

July 2016

Audit Firm Governance Code

Revised 2016

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

© The Financial Reporting Council Limited 2016

The Financial Reporting Council Limited is a company limited by guarantee.

Registered in England number 2486368. Registered Office:

8th Floor, 125 London Wall, London EC2Y 5AS

Introduction

Audit is a statutory function in which there is considerable public interest. The UK Audit Firm Governance Code (the Code) is intended to enhance trust and confidence in the value of audit amongst the public and particularly investors. The Code applies to firms auditing 20 or more listed companies.

This version of the Code was issued in July 2016 and is applicable for financial years beginning on or after 1 September 2016.

Purpose

The Code provides a benchmark of good governance practice against which firms which audit listed companies can report. Its principal objectives are:

- To promote audit quality.
- To help the firm secure its reputation more broadly, including its non-audit businesses.
- To reduce the risk of firm failure, which in relation to the largest firms would be of systemic significance.

The Code is principally intended to benefit investors. However, other stakeholders also have an interest, including:

- Directors, particularly audit committee members, with responsibilities for the appointment of auditors;
- Audit regulators; and
- Partners and employees of audit firms.

Background and approach

In 2007, at the invitation of the FRC, the Institute of Chartered Accountants in England and Wales (ICAEW) formed an independent working group under the chairmanship of Norman Murray (then Chairman of Cairn Energy PLC) to develop the Code. The Audit Firm Governance Code was published jointly by the ICAEW and FRC in January 2010. It included 20 principles and 31 provisions and operated on a “comply or explain” basis. It applied to firms auditing 20 or more listed companies. As well as codifying existing requirements and practice it introduced two new concepts:

- The appointment of independent non-executives within the governance structures of the firms; and
- Dialogue between the firms and investors in listed companies.

During 2014-15 the FRC reviewed the Code’s implementation. That review found that the Code had been adopted by all firms within its scope (and at least one outside of it). Firms had implemented the Code in different ways, with a particular diversity in the positioning of independent non-executives within governance structures. The FRC does not intend to prescribe a uniform approach in this area. However, firms should report publicly on why they have adopted a particular approach and how that approach serves the public interest by promoting audit quality.

Our review of the Code also raised a number of other issues:

- The Code itself has insufficient visibility.
- Investors are not clear about the role which independent non-executives (INEs) play and have concerns about their independence.
- Dialogue with investors has not worked as well as hoped. Aspects of the Corporate Governance Code could usefully be incorporated into the Code.

Following the review we have made a number of changes to help promote good governance of audit in particular; to strengthen transparency; and to introduce some additional provisions from the Corporate Governance Code. The principles remain unchanged.

To facilitate the Dialogue principle, the FRC will work to facilitate improved engagement between firms and investors, including by organising meetings attended by investors and INEs from all firms. This is intended to supplement and not replace the firms' direct interaction with shareholders.

Transparency is key to addressing the other matters identified in the review. All firms which audit listed companies are required by regulation to produce annual transparency reports containing, *inter alia*, information about the operation of the Code within that firm. However, these reports are not widely read and have been described as compliance documents of limited interest. As well as providing information to stakeholders, reporting enhances accountability and helps ensure leadership focus on the key governance and performance issues which it covers.

We believe that the firms should revise their transparency reports to include content which is of greater relevance to investors, regulators and other stakeholders. In particular, firms applying the Code should make sure that their report is fair, balanced and understandable as required of companies by the Corporate Governance Code and should include the following:

- A report on the work of the firm's Board and its INEs including performance against any KPIs in place.
- A separate report from the independent non-executives and/or public interest committee; several firms already do this. This report should include an explanation of how the independent non-executives or public interest committee have overseen the UK audit practice in particular, as well as the wider UK business more generally, over the reporting period.
- What the Board and the independent non-executives have done to satisfy themselves that the appropriate culture exists throughout the organisation.
- An explanation of why the firm has chosen to position its independent non-executives in the way that it has and how it believes that this serves the public interest by helping to ensure audit quality.
- A statement of how the Board and independent non-executives have worked during the year to fulfil the Code's purpose defined above.
- Details of any provisions from the UK Corporate Governance Code which it has adopted within its own governance structures in addition to those already in the Code and a consideration of whether there are any others it might adopt in the future. Appendix 2 comprises a checklist of Corporate Governance Code provisions which firms may find helpful to this consideration. Many of these provisions are already reflected in the Code.

The FRC will conduct regular reviews of transparency reports. As part of this we will highlight best practice and innovation in governance.

In our reviews of transparency reports we will consider the extent to which firms are adopting additional provisions from the UK Corporate Governance Code are being adopted and whether their formal incorporation into the Code would be beneficial. Firms are encouraged to focus on those of greatest significance to governance such as the provisions around appointment procedures, Board development and separation of the Chairman and Chief Executive roles may be introduced. A checklist to assist firms in this regard can be found in Appendix 2.

The major firms have global clients and all are members of international networks. We encourage UK firms to promote the Code, and in particular the concept of independent challenge within the governance structure, across their networks. The FRC is itself promoting the concept internationally.

Audit is undertaken by national firms in accordance with national regulatory requirements. It is most important that the firms ensure there is good governance at a national level even if they move towards fully globally managed structures. They should ensure and report on how their governance arrangements protect the public interest in audit in the most significant national markets and ensure that they have the necessary UK governance in place to fulfil the Code's purpose.

Financial Reporting Council

July 2016

Throughout this Code reference to 'a firm' means 'a firm that audits listed companies in the UK'

A Leadership

A.1 Owner accountability principle

The management of a firm should be accountable to the firm's owners and no individual should have unfettered powers of decision.

Provisions

- A.1.1 The firm should establish a board or equivalent governance structure, with matters specifically reserved for its decision, to oversee the activities of the management team.
- A.1.2 The firm should state in its transparency report how its governance structures and management operate, their duties and the types of decisions they take. In doing so the firm should explain how its governance structure provides oversight of both the audit practice and the firm as a whole with a focus on ensuring the Code's purpose, is achieved. If the management and/or governance of the firm rests at an international level it should specifically set out how management and oversight of audit, is undertaken and the Code's purpose achieved in the UK.
- A.1.3 The firm should state in its transparency report the names and job titles of all members of the firm's governance structures and its management, how they are elected or appointed and their terms, length of service, meeting attendance in the year, and relevant¹ biographical details.
- A.1.4 The members of a firm's governance structures and management should be subject to formal, rigorous and ongoing performance evaluation and, at regular intervals, members should be subject to re-election or re-selection.

A.2 Management principle

A firm should have effective management which has responsibility and clear authority for running the firm.

Provision

- A.2.1 Management should have terms of reference that include clear authority over the whole firm including its non-audit businesses and these should be disclosed on the firm's website.

B Values

B.1 Professionalism principle

A firm should perform quality work by exercising judgement and upholding values of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour in a way that properly takes the public interest into consideration and meets auditing and ethical standards.

Provisions

- B.1.1 The firm's governance structures and management should establish and promote throughout the firm an appropriate culture, supportive of the firm's public interest role and long term sustainability. This should be achieved in particular through the right tone from

¹ Relevant being judged by reference as to the Code's purpose.

the top, through the firm's policies and practices and by management publicly committing themselves and the whole firm to quality work, the public interest and professional judgement and values.

- B.1.2 Firms should introduce KPIs on the performance of their governance system, and report on performance against these in their transparency reports.
- B.1.3 The firm should have a code of conduct which it discloses on its website and requires everyone in the firm to apply. The Board and independent non-executives should oversee compliance with it.

B.2 Governance principle

A firm should publicly commit itself to this Audit Firm Governance Code.

Provision

- B.2.1 The firm should incorporate the principles of this Audit Firm Governance Code into an internal code of conduct.

B.3 Openness principle

A firm should maintain a culture of openness which encourages people to consult and share problems, knowledge and experience in order to achieve quality work in a way that properly takes the public interest into consideration.

C Independent Non-Executives

C.1 Involvement of independent non-executives principle

A firm should appoint independent non-executives to the governance structure who through their involvement collectively enhance the firm's performance in meeting the purpose of the Code.

Provisions

- C.1.1 Independent non-executives should number at least three and be in the majority on a body that oversees public interest matters; and/or be members of other relevant governance structures within the firm. They should also meet as a separate group to discuss matters relating to their remit. They should have full visibility of the entirety of the business but should pay particular attention to and report on risks to audit quality and how they are addressed. If a firm considers that having three INEs is inappropriate given its size or number of public company clients, it should explain this in its transparency report and ensure a minimum of two at all times. Where the firm adopts an international approach to its management it should have at least three INEs with specific responsibility and relevant experience to focus on the UK business and to take part in governance arrangements for this market; or explain why it regards a smaller number to be more appropriate, in which event there should be a minimum of two.
- C.1.2 The firm should disclose on its website and in its transparency report information about the appointment, retirement and resignation of independent non-executives; their remuneration; their duties and the arrangements by which they discharge those duties; and the obligations of the firm to support them. The firm should report on why it has chosen to position its independent non-executives in the way it has (for example, as members of the main Board or on a public interest committee). The firm should also disclose on its website the terms of reference and composition of any governance structures whose membership includes independent non-executives.
- C.1.3 The independent non-executives should report in the firm's transparency report on how they have worked to meet the purpose of the Code defined as:

- Promoting audit quality.
- Helping the firm secure its reputation more broadly, including in its non-audit businesses.
- Reducing the risk of firm failure.

C.1.4 Independent non-executives should have regular contact with the Ethics Partner, who should under the ethical standards have a reporting line to them.

C.2 Characteristics of independent non-executives principle

The independent non-executives' duty of care is to the firm. They should command the respect of the firm's owners and collectively enhance shareholder confidence by virtue of their independence, number, stature, experience and expertise. They should have a balance of relevant skills and experience including of audit and a regulated sector. At least one independent non-executive should have competence in accounting and/or auditing, gained for example from a role on an audit committee, in a company's finance function, as an investor or at an audit firm.

Provision

C.2.1 The firm should state in its transparency report its criteria for assessing the impact of independent non-executives on the firm's independence as auditors and their independence from the firm and its owners.

C.3 Rights and responsibilities of independent non-executives principle

Independent non-executives of a firm should have rights consistent with their role including a right of access to relevant information and people to the extent permitted by law or regulation, and a right to report a fundamental disagreement regarding the firm to its owners and, where ultimately this cannot be resolved and the independent non-executive resigns, to report this resignation publicly.

Provisions

C.3.1 Each independent non-executive should have a contract for services setting out their rights and duties.

C 3.2 Independent non-executives should be appointed for specific terms and any term beyond nine years should be subject to particularly rigorous review and explanation.

C 3.3 The responsibilities of an independent non-executive should include, but not be limited to, oversight of the firm's policies and processes for:

- Promoting audit quality.
- Helping the firm secure its reputation more broadly, including in its non-audit businesses.
- Reducing the risk of firm failure.

C.3.4 The firm should ensure that appropriate indemnity insurance is in place in respect of legal action against any independent non-executive in respect of their work in that role.

C.3.5 The firm should provide each independent non-executive with sufficient resources to undertake their duties including having access to independent professional advice at the firm's expense where an independent non-executive judges such advice necessary to discharge their duties.

- C.3.6 The firm should establish, and disclose on its website, procedures for dealing with any fundamental disagreement that cannot otherwise be resolved between the independent non-executives and members of the firm's management team and/or governance structures.

D Operations

D.1 Compliance principle

A firm should comply with professional standards and applicable legal and regulatory requirements. Operations should be conducted in a way that promotes audit quality and the reputation of the firm. The independent non-executives should be involved in the oversight of operations.

Provisions

- D.1.1 The firm should establish policies and procedures for complying with applicable legal and regulatory requirements and international and national standards on auditing, quality control and ethics, including auditor independence.
- D.1.2 The firm should establish policies and procedures for individuals signing group audit reports to comply with applicable standards on auditing dealing with group audits including reliance on other auditors whether from the same network or otherwise.
- D.1.3 The firm should state in its transparency report how it applies policies and procedures for managing potential and actual conflicts of interest.
- D.1.4 The firm should take action to address areas of concern identified by audit regulators in relation to the firm's audit work.

D.2 Risk management principle

A firm should maintain a sound system of internal control and risk management over the operations of the firm as a whole to safeguard the firm and reassure stakeholders.

Provisions

- D.2.1 The firm should, at least annually, conduct a review of the effectiveness of the firm's system of internal control. Independent non-executives should be involved in the review which should cover all material controls, including financial, operational and compliance controls and risk management systems as well as the promotion of an appropriate culture underpinned by sound values and behaviour within the firm.
- D.2.2 The firm should state in its transparency report that it has performed a review of the effectiveness of the system of internal control, summarise the process it has applied and confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review. It should also disclose the process it has applied to deal with material internal control aspects of any significant problems disclosed in its financial statements or management commentary.
- D.2.3 The firm should carry out a robust assessment of the principal risks facing it, including those that would threaten its business model, future performance, solvency or liquidity. This should reference specifically the sustainability of the audit practice within the UK.

D.3 People management principle

A firm should apply policies and procedures for managing people across the whole firm that support its commitment to the professionalism, openness and risk management principles of this Audit Firm Governance Code.

Provisions

- D.3.1 The firm should disclose on its website how it supports its commitment to the professionalism, openness and risk management principles of this Audit Firm Governance Code through recruitment, development activities, objective setting, performance evaluation, remuneration, progression, other forms of recognition, representation and involvement.
- D.3.2 Independent non-executives should be involved in reviewing people management policies and procedures, including remuneration and incentive structures, to ensure that the public interest is protected.

D.4 Whistleblowing principle

A firm should establish and apply confidential whistleblowing policies and procedures across the firm which enable people to report, without fear, concerns about the firm's commitment to quality work and professional judgement and values in a way that properly takes the public interest into consideration. The independent non-executives should be satisfied that there is an effective whistleblowing process in place.

Provision

- D.4.1 The firm should report to independent non-executives on issues raised under its whistleblowing policies and procedures and disclose those policies and procedures on its website.

E Reporting

E.1 Internal reporting principle

The management of a firm should ensure that members of its governance structures, including owners and independent non-executives, are supplied with information in a timely manner and in a form and of a quality appropriate to enable them to discharge their duties.

E.2 Governance reporting principle

A firm should publicly report how it has applied in practice each of the principles of the Audit Firm Governance Code and make a statement on its compliance with the Code's provisions or give a considered explanation for any non-compliance.

Provisions

- E.2.1 The firm should publish on its website an annual transparency report containing the disclosures required by Code Provisions A.1.2, A.1.3, B1.2, C.2.1, D.1.3, D.2.2, E.2.2 and E.3.1.
- E.2.2 In its transparency report the firm should give details of any additional provisions from the UK Corporate Governance Code which it has adopted within its own governance structure.

E.3 Transparency principle

A firm should publish on an annual basis in its transparency report a commentary on the firm's performance, position and prospects.

Provisions

- E.3.1 The firm should confirm that it has carried out a robust assessment of the principal risks facing the audit firm, including those that would threaten its business model, future performance, solvency or liquidity. The firm should describe those risks and explain how they are being managed or mitigated.
- E.3.2 The transparency report should be fair, balanced and understandable in its entirety.

E.4 Reporting quality principle

A firm should establish formal and transparent arrangements for monitoring the quality of external reporting and for maintaining an appropriate relationship with the firm's auditors.

Provision

- E.4.1 The firm should establish an audit committee and disclose on its website information on the committee's membership and terms of reference which should deal clearly with its authority and duties, including its duties in relation to the appointment and independence of the firm's auditors. On an annual basis, the audit committee should publish a description of its work and how it has discharged its duties.

E.5 Financial statements principle

A firm should publish audited financial statements prepared in accordance with a recognised financial reporting framework such as International Financial Reporting Standards or UK GAAP, and should be clear and concise.

Provisions

- E.5.1 The firm should explain who is responsible for preparing the financial statements and the firm's auditors should make a statement about their reporting responsibilities, preferably in accordance with the extended audit report standards.
- E.5.2 The firm should state whether it considers it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to its ability to continue to do so, with supporting assumptions or qualifications as necessary.

F Dialogue

F.1 Firm dialogue principle

A firm should have dialogue with listed company shareholders, as well as listed companies and their audit committees, about matters covered by this Audit Firm Governance Code to enhance mutual communication and understanding and ensure that it keeps in touch with shareholder opinion, issues and concerns.

Provision

- F.1.1 The firm should disclose on its website its policies and procedures, including contact details, for dialogue about matters covered by this Audit Firm Governance Code with listed company shareholders and listed companies. It should also report on the dialogue it has had during the year. These disclosures should cover the nature and extent of the involvement of independent non-executives in such dialogue.

F.2 Shareholder dialogue principle

Shareholders should have dialogue with audit firms to enhance mutual communication and understanding.

F.3 Informed voting principle

Shareholders should have dialogue with listed companies on the process of recommending the appointment and re-appointment of auditors and should make considered use of votes in relation to such recommendations.

Appendix 1

Independence considerations

Code Principle C.2 identifies the independence of an audit firm's independent non-executives as a characteristic which enhances shareholder confidence. This appendix provides background information to help firms and independent non-executives in their consideration of independence issues related to independent non-executives.

A firm applying the Code needs to address two independence issues:

- auditor independence: relationships between an independent non-executive and an entity that a firm audits may prevent a firm from acting as auditor of that entity or otherwise reduce confidence in the firm's independence; and
- non-executive independence: relationships between an independent non-executive and a firm and its owners may be inconsistent with Code Principle C.2 on characteristics of independent non-executives.

Firms develop their own policies on auditor independence with the aim of helping to ensure compliance with the UK's Ethical Standards and other national requirements. Where a firm develops its own criteria for independent non-executives to support compliance with auditor independence requirements, Code Provision C.2.1 calls on a firm to state those criteria in its transparency report.

In relation to non-executive independence from a firm and its owners, a number of relationships that may cause concern will already be precluded because of auditor independence requirements. However, because there are no specific requirements which define non-executive independence, Code Provision C.2.1 also calls on a firm to disclose its criteria for assessing whether its independent non-executives are independent from the firm and its owners. This should include any term limits which the firm applies. Where an independent non-executive has served for longer than this term, or nine years, whichever is shorter, this should be subject to particularly rigorous review and should also be disclosed in the firm's transparency report.

The definition of a "covered person" in the Ethical Standards includes a person in a position to influence the conduct or outcome of an individual audit. It is not envisaged that an independent non-executive would be a covered person and in the glossary to the Ethical Standards it is stated explicitly that the definition **"does not include any independent non-executive individuals on a supervisory or equivalent board"**. Independent non-executives should not be precluded from oversight of a firm's processes – for example by sitting on a remuneration committee – provided that they are unable to influence the compensation of any individual and/or recuse themselves from any situations where this might arise.

In developing criteria, a firm is expected to reflect the views of an objective, reasonable and informed third party. Therefore, firms should not exclude individuals from consideration as potential independent non-executives simply on the basis that independence issues might arise in the future. However, a current partner or member of staff should never be considered independent for these purposes and a proposal to appoint a former partner or employee would need to be subject to careful consideration.

Once appointed, independent non-executives will need to be sensitive to potential conflicts of interest, report them and ensure that they exclude themselves from any related decisions. For example, an independent non-executive who also sits on the board of a company which is considering appointing the audit firm as auditor, should recuse himself from any involvement in the tender process on either side.

Independent non-executives will also need to comply with relevant requirements such as insider dealing legislation in relation to information that they might become aware of through their involvement with a firm.

Appendix 2

Corporate Governance Code checklist

Corporate Governance Code	Potentially relevant to audit firms?
Role of the Board Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.	Already in
A1.1 The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.	✓
A.1.2 The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees. It should also set out the number of meetings of the board and those committees and individual attendance by directors.	Already in
A.1.3 The company should arrange appropriate insurance cover in respect of legal action against its directors.	Already in (in the context of INEs)
Division of responsibilities There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.	✓
A.2.1 The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.	✓
The Chairman The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.	✓
A.3.1 The chairman should on appointment meet the independence criteria set out in B.1.1 below. A chief executive should not go on to be chairman of the same company. If exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.	✓
Non-executive directors As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.	✓ In the context of INEs
A.4.1 The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate.	✓ In the context of INEs
A.4.2 The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance and on such other occasions as are deemed appropriate.	✓ In the context of INEs
A.4.3 Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.	Already in (in the context of INEs)

Corporate Governance Code	Potentially relevant to audit firms?
<p>Composition of the Board <i>The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.</i></p>	<p>Already in (in the context of INEs)</p>
<p>B.1.1 The board should identify in the annual report each non-executive director it considers to be independent. The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:</p> <ul style="list-style-type: none"> • has been an employee of the company or group within the last five years; • has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company; • has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance related pay scheme, or is a member of the company's pension scheme; • has close family ties with any of the company's advisers, directors or senior employees; <ul style="list-style-type: none"> • holds cross-directorships or has significant links with other directors through involvement in other companies or bodies; • represents a significant shareholder; or • has served on the board for more than nine years from the date of their first election. 	<p>Already in (in the context of INEs)</p>
<p>B.1.3 Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.</p>	<p style="text-align: center;">✓</p> <p>In the context of INEs</p>
<p>Appointments to the Board <i>There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.</i></p>	<p style="text-align: center;">✓</p> <p>(in the context of INEs)</p>
<p>B.2.1. There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board</p>	<p style="text-align: center;">✓</p> <p>In the context of INEs</p>
<p>B.2.2 The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.</p>	<p style="text-align: center;">✓</p> <p>In the context of INEs</p>
<p>B.2.3 Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director. Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.</p>	<p style="text-align: center;">✓</p> <p>In the context of INEs</p>

Corporate Governance Code	Potentially relevant to audit firms?
B.2.4 A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board's policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.	✓ In the context of INEs
Commitment All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.	✓
B.3.1 For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and their impact explained in the next annual report.	✓
B.3.2 The terms and conditions of appointment of non-executive directors should be made available for inspection. The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.	Already in (in the context of INEs)
B.3.3 The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.	X
Development All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.	✓
B.4.1 The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, directors should avail themselves of opportunities to meet major shareholders.	✓
B.4.2 The chairman should regularly review and agree with each director their training and development needs.	✓
Information and support The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.	Already in (in the context of INEs)
B.5.1 The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.	Already in (in the context of INEs)
B.5.2 All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.	✓
Evaluation The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.	Already in
B.6.1 The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.	Already in

Corporate Governance Code	Potentially relevant to audit firms?
B.6.2 Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company.	Potentially although FTSE 350 reference would not apply
B.6.3 The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.	Potentially
Re-election All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.	Already in
B.7.1 All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. Non-executive directors who have served longer than nine years should be subject to annual re-election. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.	X
B.7.2 The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role.	X
Financial and business reporting The board should present a fair, balanced and understandable assessment of the company's position and prospects.	Already in
C.1.1 The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy. There should be a statement by the auditor about their reporting responsibilities	Already in
C.1.2 The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company	✓
C.1.3 In annual and half-yearly financial statements, the directors should state whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements. 1	Already in
Risk management and internal control The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.	Already in
C.2.1 The directors should confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated.	Already in

Corporate Governance Code	Potentially relevant to audit firms?
C.2.2 Taking account of the company's current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.	Already in
C.2.3 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.	Already in
<p>Audit committee and auditors <i>The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.</i></p>	Already in
C.3.1 The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.	Audit Committee requirement already in, although requirements on non-executive participation are not and are potentially relevant
<p>C.3.2 The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:</p> <ul style="list-style-type: none"> • to monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them; • to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems; • to monitor and review the effectiveness of the company's internal audit function; • to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor; • to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements; • to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and • to report to the board on how it has discharged its responsibilities. 	Already in (to some extent)

Corporate Governance Code	Potentially relevant to audit firms?
C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available	Already in
C.3.4 Where requested by the board, the audit committee should provide advice on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.	✓
C.3.5 The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.	Already in (in the context of INEs)
C.3.6 The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.	✓
C.3.7 The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. FTSE 350 companies should put the external audit contract out to tender at least every ten years. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.	✓
C.3.8 A separate section of the annual report should describe the work of the committee in discharging its responsibilities. The report should include: <ul style="list-style-type: none"> • the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed; • an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, and information on the length of tenure of the current audit firm and when a tender was last conducted; and • if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence are safeguarded. 	Already in
Level and components of remuneration Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.	X
D.1.1 In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code. Schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so	X
D.1.2 Where a company releases an executive director to serve as a non-executive director elsewhere, the remuneration report should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.	X

Corporate Governance Code	Potentially relevant to audit firms?
D.1.3 Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options or other performance-related elements. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. Holding of share options could be relevant to the determination of a non-executive director's independence (as set out in provision B.1.1).	X
D.1.4 The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.	X
D.1.5 Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.	X
Procedure <i>There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.</i>	X
D.2.1 The board should establish a remuneration committee of at least three, or in the case of smaller companies two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board. 22 Where remuneration consultants are appointed, they should be identified in the annual report and a statement made as to whether they have any other connection with the company.	X
D.2.2 The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level.	X
D.2.3 The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.	X
D.2.4 Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.	X
Dialogue with shareholders <i>There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.</i>	X

Corporate Governance Code	Potentially relevant to audit firms?
E.1.1 The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.	X
E.1.2 The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.	X
Constructive use of general meetings The board should use general meetings to communicate with investors and to encourage their participation.	X
E.2.1 At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should in particular propose a resolution at the AGM relating to the report and accounts. For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote. The proxy form and any announcement of the results of a vote should make it clear that a 'vote withheld' is not a vote in law and will not be counted in the calculation of the proportion of the votes for and against the resolution.	X
E.2.2 The company should ensure that all valid proxy appointments received for general meetings are properly recorded and counted. For each resolution, where a vote has been taken on a show of hands, the company should ensure that the following information is given at the meeting and made available as soon as reasonably practicable on a website which is maintained by or on behalf of the company: <ul style="list-style-type: none"> • the number of shares in respect of which proxy appointments have been validly made; • the number of votes for the resolution; • the number of votes against the resolution; and • the number of shares in respect of which the vote was directed to be withheld. When, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result.	X
E.2.3 The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.	X
E.2.4 The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting. For other general meetings this should be at least 14 working days in advance.	X



Financial Reporting Council

8th Floor
125 London Wall
London
EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk