Mr D Styles
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Dear Mr Styles

In May, the FRC released a consultation on proposed changes to the UK Corporate Governance Code (the "**Proposals**"). The consultation included 26 questions, with a deadline to respond by 13 September 2023. This response sets out the views of the Board of Directors of Spirax-Sarco Engineering plc on a number of these questions and we thank you for the opportunity to comment. We are available for any follow up discussion, should that be helpful to you.

Company background

Spirax-Sarco Engineering plc is a leading global thermal energy management and fluid technology solutions Group that aims to deliver sustainable value to all its stakeholders through engineering a more efficient, safer and sustainable world. It comprises three world-leading Businesses: Steam Specialties, for the control and management of steam; Electric Thermal Solutions, for advanced electrical process heating and temperature management solutions; and Watson-Marlow, for peristaltic pumping and associated fluid path technologies.

The Group is headquartered in Cheltenham, UK and has strategically located manufacturing plants around the world, employing more than 10,000 people (c.2,700 based in the UK), including more than 2,100 direct sales and service engineers. The Company's shares have been listed on the London Stock Exchange since 1959 (symbol: SPX) and it is a constituent of the FTSE 100 and the FTSE4Good Indexes.

Company approach to the response

We understand the drivers behind the Proposals to enhance UK Corporate Governance requirements and acknowledge their potential benefits, particularly regarding improving corporate governance and internal controls, thereby increasing reliability over reporting and investor confidence.

The intention of our response is to highlight the complexities inherent in the implementation of the Proposals, the current lack of clarity around specific key aspects of the Proposals and the potential consequences on implementation. We have sought the views of a range of leaders across our business who would be responsible for the implementation of the Proposals.

We have structured our response around a number of key thematic areas where we seek to highlight the current opportunities and challenges we perceive with the Proposals.

Scope of proposed controls attestation

Under the Proposals, Groups such as ours would be required to make a formal attestation on the effectiveness of reporting (both financial and non-financial), compliance and operational internal controls. The latest Proposals have therefore extended the scope of the attestation from 'financial reporting' to 'reporting' (e.g. all Annual Report content has now moved into scope).

In response to (i) the breadth of the Proposals, (ii) the current lack of detailed implementation guidance (discussed in more detail later in the response), (iii) the material cost and resourcing implications for organisations and (iv) the current proposed implementation date being 1 January 2025 despite the requirements and parameters still being consulted on, we would propose a staged implementation approach is taken. This will provide businesses with the time to plan and implement the required internal control attestation structures in a sustainable manner to meet the aims of the Proposals. This would also provide the added benefits of enabling further implementation guidance to be written and issued, alongside best practice in the market to be developed ensuring businesses report only on material risks that are important to them and their stakeholders.

The recommendation would be as follows:

- The internal controls attestation should begin with including <u>only</u> financial reporting controls in the initial years of the Proposals. We believe this is the most appropriate first step for organisations to take, given:

    - We are only c.12 months from the Proposals implementation date for control effectiveness and it is unreasonable to expect organisations to scope and implement such broad (i.e. across all areas outlined in the Proposals) internal controls requirements in such a short period of time with limited current guidance.

    - Many organisations, such as our own, have focussed their current resource and efforts on preparing for the Proposals in the area of financial reporting, as (i) it is most familiar to the teams who are often leading the response, (ii) it is the area most critical to many of our stakeholders and (iii) there is an ability to read across from implementation structures and principles from US Sarbanes Oxley compliant organisations who have taken a similar path previously.

    - Starting with financial reporting controls in the first years of the Proposals will provide a more manageable approach for organisations whilst also providing a solid base and set of frameworks from which further control areas can be increasingly formalised over time.

- Following the implementation of the financial reporting controls, we would envisage the "non-financial reporting" and "compliance" controls could then be implemented. However, the scope of their inclusion should be subject to their materiality and importance to our stakeholders. The Proposals for these controls should not unnecessarily burden our businesses to implement, track and test internal controls that are not materially significant to our stakeholders (see "Implementation guidance" section below). There could be an unintended consequence whereby preparers of accounts reduce the disclosures in the front half of the annual report (impacting stakeholders) if all reporting areas need to be underpinned by an overly complex internal control reporting framework.

- We do not endorse including operational controls within the scope of the internal controls attestation requirements. The identification and reporting of Principal Risks is already well established and for listed organisations such as ours, extensive reporting is already publicly available in the Strategic Report in our Annual Report in a consistent framework and format. The existing Principal Risk reporting already highlights (at a materiality and scale that is sufficient for the key stakeholders of our business) the key operational risks we are managing and the internal controls in place to manage these risks and how these are operating. We do not see the benefit of mandating more rigid internal controls requirements in the operational environment of our business, versus the already well-established market practice in place to manage these risks. Using the consultation's definition of a "material weakness", being one that prevents a company meeting its operational objectives, we would consider the current approach to Principal Risks and their associated internal controls to be an appropriate mechanism to monitor this.

Implementation guidance

Given that significant time has elapsed since the broad Proposals were first considered and issued for original consultation to the market in May 2021 we would have expected much more extensive guidance to have been issued to date to help businesses understand the requirements in a greater level of practical detail. There is currently very little detailed guidance provided to underpin the requirements contained within the Proposals, the nature of some of the language shows consistency with a Sarbanes Oxley style framework but without any of the clarity or an associated implementation framework.

We believe the provision of more detailed implementation guidance to be essential if there is to be a consistent approach to implementation taken across the market which is required to permit comparability across organisations for all stakeholders. Below are some of the areas highlighted where we would expect to see much more definitive guidance to support implementation:

- A definition of what areas of internal controls focus could be expected to be implemented under the very broad "operational" and "compliance" headings (subject to our proposed exclusion of operating controls above). Under the Corporate Governance Code each impacted organisation could have a different interpretation of what is expected under each heading making comparability across peer group organisations very difficult.

- The proposals request disclosure that material internal controls have been effective throughout the year (see "declaration date" below). However, there is no guidance issued on the definition of materiality. Whilst materiality in the context of financial reporting is a widely used concept, the interpretation of materiality in a non-financial context is much more complex and would benefit from further guidance. The breadth of the non-financial reporting internal controls could cover include topics as varied as health and safety, organisational diversity statistics and greenhouse gas emissions. All these areas have different risk profiles and importance to different stakeholder groups. Currently, all of this appears to be left to the Company discretion – whilst we could adopt an approach that we consider reasonable, we feel that the risk that this is not in line with the expectations of the Proposals or other peers is considerable without guidance. Furthermore, different organisations will likely interpret and apply different levels of materiality depending on their risk appetite – thereby reducing the ability to compare and benchmark. Without this guidance, there is unlikely to be consistency in the approach to internal controls reporting taken in the market.

- From a practical implementation perspective each organisation will be required to make a number of key decisions when developing a structured plan as to how they will design their internal control frameworks and supporting processes. These include factors such as (i) the level of coverage of the financial reporting they will target achieving, (ii) the frequency and scope of testing of internal controls and (iii) the assurance strategy, including determining the associated assurance providers, they intend to implement over the control frameworks. Without detailed implementation guidance each organisation will move ahead with a considered approach based on their own interpretation of what is required and appropriate (which will drive additional disclosures to explain the approach taken), however, these interpretations will differ materially across the market resulting in a lack of comparability and potential meaningful changes being required over time by organisations, as market practice looks to align, which will drive further cost and resource requirements.

- Finally, an example of the expected disclosures required as part of the Annual Report would be beneficial to illustrate to businesses the depth and detail of the expectations. The content within Annual Reports has grown significantly over the last decade, primarily as a result of increased regulatory requirements and associated disclosures. Providing detailed guidance as to the expected disclosures will help establish market practice and ensure that external disclosures are aligned with the proposed requirements of the Regulator and that organisations do not include additional information that is not required by the FRC in this case.

Without this clarity, there remain a series of unknowns that could have a significantly differing impact on the scale (breadth and depth) of the changes required and how the internal controls environment should be monitored and assessed. It will be important to ensure that there is sufficient guidance for businesses to drive consistent interpretation and to ensure that Directors understand what standard they are being held accountable against. This guidance should be issued in a timely manner, with businesses given sufficient scope to review, challenge and then embed well ahead of the required implementation dates.

Timing of proposed changes

Given the scale, complexity and global nature of businesses that will be required to comply with the Proposals, a significant amount of work will be required to design and embed the necessary processes and governance. Therefore, it is vital that organisations have sufficient time to implement, test, and embed all changes before the first attestation is required. There will be practical limitations on the ability, capacity and pace that companies (including ourselves), Audit Committees, auditors and third-party organisations are able to support the implementation all of the proposed changes. Sufficient time will be needed to ensure internal teams are appropriately trained and that organisations have the right capability and capacity to deliver against the requirements. This is magnified by the proposed scope and breadth of the expected attestation alongside the current lack of existing detailed implementation guidelines and established market practice.

As such, and following on from our recommendation for a staggered implementation timetable above, we believe a realistic timetable for the implementation of the financial reporting controls (only) would be from periods beginning on or after 1 January 2026. The current proposed timetable is too aggressive, falling only c.12 months from the closure of the consultation and without significant implementation guidance to help businesses understand the expectations in meaningful detail.

As a natural progression we would propose a phased implementation of the non-financial reporting and compliance controls commencing in period starting (no earlier) than 1 January 2027 onwards.

Board & Audit Committee impact

Consideration should be given to the extent that the Proposals place additional responsibility on the Non-Executive Directors and Audit Committee, especially when considered alongside the proposed Audit & Assurance Policy statutory requirements. We consider that the Board should maintain the overall Governance responsibility for such matters. It should be for the Board to determine how it structures its Governance model and to remain responsible for the internal control environment. Furthermore, in our experience investor interest in internal controls is relatively low (if not driven by a specific control failure) and there are already established channels of interaction between external investors and both management and the Board to discuss any areas of interest or concern.

There appears to be an underlying assumption that Non-Executive Directors will immediately have the scope, skills and experience to meet all of these new regulatory requirements in a short timeframe. A number of the requirements will introduce new areas of focus requiring detailed technical expertise (e.g. the complex frameworks that underpin sustainability and ESG reporting). Continually increasing the expectations of a Non-Executive Director role is likely to lead to "UK PLC" becoming a less attractive place to do business and could make individuals hesitant in seeking such roles in the future.

Furthermore, there is a risk under the Proposals, given the lack of implementation guidance and established market practice, that Non-Executive Directors could be pushed into seeking "over-assurance". Such an outcome would undermine the purpose of the proposals and likely adversely impact the performance of businesses.

Assurance

To date no prescriptive guidance or requirements have been provided around the levels and scope of expected assurance to be obtained to support the internal controls attestation. Similarly, there is a lack of clarity with regards to the assurance standards to be followed across the various internal control requirements. With no clarity we will not achieve a consistent approach to assurance within the market. Furthermore, there is a risk that, without intention, market forces drive organisations towards "over-assurance" and obtaining external assurance over the Directors' statement, without further guidance from the FRC.

As with the provision of the external audit, there will naturally be a limited availability and choice of third-party assurance providers, this factor will also contribute towards these organisations looking to influence and determine what becomes the "market standard," rather than leaving that responsibility with the Board. The lack of choice will also likely further delay the implementation timetable further.

Declaration date of the internal controls attestation

We advocate that the Directors statement should be based on control effectiveness as at the balance sheet (not the Annual Report date).

For reporting controls (specific compliance controls will differ) that impact information included in the Annual Report, only material weaknesses not resolved or mitigated at the balance sheet date should warrant disclosure. Any material weaknesses identified and resolved during the year, by definition, could not impact the reporting and therefore do not warrant disclosure.

Following on from our feedback requesting more detailed implementation guidance on the internal controls testing requirements, the Proposals refer to "continuous monitoring" throughout the period to support the Directors make their declarations. We suggest that these be referred to as "regular monitoring" – giving businesses the flexibility and scope to design internal controls testing programmes that are appropriate to the size and complexity of the risks being managed. It is not feasible to test all material controls at a single balance sheet date.

Conclusion

We are broadly supportive of the intentions underlying the Proposals, including maintaining the reputation of the UK's capital markets, founded upon high quality and trusted corporate governance. The specific points which we have raised above, highlight the challenges and impacts businesses, such as ours, will face in implementing the Proposals and we hope that the consultation outcome will take these into account.

We believe that it is unrealistic to implement the internal controls Proposals in the timeline proposed and, in the case of operational controls, not beneficial to our business, or our stakeholders, to move away from the current approach. The lack of detailed implementation guidance issued to date does not support the requirements being implemented in a consistent manner by companies or facilitate the establishment of a "market standard" approach which would provide comparability across organisations. A more realistic timetable should be strongly considered which would also give time for more detailed implementation guidance to be published.

The appended table sets out our more detailed responses to the specific questions raised within the consultation paper where we felt a response was required. Please do contact us should you wish to discuss any of our comments in further detail.

Yours sincerely

On behalf of the Board of Directors of Spirax-Sarco Engineering plc

[redacted]

[redacted]

Appendix: Detailed answers to specific questions

Consultation Question	Our Response
Governance	
Q1. Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?	We support the change to focus more on the outcomes of the governance activity of the Board, rather than policies and procedure.
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?	We already report on the governance and strategy of climate related risks and opportunities in the Annual Report, under TCFD reporting requirements. It is positive for the FRC to strengthen its strategy and governance requirements for climate ambitions and transition planning. However, any revisions must be considered in light of the extensive reporting requirements and changes companies are already facing. The regulations and reporting standards in this area are complex and evolving, making it complex and burdensome for companies to manage - particularly across large multi-national organisations - within a tight yearend reporting timeframe. The value of additional disclosures must be weighed against the time and resource needed by companies to prepare them, which could - arguably - be more effectively spent driving progress against net zero targets.
Q3. Do you have any comments on the other changes proposed to Section 1?	We support these changes and are already including many in our Annual Report.
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?	We support the inclusion of other non-listed commitments as part of the board performance reviews.
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 agree that this would be beneficial to both parties, greater clarification around what is deemed 'significant' would be helpful.

Consultation Question	Our Response
Q6. Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?	We do not consider there to be any duplication, just more detailed explanations of why the outside commitments do not impact performance.
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?	We welcome the wider recognition of all protected characteristics under the Equality Act in the updated text. There is, however, a risk that removing specific reference to gender and ethnicity might be viewed as these no longer needing specific focus. To prevent this, and to clarify the text further, Principle I could potentially be amended to state: "They should ensure equal opportunity for candidates from a diverse range of backgrounds, and inclusion of those with protected characteristics (including, but not limited to, gender and ethnicity) and non-protected characteristics (such as cognitive and personal strengths)."
Q8. Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?	We support the changes to promote greater transparency and depth in reporting on succession planning and senior appointments. We would add that reporting against this provision would need to be high level given the commercial confidentiality of succession planning at this level.
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?	As above guidance around what is considered 'significant' in terms of external commitments would be beneficial (e.g. time required, organisational size, etc).
Internal Controls and Reporting	
Q10. Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?	This is not applicable to our Group as we are a Public Interest Entity (PIE) and will be implementing an AAP on a statutory basis.

Consultation Question	Our Response
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?	We agree consolidating the requirements to reference a single source is sensible.
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 proposals place a burden and emphasis on the Audit Committee. The Board should be free to determine how it wishes to design its governance structures. There is also an underlying assumption that the Audit Committee are already equipped with the skills and experience to satisfy the proposed new requirements with a very short implementation timeline. We would also highlight the timeline challenges involved given the complexity and volume of sustainability disclosures, legislation and number of frameworks involved, which are continuously evolving. This area will be a challenge until the landscape and market practice becomes better established.
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 recognise the importance of internal controls and risk management. The open-endedness and breadth of the current draft requirements (including focus on operational, compliance and reporting controls) creates a complex implementation challenge involving almost all aspects of our business. Given the 'comply or explain' basis it is difficult to understand what market practice will be initially across all companies. We would propose breaking down the internal controls reporting requirements into Financial Reporting first before moving on to non-financial reporting and compliance on a targeted basis. We propose not to include operational controls. We propose extending the implementation date on financial controls to 1 January 2026, given the fact the proximity of consultation closure to actual implementation.
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 propose that the declaration should be based on the reasonable expectation of control effectiveness at a balance sheet date based upon an ongoing testing and monitoring programme taking place throughout the financial year. We do not support testing all material controls as at single balance sheet date.

Consultation Question	Our Response
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?	The description has been changed in the latest guidance from 'financial reporting' to 'reporting.' Extending the scope to a wider 'reporting' approach is very onerous due to the much wider breadth of disclosure and provides much less clarity around the requirements. There is a potential risk of reduced useability of these disclosures to the users of the report, if the required breadth of control requirements negatively impacts the depth to which preparers are willing to disclose. This should be introduced in a staggered manner with financial reporting only as a first step.
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?	The guidance should set out clear examples that are practically implementable with a sensible resource allocation investment assumed - to guide companies on their implementation programme. Examples of this should include - coverage and materiality concepts (for both financial and non-financial risks, e.g., Health and Safety), how to approach a financial reporting framework, where to begin scoping non-financial reporting and compliance risks and controls in an organisation.
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?	Some more granular guidance and examples of what is considered to be a 'material weakness' would be useful. The Code appears to be using PCAOB language in this area, but not against a consistent and clear controls framework in place - which could lead to reduced consistency between organisations. We need to establish a UK market standard approach and accepted set of materiality definitions across all in scope controls.
Q18. Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?	The extended Code is more than sufficiently challenging given the extended breadth of controls and the implementation timelines proposed.

Consultation Question	Our Response
Going Concern and Remuneration	
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)?	As a PIE we agree that we should continue to adopt a going concern basis of accounting.
Q20. Do you agree that all Code companies should continue to report on their future prospects?	As a PIE we agree that we should continue to report on our future prospects in a similar way to that which we do now under the going concern, resilience statement and viability statement.
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?	Not applicable to our company as we are a PIE.
Q22. Do the proposed revisions strengthen the links between remuneration policy and corporate performance?	We believe companies should clearly align their reward frameworks with the company strategy and performance drivers. We would suggest the guidance is not so prescriptive in how this is done. For example, we would suggest environmental, social and governance objectives be considered when setting performance measures, rather than prescriptively being included, as the current draft wording suggests.
Q23. Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?	We believe the proposals will lead to greater transparency should malus/clawback provisions be invoked, but is likely to increase standard "boiler plate" wording on minimum periods/causes (e.g. "maximum value" column in Reward Policy tables).
Q24. Do you agree with the proposed changes to Provisions 40 and 41?	We support the inclusion of additional guidance within provision 40 and 41 in order to provide greater clarity on the intended disclosures.

Consultation Question	Our Response
Q25. Should the reference to pay gaps and pay ratios be removed, or strengthened?	Pay ratios and pay gaps add useful focus on driving equality and fairness but we believe the reference in the current Code to be appropriate. We would caution against strengthening the focus on these gaps and ratios as the nature of the standard methodology given the very diverse workforces, industries and results across companies can lead to unhelpful and inaccurate interpretation of outcomes, increasing the risk of unhelpful "boiler plate" wording, rather than clear and transparent dialogue with stakeholders.
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?	No other changes proposed to the Code.