UK Corporate Governance Code – Guidance for boards

KPMG Board Leadership Centre

Following publication of the 2024 UK Corporate Governance Code, the FRC have now published their digitally accessible Guidance on the Code. The guidance – which is designed to support those who use the Code by providing advice, further detail and examples - builds on the previous published FRC guidance: The Guidance on Board Effectiveness, Guidance on Audit Committees, and Guidance on Risk Management and Related Financial and Business Reporting. The guidance is not intended to be prescriptive.

The primary purpose of the guidance is to stimulate boards' thinking on how they can carry out their role in governing the company effectively. It includes a series of questions and concepts that boards may wish to consider depending on the size, complexity and maturity of the company.

The guidance should not be used as a tick-box list of actions which should be followed in every situation. Reporting against the Code should always be proportionate and appropriate to the company.

The guidance is not mandatory, not part of the Code itself, and is not prescriptive. It contains suggestions of good practice to support directors and their advisors in applying the Code.

As Board committees have comparable composition and practices, the FRC have introduced a section to support the effective management of board committees. This includes Risk and Sustainability committees (along with the Audit, Remuneration and Nomination committee) which, although not referenced in the Code, may be needed by companies under other legislation or regulation.

A summary of each section is set out below:

Board Leadership and Company Purpose

This section covers board decision-making, culture and engagement with shareholders and stakeholders. In line with the new Code Principle there is discussion of the importance and benefits of reporting on outcomes.

Boards need to consider how they carry out their role. The behaviours they display, individually as directors and collectively as the board, set the tone from the top. There is no one way to do this and the guidance is designed to provoke discussion.

With regard to decision making, the Guidance notes that most complex decisions depend on judgement, but the decisions of well-intentioned and experienced leaders can, in certain circumstances, be distorted. Factors known to distort judgement are conflicts of interest, emotional attachments, unconscious bias, and inappropriate reliance on previous experience and decisions; and risk factors for poor decision-making include:

- A dominant personality or group of directors on the board, inhibiting contribution from others.
- Insufficient diversity of perspective on the board, which can contribute to 'group think'.
- Excess focus on risk mitigation or insufficient attention to risk.
- A compliance mindset and failure to treat risk as part of the decision-making process.
- Insufficient knowledge and ability to test underlying assumptions.
- Failure to listen to / act upon concerns that are raised.
- Failure to recognise the consequences of running the business on the basis of self-interest and other poor ethical standards.
- A lack of openness by management, a reluctance to involve non-executive directors, or a tendency to bring matters to the board for sign-off rather than debate.
- Complacent or intransigent attitudes.
- Inability to challenge effectively.
- Inadequate information or analysis.
- Insufficient notice or a lack of time for debate.
- Undue focus on short-term time horizons.

Division of Responsibilities

This section covers the different roles within the board; chair, CEO, executive directors, non-executive directors and company secretary and the important role each plays in achieving good governance. This section also briefly covers board papers and the role of the company secretary in bringing information together.

Good Practice Guidance for the successful management of board committees

The FRC have, for the first time, brought together foundational information relating to the make-up and general approach of board committees. The Guidance draws out the importance for board committees to have clear oversight and that they are able to work both independently of the board and when necessary, share relevant information.

Composition, Succession and Evaluation

This section discusses the importance of having a breadth and depths of skills and perspectives on any board. Suggestions related to recruitment and improving the talent pipelines are discussed alongside approaches to diversity and inclusion. The guidance does not promote any one approach but links to a number of initiatives for further information.

Board performance can be improved by a monitoring and assessment process. The guidance discusses both the importance of, and approach to, board performance reviews.

Audit, Risk, and Internal Controls

This section is split into three sub-sections – Audit, Risk Management, and Internal Controls.

Audit – The guidance is materially unchanged from the FRC's 2016 Guidance on Audit Committees, though reference is now made to the 'Audit Committees and the External Audit: Minimum Standard' (the Minimum Standard), which is now explicitly addressed in Provision 25 (the main roles and responsibilities of the audit committee) and Provision 26 (the audit committee report) of the Code.

While all directors have a duty to act in the interests of the company, the Guidance notes that the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control.

The Guidance contains recommendations about the conduct of the audit committee's relationship with the board, with the executive management and with internal and external auditors. The essential features of these interactions are a frank, open working relationship and a high level of mutual respect. The Guidance notes that the audit committee should be prepared to take a robust stand, and all parties should be prepared to make information freely available to the committee, to listen to their views and to talk through the issues openly.

Risk Management – The guidance prompts boards on the matters to consider when determining and maintaining their emerging and principal risks.

Specifically, the Guidance sets out that the board has ultimate responsibility for an organisation's overall approach to risk management and internal control, including:

- establishing and maintaining an effective risk management and internal control framework.
- determining the nature and extent of the principal risks and those risks which the organisation is willing to take in achieving its strategic objectives (determining its 'risk appetite').
- agreeing how the principal risks should be managed or mitigated to reduce the likelihood of their incidence or their impact.
- monitoring and reviewing the risk management and internal control systems, and the management's process for this, and satisfying itself that they are functioning effectively, and that corrective action is being taken where necessary.
- ensuring effective external communication on risk management and internal control.

The guidance does not set out in detail the procedures or framework by which a company designs, implements and operates its risk management and internal control framework – noting that attempting to define a single approach to achieving good practice would be counterproductive if it led boards to underestimate the crucial importance of high-quality risk management of the culture and behaviour they promote.

However, the Guidance does set out that boards could use a recognised framework or standard as part of its process for designing and maintaining the effectiveness of the risk management and internal control framework (e.g. COSO, ISO, COBIT, etc.). Such framework or standard should be relevant for those areas which it relates to (e.g. financial reporting, technology, etc.) when reporting against the Principles and Provisions of the Code.

Internal Controls – In addition to monitoring and reviewing the effectiveness of the company's risk management and internal control framework, the 'new' 2024 Code asks boards to inter alia, include a declaration of effectiveness of the material controls as at the balance sheet date.

The Guidance does not set out a framework to be followed nor define what constitutes a material control – rather it states that material controls will be company-specific and therefore different for every company depending on their features and circumstances, including for example size, business model, strategy, operations, structure and complexity.

The guidance goes on to state that when determining which controls are 'material', the board considers how a deficiency in the control could impact the interests of the company, shareholders and other stakeholders.

Furthermore, while the board decides which controls are material these could include, but are not limited to, controls over:

- risks that could threaten the company's business model, future performance, solvency or liquidity and reputation (i.e. principal risks).
- external reporting that is price sensitive or that could lead investors to make investment decisions, whether in the company or otherwise. [Here reference is made to the IFRS definition of material financial information which the FRC say could also be applied to non-financial information]
- fraud, including override of controls.
- Information and technology risks including cyber security, data protection and new technologies (e.g. artificial intelligence).

Usefully, the Guidance clarifies that the declaration relates to what the board determine to be material internal controls and not the framework as a whole.

It will take time to digest the guidance fully, but the suggestion that material controls might include controls beyond those associated with the principal risks may leave the back door open to a Sarbanes-Oxley style regime – which was not the FRC's intention. More work will be needed by preparers, the regulator, and others to marry the FRC's expectations with the procedures necessary for boards to provide a reasonable conclusion regarding the effectiveness of material controls.

Remuneration

This section concentrates on the role of the remuneration committee. It does not comment on the existing legislation that is applicable to determining levels of remuneration; it deals with workforce remuneration, non-executive remuneration and remuneration policies – specifically the use of discretion and malus and clawback provisions.

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

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