boardinsight:

UK Corporate Governance Code 2014

How should you approach the changes?

Where can I access the Code?

At the link below you will find the Code plus the following related documents:

- The FRC press notice
- The FRC feedback statement on revisions to the Code (the Appendix shows the changes from the 2012 Code)
- The revised Guidance on Risk Management, Internal Control and related Financial and Business Reporting (successor to Turnbull and the going concern guidance)
- New Guidance for Directors of Banks on Solvency and Liquidity Risk Management and the Going Concern Basis of accounting
- Extracts from International Standards on Auditing (UK and Ireland) 260, 570 and 700 (revised September 2014)

http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/September/FRC-updates-UK-Corporate-Governance-Code.aspx

When does the Code come into force for my company's year end?

The Code applies for financial reporting periods beginning on or after 1 October 2014. So:

- For 30 September year end companies it will apply from 1 October 2014
- For 31 December year ends it will apply from 1 January 2015
- For 31 March year ends it will apply from 1 April 2015

What immediate action do I need to take?

The Code requires certain things to be reported on differently in future. For 30 September year end companies, which are the first to be affected by the changes, this new reporting will be required in the Annual Report for the year to 30 September 2015. Others will generally report later, so there is some time to consider how to approach this.

The Code also calls for certain changes in practice. These come into force as soon as your company becomes subject to the new Code, clearly much earlier than the reporting requirements. They will inform your subsequent reporting.

What are the key Code changes?

See the Appendix to the FRC feedback statement at the link above for a list of all the changes from the 2012 version, showing the new wording.

The new Code is very much as expected from the previous consultations. The key changes are:

New longer-term viability statement (provision C.2.2)

Directors should explain in the Annual Report how they have assessed the prospects of the company and over what period and state whether they expect the company to be able to continue to operate and meet its liabilities over that period. The FRC expects ‘this statement will look forward significantly longer than 12 months’ - each board will decide the timeframe.

Previous going concern statement dropped (provision C.1.3)

The previous going concern statement is replaced by a provision that directors should state in the full and half-yearly reports whether they considered it appropriate to adopt the going concern basis of accounting

*Risk (*provisions C.2.1, C.2.3)

Risk assessment should be ‘robust’, principal risks should be described, with an explanation of how they are being managed. The review of the effectiveness of the risk management and internal control systems should be reported on in the Annual Report.

Remuneration (Principle D.1. provision D.1.1)

Directors’ remuneration to be designed to promote the long-term success of the company. Clawback provisions to be put in place.
The remuneration committee should take care to recognise and manage conflicts of interest

Board behaviours
More emphasis on the importance of diversity, ‘tone from the top’ and board behaviours (preface)

Points you might want to consider

- How and when to brief the board in outline on the new requirements (followed by detailed committee review)
- Diarising a time for the audit, remuneration and nomination committees to consider the new provisions (and risk committee if you have one) and how and when they will report their views back to the board.
- Below are some suggestions for committee consideration. These are not intended to be comprehensive, but should be a good starting point:

  Audit committee

  - Decision on going concern basis of accounting (C.1.3)
  - How will a 'robust' risk assessment be carried out? (C.2.1)*
  - How will principal risks be described in the Annual Report (C.2.1)*
  - Does more need to be done to manage/mitigate risk and to enable this to be reported on? *(C.2.3)
  - How will the long-term viability statement be approached? What professional advice might be needed? How and when will the decision on the length of the term covered by the statement be reached? (C.2.2)
  - Views on shareholder engagement on these issues, for discussion with the board

  Risk committee, if there is one, to consider points marked *

  Remuneration committee

  - Consider the provision on directors' remuneration being 'designed to promote the long-term success of the company' and any changes this might mean for remuneration design (D.1)
  - Are performance elements 'transparent, stretching and rigorously applied'? (Principle D.1)
  - Do they or should they include non-financial metrics? (Schedule A)
  - Are incentives compatible with risk policies and systems? (Schedule A)
  - How can you avoid 'paying more than is necessary' (Supporting principle D.1)
  - Is there an appropriate balance between immediate and deferred remuneration? (Schedule A)
  - Consider introducing clawback provisions if you do not have these already (D.1.1)
  - For share-based remuneration, consider requiring directors to hold a minimum number of shares for a further period after vesting or exercise, including after leaving the company (Schedule A)
  - How can the committee take care to recognise and manage conflicts of interest when receiving views from executive directors or senior management? (D.1)

    - Consider how to approach the provision for committee chairman to engage with shareholders about remuneration (D.1)
    - Views on shareholder engagement on these issues, for discussion with the board

  Nomination committee

    - Review board diversity in the light of changes to the Code preface (para 3)

- The board should discuss and agree with committees, as appropriate, the points shown above
- Consider the new ‘tone from the top’ and behaviours wording in the Code preface (para 4). Are any changes needed in practice?
- Consider the provision to take actions to understand the reasons behind a significant proportion of shareholders opposing any resolution (E.2.2). What would this involve in practice?
- Take an early view, at the annual report planning stage, as to which new elements of reporting will go where and what this may mean for the length and layout of the report. For example, will you include the long-term viability statement in the Strategic Report (where it will benefit from the ‘safe harbour’ provisions)?

What special action is needed if my company is a bank?

Note that there is separate guidance for banks on solvency, risk and going concern which concerns how these aspects should be addressed. This should be considered together with the revised Risk and Internal Control guidance.

To sum up

The Code introduces changes of emphasis in how you deal with the key areas of risk, going concern, remuneration and board diversity and behaviours.

Companies need to consider these over the coming months, seeking advice where necessary from external auditors and remuneration consultants in particular, and bearing shareholders views in mind.

Factoring consideration into your existing board and committee meeting schedule will generally make the best use of time.