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# Briefing

## **FRC consults on revisions to the UK Corporate Governance Code - key considerations**



INSTITUTE OF DIRECTORS  
IN IRELAND

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On 24 May 2023, the UK Financial Reporting Council published a consultation paper ([link](#)) proposing changes to the UK Corporate Governance Code. The changes focus largely on issues of internal control, assurance and resilience.

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### **Background**

The UK Corporate Governance Code (formerly the Combined Code) remains the pre-eminent corporate governance code and is widely adopted by Irish companies. The Code has been successful because it is principles-based and flexible, rather than being prescriptive. The Listing Rules of Euronext Dublin require every company listed on Euronext Dublin to state in its annual report how the principles of the Code have been applied on the famous “comply or explain” basis.

The FRC's consultation responds to the legislative and governance reforms that the UK Government proposes to introduce to strengthen the UK's audit, corporate reporting and corporate governance systems, as set out in UK Government's May 2022 white paper “Restoring trust in audit and corporate governance”. In that paper, the UK Government said that it intended to refine the UK's audit and corporate governance framework “seizing the opportunities of the UK's departure from the EU to shape rules and processes that work for our specific circumstances”. The UK reforms are to be implemented through a range of measures some of which will require legislation that will not apply to Irish companies.

Unlike the wide-ranging review of the Code in 2018, the proposed revisions are, generally, targeted and technical. No changes are proposed to the general approach of a principles-based framework that engages on a “comply or explain” basis.

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## Summary of changes

The majority of changes are linked to the UK Government's white paper and are proposed to be made to Section 4 (Audit, Risk and Internal Control). These proposed changes concern those parts of the Code which deal with the need for a robust framework of prudent and effective risk management and internal controls and are aimed at providing a stronger basis for reporting on, and evidencing the effectiveness of, the framework during the reporting period.

Other revisions reflect the wider responsibilities of the board and audit committee for expanded environmental, social and governance (ESG) reporting and areas which the FRC has consistently identified as those where reporting can be improved including regarding "overboarding".

Full marked versions of the proposed revised Code are included in the consultation.

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## Key changes

The key changes being proposed are as follows.

### Section 1 - Board leadership and company purpose:

The FRC proposes to introduce a new Principle setting out an expectation that companies should, when reporting on their governance activity, focus on outcomes to demonstrate the impact of governance practices.

Minor amendments are proposed to the provisions in Section 1 which would increase the focus on environmental and social matters, including in relation to climate ambitions and transition planning.

### Section 2 - Division of responsibilities:

The FRC notes increased concern from investors about the number of board positions held by executive and non-executive directors of listed companies – "overboarding".

The FRC proposes that the provisions of Section 2 be expanded to require that annual reports include more information on director appointments, including how each director has sufficient time to undertake their role effectively in light of commitments to other organisations.

### Section 3 - Composition, succession and evaluation:

The FRC proposes amendments in Section 3 to strengthen the Code in the area of diversity and inclusion. The Principles will be revised to include a reference to "inclusion", giving equal weight to all protected and non-protected characteristics, to encourage companies to consider diversity beyond gender and ethnicity. Diversity and inclusion initiatives, along with any targets set, should contribute to the succession plan.

The description in the annual report of the work of the nomination committee is to include an explanation of how the committee has overseen the development of a diverse pipeline for succession and comment on the effectiveness of the diversity and inclusion policy, including progress towards company objectives and adherence to established initiatives.

#### **Section 4 - Audit, risk and internal control:**

Section 4 is where the majority of the changes to the Code are proposed to be made, including those that would align with the proposals set out in the UK Government's May 2022 white paper "Restoring trust in audit and corporate governance".

As part of those proposals, the UK Government intends to require certain UK-incorporated companies to have an Audit and Assurance Policy. The FRC proposes that this requirement should extend to all companies that report against the Code (including Irish companies, albeit on the "comply or explain basis") and that the audit committee should have responsibility for developing, implementing and maintaining the policy.

The FRC proposes that the audit committee have responsibility for monitoring the integrity of narrative reporting, including on sustainability matters. The audit committee report in the annual report would cover the significant issues that the audit committee considered relating to narrative reporting, including sustainability matters and, where a company commissions assurance of environmental, social and governance metrics and other sustainability matters, this should be reported on in the annual report.

To strengthen the provisions on risk and internal controls, boards will be required to provide in the annual report:

- a declaration of whether the board can reasonably conclude that the company's risk management and internal control systems have been effective throughout the reporting period and up to the date of the annual report.
- an explanation of the basis for its declaration, including how it has monitored and reviewed the effectiveness of these systems.
- a description of any material weaknesses or failures identified and the remedial action being taken, and over what timeframe.

The going concern and viability statement provisions are to be retained.

#### **Section 5 - Remuneration:**

The FRC proposes changes to the Principles in Section 5 highlighting the importance of aligning remuneration outcomes to company performance, purpose and values, with a specific mention of ESG objectives. A specific reference would be included to company and workforce pay and conditions being a factor which remuneration committees should have regard to in determining executive pay.

Director contracts and/or other agreements or documents which cover director remuneration should include 'malus' and 'clawback' provisions, and a new provision

would prescribe information on ‘malus’ and ‘clawback’ to be covered in the remuneration report.

It is proposed that references to pay ratios and pay gaps be removed from the Code, avoiding duplication of disclosure for the many companies who are separately obliged to report on these matters.

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## Next steps

The deadline for responses is Wednesday 13 September 2023 and the intention is for the revised Code to apply to financial years starting on or after 1 January 2025. The FRC will also publish updated guidance (including on audit committees, board effectiveness and risk management, internal control and related financial and business reporting) to sit alongside the revised Code.

### *Further information is available from*



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