DECISION FOCUS

White Paper

Adapting to the New UK Corporate Governance Code: What's Changing & Why It Matters for Your Business

Executive Summary

The 2024 revision of the UK Corporate Governance Code (UK CGC) is shaking up the way we think about governance, risk management, and board accountability. While at first glance, the changes might seem like the usual regulatory updates, Provision 29 (which requires boards to formally declare the effectiveness of their internal controls and risk management) adds a fresh layer of complexity and responsibility. It's not just about ticking the compliance box anymore; it's about proactively shaping an organisation's governance culture and ensuring that risk management and internal control systems are embedded at every level.

The Code's updates signal a shift from a reactive approach to a more proactive and integrated governance model, and it challenges UK companies to view internal controls as a critical part of long-term strategy. But with challenges come opportunities. For businesses that embrace these changes, there are clear benefits, such as improved resilience, greater transparency, and stronger relationships with investors and other stakeholders. This white paper explores the important changes to the 2024 Code, dives into the implications of Provision 29, and offers strategic insights on how businesses can not only meet these regulatory demands but thrive by embedding governance deeper into their operations.

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Introduction

The UK Corporate Governance Code has evolved alongside the business landscape. Since its inception in 1992, the Code has been a guiding light for corporate governance in the UK. It has adapted over time, responding to emerging risks, corporate failures, and shifting expectations from investors, regulators, and the public. The 2024 update is no different. While some see this revision as just another compliance hurdle, it actually represents a paradigm shift in how companies should approach governance.

Provision 29, requiring boards to actively declare the effectiveness of internal controls and risk management systems, is the headline change. This marks a significant departure from past practices, where governance was often seen as a checklist or annual review. Now, boards are being asked to take ownership of internal controls, to embed them in the company's culture, and to ensure they are effective year-round, not just during an annual audit.

It's no longer enough to simply have internal controls in place. The real challenge now is proving their effectiveness, showing that they are designed to mitigate risks and to support the company's long-term strategy. As the risk landscape continues to evolve, this new requirement is an opportunity for businesses to strengthen their governance and risk management frameworks in a way that drives value, not just compliance.

Leveraging FRC Guidance for Effective Compliance

In this dynamic and evolving landscape, the Financial Reporting Council (FRC) guidance plays a crucial role. As the independent regulator responsible for overseeing the UK's governance and corporate reporting frameworks, the FRC offers important direction and clarity regarding the implementation of the 2024 Code. The FRC's guidance helps companies interpret the provisions of the Code, particularly with regards to how internal controls should be designed, tested, and monitored.

For example, the FRC offers detailed advice on what constitutes effective internal controls, how boards can assess them, and how they should report on them transparently. The FRC's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' provides companies with practical steps for achieving compliance with Provision 29, offering a framework for boards to evaluate the effectiveness of their controls and understand what needs to be reported. This guidance is a vital resource for boards looking to meet the new expectations set out by the Code.

By aligning with this guidance, companies can ensure that their internal control and risk management systems are robust, well-documented, and in line with the FRC's expectations. This is key not just for compliance, but also for building trust with investors and ensuring the company's governance systems are fit for the long-term challenges ahead.

What's Changed in 2024?

The 2024 revision of the UK CGC introduces several changes that directly impact how boards approach governance. These changes aim to make boards more accountable, more transparent, and better positioned to manage risks in a dynamic business environment.

Provision 29 is the star of the show in this revision. It requires boards to declare the effectiveness of their internal controls and risk management systems in their annual reports, making the board accountable for ensuring that these systems are working as intended. This is a big shift from past practice, where internal controls were often viewed as a back-office function handled by compliance or finance teams.

Now, the board is on the hook. They must ensure that the company has the right internal controls in place and that they are effective in mitigating risks. The key here is that boards are no longer just monitoring internal controls, they are owning them. This places a new burden on directors to take a hands-on approach in overseeing risk management and internal control systems.

For many companies, this means a shift from compliance-focused thinking to a more strategic approach to governance. It's about ensuring that internal controls are aligned with the company's overall objectives and strategy, rather than just meeting the minimum regulatory requirements.

A More Flexible, Transparent Approach

The Code's flexibility remains intact. As always, the "comply or explain" approach is a hallmark of the UK CGC, allowing companies to tailor their governance structures to their unique needs. However, this flexibility comes with a catch – explanations for non-compliance need to be substantive and well-justified.

For Provision 29, this means that if a board feels it cannot make the effectiveness declaration for certain internal controls, it must provide a clear explanation of why that is the case and outline the steps it is taking to address any weaknesses. The Code's goal is to make governance more transparent and to ensure that investors and stakeholders have a clear picture of how the company is managing risk.

In other words, explanation is not an escape clause, it's an opportunity to show how seriously the board takes its governance responsibilities and to build trust with investors and regulators alike.

Embedding Governance into Company Culture

Governance is no longer just a compliance function that happens once a year. The 2024 Code places a strong emphasis on corporate culture and how governance is embedded into the organisation's day-to-day activities. Provision 2 of the Code, which requires boards to ensure the company's culture supports its strategy, has been expanded. Boards are now expected to report on how the desired culture is being actively reinforced across all levels of the organisation.

Culture is the foundation of good governance. A company's culture affects everything from risk management practices to ethical decision-making. The 2024 Code acknowledges this and encourages boards to measure and monitor culture, ensuring that it is aligned with the company's long-term objectives.

For companies, this means moving beyond just setting values on a website or in a report. It's about creating a culture of accountability, transparency, and integrity that runs through every decision and action at the company. It's about ensuring that governance is not just about compliance, it's about building a company that can withstand challenges and thrive in the face of risks.

Deep Dive into Provision 29: Internal Controls and the Board's Role

Provision 29 is the game-changer of the 2024 Code. It's the provision that will have the most immediate and far-reaching impact on how boards approach their governance responsibilities. Here's what it means in more detail:

Under Provision 29, boards are required to review and declare the effectiveness of their internal controls and risk management systems as part of their annual reports. This is no longer just a check-the-box activity. The declaration must be backed by evidence that the controls are working as intended and that they are sufficient to manage the company's material risks.

The board must also disclose any weaknesses in the control systems, providing a clear plan for how those weaknesses will be addressed. This will require companies to invest in stronger internal control systems, implement more frequent risk assessments, and create a culture of continuous improvement.

This provision pushes boards to take ownership of the control environment and not simply delegate this responsibility to management. It's about ensuring that controls are in place to mitigate risks effectively, and that these controls are fit for purpose as the company evolves.

Why It's Not Just "UK SOX"

Some have compared Provision 29 to the U.S. Sarbanes-Oxley Act (SOX), particularly Section 404, which requires U.S. companies to certify the effectiveness of their internal controls over financial reporting. While there are similarities, the analogy is a bit misleading.

Provision 29 is not just about financial controls. It covers all material controls, including operational, compliance, and reporting controls, giving boards a broader view of the organisation's risk management framework. Unlike SOX, which requires an external auditor to attest to the effectiveness of controls, Provision 29 places the responsibility firmly with the board. This means that boards will need to actively engage with the company's internal control processes, ensuring that the controls are working effectively and that they are aligned with the company's broader strategic goals.

In short, Provision 29 is not just compliance. It's about embedding risk management at the heart of governance and taking a proactive, strategic approach to internal controls within the organisation.

The Strategic Importance of Internal Controls

Internal controls are no longer just a back-office function. They are integral to the company's long-term strategy. Boards must ensure that their internal control systems are designed to not only mitigate risks but to also support the company's objectives.

To comply with Provision 29, companies will need to:

- **Assess all material controls:** This means reviewing not just financial reporting controls but also operational, compliance, and strategic controls.
- **Implement a continuous monitoring system:** Rather than waiting until the year-end to assess controls, companies must build a system that allows them to monitor controls on an ongoing basis, ensuring they are effective and up to date.
- **Foster a culture of accountability:** Internal controls should be owned by the entire organisation, not just the board or the compliance team. This requires a shift in how risk is managed across the business.

The goal of Provision 29 is to help companies create a resilient and strategically aligned risk management framework that is continuously assessed, updated, and improved.

Strategic Actions for Compliance

Adapting to the changes in the 2024 Code is a strategic challenge that requires companies to take a long-term, proactive approach to governance. Below are some of the most critical actions businesses can take to ensure they meet the expectations set by Provision 29:

1. **Break Down Silos and Foster Collaboration:** Internal controls and risk management should not be fragmented across different departments. Companies need to foster cross-functional collaboration, ensuring that all departments are aligned when it comes to risk management. This will enable the board to have a comprehensive view of the company's risk landscape and ensure that all material controls are being effectively managed.

2. **Align Governance with Business Strategy:** Governance should not be a standalone function. It should be integrated into the company's overall business strategy. The board's responsibility is to ensure that internal controls and risk management are aligned with the company's strategic objectives and that they support the business in achieving long-term success.

3. **Invest in Continuous Monitoring and Technology:** The days of relying solely on annual audits are over. Companies must invest in continuous monitoring systems that provide real-time data on the effectiveness of internal controls. By leveraging technology, companies can proactively identify potential weaknesses and address them before they become major risks.

4. **Define Material Controls Clearly:** Not all controls are created equal. Companies need to identify the most material controls, those that directly impact the company's ability to achieve its strategic objectives and focus their efforts on ensuring these controls are robust and effective. This will help avoid the trap of over-controlling and creating unnecessary complexity.

5. **Embed a Culture of Risk Awareness:** For companies to succeed in meeting the Code's expectations, risk management must be embedded into the company culture. This means ensuring that all employees understand the importance of internal controls and their role in maintaining them. When governance becomes a shared responsibility, the company's ability to manage risk improves, and the board can declare the effectiveness of controls with confidence.

The 2024 update to the UK Corporate Governance Code is a critical step in enhancing the governance and resilience of UK-listed companies. Provision 29, with its focus on internal controls and risk management, represents a fundamental shift in how boards approach governance. Rather than viewing risk management as a compliance task, companies are now required to embed it into their culture and strategy.

For boards and senior executives, it is abundantly clear that internal controls are no longer just about compliance, they are a strategic tool that can drive long-term value, build investor trust, and ensure organisational resilience. The time to act is now. Companies that embrace these changes will be better positioned to thrive in an increasingly complex and risk-laden business environment.

By proactively engaging with the new requirements of the Code, companies can not only meet regulatory expectations but also build a stronger, more resilient business that is aligned with its long-term strategic goals. Let's move beyond ticking boxes and toward creating a culture of governance that drives success.

About Decision Focus

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