

**Financial Reporting Council**

8<sup>th</sup> Floor  
125 London Wall  
London  
EC2Y 5AS

By email to: [codereview@frc.org.uk](mailto:codereview@frc.org.uk)

Centrica plc  
Millstream West  
Maidenhead Road  
Windsor  
Berkshire SL4 5GD

Telephone 01753 494000  
Facsimile 01753 431010  
Website: [www.centrica.com](http://www.centrica.com)

13<sup>th</sup> September 2023

Dear Sir/Madam,

***UK Corporate Governance Code consultation***

Thank you for the opportunity to respond to your consultation on the FRC's consultation ("the Consultation" on the UK Corporate Governance Code ("the Code"). The below letter provides a summary of Centrica plc's response, with more detail provided to your specific questions in the appendix.

In general, Centrica plc ("we") are supportive of the consultation's aims, to restore trust in and improve the UK's audit, corporate reporting and corporate governance systems. We recognise that it is important for these areas to develop to meet the changing needs of users and investors and as the business landscape evolves. We also agree with the need to keep the UK's corporate governance framework under periodic review to determine whether it is still fit for purpose. However, it is important that the final proposals are proportionate and do not damage the competitiveness of UK companies through an excessive regulatory burden.

We have assessed the proposals put forward in the Consultation through applying the following principles which we feel are key in forming our conclusions:

- The extent to which there is a clear purpose for the proposed change to the Code;
- The extent to which the proposed change is consistent with the principle of proportionality (established where appropriate through a cost benefit analysis);
- The extent to which the proposed change promotes or enhances regulatory certainty that will support the UK as a destination for investment; and
- The ease of implementation of the proposed change.

With reference to the above principles, our key observations are as follows:

- The proposed changes are onerous, requiring large scale organisational change, with the benefits not clear in a number of instances; more consideration should therefore be given to the design of the reforms and/or the time needed for implementation.
- Any additional investment or complexity as a result of implementing the proposal should be weighed against maintaining a competitive landscape for UK based companies and the UK as an investment destination.
- Further implementation guidance is required on a number of sections of the proposal, particularly on control attestation requirements, to allow appropriate implementation time. The proposed timeline of 2025 is already a real risk.
- The proposed expansion of the Board of Director's responsibilities expand beyond governing responsibilities into managerial ones. The requirement for Boards to comment on material weaknesses throughout the reporting period should be amended materially or dropped

- Overlapping reporting requirements on sustainability with other reporting obligations should be harmonised where possible.
- Strengthening risk management and the internal control system should be balanced to avoid a disproportionate level of regulatory burden.
- The expansion of this scope to include a wider scope of reporting, operational and compliance controls would significantly increase the level of regulatory burden and therefore consideration should be given for the time needed to implement any changes.
- An impact assessment should be undertaken to understand the implications of the proposed changes before final decisions are taken.

## Centrica's Overall View of the Proposals

Centrica is a uniquely integrated energy company comprising three pillars: (i) retail serving over 10 million residential and business customers; (ii) material power and gas infrastructure; and (iii) market leading optimisation capability. We operate mainly in the UK and Ireland, through strong brands such as British Gas, Bord Gáis and Centrica Business Solutions, supported by our 20,000 strong team including around 7,500 engineers and technicians. We have a green-focused growth and investment strategy that will involve making material investments in helping the UK and Ireland achieve Net Zero. We are a FTSE100 company.

The UK is already seen as an internationally renowned environment for corporate reporting, corporate governance, and audit, and so the consultation should seek to prioritise those changes which will incrementally enhance this environment without creating a significant cost and administrative burden or reducing the attractiveness of the UK market. In that context, the FRC should assess the extent to which the UK's current regulatory regime for listed companies, including in relation to continuing obligations, has deterred organisations from electing to list in the UK and quantify the potential economic loss arising therein. We believe that a rationalisation of the overall regulatory requirements will support the attractiveness of the UK market.

We believe that in their current format, some of the proposals are too broad to implement, and require further guidance, particularly in the language and definitions used. In our view, a number of the proposals should be reduced in scale and the remaining suite implemented in a piecemeal, ordered basis, for example expanding the scope of reporting, operational and compliance controls.

We would also highlight that some of these proposals are complex and will have impact across our organisation. The investment and resources needed to implement the proposals should not be under-estimated, and in our view the time given for implementation should be considered accordingly. These may limit the ability of companies (and their audit committees and auditor, as well as ARGAs) to implement the changes efficiently and robustly. Implementation will need to be phased and prioritised to allow enough time for impacted stakeholders (companies, audit committees, their auditors and the regulator) to develop expertise.

In relation to the board's attestations with regards to the risk management and internal control framework, as the proposal is currently framed, there is a real question as to whether Boards are being invited to move into the realms of management as opposed to governance and oversight. Furthermore, in our view it will not be pragmatic for Boards to comment on material weaknesses throughout the reporting period because if there are material weaknesses, Boards will find it difficult to provide any attestation. The key objective for the company's stakeholders is that at the relevant point in time, a Board can confirm that the company's risk management and internal control framework is robust.

The proposals relating to sustainability reporting and creating a new obligation for audit committees overlaps with other reporting obligations on the same topic. We encourage identifying the scope for harmonisation of all these different obligations wherever possible.

We would like to highlight that detailed guidance is needed to support the Resilience Statement. We agree that a resilience statement would be a good way to bring together considerations from the current viability reporting and going concern assessments and to highlight the key risks to the business over different time periods.

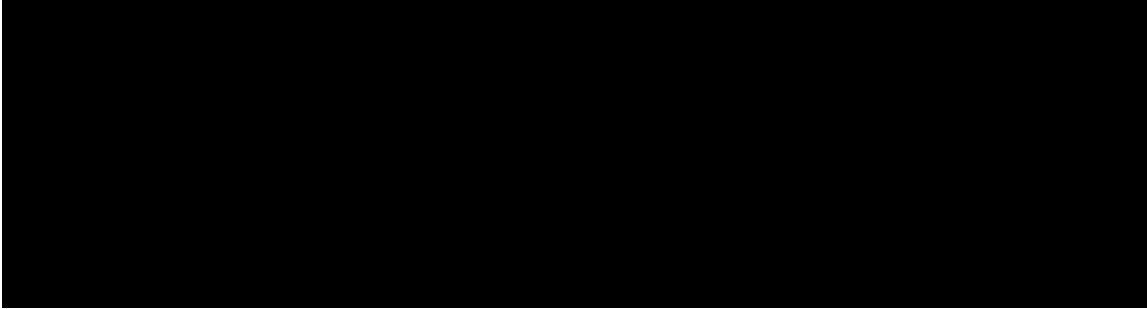
We would further highlight that detailed guidance would be required to support the Audit and Assurance Policy (AAP) disclosure, in particular an understanding of the proposed divergence between the AAP only requiring a disclosure on the effectiveness of a company's internal controls over financial reporting and the UK Corporate Governance Code requiring an explicit statement on reporting, operational and compliance controls. We would request clarity on the definitions and parameters of controls in scope as well as 'internal' and 'external' assurance to avoid any misinterpretation.

We recognise that some of the required changes will result in a wide organisational change and therefore we believe organisation will require an appropriate time for implementation. Ideally, organisations will have sufficient time to implement the changes and have a testing period

before reporting externally. We understand the current implementation proposal is for period commencing on or after 1 January 2025 and we believe a balanced approach between the requirements and the time to implement should be considered or alternatively, a phased approach.

Once again, thank-you for the opportunity to comment on these proposals. Please do feel free to contact us if you would like to discuss any to these observations.

Yours faithfully



## Appendix – Consultation Question Responses

### **Section 1 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 note that, through the proposed changes to Principle D, there is potential for some ambiguity as to what constitutes “governance activities” and “governance outcomes”. Focussing Principle D instead on an obligation to provide a clear explanation of departures from the Code’s provisions would provide an approach that is more capable of being consistently applied.

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?*

–No.

The proposed reforms to Provision 1 overlap with disclosures arising under the Taskforce on Climate-related Financial Disclosure (“TCFD”) and disclosures required under Listing Rule 9.8.6(8) and, in due course, the mandatory transition plan regime. We consider that it would therefore be helpful for Section 1 to be clear as to whether or not the Code requires boards to report beyond the TCFD-based regime requirements and, if so, how.

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

–We have no further comments on the proposed changes to Section 1.

### **Section 2 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?*

-Yes.

We seek clarity as to whether the assessment is to be in relation to all commitments to other organisations (as referred to in the draft change to Principle K) or limited only to significant external commitments (as referred to in this question and Provision 15). Whilst we would, as mentioned, routinely consider the implications of all external appointments in aggregate, we do consider there is an important distinction between listed company directorships, non-listed company directorships and other roles (such as adviser and consultant positions), all of which are commonly held by listed company directors.

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?*

-Yes, we support transparency of directors’ significant external appointments.

### **Section 3 Composition, succession, and evaluation**

#### **3.1 Diversity and inclusion**

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

-Yes.

When setting the proposed reforms to the Code (particularly Principle 24) alongside Listing Rules 9.8.6 and 14.3, we note that there is some duplication (notably regarding board and senior management gender composition) and also that there are some differences (notably regarding the “direct reports” of senior management). As such, there

is a risk that reporting of diversity matters becomes unnecessarily complex to prepare and/or complex to interpret. We would therefore see benefit in the reporting obligations in the Code and the Listing Rules aligning or, alternatively, arising only from the Listing Rules.

We also query whether introducing reporting obligations in respect of “direct reports” of senior management is a valuable and consistently applicable metric as reporting structures will inevitably vary from company to company and may not always be indicative of an ‘N-2’ population.

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

-Yes.

We note, however, that there has been considerable commentary that, due to its inherent breadth, the proposed reference in Principle I to “protected characteristics and non-protected characteristics” may not best achieve its intended objectives. It has also been highlighted that this expectation would involve some challenges as it would depend upon a high degree of voluntary disclosure by individuals. Similarly, we note commentators have queried the rationale for specifically citing “cognitive and personal strengths” as a factor to be taken into account in board appointments but not specifying other characteristics. These are valid comments and, accordingly, it may be beneficial in Principle I to focus on board and senior management appointments and succession plans promoting board and senior management teams that are intrinsically diverse and inclusive.

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

-No.

Whilst we naturally recognise the importance of the nominations committee focussing on succession planning for board and senior management positions, much of the substance of that work is inherently sensitive and would not be appropriate to report publicly without undermining its purpose or risking other unintended consequences. We therefore consider that it would be most appropriate for reporting obligations to be limited to describing how succession planning is approached, including the methodology being used.

### 3.2 **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?*

-Yes.

We have no objections to the CGI recommendations in respect of board performance reviews.

## **Section 4 Audit, risk, and internal control**

### **4.1 Audit and Assurance Policy**

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

-Yes.

We agree that an Audit and Assurance Policy is a good way to articulate to stakeholders the level of assurance obtained, or expected to be obtained, over various sections of the annual report and to explain any reliance on the internal audit function.

## 4.2 **Audit Committees and the External Audit**

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 that referring to the External Audit: Minimum Standard in Provision 26 is a suitable way of avoiding duplication.

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?*

-No.

We consider that the remit of particular board committees should be at the board's discretion and not prescribed by the Code as exclusively matters for audit committees, since this may not deliver the most productive or efficient outcome.

## 4.3 **Risk management and internal controls**

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?*

-Yes.

Strengthening the internal controls framework for UK companies will improve consistency of approach and increase investor confidence. However, it will be important to ensure the final requirements are proportionate. There will inevitably be an increase in cost for preparers which will be dependent on the scope of the final control requirements and the assurance therein.

We are broadly open to an extension of the control requirements, based on financial reporting controls, though recognise this would create a significant extra time and cost burden on businesses, both during the implementation phase and on an ongoing basis.

There are likely to be significant resource issues across preparers and auditors as the new regulations come in, so implementation requirements and timelines need to be carefully considered so as not to impact existing annual reporting timelines.

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?*

-based on the balance sheet date.

The declaration should be given as at the financial year end, and neither throughout the reporting period or up to the date of the annual report. The current wording in Provision 30 would make the process of preparing the declaration and obtaining board confirmation unnecessarily onerous.

Whilst we may have an internal ambition to assure controls via continuous monitoring with real-time data, January 1, 2025, is too soon to achieve this objective, and at the very least, we recommend a phased approach to implementation.

It is not clear how a board or board committee will balance, on the one hand, a desire to forensically challenge the controls framework to seek to identify areas for improvement with the envisaged requirement under Provision 30 to describe to the external market any material weaknesses or failures identified and the remedial action taken. A requirement to give the declaration would seem sufficient, without the complication of a disclosure requirement in respect of matters that have had to be addressed to reach a position where the board is comfortable to provide that declaration.

Further, the current drafting of requirements may in some circumstances make it impossible for a director to give the declaration. If, for example, a "material weakness" is identified and remediated without consequence for the business during the financial year,

a director would likely be unable to conclude that the systems have been effective “throughout the reporting period”. They would, however, be able to give a declaration as at the year end, and in this circumstance would still be able to explain the “material weakness” and how it was addressed. The first scenario could impact stakeholder decisions, even if any weakness was quickly remediated, whilst the latter gives a more balanced representation.

Overall, we would like to understand better the mechanism and purpose of the board declaration and whether there is a more productive or efficient way around it considering the disclosure in the annual report and accounts.

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?*

-No.

The scope of controls under review should be limited to financial reporting controls only because it aligns with the financial statement reporting process. The expansion of this scope to include a wider scope of reporting, operational and compliance controls would significantly increase the level of regulatory burden. Consideration should be given for time required to implement those changes under the expanded framework.

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?*

- Principles and guidance around the internal control framework to be used will need to be sufficiently well defined to ensure both market consistency and a clear approach for both companies and auditors to implement. At the same time, this will need to be balanced with the flexibility to allow companies to implement the requirements in the most appropriate way for their business and industry.

In terms of internal control frameworks currently in operation, we would support specifying a preferred option (e.g. Committee of Sponsoring Organisations of the Treadway Commission (COSO)) to facilitate the design and annual attestation process.

We would envisage that the regulator would need to further develop the detailed principles and guidance by engaging with relevant stakeholders and may then need to go through a further consultation process.

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?*

-Yes.

The language in the revised Code, notably “effective risk management and internal controls system”, “materially adversely affected”, “material weakness” “continuous” rather than “at a point in time” needs to be more clearly defined to facilitate consistency and alignment across organisations and to provide clarity as to what this means from an assurance, cost and board liability perspective.

Consideration will need to be given to guidance around the disclosure of deficiencies. There will be an initial nervousness about investor reaction to such disclosures and there will be a need to distinguish between those significant deficiencies that have a higher likelihood of leading to material misstatement and those that do not, to ensure appropriate interpretation by investors and other users of the accounts.

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

-Yes.

The language in the revised Code should provide more clarity and explanation of the specific meaning of the proposed definitions and nature of controls within scope.



- 4.4 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 the current Provision should be retained to keep this reporting together with reporting on future prospects and to achieve consistency across the Code for all companies.
- 4.5 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. We believe that the resilience statement should be done on the whole organisation, including PIEs within it.
- 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 non-PIE Code companies to report on their future prospects.
- Section 5 Remuneration**
- 5.1 Changes to strengthen links to overall corporate performance**
- Q22 *Do the proposed revisions strengthen the links between remuneration policy and corporate performance?*
- Yes.
- We have no comments on the re-ordering of the wording in current Principles P, Q, and R. Therefore, we do not believe this will have any impact on the link between remuneration and corporate performance. At Centrica, we already link annual and long-term remuneration to ESG (via our People & Planet goals), and we welcome specific reference to this to ensure consistency and progress across other companies.
- New Principle O refers to “long-term sustainable success”; the definition of “success” is highly subjective and will vary across stakeholders. We would like clarity on what the FRC defines as “success”. It is also worth noting that you refer to “poor performance” in Provision 34. We would like clarity on what the FRC define as “poor”.
- We are supportive of the inclusion of the wider workforce in Provision 35, however, we are unclear what “an explanation of the company’s approach to investing in..” would mean.
- 5.2 Malus and clawback**
- Q23 *Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?*
- Yes.
- Centrica has a very broad set of circumstances that could trigger the use of malus and clawback. We also specify the time period applicable for malus and clawback. However, the use of malus and clawback must be considered in the context of the specific circumstances and therefore we do not agree that companies should set a “minimum

circumstance” as this could undermine the Remuneration Committee’s judgement and discretion and may result in more formulaic or unintended outcomes.

We have no strong views on reporting the use of malus and clawback in the reporting year but feel that it is unnecessary to set this out for the last five years.

### **5.3 Changes to improve the quality of reporting**

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

-Yes.

We agree with the proposed deletion of current Provision 40 (as we are not convinced this currently adds any value), and we are supportive of the proposed word changes to current Provision 41

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

-Yes.

We are supportive of the removal of pay gap and pay ratio reporting from the remuneration report section of the annual report. Pay gap reporting is best left to a separate report and this is where companies should also explain what actions they have taken / will take to reduce the gaps. CEO pay ratios are a blunt and crude tool that we do not believe is very effective, nor can reasonable comparisons be made across companies/industries. We would be supportive of the removal of CEO pay ratios.

### **Other Matters 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?*

-Yes.

We support the position that we understand will be articulated by the GC100 on this point which is that, at this time, it would be premature to make any amendment to the Code or related guidance in respect of artificial intelligence given that the legislative position on artificial intelligence is currently at an relatively nascent stage of development.