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By e-mail to codereview@frc.org.uk

Response to the FRC's consultation on changes to the UK corporate governance code

Croda is a FTSE100 chemical ingredient company, the longest surviving listed entity in the UK chemical sector, having listed in 1964. We have responded to the previous BEIS consultations, "Restoring Trust in Audit and Corporate Governance" and are pleased to set out below Croda's views on the FRC's consultation on changes to the UK corporate governance code.

Given the wide scope of the consultation, we have structured our response to give overall comments on the proposals, with responses to the specific questions within the consultation included in the Appendix.

Overview
Croda actively endorses endeavours to enhance corporate reporting standards in the UK, particularly the FRC's emphasis on elevating audit quality, and we welcome initiatives surrounding the Resilience Statement and the Audit and Assurance Policy. Furthermore, we recognise the need for standardization of reporting on the board's supervision of risk management and internal control systems, as this will promote transparent and well-informed decision-making for all stakeholders involved.

We hold our reporting responsibilities in high regard, and as such, any increase of reporting obligations should be clarified in terms of the benefits anticipated from the proposed alterations. Additional resources will be needed to implement and consistently adhere to these changes on an annual basis. Therefore, we believe that a thorough cost-benefit analysis of the modifications is imperative. Stakeholders must be assured that the necessary investment, especially during a period of significant pressure from macroeconomic factors, will yield a net positive outcome.

As outlined in our detailed response, we are not in favour of the suggested alterations to the reporting of risk management and internal control system effectiveness. We believe that encompassing all internal controls in the declaration, along with assessing their effectiveness throughout the year, would place a substantial new strain on company resources, setting a considerably higher regulatory standard in the UK compared to other major international markets.

Lastly, we are confident that this review of the Code offers the chance to enhance the usefulness of annual reports. This could be achieved by eliminating reference data such as standing data, policies, and process information, and instead, directing the annual report's focus towards performance data, encompassing both financial and non-financial aspects pertinent to the reporting period.

Areas of concern
Below we outline various concerns and recommendations regarding proposed changes to the UK Corporate Governance Code.

- **Alignment with other Corporate Initiatives**
  Any alterations to the Code should harmonize with other ongoing corporate reform initiatives, including new reporting regulations, proposed simplification of the listings regime, review of

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non-financial reporting, and ISSB standards implementation. Notably, there are discrepancies between the Audit and Assurance Policy regulation, which pertains to internal controls over financial reporting, and the proposed Code declaration, which encompasses all controls. The current proposals lack a clear rationale and fail to outline how they integrate with other reform efforts.

- **Cost-benefit**
  Given the anticipated additional time and financial investments required, there is scepticism regarding whether the proposed changes to the Code would bring demonstrable advantages to stakeholders. We believe that a more effective case for change should be established through a thorough assessment of incremental costs versus incremental benefits.

- **Reporting of risk management and internal control system effectiveness**
  We are not in favour of the proposed changes to the reporting of the effectiveness of risk management and internal control systems. While the absence of detailed guidance and worked examples result in wide-ranging interpretations, we anticipate the proposed changes will require substantial resource allocations to attend continuous monitoring requirements and inclusion of all non-financial controls in the proposed scope of the Code.

- **External assurance providers**
  Currently, there is a shortage of competent and appropriately regulated external assurance providers in the UK market. The proposed changes to the Code are expected to exacerbate this situation. As boards and Audit Committees seek additional assurance, existing providers may struggle to meet demand. Both existing and new entrants will need to be regulated to ensure minimum standards are met. The potential for conflicts of interest arises as financial audit firms offer a wider range of non-financial assurance services. This may further limit the choices of financial audit firms, potentially creating a more restricted market and increasing audit costs for UK companies.

- **Annual reports**
  While most of the individual proposals are supported, the amount of change in the proposal is substantial. We believe that there's a missed opportunity to create space in annual reports by relocating existing policy and process details, possibly to company websites or other repositories. This would enable annual reporting to focus more on performance outcomes, as opposed to becoming excessively dense and lengthy.

We urge you to ensure that proposals are cost effective. You should evaluate whether all the proposals are indeed necessary; consider whether there is sufficient capacity in companies, investors, audit firms and the regulator to absorb and deliver the change; and prioritise the actions so as to implement the most important aspects first. It will also be important to ensure that additional requirements imposed do not place UK PLC at a competitive disadvantage with other global capital markets.

Responses to individual sections of the consultation document
We are pleased to attach in the Appendix our detailed responses to those questions of the consultation which we have an opinion to share.

We are supportive of the general direction of travel to improve the Code but believe that not all the proposals are required or appropriate to achieve the objective. We hope you find this input helpful in your considerations.

Yours sincerely,

[redacted]

Appendix: Responses to individual consultation questions

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?**
Response	Yes, we agree. Annual reports continue to get larger and larger and a focus on outcomes could be facilitated by allowing more process and policy disclosures to be included on a website.
Board leadership and company purpose	
Q3	**Do you have any comments on the other changes proposed to Section 1?**
Response	We do not support the amendment to Provision 3. Regarding the suggested change in responsibility for committee chairs to "engage" with shareholders instead of the current phrasing, which states they should "seek engagement," we see a challenge in this shift due to limited interest from the investment community in engaging with audit committee chairs. Consequently, we recommend not amending Provision 3 in this manner, and instead, retaining the responsibility to "seek engagement." However, we propose including encouraging language in supporting guidance, urging audit committee chairs to report on the outcomes of their efforts to engage with shareholders.
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?**
Response	Yes, we agree. We support the Code including a recommendation for all companies to prepare an AAP. We are broadly supportive of the concept of the AAP particularly where it can be implemented in a proportionate manner on a 'comply or explain' basis.
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?**
Response	Yes, we agree. We are 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?**
Response	We are not supportive of this extension of the audit committee remit, as we believe the Code should allow more flexibility.
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?**

Response	We do not support the proposed amendments in relation to the risk management and internal control systems declaration. While we endorse the concept behind the proposed amendments, a critical factor in their successful execution lies in the availability of supporting guidance. Without this, it is challenging to arrive at a definitive conclusion. It was explicitly stated that the Government opted against a legislative approach to "UK Sox" due to a cost-benefit analysis. However, we remain unconvinced that the case for adopting this Code-based approach has been sufficiently articulated to demonstrate that it can be implemented in a balanced manner, providing more benefits than costs. This scepticism primarily stems from the current absence of comprehensive implementation guidelines.
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?**
Response	We advocate for the board's declaration to be made as of the balance sheet date. We support the declaration covering the reporting period given the complexity of implementing continuous monitoring and control attestation. We could progress to continuous monitoring over time but not immediately.
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?**
Response	We believe reporting should be limited to controls over financial reporting.
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?**
Response	Guidance is required to ensure adequate attention is given to what is materially significant for business operations. This aspect is crucial for implementing these changes in a balanced manner. It pertains not only to defining the extent of material controls to be addressed in the new board declaration but also to reporting any identified material weaknesses.
Q18	**Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?**
Response	See Q17
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)?**
Response	Yes, we agree that Provision 30 should be retained
Resilience Statement	
Q20	**Do you agree that all Code companies should continue to report on their future prospects?**
Response	Yes, we agree that all Code companies should continue to report on their future prospects.