25 July 2023

Mr David Styles
Director, Corporate Governance and Stewardship
Financial Reporting Council

BY E-MAIL

Dear David,

FRC Consultation on the UK Corporate Governance Code

Thank you for the opportunity to respond to the above consultation. By way of background, Ceradas is a niche governance and board advisory business. We support our clients and their stakeholders in three ways – by advising boards so they become more effective in their governance; performing independent board effectiveness reviews; and by working with growth companies to put sound governance and business structures in place that support their continued development.

We set out below our responses to the questions raised in the Financial Reporting Council's (***FRC***) consultation on the UK Corporate Governance Code (the ***Code***) which was published in May 2023 (the ***Consultation***).

Question	Ceradas Response
Section 1 – Board leadership and company purpose	
Question 1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?	The requirement that companies focus on outcomes to demonstrate the impact of governance practices should, in theory at least, lead to a shift away from merely describing the inputs and processes of the governance framework to a fuller assessment of the effects of that framework. We can see this resulting in significant changes to reports in the first year of reporting under an amended Code, where boards are forced to think about why processes are in place. However, we question whether this will continue over subsequent years where there may be a temptation to simply repeat the narrative of previous reports. We would argue that it is only changes in the framework which might truly "impact" the running of a company. Once satisfactory governance practices are in place the impact from year to year would be difficult to assess. We also feel that good governance only provides the framework for good decision-making, it is an enabler i.e. it is not the driver of good-decisions and therefore its role should be seen in that context.
Question 2: 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 surrounding governance?	Given that companies are in a position to play a huge and meaningful role in addressing climate change, and the growing importance of environmental issues to all major stakeholders, it would seem logical for the annual report to demonstrate how these matters have been taken into account in the delivery of strategy. However, we feel it is important that companies do not feel that climate ambitions are regarded as an adjunct to environmental reporting but rather as an integral part of risk management and sustainability planning.

Question	**Ceradas Response**
	As such it is more important that these are included in the Strategic Report than Governance Section (as is already the case as a result of TCFD and non-financial reporting requirements). There is a danger of duplicated reporting if this is brought into the Governance Report as well.
Question 3: Do you have any comments on the other changes proposed in Section 1?	We have no further comments on this section.
Section 2 – Division of Responsibilities	
Question 4: Do you agree with the proposed change to Code Principle K (in section three of the code), which makes the issue of significant external commitments an explicit part of board performance reviews?	Overboarding can lead to concerns about limited availability, divided attention, conflicts of interest and, potentially, compromised decision making and we therefore feel that boards should explain how they have satisfied themselves that directors have the time to commit to the board given their other commitments and report to shareholders accordingly. Given that most board reviews are interview or questionnaire based, meaning that the reviewer is dependent on what they are told by the director concerned, it is difficult to know how this particular issue can be explored meaningfully in a board review context.
Question 5: 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 feel that a requirement for companies to describe how each director has sufficient time to undertake their role effectively in the light of other commitments may be problematic. We feel that whilst the chair and fellow directors have a duty to stakeholders to satisfy themselves that they and their colleagues are spending sufficient time, and contributing adequately, to board meetings and company events, any published description is likely to be fairly circumspect and, therefore, of limited value. The individual time management strategies employed by individual directors are likely to be complex and unnuanced descriptions could be open to misinterpretation or lead to incorrect conclusions on capacity. There is an additional issue in that availability is most critical when a board is dealing with a crisis or urgent situation. Thus, whilst most directors can plan their scheduled meetings reasonably well across multiple boards, such planning is challenged when several board meetings need to be held in quick succession at short notice. That said, talented NEDs who have a good relationship with each of their boards are usually able to make themselves available for such meetings at short notice. Documenting this flexibility in an annual report may be convoluted and would not be particularly helpful.
Section 3 – Composition, succession and evaluation	
Diversity and inclusion	
Question 6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?	We do not feel that the proposals introduce duplication.

Question	Ceradas Response
Question 7: 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 agree with the move away from restricted list of diversity characteristics and feel that the language proposed will free companies to further increase diversity within boards.
Question 8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?	The changes proposed in Provision 24 would certainly lead to a more transparent approach to reporting on succession planning and senior appointments, however, account should also be taken of how potentially commercially sensitive such planning may be. Again this may lead to fairly circumspect descriptions, the value of which may be limited. We feel that assurances that such procedures are in place should be sufficient.
Board performance reviews	
Question 9: 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?	We welcome the changes to the section of the Code dealing with board performance reviews and agree that the market is now mature enough to sustain a requirement that board chairs, commission, rather than consider, a board review. We question whether the change of terminology from "board evaluation" to "board performance review" will have the desired effect of changing the perception that the review is intended as a "backwards-looking" assurance function. We wonder if the language used can be even more specific eg "a regular externally facilitated board performance review looking at both past performance and present and future effectiveness".
Section 4 – Audit, risk and internal control	
Audit and Assurance Policy	
Question 10: Do you agree that all Code companies should prepare an Audit and Assurance policy, on a 'comply or explain' basis?	We agree that introducing the 'comply or explain' requirement into the Audit and Assurance section will result in more consistency across Code companies. It also allows different companies to be flexible in their approach. The danger however is that comply or explain becomes comply or else in the minds of both auditors and investors.
Audit Committees and the External Audit: Minimum Standard	
Question 11: 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 that the referral will serve to remove duplication.
Sustainability Reporting	
Question 12: Do you agree that the remit of audit committee 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 agree that the audit committee's experience in setting policies and frameworks could be adapted to ESG metrics and that the market providing external assurance on sustainability is relatively immature, however, we would be cautious about expanding the audit committee's remit to include these areas. Firstly, we wonder if an expanded brief, leading to an increased workload for the committee, might result in a dilution of focus on other areas under the committee's remit. Audit Committees have a large enough brief as it is, giving them a brief over ESG metrics will make it highly unwieldy.

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	Secondly, we wonder if the Committee itself, due to a lack of expertise, might look for external assurance before reporting back to the board. This would defeat the object of including sustainability and ESG reporting in its terms of reference and could lead to a board relying on an audit committee which is in turn relying on a third party for assurance. Finally, there is a danger that companies will interpret this requirement to mean that they should not have an ESG or Sustainability Committee which would be unhelpful given the scope that such committees offer to allow boards to maintain a separate focus on non-financial aspects of ESG, sustainability and climate-change.
Risk Management and Internal Controls	
Question 13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal control systems in a proportionate way?	We feel that the proposed amendments to the Code may well increase transparency in the reporting of risk management and internal control systems and that the proposed requirements are proportionate and not over burdensome. The requirement to report will not, however, directly lead to a strengthening of the systems employed. Companies with robust systems will demonstrate that through their narrative reporting. Companies perceived to have weaker systems may find themselves open to stakeholder pressure to improve.
Question 14: 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 would expect the board's declaration to be based on continuous monitoring rather than a snapshot at the balance sheet date.
Question 15: 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 finance reporting?	We suggest that the Code is more specific in its aim to capture controls on narrative as well as financial reporting and feel that a reference 'financial' should be left within (new) Provision 20 and a reference to 'reporting' should be added.
Question 16: 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?	We feel that examples in the guidance would be most helpful although we recognise that this may lead to these examples being used as templates or regarded as the "desired" format for reporting. This is not necessarily a bad thing, particularly for stakeholders looking for consistency, however companies should be encouraged adapt and customise the examples provided.
Question 17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal control system or material weaknesses?	We feel that, to avoid duplication and over complication, any definition of an effective risk management and internal control systems should reference international standards already in existence e.g. ISO 31000. We agree with the suggested definition of a material weakness.
Question 18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?	No, we feel the proposed amendments and additions are adequate.

Question	**Ceradas Response**
Going concern	
Question 19: Do you agree that the current Provision of 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)?	We agree that this would help to achieve consistency.
Resilience Statement	
Question 20: Do you agree that all Code companies should continue to report on their future prospects?	We agree.
Question 21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?	We agree that, despite the duplication caused by the Resilience Statement requirement, leaving Provision 32 (previously provision 31) in place is necessary to ensure non-PIE Code companies report on the future prospects which is an area of great interest to investors and other stakeholders.
Section 5 – Remuneration	
Changes to strengthen links to overall corporate performance	
Question 22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?	The requirements of new Principle P explicitly sets out the requirement to link the remuneration policy with corporate performance.
Malus and clawback	
Question 23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?	Whilst many companies do report comprehensively on their malus and clawback arrangements, we agree that the proposed reporting changes will serve to improve consistency across Code companies.
Changes to improve the quality of reporting	
Question 24: Do you agree with the proposed changes to Provisions 40 and 41?	Whilst we appreciate that the deletion of the text in the existing provision 40 is intended to avoid companies simply quoting the Code when describing remuneration policies and practices, we do believe that the provision encapsulates good practice and should be included in any guidance issued. We agree with the amended wording in new Provision 43.
Question 25: Should the reference to pay gaps and pay ratios be removed, or strengthened?	We feel deletion of references to pay gaps and pay ratios would be a backwards step. There has not yet been sufficient improvement in this area to justify the omissions.
Other matters for consideration	
Question 26: 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 feel it is necessary for the Code to opine on companies' use of artificial intelligence. We believe that reporting on its use will grow organically through companies' existing reporting channels e.g. within strategy statements and/or risk reporting. We would argue that it should be reported on as a principal risk along with the other areas of risk in the same way that other significant generic risks such as climate and cyber have been reported until now.

We hope these observations and suggestions are helpful. Please contact us if you would like to discuss any of the points made in this submission in more detail.

Yours sincerely

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Ceradas Ltd