ACCIF
AUDIT COMMITTEE CHAIRS' INDEPENDENT FORUM

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By email: codereview@frc.org.uk

Dear David

Consultation on the UK Corporate Governance Code

SECTION 1: Introduction

The board of the Audit Committee Chairs' Independent Forum (ACCIF) is very pleased to contribute our thoughts on the proposed changes to the UK Corporate Governance Code. ACCIF exists to be a voice for chairs and members of FTSE350 audit committees, and in developing our overall response we surveyed our members, asking for their views on specific topics. The attached document consists of an executive summary of our key responses, along with answers to your specific questions which incorporate the results of our survey and a selection of verbatim comments from our members.

ACCIF strongly supports efforts to improve corporate reporting in the UK (including the FRC's focus on audit quality) and we are committed to encouraging audit committees to play their full part in this important activity. We recognise the need to enhance the transparency of how reporting responsibilities are discharged by boards and audit committees, and we welcome initiatives around the Resilience Statement and the Audit and Assurance Policy. We also believe that the reporting on the board's oversight of the effectiveness of risk management and internal control systems needs to be more standardised to facilitate informed decision-making by all stakeholders.

The vast majority of companies in the UK take their reporting responsibilities very seriously and therefore any expansion of reporting requirements should be explained in the context of the value that will flow from the proposed changes. Extra resource will be required to both effect the changes and comply with them on an annual basis and at a time when the competitiveness of the UK listed market is under pressure from alternative international locations, we believe a robust cost/benefit analysis of the changes is required. Companies must have confidence that the required investment, at a time when they are under significant pressure from macro factors, will deliver net benefit to their stakeholders.

As you will see from our detailed response, we do not support the proposed changes to the reporting of the effectiveness of risk management and internal control systems. In our view, the proposals to include all internal controls within the scope of the declaration, and their effectiveness throughout the year will impose a significant new burden on companies and creates a much higher bar in the UK than any other major international market.

Finally, we believe that this review of the Code presents an opportunity to improve the usefulness of annual reports by removing reference data (standing data, policies and process information etc) and focussing the annual report on performance data, both financial and non-financial, relevant to the reporting period. We strongly encourage the FRC to embrace this opportunity.

[redacted]

SECTION 2: EXECUTIVE SUMMARY

1. **Changes to the Code must align with other, on-going corporate initiatives**

   The UK Corporate Governance Code (the "Code") is only one part of the business ecosystem in the UK, and we believe that any changes to the existing Code need to be fully aligned with other elements of the corporate reform agenda, e.g. the new reporting regulations, proposed simplification of the listings regime, review of non-financial reporting and ISSB standards implementation. We note inconsistencies such as the way that the Audit and Assurance Policy regulation refers to internal controls over financial reporting whereas the proposed Code declaration covers all controls. We feel that the current proposals lack a clear description of what problems they are designed to address and how they fit with other corporate reform initiatives. We are worried that without this clarity of vision, there is a danger that the proposed changes will make the UK a less attractive place to do business.

2. **The benefits arising from the proposed changes should outweigh the costs of implementation**
   ACCIF believes that the cost/benefit argument for the proposed changes to the Code has not yet been made. Our members are concerned that many of the proposed changes will result in significant extra time and cost being incurred by their companies, with little confidence that the changes will result in demonstrable benefit to stakeholders. We believe that the case for change needs to be made more effectively, in large part through a robust analysis of incremental cost measured against incremental benefit. ACCIF strongly supports the retention of the "comply or explain" regime, which we believe could be helpful during the implementation phase of the proposed changes, but we are concerned that certain stakeholders, in particular the proxy agencies, substitute this part of the Code with "yes/no". Such behaviour will undoubtedly have adverse consequences on some companies.

3. **Additional requirements may make annual reports even longer and less easy to use**
   While we support many of the individual proposals, the sheer volume of change is significant and we are disappointed that there has been no attempt to create space in annual reports by removing existing policy and process information, perhaps to company websites or other repositories, leaving annual reporting to focus on performance outcomes in the year. This should also be applied to new requirements such as the Audit & Assurance Policy – the policy itself should be on a website and then the annual update statement in the annual report. We recognise the challenge presented by moving relevant information outside annual reporting, but we feel that simply layering new on existing requirements runs the risk of making annual reports less useful by way of their sheer complexity, denseness and length and may even encourage "boiler-plating".

4. **Significant incremental effort will be required to make the declaration on the effectiveness of risk management and internal control systems**
   We do not support the proposed changes to the reporting of the effectiveness of risk management and internal control systems. At a conceptual level many of these

proposals make sense and build on existing requirements in the Code. However, at a practical level, we are very concerned that the proposals represent a significant change for many companies and we believe that the level of incremental resource required may be considerable. In the absence of detailed guidance and worked examples we are worried that there will be a wide range of interpretation which will lead to comparability challenges between sectors and competitor companies. We also feel that, despite your comments to the contrary, the proposed changes do represent an extension of the requirements that some UK companies currently comply with as US Foreign Registrants. Therefore, it is important to identify what additional work will be necessary (for example, a declaration of effectiveness throughout the year rather than point in time (referred to by yourselves as "continuous monitoring"), and the inclusion of all controls, rather than just those relating to financial reporting). It would be helpful to understand how you can conclude that this is a lesser requirement than for Sarbanes-Oxley.

Finally, we are concerned that many companies may perceive the proposed changes as simply requiring more extensive narrative reporting. We note the FRC's own conclusion that "Currently there is a lack of information about the risk management and internal control systems operated by companies, and the work carried out during the reporting period to maintain their effectiveness". We do not believe that this information currently exists at board level in many companies, hence our view that we cannot support these proposals as they will be both time-consuming and costly to a large proportion of companies reporting under the Code.

We suggest that thought be given to the following options:

1. Call for specific narrative on the steps taken by the board to assess the effectiveness of the risk management and internal control systems.
2. Focus the declaration just on the effectiveness of internal controls over financial reporting in the first instance.
3. Make the declaration on the effectiveness of internal controls over financial reporting as at the balance sheet date.
4. Stagger the implementation of these proposed changes, so that well-resourced organisations, perhaps with experience of Sox reporting, are required to adopt the changes first with a phased implementation thereafter.

Whatever approach is adopted, it will be important to reflect the wide variety of business models which exist and to acknowledge that one size does not fit all. Those in the financial services industry are already subject to various regulations over risk management which are appropriate for the risks facing those businesses, but we do not believe that these requirements should be extended to all UK companies.

5. An expectation gap may be created if additional ESG/narrative reporting responsibilities are allocated to the Audit Committee

A number of our members have pointed out that the Audit Committee often takes overall responsibility for the annual report, but we believe that there is danger that an expectation gap may be created. We believe that each board is best placed to identify the most appropriate committee to take responsibility for ESG and narrative reporting and we therefore do not agree with the proposed change to the Code that suggests the Audit Committee should be the default answer. Many companies have established sustainability committees with relevant capabilities which have a better understanding of what should be assured and how it should be reported to the shareholders. There is a danger that if responsibility for the integrity of narrative reporting is delegated to audit committees under the Code, an expectation gap may be created as to the level of assurance provided on ESG measures when compared to financial reporting. Over time, this may lead to "assurance-creep" which will have significant cost implications.

6. **Shortage of competent and appropriately regulated providers of external assurance**
   We believe that currently there is a shortage of competent and appropriately regulated providers of external assurance in the UK market and the proposed changes to the Code will only exacerbate this position. As boards and Audit Committees seek additional assurance, particularly over risk management and internal control systems and the statements that boards will be required to make, it is likely that existing providers will struggle to meet demand. New entrants will come forward, and we believe that both existing and new entrants will need to be regulated to ensure that minimum standards are met. In addition, conflicts of interest are likely to occur as financial audit firms offer a wider range of non-financial assurance services. An already restricted choice of financial audit firm may become more acute as a result.

   A further, related issue in relation to the provision of external assurance is both the availability of appropriate standards of assurance and the differing levels of assurance. Whilst the concepts of reasonable and limited assurance are becoming more familiar, for certain non-financial data, e.g. CO_2 measures, the amount of estimation involved creates a significant challenge to delivering effective limited or reasonable assurance.

NEXT STEPS

We believe that the FRC should prepare and publish a detailed cost/benefit analysis of the proposed changes to the Code, indicating the need for the change, the cost of implementation and the benefits that will accrue from the change. Further, proposals should be developed to ensure that annual reports do not get longer as a result of the proposed changes to the Code.

We suggest that more work is required to ensure that proposed changes to the Code are fully aligned with, and complement, other corporate reforms and initiatives.

We are very concerned that some proposed changes, particular those relating to risk management and internal control systems, will impose a significant extra burden on many UK companies and will make a listing in the UK unattractive at a time when we are seeking to improve our global competitiveness.

We are worried that a number of the proposed changes are open to a considerable range of interpretation, which increases the importance of developing extensive guidance and worked examples to assist in implementation.

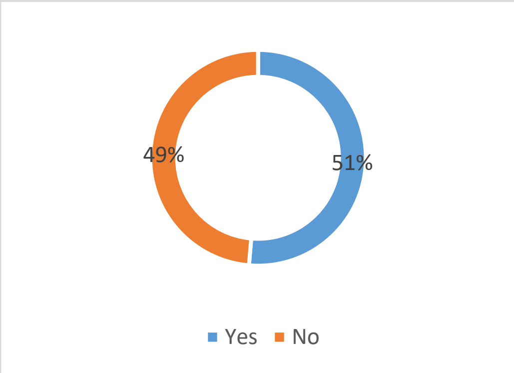
Finally, we believe there is a need to develop an appropriate regulatory framework to be applied to providers of non-financial assurance to ensure quality and comparability.

SECTION 3: Responses to the consultation questions

<u>Questions of direct relevance to the audit committee agenda</u>

Board leadership and company purpose

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



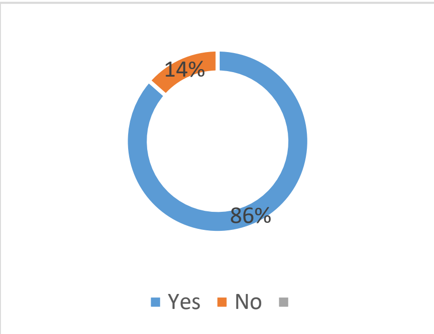
We do not support the amendment to Provision 3.

We asked ACCIF members if they supported the amendment to Provision 3 in relation to there being a responsibility for committee chairs to "engage" with shareholders on their areas of responsibility rather than the current wording which states that they should "seek engagement". Whilst the responses were evenly split, the free text comments from respondents made clear that the real challenge with engagement with shareholders for audit committee chairs, is the lack of appetite from the investment community. Our recommendation is therefore that Provision 3 is not amended in this way and the responsibility remains to "seek engagement" with encouragement in supporting guidance for audit committee chairs to report on the success or otherwise of their attempts to engage.

- *"The change of wording seems to put the onus on the AC Chairs whose "fault" it will then be if no engagement occurs whereas the existing wording is fair in that it requires intent and availability which is within their control."*
- *"With regard to shareholder engagement there is no point in telling us we should engage when no one wants to engage with us."*
- *"Shareholders will not engage on this matter unless mandated to."*
- *"Unclear how will be able to engage unless there is an equivalent obligation on investors to engage with ALL companies they own."*
- *"We have seen no interest from shareholders in engaging on the audit. I can't see how "should engage" is practical."*

Audit and Assurance Policy

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



Yes, we agree that all Code companies should prepare an AAP on a 'comply or explain' basis.

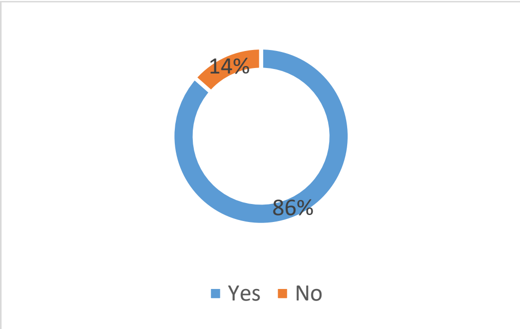
86% of members surveyed supported the Code including a recommendation for all companies, regardless of size, to prepare an AAP. The ACC community has been broadly supportive of the concept of the AAP particularly where it can be implemented in a proportionate manner. We encourage the FRC to make clear in supporting guidance that the 'comply or explain' element is in relation to providing an AAP rather than specifically providing an AAP in accordance with the new reporting regulation. So, companies below the 750:750 threshold will be encouraged to use the regulations as a guide but will be able to adapt them as best fits their circumstances.

Audit Committees and the External Audit: Minimum Standard

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?

Yes, we agree.

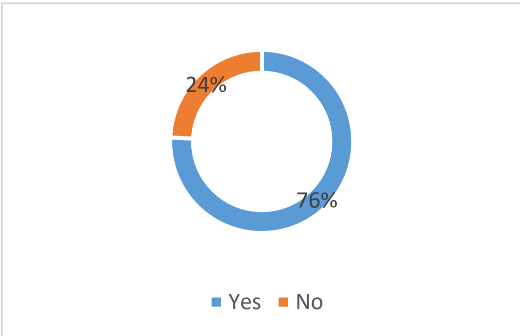
The majority of ACCIF members surveyed were supportive of referencing the new Minimum Standard for Audit Committees in the Code and removing elements of duplication.



Sustainability reporting

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?

We do not agree that the audit committee should be the default for responsibility for narrative reporting.



Just over three quarters of ACCIF members surveyed were supportive of this extension of the audit committee remit, although many of the free text comments noted that the Code should allow more flexibility than the current provision suggests. For example, the proposed Code provision does not use the wording used in this question "where such matters are not reserved for the board" which many of our members felt was important to note.

"I think we have to be very careful in putting everything on to the audit committee. Different companies have different committee structures and members of the board are appropriately allocated to these committees. Putting all ESG reporting responsibilities onto the audit committee for example might mean that we need to change the composition of the committee in order to bring in specific ESG expertise...and as importantly an ESG committee will live with ESG issues all year and so have all the context needed to judge the ESG metrics disclosed....if the audit committee has to deal with this once a year that

context is missing which is a major issue for me. Let boards decide where this matter is best addressed."

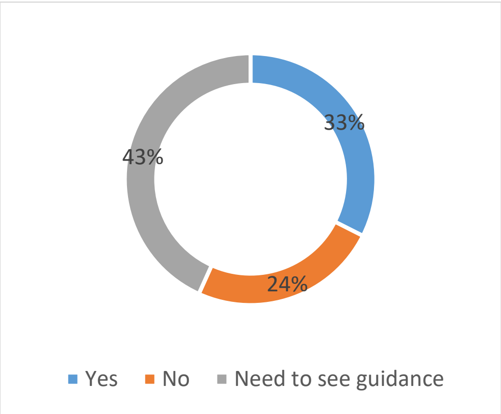
"I worry that by suggesting Audit Committees should have responsibility for narrative reporting and ESG reporting two things will happen. First, boards will delegate this responsibility whereas I believe this to be a board matter. Second, there is a danger of "expectation gap" regarding the reliability of often forward-looking information, compared with historical, mainly financial, information which Audit Committees have traditionally been responsible for."

Risk management and internal control questions

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?

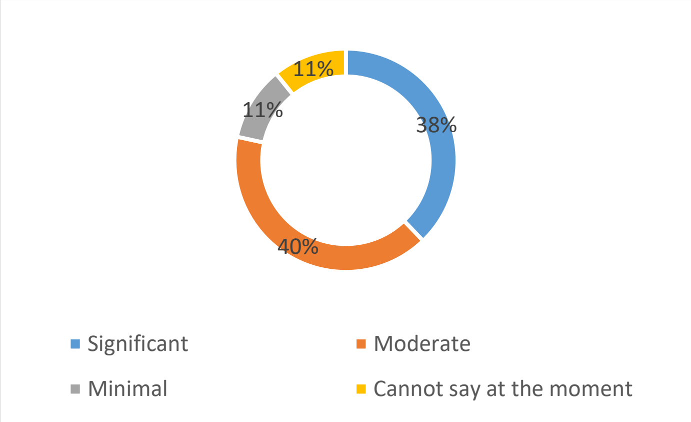
We do not support the proposed amendments in relation to the risk management and internal control systems declaration.

The key message from our member survey here was that whilst many support the concept of the proposed amendments, a key element of how this gets implemented will be the supporting guidance and so it is difficult to conclude without that.

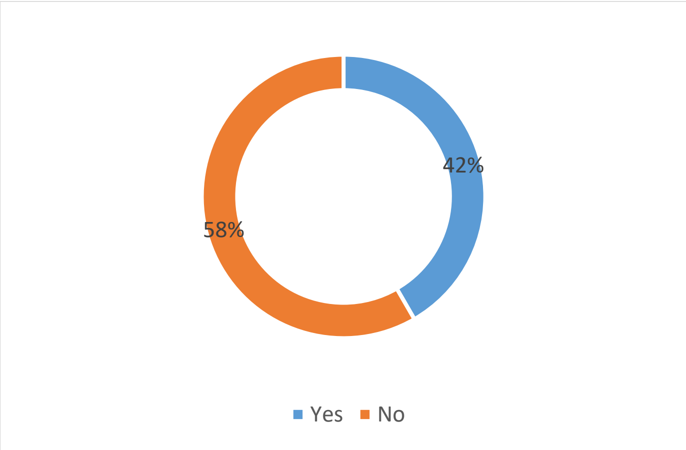


"There is the potential for significant variation in the depth and cost of implementation. It would be helpful to understand the expectations so that a debate can be had on the practicalities."

Members were also asked what their current expectation of the additional costs required to provide the new board declaration was:



We also asked whether members felt this additional cost would represent value for money in the eyes of stakeholders, including investors:



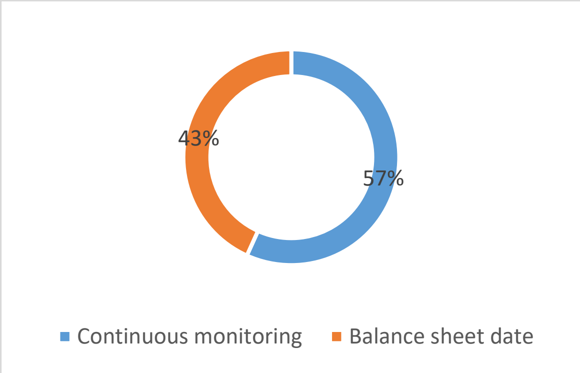
It was made clear that the Government decided not to move forward with a legislative approach to "UK Sox" on the grounds of cost vs benefit, yet we are not confident that the case has been made sufficiently clearly that this approach through Code can be delivered in a proportionate manner which delivers more benefit than cost. Much of the reasoning for this is the lack of clear implementation guidance at present.

> *"It is clear that the FRC do not clearly understand the implications of what has been proposed, and how the requirements will be interpreted by companies and Boards. They have significantly underestimated the associated effort and costs required to implement what is proposed."*
>
> *"I believe we need a clear articulation of why and how this is not Sox. This is where people are struggling most to consider their response. What are we not doing that was in Sox?"*

We hope that the FRC will take the time to consult widely on the supporting guidance and ACCIF would welcome the opportunity to provide feedback as part of that process.

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?

We believe that the board's declaration should be at the balance sheet date.



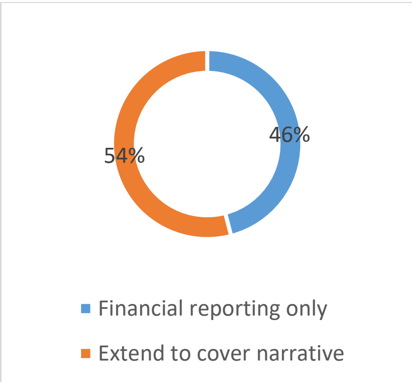
The majority of members surveyed supported the declaration covering the reporting period and recognise that this aligns with their existing responsibilities under the Code. Some did raise concerns around misalignment of such an approach with other jurisdictions:

> *"In terms of continuous monitoring versus balance sheet date, this is something that could evolve over time. It makes sense to start with balance sheet date, not least because this aligns to existing control attestations in other jurisdictions, e.g. US Sarbanes Oxley."*

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?

We believe reporting should be limited to controls over financial reporting.

Members were fairly evenly split in relation to whether "financial" should be changed to "reporting" but the majority did support an extension to cover narrative reporting controls also:



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?

Members raised a number of interesting observations about the guidance including around the need to avoid too much prescription but also considering practical assistance on implementation:

> *"The methodology adopted should be specifically aligned to the business in question, not based on a template example."*
>
> *"I think there should be a combination of guidance and examples i.e. how would the guidance be implemented?"*

"Think that some specific examples would also be useful in the guidance."

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?***

There was broad consensus amongst members that guidance was required around how to ensure that there is sufficient and appropriate focus on what is material to the running of a business. Getting such considerations will be key to the ability to apply these changes proportionately. This applies both to determining the scope of material controls to be covered by the new board declaration but also in relation to the reporting of material weaknesses.

"The methodology should be driven by a clear understanding of materiality, a risk assessment and high-level key controls. Materiality should not be a technical assessment on a variation of a profit number but a sensible assessment as to whether a reader of the financial statements would have a materially different view of the company."

"The definitional framework should be based on the Board's risk and control self-assessment, and Risk Appetite Statement. Suggest a material weakness is one that tests the risk tolerance/boundary in a specific area."

"We need to be clear that an effective system is one that from time to time highlights control weaknesses and risks. And then enables the right detective activities and monitoring to be in place to limit the impact of these issues. It does not require evidence preventative controls in all instances (as per a Sox environment)."

"The Board should determine what is material for its business."

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

In addition to the comments above, we felt the following member comments were worth sharing:

"The guidance needs to be written not just for the benefit of the preparers but also to set clear expectations of the users of the statements. There is a clear mismatch risk, especially if what I believe to be the FRC's desire to focus only on critical risks plays out as this means that actual control failings that became public would be perfectly plausible without undermining the statement made."

"The implementation of this requires a lot of thought so that we don't end up with an unwieldy and costly exercise. Expectations need to be set and the various stakeholders for whom this is important need to be aligned so that misunderstandings are avoided. There could be some pilots especially with/without assurance to gain confidence that we don't create a monster but that we end up with a sensible robust activity that underpins the principles of the Code."

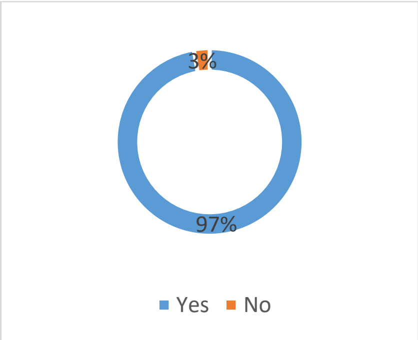
"This will require increased reporting to the audit committee and the executives will also need to be brought along with the additional governance requirements. It will also be important to understand from the guidance what the expectations are of the audit committee as there is a danger that in order to execute its responsibilities the audit committee feels it's becoming too executive."

Going concern

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, we agree that Provision 30 should be retained.

Only a very small minority of members surveyed did not support retention of the going concern disclosure requirements.



Resilience Statement

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

Yes, we agree that all Code companies should continue to report on their future prospects.

Members surveyed agreed unanimously that all Code companies should continue to report on their future prospects.

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?

Yes, we agree that the proposed revisions to the Code provide sufficient flexibility for companies below the 750:750 threshold to report on their future prospects.

The current drafting does appear to allow a choice for Code companies below the 750:750 threshold in either choosing to provide a Resilience Statement in line with the new Companies Act regulations or reporting on going concern and future prospects in line with the updated Code provisions. We believe this flexibility is appropriate and that there should not be a specific 'comply or explain' requirement on companies in relation to the Resilience Statement as there is for the AAP.

Other questions ACCIF members wished to comment on

Board leadership and company purpose

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

Yes, we agree.

Members were supportive of a focus on outcomes-based reporting. Many observed that annual reports continue to get larger and larger and that a focus on outcomes should be facilitated by allowing more process and policy disclosures to be included on a website.

> *"Focus on outcomes yes and then drop the process reporting otherwise we balloon the annual report yet again."*
>
> *"Remuneration policy disclosures should not be in the annual report. They should be on the website and referred to. The same applies to all policies outside the financial statements. The annual report should deal with performance not policy."*

Division of responsibilities

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?

We do not support the proposed change to Code Provision 15.

We have some reservations about the call for greater transparency on directors' commitments to other organisations as likely to result in yet more boilerplate disclosure which does not help highlight actual issues. Our recommendation would be to leave for boards to decide whether or not there is a potential for an over boarding issue to arise and to address it directly on a case by case basis, rather than asking for disclosure across the board where issues may not exist at all.

> *"Do not support the call for additional description being added to the Annual Report on each individual directors' time commitments to undertake the role effectively. We consider this will result in considerable standard disclosures being added to the reporting with limited value for investors. Rather, we would expect the company to make a judgement on whether their investor base would consider a director to be perceived as over-boarded and to make the necessary disclosures in the annual report as to how this was assessed by the board."*
>
> *"Re over boarding, would it not be better to focus on where there is an issue (how extensive is this in fact?) rather than everyone put in more reporting where there is no question to answer?"*

Artificial intelligence

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?

We do not believe that it is the appropriate time to amend the Code in relation to artificial intelligence. Artificial intelligence is a fast-moving area of regulation and it is right that the Government is considering various disclosure options in its White Paper. Existing requirements around assessment and disclosure of principal and emerging risks should provide sufficient opportunity for boards to consider and explain their approach to this developing area.

Questions ACCIF not responding on

Board leadership and company purpose

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?***

Division of responsibilities

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?***

Diversity and inclusion

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

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?***

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

Board performance reviews

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?***

Remuneration

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

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

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

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