largest professional body of management accountants. CIMA works closely with employers and sponsors leading-edge research, constantly updating its professional qualification and professional experience requirements to ensure it remains the employer's choice when recruiting financially trained business leaders.

The American Institute of CPAs® (AICPA), the world's largest member association representing the CPA profession, sets ethical standards for its members and U.S. auditing standards for private companies, not-for-profit organisations, and federal, state, and local governments. It also develops and grades the Uniform CPA Examination and builds the pipeline of future talent for the public accounting profession.

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13 September 2023

Dear David

UK Corporate Governance Code Consultation

The Government's "Restoring Trust in Audit and Corporate Governance" introduced critical reforms that have the potential to recalibrate the corporate ecosystem: by focusing on good governance and strong corporate reporting as the foundations of a well-run company.

We very much welcome the changes being made to the UK Corporate Governance Code, and the recent legislative reforms proposed over the summer, which are designed to enhance the UK's reputation for world class corporate governance. These are another step towards securing the long-term attractiveness of the UK capital markets.

We enclose our consultation response for your consideration. Please don't hesitate to let me know if we can be of any further assistance.

Yours sincerely,

[redacted]

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