Corporate Governance Code Consultation

Grafton Group Plc Response

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?

We agree that stressing the requirement for Boards to clearly explain any departures from the code should deliver better and more outcomes-based reporting.

In addition to giving guidance on the information to be provided when explaining departures, it would be helpful if the intended guidance provided examples of the "outcomes -based" reporting that is required.

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 support the requirement for board reporting to cover environmental and social matters, however by specifically including "climate ambitions and transition planning" there is a risk that the Code is departing from its principles-based approach. In addition, reporting on climate change targets and transition planning is already covered by TCFD requirements. If this specific requirement remains, there needs to be clear guidance on whether compliance with TCFD reporting requirements would also satisfy this requirement.

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

It would be helpful to have guidance on the proposed reporting on the effectiveness of embedding the desired culture and how this should be implemented.

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 agree that the board's performance review should include an assessment of an individual's ability to discharge their responsibilities effectively, which would naturally involve assessing the amount of time that an individual spends on board duties, which may be impacted by other external commitments.

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 do not agree with the proposed change to Provision 15. The Chair and Board have a responsibility to ensure that directors can commit the appropriate time to their duties for the company and where this is not happening it will be apparent in the directors' interactions with the Board. We believe the current wording in Provision 15 and the proposed change to Principle K are sufficient for this matter.

Section 3 – Composition, succession and evaluation

Diversity and inclusion

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

Other than the point we refer to in Q7 below, the proposed changes appear to strike an appropriate balance between encouraging more diversity and inclusion at a board level without introducing significant new requirements which may duplicate other regulations.

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 change to Principle I which states that appointments "should promote equal opportunity, and diversity and inclusion" and the removal of the references to specific characteristics i.e., "gender, social and ethnic backgrounds".

However, we believe that the reference to "protected characteristics and non-protected characteristics" is unnecessary. The existing listing rules already set specific targets for gender and ethnicity, and it is not possible Boards to represent everyone in the population. The Code should not be specific and should remain Principle-based in this regard.

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 as they do make the requirements slightly more explicit.

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 changes and would expect the guidance to include the minimum scope and areas to be covered by a board performance review.

Section 4 – Audit, risk and internal control

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?

We agree with the requirement for all Code companies to prepare an AAP on a "comply or explain" basis. This should include how companies use and obtain internal assurance over areas where management deem it unnecessary to obtain external assurance. We believe companies should also be encouraged to disclose any planned developments in the assurance they obtain e.g., the areas where they plan to increase the level of internal or external assurance they obtain in the future.

We do not agree that Audit Committee should be required to engage with shareholders or other stakeholders on the AAP. We believe that the existing communication routes for the Board to consult with and engage with investors gives scope to embrace a discussion on the AAP if either view this as desirable.

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?

Yes.

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 would be concerned that the expansion of the Audit Committee's remit to include narrative reporting may place an additional legal liability on the Audit Committee over and above its current responsibility.

There needs to be clear guidance on what is included within the definition of narrative reporting. There should also be consideration as to whether some areas of narrative reporting and non-financial metrics should be the responsibility of other sub-committees as delegated by the Board.

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 do strike an appropriate balance in strengthening risk management and internal controls systems, however, in order to effectively implement these in a way that consistently achieves the intended outcomes, more detailed guidance is required.

The consultation paper states that the guidance will not be prescriptive, but a level of detail, in our view is required. We accept that the guidance needs to be flexible so that businesses can adopt a system that is suitable to their organisation, however, the guidance needs to at least include examples of what would be considered adequate and inadequate practice.

In addition, we would like to comment on the proposed effective date of 1 January 2025 for the new requirements. The Government have always been clear from the initial White Paper in 2021 that businesses would be given sufficient time to implement and comply with the new requirements, which has commonly been interpreted as allowing at least two years. Whilst the proposed Code changes provide the outline of what will be required, without the detailed guidance promised by the end of 2023 it is difficult to fully plan for the actions required for implementation, particular in a large organisation such as Grafton Group which is made up of several businesses with their own distinct control environments.

We would, therefore, request a delay to the effective date of at least 12 months to 1 January 2026.

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?

On the basis that we believe the current focus should be on financial controls (see response to Q15) then the board’s declaration should be based on the date of the balance sheet. This would make the requirements consistent with other international control statement regimes e.g., US Sox, and assist where there is an external assurance requirement for some companies.

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 believe that reporting should be limited to financial controls since the corporate failings that lie at the root of the original BEIS white paper were of a financial nature.

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 include examples of methodologies and frameworks that companies could use for their effectiveness review but shouldn’t mandate the use of any single or specific framework.

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?
We agree with the first part of the definition i.e. ““A fault, deficiency or failure in the design or operation of the risk management and internal control framework …..”

However, the second part of the definition “ … such that there is a reasonable possibility that the company’s ability to identify, assess, respond to or monitor risks to its strategic, operational, reporting and compliance objectives is adversely affected” should be more outcome based and have a materiality overrider i.e., it should refer to having a material impact on the stakeholder’s view of the company.

The guidance should include examples of what a material weakness could be e.g., a failure that results in a material adjustment to financial statements, or a material impact on future profit or cash flows.

Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?
Guidance on how to apply the new requirements to Groups of companies e.g., could non-material businesses be considered out of scope?

Guidance on the expected balance of controls between those at an entity level i.e., governance and tone at the top, vs those at a transaction level.

Guidance on testing methodologies and approach, including the frequency of testing.

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.

Resilience Statement

Q20: Do you agree that all Code companies should continue to report on their future prospects?
Yes.

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.

Section 5 – Remuneration

Changes to strengthen links to overall corporate performance

Q22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

We agree that the revised wording is an improvement and does improve the link between remuneration and long-term sustainable success of the company. The clarity that directors should not be involved in setting their own remuneration is also welcome.

Malus and clawback

Q23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?
Yes.

Changes to improve the quality of reporting

Q24: Do you agree with the proposed changes to Provisions 40 and 41?
Yes.

Q25: Should the reference to pay gaps and pay ratios be removed, or strengthened?
We agree that the reference to pay gaps and pay ratios should be removed.

There should be separate guidance for the reporting in this area, which should include focus on explaining the steps companies are taking to address any imbalance in gender representation in their organisation.

Other matters for consideration

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?
No. In our view, AI represents both a risk and opportunity to businesses in similar way to other technology developments. Where applicable, businesses should include AI with their description of principle risks and opportunities in their Annual Report, but we don't believe it needs to be specifically referenced in the Code, which should remain, where possible, principles-based