AccountAbility

Setting the Standard for Sustainability

**Response to the FRC Corporate Governance Code Consultation**
**September 2023**

| Item | Question | AA Answer / Position |
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| **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 agree that the changes would deliver more outcomes-based reporting. This could further support more results-based management and accountability. However, given that the concept of impact in the scope of its role here is new, it would be prudent to define the term and provide adherence criteria.<br><br>The *AA1000 AccountAbility Principles* (AA1000AP, 2018) introduces the principle of "Impact" which relates to monitoring, measuring and being accountable for how an organisations' actions affect their broader ecosystem. To apply and monitor the principle of "Impact", the following adherence criteria (Chapter 3, p.28) must be fulfilled:<br>• Commitment, integration & capacity building<br>• Impact identification & metrics development<br>• Impact assessment & disclosure<br><br>Providing specificity would enable improved quality control over reporting on the company's governance practices. |
| | 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 agree that the board should report on all the listed points, commensurate with their level of materiality and impact on the company and its stakeholders.<br><br>It is a leading practice for board oversight to include the governance of material sustainability/ESG matters, which may include climate-related risks and opportunities. The board should be responsible for ensuring that relevant sustainability/ESG matters are incorporated into sustainability ambitions, strategy, and governance. Boards should also, in addition to the aforementioned responsibilities, oversee and guide communication, reporting, and disclosure on these matters.<br><br>It is also vital that all board members have an adequate level of awareness and depth of understanding of sustainability/ESG matters, such as climate change, and their related risks and opportunities in order to carry out their related oversight duties and responsibilities effectively.<br><br>From a board governance perspective, in order to further the aim of aligning corporate governance with the strategy of the company, it is imperative to include retrospective and forward-looking short-, medium-, and long-term material information. |
| | Q3: Do you have any comments on the other | Although the removal of "the workforce should be able to raise any matters of concern" from Principle D ensures a |

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| | changes proposed to Section 1? | decrease in redundancy (as this is mentioned under Provision 6), the following might be added to Principle B:<br><br>*"The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success* ***while paying heed to the concerns of the workforce****".*<br><br>This would solidify, through the Principles, the need for the board to pay attention to the workforce and make amendments accordingly.<br><br>Additionally, it would also be prudent to add disclosure on how this will inform the board's strategy changes to the Principle. |
| **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? | We agree with the proposed change to Code Principle K.<br><br>Board members frequently hold many board seats and lend their expertise to the boards of multiple different companies. This may result in a limitation of the capacity and time a board member has in order to adequately fulfil their duties, which may compromise company performance. The holding of multiple board positions may also lead to conflicts of interest. Conversely, board members with multiple mandates have the potential to deliver a greater breadth of intra- or inter-industry connectivity and expertise. Board performance reviews therefore need to be tailored to each company's unique business context and evaluate board member performance in alignment with the company's strategic and governance objectives.<br><br>There is a strong need for the disclosure of this information because it aids in understanding not only the board's expertise but also the potential conflicts of interest and the capacity to govern certain issues. It might be too difficult, however, to mandate strict limitations on the number of seats board members can hold. Hence, reviewing this matter case by case as part of the board performance review process is an appropriate solution. |
| | 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 with the proposed changes to Code Provision 15.<br><br>The proposed change is needed to have increased transparency and a clear understanding of the directors' commitments to other organisations, and, ultimately, enhanced transparency regarding interest/personal interests/affiliations that could, potentially, conflict with the company's interests.<br><br>AccountAbility's recently published *7 Sustainability Trends 2023 Report* introduces the *D.I.R.E. Framework* (p. 10), which includes the principle of "Independence". This Principle recommends a rigorous declaration/conflict of interest process to alleviate any issues with prior or existing relationships. |

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| **Section 3 –** Composition, succession and evaluation<br><br>*Diversity and inclusion* | Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication? | Yes. Further, the Principles feature strong enough language. |
| | 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 support the changes to Principle I. As there are various types of diversity, an exhaustive list might not be appropriate as this could lead to unintentional omissions of characteristics. The proposed approach seems suitable. |
| | 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 Provision 24.<br><br>It is also recommended that "protected characteristics" be added to Sub-point 4 of Provision 24 and the point be edited as follows: "the balance of gender **and inclusion of protected characteristics** of those in senior management and their direct reports". This would ensure alignment with the previous concepts that were used. |
| **Section 3 –** Composition, succession and evaluation<br><br>*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? | We support the proposed adoption of the CGI recommendations as set in the draft revised Code. On the topic of board performance review, we would like to emphasise that a majority of S&P 500 companies are already tying Board and Executive compensation to the achievement of some form of sustainability performance. AccountAbility has been a strong proponent of this practice for a long time, and we have been following the evolving role of sustainability/ESG metrics in board performance reviews.<br><br>While these commitments are becoming more common, these compensation linkages are often tied to short-term or discretionary bonuses and impact a very marginal percentage of total compensation, particularly in the context of a typical executive's net worth. We would like to see board performance reviews linked to sustainability/ESG metrics, but caution that companies must have well-defined ESG strategies aligned with their organisation's purpose and material ESG issues before introducing compensation (or performance review) linkages. |
| **Section 4 –** Audit, risk and internal control<br><br>*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? | Preparing an Audit and Assurance Policy on a 'comply or explain' basis should be required. This approach would ensure consistency and meet stakeholder needs. |

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| **Section 4 –** Audit, risk and internal control<br><br>*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? | We agree that this is an effective way of removing duplication.<br><br>The following general note may also be considered:<br>The terminology here refers to "audits" and does not include "assurance", which is commonly used for verification of non-financial information. Extending the terminology to "assurance" would be in line with other suggestions such as the added bullet of *"monitoring the integrity of narrative reporting, including sustainability matters, and reviewing any significant reporting judgements;"*.<br><br>Additionally, the draft revised Code now states that *"The board should satisfy itself that at least one member has recent and relevant financial experience."* This could be amended by saying:<br><br>*"The board should satisfy itself that at least one member has recent and relevant financial experience and at least one member has the equivalent recent and relevant sustainability experience".*<br><br>Non-financial reporting and assurance will soon be mandatory, so including the assurance terminology in the Code should be considered. |
| **Section 4 –** Audit, risk and internal control<br><br>*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 agree with the proposed expansion. Non-financial reporting and assurance are becoming standardised and will soon be mandatory. Including narrative reporting, such as sustainability reporting, and where appropriate, ESG metrics, are recommended.<br><br>As highlighted by the AccountAbility *7 Sustainability Trends 2023 Report*, regulators across the European Union, United Kingdom, and others are moving towards legislation and rules that will require companies to disclose ESG performance data (p. 11). Hence, adding narrative reporting, sustainability reporting and ESG metrics will not only preemptively be in alignment with future regulations, but will also encourage companies to proactively be in compliance with these regulations.<br><br>The shift from voluntary to mandatory reporting will result in scrutiny over the quality of ESG data (p. 11). Hence, it is recommended that quality checks for the ESG data and metrics for the same, be added to the code. |
| **Section 4 –** Audit, risk and internal control<br><br>*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? | We agree that the proposed amendments strike the right balance. |

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| | 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? | AccountAbility is in favour of continuous monitoring on a 'comply or explain' basis. There are clear benefits to continuous monitoring of risk management, and it is generally regarded as good practice but may be too resource-intensive for some boards. |
| | 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 agree with a change to 'reporting' as non-financial (sustainability/ESG) reporting is becoming mandatory for some companies, and it should be included in the revised Code. |
| | 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? | |
| | 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? | The definition of principal risks should be expanded to include those risks which have a significant adverse impact on stakeholders. |
| | Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance? | |
| **Section 4 –** Audit, risk and internal control<br><br>*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)? | We agree that the Provision should be retained. |
| | Q20: Do you agree that all Code companies should | |

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| **Section 4 –** Audit, risk and internal control<br><br>*Resilience Statement* | 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? | |
| **Section 5 –** Remuneration<br><br>*Changes to strengthen links to overall corporate performance* | Q22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance? | The proposed revisions do not adequately strengthen the links between remuneration policy and corporate performance. Director and executive remuneration should be significantly linked to a company's long-term environmental, social, and governance objectives.<br><br>In the interest of building a connection between comprehensive, holistic outcomes and remuneration, it would be recommended that a link to stakeholder interests be included in Principle P. E.g.:<br><br>*"remuneration outcomes should be clearly aligned* ***and linked*** *to company performance, purpose and values, and the successful delivery of the company's long-term strategy including environmental, social and governance objectives,* ***in alignment with stakeholder values****".*<br><br>Please refer to Chapter 3 of the *AA1000 Stakeholder Engagement Standard* (AA1000 SES 2015) for further details. |
| **Section 5 –** Remuneration<br><br>*Malus and clawback* | Q23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency? | We agree that the proposed changes will result in an improvement in transparency. |
| **Section 5 –** Remuneration<br><br>*Changes to improve the quality of reporting* | Q24: Do you agree with the proposed changes to Provisions 40 and 41? | We agree with the proposed changes. |
| | Q25: Should the reference to pay gaps and pay ratios be removed, or strengthened? | The mention of pay ratios and pay gaps should be reinstated to ensure continued progress. We are in favour of the proposal to ask companies to report on what measures have been implemented to reduce and eliminate pay gaps within their organisation. |
| **Other matters for consideration**<br><br>*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? | Artificial intelligence (AI) poses considerable and novel governance challenges.<br><br>Section 5 should have a provision stipulating a responsibility for boards to assess and monitor a company's development and use of AI. The board should explain what monitoring is in place to ensure responsible AI development and use.<br><br>AI-related risks should also be included in a board's risk assessment and an appropriate internal control framework for AI-related risks should be maintained. |