

Consultation on the UK Corporate Governance Code

Comments on the questions have been requested by Wednesday 13 September 2023. Responses should be sent by email to codereview@frc.org.uk.

Full document:

<https://www.frc.org.uk/getattachment/a92c8f2d-d119-4c4b-b45f-660696af7a6c/Corporate-Governance-Code-consultation-document.pdf>

Full list of consultation questions

Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

“when reporting on their governance activity, focus on activities and outcomes to demonstrate the impact of governance practices.”

This makes sense.

The intention behind the new Principle D is clear, but some accompanying guidance and best practice would be welcomed.

Q2: Do you think the board should report on the company’s climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?

Yes

Q3: Do you have any comments on the other changes proposed to Section 1?

No

Q4: Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments an explicit part of board performance reviews?

“the annual board performance review should consider each director’s commitments to other organisations, and how directors are able to make sufficient time available to discharge their role effectively”.

We think this would work well as part of the annual board review process and agree with the proposed change – a formal annual review could help with over-boarding and further inform succession planning.

Q5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

In principle yes, however same concern / suggestion as above for Q4.

Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

“to give equal weight to all protected and non-protected characteristics, to encourage companies to consider diversity beyond gender and ethnicity.”

This makes sense, providing a definition of “all protected and non-protected characteristics” is provided.

Yes, the amendment appears to support giving equal weight to every aspect of diversity, rather than a positive bias toward gender or ethnic diversity, which is welcomed.

Q7: Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?

Yes.

Q8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?

“improving transparency to understand the role of any targets or initiatives companies have chosen to use to achieve greater diversity and inclusion in their boards and executive management.”

This should encourage better reporting, and not “boiler plate”.

“value of such reviews is in informing a continual process of self-improvement for boards.”

Yes. We think as well as giving the board greater oversight of senior management succession plans and related risks/opportunities, this develops the role and purpose of the nomination committee.

Q9: Do you support the proposed adoption of the CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?

A forward looking “review” of the board rather than more retrospective “evaluation” would be better.

The continued use of the word “targets” is increasingly difficult to align with non-protected characteristics. Reporting on company “initiatives” is arguably much more likely to achieve the stated aims of less boilerplate and outcome-based reporting. Guidance around this point and best practice case studies would be helpful.

Q10: Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?

Provided that there is clear guidance on the basis that any external assurance will be required together with defining clearly what is meant by terms like 'limited' or 'reasonable' assurance with worked examples. For a small cap / all share market issuer, the cost of audit has increased exponentially in the last 3 / 4 years, and the rationale audit firms give is increased regulatory demands. Whilst well-meaning, these changes come at a great cost to businesses and 'assurance' would presumably be a further cost to incur. In our experience to date, assurance firms are still expensive and supply /demand issues should be taken into account before implementation of any policy and related guidance.

Q11: Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?

Not applicable to us, more a question for non-listed companies which would be caught by this change.

Q12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?

The advantages of specifically making this a responsibility of the audit committee seem rather opaque. We are not sure that the audit committee members would be in a better place than the Board to review and approve ESG reporting.

We think some of the intrinsically numerical based areas of sustainability reporting (targets, metric, reductions etc) align well with the remit of the audit committee and typical skill sets of its members. However, the non-financial aspects of sustainability reporting (typically the "S") fit less well in our opinion and would benefit from the input and experience of the whole board. Also, as a smaller issuer, currently our audit committee meetings are aligned to our financial reporting periods whereas our sustainability reporting/agenda is year-round and currently comes to the board earlier in the calendar. Aligning all aspects would increase the frequency of audit committee meetings or reduce the quality of the conversations by trying to fit in to the existing calendar.

Q13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?

Regarding " inclusion of a requirement for an explicit directors' statement about the effectiveness of the company's internal controls".

It's sensible to encourage more detailed reporting regarding the directors' statement.

Q14: Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?

Somewhere in between! It is management's primary responsibility to ensure controls are effective on a day-to-day basis with any defects or concerns being reported up to the board. Not having the same level of oversight or frequency, it would be unreasonable for the board's declaration to be taken as being accurate and true on every day during the financial year and we are concerned that this is how it could be interpreted and cause conflicts. A better approach might be for the declaration to be repeated at specific intervals – perhaps at half year/interims and year end aligned to the balance sheet date.

Q15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?

"Reporting" is too general. It should be more defined.

Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

Guidance should be detailed, albeit practical bearing in mind "comply or explain" principle and the different sectors and regulatory regimes to which different issuers are subject.

Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?

A framework that is kept up to date and embedded in the organisation through proper documentation which should, where possible, be automated - enabling transparency and efficiencies, as well as ease of oversight and reporting to boards/audit committees.

Based on UK and US experience of corporate failures, some detailed examples /definitions of "material weakness" should be possible, agnostic of sector. For example: segregation of duties, problems with manual journal entry control etc.

Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

Fraud

Q19: Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?

Yes.

Q20: Do you agree that all Code companies should continue to report on their future prospects?

Yes.

Q21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?

The question is not applicable to us.

Q22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

“the importance of remuneration outcomes being clearly aligned to company performance, purpose, and values and now includes a specific mention of ESG objectives.”

We agree with this principle.

We think the wording should be softer as it could (and can think of examples where it has) lead to the wrong behaviours – i.e. tick box ESG-related measures to achieve targets (and arguably ‘game’ bonus), but not necessarily the right thing to do for all stakeholders. Examples include companies who elected to use set-off to achieve the Scope 1 & 2 targets, which ticked the box but perhaps was not the right thing to do for the genuine long-term sustainability of the company and the planet. Giving rem policy and targets a bigger voice in this space can lead to the wrong behaviours rather than actually drive sustainability measures forward in the right way.

Q23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?

Increased clarity reporting malus and clawback arrangements is sensible.

Q24: Do you agree with the proposed changes to Provisions 40 and 41?

The changes sound as though they will encourage more detailed reporting based upon your research.

Q25: Should the reference to pay gaps and pay ratios be removed, or strengthened?

Removed. In a good way, the debate about equality is much wider than pay and this now lends itself to narrative rather than ratio-based reporting.

Q26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government’s White Paper on artificial intelligence.

Further simplification would be welcomed and deletion of anything that is contained in regulation / enshrined in law already. Similar to the recent simplification of the listing rules, we believe that

further simplification could help ease the cost burden, particularly for smaller issuers, and help stimulate economic growth in the UK. Governance is often cited in our sector as a reason not to be listed, and a reduction/simplification could reverse this trend of delisting or just dispensing with IPOs altogether.