



Response to the FRC consultation on revisions to the *Corporate governance code*

Introduction

The Financial Reporting Council (FRC) issued a consultation on proposed revisions to the *UK corporate governance code*¹ (the Code). Revisions to the Code aim to enhance its effectiveness in promoting good corporate governance. It focuses on:

- revising those parts of the Code that deal with the need for a framework of prudent and effective controls to provide a stronger basis for reporting on and evidencing their effectiveness
- making necessary revisions to reflect the responsibilities of the board and audit committee for sustainability and ESG reporting and appropriate assurance in accordance with a company's audit and assurance policy
- amending the Code to take account of the new *Audit committee standard*
- improving the functioning of comply-or-explain where reporting is currently weaker, taking account of recently published FRC research and reports
- updating the Code to ensure that it aligns with changes to legal and regulatory requirements as set out in the Government's response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems², including strengthening reporting on malus and clawback arrangements.

The *Code of governance for NHS provider trusts*³ is based on the *UK corporate governance code*. The HFMA's Governance and Audit Committee is therefore responding to this consultation with a specific focus on areas of the Code that relate to NHS bodies.

¹ FRC, *Corporate governance code consultation*, May 2023

² Department for Business, Energy and Industrial Strategy, *Restoring trust in audit and corporate governance*, May 2022,

³ NHS England, *Code of governance for NHS provider trusts*, April 2023



Board leadership and company purpose

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

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?

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

Effective board leadership is essential at all times, but especially at times of challenge and change. Today the NHS is facing significant financial and operational pressures and is developing new arrangements in line with the *Health and Care Act 2022*⁴ (the Act). The recent Lucy Letby case also reiterates the need for strong board leadership and accountability. Section 1 of the Code is helpful in setting out the overarching role of the board. We agree limited amendments to this section are required, particularly those which emphasise outcomes (as in principles, point D, about the impact of governance practices), and the effectiveness of arrangements (as in section 1 point 6, about workforce concerns).

We welcome the introduction of the new principle D which sets out the expectation that companies should, when reporting on their governance activity, focus on activities and outcomes to demonstrate the impact of governance practices. Now is an ideal time for NHS bodies to review whether their governance arrangements are fit for purpose, particularly reflecting on the changes brought about by the Act and lessons learnt from changes in governance arrangements required during the Covid-19 pandemic. Principle D provides a welcome focus on outcomes.

We agree that the board should report on climate ambitions and transition planning. Climate change poses a major threat to our health as well as our planet. Responsible for around 4% of the country's carbon emissions, the NHS has an essential role to play in meeting the net zero targets and has set out clear targets in *Delivering a 'net zero' National Health Service*⁵ to:

- reduce the NHS carbon footprint (emissions the NHS controls directly) to net zero by 2040
- reduce the NHS carbon footprint plus (emissions the NHS can influence) to net zero by 2045.

The Board has a key role in planning, monitoring and delivering against these targets.

Division of 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?

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 agree it is important to recognise the time commitment and skills required by board members to provide effective leadership. Similar to companies, as the environment in which the NHS becomes more complex, it is important that those in leadership positions can devote sufficient time to their responsibilities. While Boards and individual leaders judge capacity and competence to fulfil their duties, there is also a need to address *perceptions* of over-stretch and/or conflicts of interest. NHS bodies are facing similar challenges to those of companies with new and complex issues that demand more intensive consideration and action, such as cybersecurity, artificial intelligence and the interpretation of environmental data.

Composition, succession and evaluation

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

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?

⁴ UK government, *Health and Care Act 2022*, enacted 1 July 2022

⁵ NHS England, *Delivering a net zero national health service*, July 2022

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

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?

We agree with the proposed amendment to current principle J (principle I in the new Code) to include a reference to inclusion, and to give equal weight to all protected and non-protected characteristics, to encourage companies to consider diversity beyond gender and ethnicity.

We also recognise that any reporting of diversity characteristics must consider preserving the anonymity of individuals. This is particularly relevant for small organisations, particularly when reporting at a senior grade level.

We also welcome the proposed amendment to current provision 23 (new provision 24) to provide improved clarity on approaches to succession planning. The consultation refers to its review findings that succession arrangements are reactive as opposed to proactive. The importance of succession planning applies equally in the NHS as it does to companies.

Audit, risk and internal control

Q10: Do you agree that all Code companies should prepare an audit and assurance policy, on a 'comply or explain' 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?

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?

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?

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?

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?

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?

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?

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

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)?

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

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?

At present NHS bodies are not public interest entities (PIEs). The significant additional audit requirements for PIEs would have major implications on an already challenging external audit market in the NHS and wider public sector. The challenges and issues, including that of capacity and risk, set out in HFMA's 2022 briefing⁶ still remain relevant today.

As set out in the section above, we agree that climate change reporting should be an area of focus for boards. We agree that the Code should reflect the importance of these matters and that good governance will play an essential role in assessing sustainability related risks, opportunities and

⁶ HFMA, *The NHS external audit market: an update on current issues*, August 2022

impacts, setting targets, using appropriate internal controls and commissioning assurance where necessary.

We agree that the annual report should include disclosures over assurance of ESG metrics and other sustainability related information and that the audit committee should therefore be expanded to include sustainability reporting. To support effective sustainability decision-making and accountability, information is needed to measure progress against targets. Expertise in this area at an executive and non-executive level will need to be strengthened to deliver this.

The HFMA's briefing, *Sustainability reporting in the NHS: 2022/23 and beyond*⁷, sets out current NHS environmental sustainability commitments and requirements in the NHS.

We welcome the changes to provision 29 (30 in the new Code) to ask the board to declare whether they can reasonably conclude that the company's risk management and internal control systems, including material operational, reporting and compliance controls, have been effective throughout the reporting period and up to the date of the approval of the annual report by the directors. The revised provision will also ask the board to explain the basis for its declaration, which should include an explanation of how it has monitored and reviewed the effectiveness of these systems during the period and any other relevant information. The provision will ask the board to report any material weaknesses identified in these systems during the reporting period and the actions taken by the board to address these. These requirements reflect requirements of the annual governance in the NHS and the head of internal audit opinion.⁸

It would be helpful to provide examples of how proposed revisions on going concern (the subject of Q19) and the resilience statement (the subject of Q20) would actually impact on what is currently reported in the accounts. For example, what difference, if any intended, would the proposed revisions have made to the following cases:

- **Birmingham City Council** recently issued a Section 114 notice. Their 2021-22 Accounts (last Accounts available at Going Concern section (on pg 48 of 210) states:

'Local Authorities are required by the Code of Practice on Local Authority Accounting 2021/22 to prepare their accounts on the going concern basis, that is that the functions of the Council will continue in operational existence for the foreseeable future, as it can only be discontinued as a result of statutory prescription..... the Council has identified that it has sufficient General Fund Balances and can redesignate earmarked reserves to meet any shortfall. On this basis, the Council considers that it can continue to meet its liabilities as they fall due, supporting the preparation of the financial statements on a going concern basis irrespective of the statutory requirements.'

- **Wilko Ltd** went into administration on 21 Aug 2023. Going Concern section (on pgs 28 of 51) states:

*'.....The Directors believe that the Co will have adequate resources to continue to operate until 28 Jan 2024 without additional facilities. They believe that should such facilities be required they would be able to secure them in advance of this date. As such, the Directors continue to adopt the **going concern** basis in preparing the financial statements.'*

Remuneration

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

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

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

⁷ HFMA, *Sustainability reporting in the NHS: 2022/23 and beyond*, April 2023

⁸ HFMA, *Head of internal audit annual opinion: key considerations*, March 2023

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

We have no comments on this section.

Other matters for consideration

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?

We agree the Code should reflect any frameworks introduced on artificial intelligence, ensuring consistency of requirements.

About the HFMA

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For over 70 years, it has provided independent and objective advice to its members and the wider healthcare community. It is a charitable organisation that promotes best practice and innovation in financial management and governance across the UK health economy through its local and national networks.

The association also analyses and responds to national policy and aims to exert influence in shaping the wider healthcare agenda. It has particular interest in promoting the highest professional standards in financial management and governance and is keen to work with other organisations to promote approaches that really are 'fit for purpose' and effective.

The HFMA offers a range of qualifications in healthcare business and finance at undergraduate and postgraduate level and can provide a route to an MBA in healthcare finance. The qualifications are delivered through HFMA's Academy which was launched in 2017 and has already established strong learner and alumni networks.

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