

27 February 2018

Catherine Horton
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Submitted via email: codereview@frc.org.uk

Dear Ms Horton,

The Chartered Institute of Internal Auditors (Chartered IIA) welcomes the chance to respond to the consultation on the Proposed Revisions to the UK Corporate Governance Code.

The Chartered IIA represents internal audit professionals in organisations spanning all sectors in the UK and Ireland, and it champions the contribution internal audit makes to good governance, strong risk management and a rigorous control environment leading to the long-term success of organisations.

The Chartered IIA stands ready to engage with the FRC on any of the comments in our response and if you have any questions, please do not hesitate to get in touch.

We are happy for our response to be published.

Yours sincerely,

Dr Ian Peters MBE
Chief Executive

Response to the FRC consultation on the Proposed Revisions to the UK Corporate Governance Code

We are pleased to submit our response to the FRC's consultation on the Proposed Revisions to the UK Corporate Governance Code.

The Chartered IIA represents almost 10,000 internal audit professionals in organisations spanning all sectors of the economy, including most FTSE companies, across the UK and in Ireland.

Internal audit is a function that sits within the governance structure but it must be independent of the areas it evaluates, and internal auditors must be free from undue influence from management, so that their judgments can be as objective as possible.

In 2017, the Chartered IIA produced a discussion paper for members to comment and provide feedback on, which covered three key corporate governance issues: the definition of corporate governance; corporate governance reform in the UK; and updating the UK Corporate Governance Code. We held seminars across the country and received feedback from the private sector, including many listed companies, and the public sector. This feedback has been taken into consideration when compiling this response.

Overall comments

The Chartered IIA welcomes many of the proposed changes to the UK Corporate Governance Code (Code).

We are pleased to see that the revised Code is much shorter and sharper than the current Code. The Chartered IIA welcomes the change to consolidate the essential provisions and principles. We believe this will provide greater clarity for organisations on how they should promote good corporate governance in their companies.

Furthermore, the Chartered IIA welcomes the inclusion of internal audit in Principle L of the revised Code. This highlights the important role that internal audit plays in an effective corporate governance regime.

We are pleased to see the inclusion of culture in the revised Code. Internal audit is a key mechanism for boards to assess their company's culture. Having worked closely with the FRC on the Culture Coalition, the Chartered IIA believes that the reference to culture in the revised Code will encourage boards to promote a positive 'tone from the top' and will highlight the important role that internal audit plays to business as a critical friend. We are pleased to see this reinforced in the Guidance on Board Effectiveness.

UK Corporate Governance Code and Guidance on Board Effectiveness Questions

Introduction

Q1. Do you have any concerns in relation to the proposed Code application date?

The Chartered IIA has no concerns with the proposed application date.

Q2. Do you have any comments on the revised Guidance?

The Chartered IIA welcomes the revised Board Effectiveness Guidance and the changes included. The inclusion of culture and the questions for boards are relevant and add value. Nonetheless, we would like to see more guidance on Section 4: Audit, risk and internal control on how professional internal audit can help boards meet their responsibilities for effective governance.

The Chartered IIA agrees with the FRC that other guidance will need to be reviewed, including the Guidance on Audit Committees and the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting. Where appropriate the Chartered IIA would be happy to work with the FRC to update the Guidance on these topics.

Section 1 – Leadership and purpose

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

The Chartered IIA agrees that the methods in Provision 3 will help to achieve meaningful engagement with the workforce. However, we would like to see a separate provision to address meaningful engagement with other stakeholders.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

The Chartered IIA is generally not in favour of adding in specific additional references as it detracts from the simplicity of the Code.

Q5. Do you agree that 20 per cent is ‘significant’ and that an update should be published no later than six months after the vote?

The Chartered IIA does not wish to comment on this question.

Section 2 – Division of responsibilities

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

The Chartered IIA supports the proposal to remove the exemption for companies below the FTSE 350 to have an independent board evaluation every three years as long as this remains under the ‘comply or explain’ principle. This is important to avoid the imposition of disproportionate regulatory burdens on smaller companies.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

The Chartered IIA agrees that nine years is an appropriate time period to be considered independent.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

The Chartered IIA agrees it is not necessary to provide a maximum period of tenure for non-executive directors. As stated in the Proposed Revisions to the UK Corporate Governance Code, many companies and shareholders see the nine year criterion as a ‘de facto’ tenure period. The Chartered IIA believes this is a sufficient measure to guide companies and shareholders.

Section 3 – Composition, succession and evaluation

Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

The Chartered IIA agrees that the overall proposed changes in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, executive pipeline and company as a whole; however, while the Chartered IIA welcomes the emphasis placed on increasing gender diversity, we believe that more needs to be done to achieve this goal.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

The Chartered IIA agrees with extending the Hampton-Alexander recommendation beyond the FTSE 350 as long as this remains under the ‘comply or explain’ principle.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

The Chartered IIA agrees that companies should report on levels of ethnicity in the executive pipeline.

Currently, as there is no legal requirement for ethnic diversity information to be published including a provision in the revised Code would provide publicly available information to highlight the severe lack of ethnic diversity, without which it is unlikely any significant change will occur.

The Chartered IIA would recommend that initially only FTSE 350 organisations should be required to report on ethnic diversity in the executive pipeline. This would be in line with the gender reporting requirements.

Section 4 – Audit, risk and internal control

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

The Chartered IIA agrees with retaining the requirements in the current Code, even though there is some duplication with other rules. This is because the UK Corporate Governance Code is often used by companies that are not listed and do not have shareholders, as a measure of best practice. In addition, the Code is used as a model internationally, and removing these provisions may imply they are not of significant importance.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

The Chartered IIA does not support the removal of section C.3.3 to the Guidance as this might be interpreted as a weakening of the requirement to publish, which we believe would be a retrograde step.

Under the ‘comply or explain’ principle of the Code, companies can explain why they have not made the terms of reference for the audit committee available if they choose.

The Chartered IIA suggests that C.3.3. be amalgamated into the revised Code in Provision 24 to state (changes underlined):

The board should establish an audit committee of independent non-executive directors, with a minimum membership of three. The chair of the board should not be a member. The board should satisfy itself that at least one member has recent and relevant financial experience. The committee as a whole shall have competence relevant to the sector in which the company operates. The terms

of reference of the audit committee, including its role and the authority delegated to it by the board, should be made publicly available.

Other comments on Section 4

The Chartered IIA suggests a change to the wording of Provision 25.

In the revised Code, Provision 25, sub-paragraph 3 on internal audit, which states the audit committee's role as:

- monitoring and reviewing the effectiveness of the company's internal audit function, or where there is not one, considering annually whether there is a need for one and making a recommendation to the board.

This is compared to Provision 25, sub-paragraph 5, which states the role of the audit committee in relation to external audit involves:

- reviewing and monitoring the external auditor's independence and objectivity, and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements.

The Chartered IIA proposes that the sub-paragraph on internal audit should be updated to state (changes underlined):

- monitoring and reviewing the independence, objectivity and effectiveness of the company's internal audit function and audit process, taking into consideration relevant UK professional and regulatory requirements. Where there is no internal audit function, considering annually whether there is a need for one and making a recommendation to the board.

This would emphasise the importance of both internal and external audit, which are both elements of effective corporate governance. Furthermore, internal audit's independence and objectivity are essential for the provision of assurance to the board that risks are being managed effectively.

The wording, "taking into consideration relevant UK professional and regulatory requirements", highlights the importance of the IIA Standards and other relevant frameworks, for example, the Chartered IIA's Guidance on Effective Internal Audit in the Financial Services Sector.

Section 5 – Remuneration

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

The Chartered IIA agrees with the wider remit for the remuneration committee. Recent examples of corporate governance failures indicate a more rigorous regime is required over executive remuneration packages to ensure that remuneration drives appropriate and sustainable behaviour.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

The Chartered IIA does not wish to comment on this question.

Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

The Chartered IIA believes that the changes proposed will give meaningful impetus to boards in exercising discretion.

UK Stewardship Code Questions

The Chartered IIA does not wish to comment on these questions.

ENDS

About the Chartered Institute of Internal Auditors

Established in the UK and Ireland in 1948, the Chartered Institute of Internal Auditors (Chartered IIA) has almost 10,000 members. It is the only professional body dedicated exclusively to training, supporting and representing internal auditors in the UK and Ireland. We are part of a global network of 180,000 members in more than 170 countries. Members of the Chartered IIA work in all sectors of the economy: private businesses (including most FTSE 100 organisations), government departments, utilities, voluntary sector organisations, local authorities, and public service organisations such as the National Health Service. All members work to the same global International Standards and Code of Ethics, which are part of a globally agreed International Professional Practices Framework and have been recognised in the Financial Reporting Council's Guidance for Audit Committees and adopted as the basis of the Public Sector Internal Audit Standards in UK central government, local government and the NHS.