RSM

11 September 2023

FAO Mr Styles - Director, Corporate Governance and Stewardship
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Dear Mr Styles,

Proposed revisions to the UK Corporate Governance Code

RSM has offices in the UK and in Northern Ireland and is a member of the RSM International network, the sixth largest network of audit, tax and consulting firms globally with 43,000 people across more than 120 countries. RSM is a leading audit, tax and consulting firm to the UK middle market, including the SME sector and a large number of listed companies. RSM audits companies in both the PIE and FTSE 350 space.

We welcome the opportunity to respond to the consultation on the proposed revisions to the UK Corporate Governance Code ('the Code'), aimed at enhancing its effectiveness in promoting good corporate governance. We support the proposals and agree with much, but not all the detail. There are also areas where we consider detailed guidance is required to clearly define responsibilities and expectations.

We agree with using the Code to extend legislative requirements to all companies which apply the Code on a 'comply or explain' basis, in particular the need to determine and disclose an Audit and Assurance Policy and to prepare and disclose a Resilience Statement.

Similarly, we agree with the amendments which serve to emphasise the increased focus on the non-financial elements of the Annual Report, such as extending the remit of the Audit Committee to include narrative reporting; pushing for outcomes-based reporting; and putting more attention on the evaluation of Director performance.

Increased transparency in respect of the effectiveness of risk management and internal controls systems is needed and the amendments will provide valuable information for stakeholders. Companies should have the flexibility to determine an appropriate risk management and internal controls framework which is commensurate with the level of complexity and risk. We do, however, consider that it would be useful to require Companies to disclose details of the risk management and internal control framework that they have adopted, along with the FRC providing guidance with example acceptable frameworks to enable stakeholders to assess and compare Company approaches.

We agree, in principle, with giving Directors the ability to determine the level of assurance required over the parts of the Annual Report which are not subject to statutory audit rather than mandating attestation. Our strong view is that the responsibilities of the auditor in respect of the Directors' declaration over the effectiveness of risk management and internal controls need to be clearly defined. In addition, we have suggested changes to definitions to ensure that they align with those currently in use, and highlighted where we feel that there are inconsistencies or a lack of clarity between differing requirements.

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We have set out our comments on the specific questions 1-25 posed in the consultation below.

Should you wish to discuss any matters included in this letter, please contact

Yours sincerely,

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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?

We agree. In our experience, which echoes the findings of recent FRC Corporate Governance Reporting reviews, many boards still provide 'boiler plate' disclosures which are unhelpful to stakeholders in understanding the governance framework in place and interpreting how the company's governance policies and procedures have been applied. This update will necessitate a mindset change in those composing the governance report from simply reporting on what has been done – at board, committee, and organisational level – to reporting the impact of what has been done.

This should allow stakeholders to assess the importance placed on governance by the company and the contribution governance makes to the success and development of the business. The outcomes referenced should be, in part, leverageable from disclosures already made by UK companies in respect of Section 172 reporting and stakeholder engagement (e.g., highlighting the effect on their principal decisions when considering stakeholder views), the business review which should highlight significant reportable events or transactions and where applicable the required strategic report disclosures in respect of policies and outcomes. Restructuring of the front half sections may be required; clear and specific cross referencing will be important for cohesiveness and to avoid duplication of information.

We would recommend further emphasis throughout the Code to reiterate the requirement to illustrate actions and outcomes from governance policies and procedures within each relevant reporting Provision.

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?

The Listing Rules and the Companies Act require in-scope companies to provide climate-related financial disclosures. For premium listed companies, where material climate related risks and opportunities are identified, the board is required to disclose its future strategy, including its transitional planning arrangements. For other companies captured by the Companies Act requirements, similar disclosures are required where material. Consequently, we do not consider that explicit requirements for the board to report on its climate ambitions and transition planning need necessarily be codified in the updated Code. That said, given the role of the Code as an international indicator of best practice, we have no objection to the proposed amendments to Provision 1. The benefits to all users of Annual Reports receiving information on climate strategy and transition planning in the context of the climate emergency cannot be overstated.

As previously noted in the response to Question 1 above, we reiterate our view that care needs to be taken by companies to ensure that reporting on Environmental (including climate ambitions and transition planning), Social and Governance (including risk management and the resilience statement) ('ESG') is integrated and cohesive rather than each issue be considered in isolation.

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

We welcome the proposed change to Provision 3 to require committee chairs to engage with shareholders on significant issues and to report annually on the outcome of these discussions. The proposed change makes it clear that committee chairs must proactively engage with shareholders rather than 'seek engagement'. The requirement to report on outcomes will allow other stakeholders to better understand the views of shareholders and, ideally, how the board has considered these views in developing future strategy and what topics are of importance to shareholders.

Views could differ between shareholder and other key stakeholders and as such we would recommend that the provision is strengthened to also require committee chairs to engage with other stakeholders and obtain and act on feedback on key issues. This is already included in relation to the audit committee within Provision 26 and for the remuneration committee within Provision 43 in respect of workforce. Section 172 of the Companies Act 2006 also requires that the directors take into consideration the interest of the company's employees and the need to foster business relationships with suppliers, customers, and others. Engagement and understanding of the views of these groups should, therefore, be occurring and reinforcing this point within the Code would ensure consistency in requirements.

We are also supportive of codifying the requirement for boards to provide a clear explanation where departures from the Code's provisions have been identified as, in our experience, the quality of disclosures given is varied.

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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?

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 change to Code Principle K requiring the annual performance review to consider each director's commitments to other organisations and their ability to discharge their responsibilities effectively.

Since the publication of the Code in 2018, companies have experienced the impact of Covid-19, significant changes in global macroeconomic factors and the impact of increased focus on climate change. Collectively, these external events have required directors to commit more time to running companies and this is expected to continue, with increasing investor focus on narrative reporting and further regulatory pressures.

The FRC continues to avoid placing firm limits or restrictions on the number of external commitments within the Code and we agree with this flexibility. It would be difficult to apply a single set of rules, as the expectations of a director's role will depend on the complexities of the specific company and the contribution of a director is not only dependent on the number of additional appointments they hold.

The proposed change will encourage boards to reflect in their annual performance assessment on whether each director has time to devote to their role in that company, and if the number of external appointments held is negatively impacting their engagement and ability to provide adequate challenge to management and the board. This should result in improved reporting and will allow stakeholders to make a better-informed assessment of whether a director is devoting sufficient time to their role with the company considering other outside appointments. This may, for shareholders, ultimately influence their decision regarding whether to re-appoint them to the board.

From our experience, many companies provide details of external appointments within each director's biography. The proposed principle for the board to consider how each director has the time to discharge their commitments considering other appointments and any actions taken because of the board assessment should, in our opinion, result in a change in mindset and approach. Awareness of overboarding may limit the number of appointments accepted by directors (and/or permitted by boards), providing opportunities for others to become non-executive directors, and contributing to boards becoming more diverse.

We consider the proposed changes to Provision 15 are necessary to ensure that the change of approach envisioned by the proposed amendments to Principle K are reported, resulting in improved transparency. The board should be clear that it has a responsibility to assess each director's commitment to other organisations and whether they will have sufficient time to undertake their role on the company's board effectively. As such we propose the below wording change:

'All significant director appointments should be listed in the annual report, describing how ***the board, has assessed that*** each director has sufficient time to undertake their role effectively in light of commitments to other organisations. This should describe any actions taken as a result of this assessment.'

Section 3 – Composition, succession and evaluation

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

Listing rules 9.8.6 R (9) and LR 14.3.33 R (1) require in-scope companies to disclose whether they met targets in respect of gender and ethnicity, and to provide standardised data on the composition of their board and senior management by gender and ethnic background. In addition, the scope of DTR 7.2.8A R has been extended to require disclosure of how the diversity policy is considered in remuneration, nomination, and audit committees. The requirements in the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 Chapter 4A s414C (8) extends the listing rule requirements to the number of persons of each sex who were directors, senior managers, and employees of the company.

We consider that the proposed changes outlined support the existing requirements referenced above without introducing duplication.

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 agree that the changes to Principle I should result in boards considering all elements of diversity rather than just those characteristics protected by law.

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 proposed changes to Provision 24. In our experience, current reporting against Code Provision 17 regarding succession plans linked to developing a diverse pipeline for succession has been varied. We consider the proposed changes will likely enhance disclosures regarding how companies intend to refresh and diversify their boards, which is especially important where companies which are family run or have a significant shareholder may have chosen in the past to remain silent on succession planning.

We consider that the proposed wording in Provision 18 could be strengthened by requiring the nominations committee to ***formalise*** the succession plans ***in writing with a clear timeframe*** to emphasise the importance of forward planning at both the board and senior management levels.

In addition, we propose expanding the requirement within Provision 24 to 'the gender ***and ethnicity*** balance of those in the senior management and their direct reports' to reflect the findings of both the Hampton-Alexander and Parker 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 out on page 13 of the consultation, especially codifying that the board should commission a third-party independent board performance review on a periodic basis rather than relying solely on internal reviews. We consider that the suggested frequency for FTSE 350 companies should be extended to all companies that apply the Code.

We are not convinced that changing the term used for the process of the review from 'evaluation' to 'board performance review' will change the perception that the objective of the review process should be to inform a continual process of self-improvement. We therefore consider that it would be helpful if Principle K included an explicit requirement for boards to disclose the recommendations arising from the prior period's review process (in addition to the requirement to disclose the current period outcomes and actions) and how the board has responded to these recommendations subsequently. At the very least, and in accordance with paragraph 13 of the CGI recommendations, we support the proposal that "[w]here companies have identified in previous annual reports specific actions that they intend to take as a result of the evaluation carried out in that reporting year, they should report on whether those actions have been implemented, and if not explain why not."

The CGI draft guidance does not include any specific guidelines in respect of assessing individual directors' performance as part of the board performance review. Clearly, the specifics of individual performance, and what the board is looking for by way of contribution and challenge from a director, will vary widely. However, general guidance in respect of this area of the evaluation and any associated disclosure requirements is likely to be helpful.

Principle K and Provision 22 should be expanded to require evaluation of the information provided to the board within board packs and a review of the suitability of the governance structure, including the board, committees, and sub-committees on a periodic basis.

Section 4 – Audit, risk and internal control

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

The legislation proposed by the government will require an Audit and Assurance Policy ('AAP') for all Public Interest Entities ('PIEs') who meet the size threshold. The proposed inclusion within the revised Code extends this requirement to all entities which apply the Code including those that are, for example, smaller listed companies, incorporated overseas and premium listed or otherwise do so on a voluntary basis.

We agree that all Code companies should prepare an AAP on a 'comply or explain' basis. The AAP will provide shareholders and other stakeholders with a better insight into how directors assess internal controls over the integrity and accuracy of non-financial information (including the resilience statement and internal control effectiveness declaration), and thus aids comparability. Where directors consider that additional external assurance is required this will be formally documented and disclosed.

Those companies that voluntarily adopt the Code may have more informal control processes and therefore the ability to report on a 'comply or explain' basis will allow them the reporting flexibility needed, without undue additional costs of compliance. We have also seen that non-Code companies, such as those listed on the Alternative Investment Market, that wish to comply with best practice are considering adopting an AAP which suggests that there is appetite for extending this beyond those in scope of the draft legislation.

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 with the proposed changes to Provisions 25 and 26 to remove those aspects regarding the work of the audit committee in relation to external audit, and the requirement for the audit committee to report on this and referring companies instead to the Minimum Standard for Audit Committee. However, we also note that the following paragraph is included within the Minimum Standard for Audit Committees and therefore need not be added to the proposed draft:

- Developing and implementing policy on the engagement of the external auditor to supply non-audit services, ensuring there is prior approval of non-audit services, considering the impact this may have on independence, taking into account the relevant regulations and ethical guidance in this regard, and reporting to the board on any improvement or action required.

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, in principle, with this change given audit committees' experience of overseeing the financial statement process, working with internal and external auditors, their understanding of the process and controls over financial reporting and their existing responsibility for advising the board that the Annual Report as a whole is fair, balanced, and understandable.

Concerns have been raised that, in practice, with the current responsibilities of the audit committee, that there may not be sufficient time for them to effectively consider and challenge the assurance of ESG and sustainability matters. There may also be a need for the audit committee to update their skillset, and perhaps drawing from existing resources and expertise within the business. Our view is that the audit committee can achieve oversight in a way that is commensurate with the risk to their company and subject to the board's direction on what its responsibilities should be.

We note that 'sustainability matters' is called out specifically and would suggest that this emphasis is removed as it may result in too narrow a focus – for example similar monitoring of the integrity of reporting in respect of Health and Safety compliance (or other ESG matters), where a significant area for the company, would be required.

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 consider the proposed amendments are likely to result in improved transparency. There is no direct impact on the risk management and internal control systems used by management, for example by mandating a specific framework or controls processes. This retains appropriate flexibility for directors to establish and

maintain risk management and internal control systems that are tailored to their specific circumstances, which we consider proportionate.

Placing further onus on the directors to critically assess their risk management processes and internal controls systems and requiring them to report on the effectiveness of these systems as part of the required declaration is likely, in our view, to increase director focus in this area. Preparation in meeting the requirements, and feedback from any assurance commissioned on an ongoing basis, coupled with the remediation of weaknesses identified through the controls review, should have a positive impact. The additional disclosure requirements will, once clearly defined, increase external understanding of a company's risk management approach, and give shareholders information with which to challenge directors which will increase accountability.

We have two main observations on the proposals as they stand:

1. The scope of the proposed declaration on effectiveness of risk management and internal controls systems in Provision 30 extends far beyond that of the US Sarbanes-Oxley regime ('US SOX') which is limited to controls over financial reporting. It is also inconsistent with the AAP as it is currently drafted. (Please see Question 15 for further details). In addition, attestation through external assurance is not required in the current form.

2. The auditors' responsibilities under International Standards on Auditing UK ('ISAs (UK)) 700 are clear that the auditors' opinion does not extend to the effectiveness of the internal control systems. Sections 496 and 497A of the Companies Act 2006 and ISA (UK) 720 explain the auditors' responsibilities in respect of 'Statutory Other Information', which are to read the information and design procedures as deemed required using professional judgement to identify whether the information is consistent with the financial statements and the auditor's knowledge obtained during the audit and is prepared in accordance with legal requirements. The corporate governance statement is a Directors' Report requirement but can be provided separately. There are specific requirements under section 497A for when a separate corporate governance statement is provided, and these include procedures over the disclosure of the main features of the company's risk management and internal control systems, but again, there is no current requirement to opine on the effectiveness.

   Note: Please see Appendix – Definitions for full excerpts from the ISAs (UK) and the Companies Act 2006

   The lack of requirement for mandatory external assurance over the declaration may result in a challenging position and whether or not external assurance is sought by the board under the AAP over the declaration (or indeed other sections of the report), the external auditor continues to have responsibility in respect of the "Statutory Other information" as described above.

   Auditors can currently choose whether to place reliance on controls by testing operating effectiveness but may choose not to where this is not the most efficient and effective approach. Given the increased focus which will likely be placed on the new internal controls' effectiveness assessment and investor expectation, external auditors may be reluctant to sign off their Audit Reports without further work over the declaration, or they will extend the scope of their statutory audit work to test the operating effectiveness of key controls, whether or not they are designed to address the assessed risks of material misstatement in the financial statements.

In addition, we believe that the drafting of Principle N should be considered further, with proposed amendments highlighted below:

'The board should also establish and maintain an effective risk management and internal control framework. ***This should include clear documentation of how the board will identify, measure, and respond to the principal risks the company faces in seeking to achieve its long-term strategic objectives. In addition, the board should monitor the risk management and internal control framework, including the progress made in remediating any deficiencies to ensure that this is timely and commensurate with the risk that they mitigate.'***

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?

From a cost of compliance perspective, we consider, on balance, the board's declaration should be based on the position as at the date of approval of the Annual Report and Accounts. Whilst there is merit in the declaration being *'throughout the reporting period and up to the date of the annual report'* as per the draft Provision 30, practically, many companies have more formalised controls aligned to their financial reporting year end. Consequently, companies are likely to be more able to meet the proposed requirement of reporting on compliance at the date of approval, following a full annual review.

Principle N and the associated Provisions 26 and 30 imply that monitoring should be continuous, but our view is that this should be stated clearly, in the same way that the provisions specify that the review, upon which the declaration is based, should be performed *'at least annually'*.

We note that the proposal includes a requirement to report on any material weaknesses identified in the period through testing of operating effectiveness, whether remediated or not, which will provide stakeholders with the key information for the full reporting period.

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 the change from 'financial' to 'reporting' controls as this makes explicit the responsibility of the board to cover controls over narrative information given the increased investor focus on this area and the need for consistency between the annual report and the financial statements. In addition, this approach is in line with the extension of the remit of audit committees to be responsible for monitoring the integrity of narrative reporting.

However, there needs to be consistency in scope and language between Provision 30 (and associated definitions), the AAP, and any implementation guidance provided as these, as currently drafted, could lead to further expectations gaps and misunderstandings with respect to assurance commissioned.

By way of example, the draft AAP legislation, requires the directors to (1) '*describe what external assurance, if any, the company intends to seek in the next three years, in relation to the annual accounts and reports of the company*' and separately to provide (2) '*an explanation of whether, and if so how, the company intends to seek external assurance over… the effectiveness of the company's internal controls over financial reporting*'. The scope of Provision 30 as drafted is purposefully much wider and does not focus on controls over financial reporting but extends this to include narrative reporting as well as operational and compliance controls.

Where the board decide that external assurance is required over (2) '*the effectiveness of internal controls over financial reporting'*, it may be inferred that, given this could be included within the overall board declaration under Provision 30, assurance has been provided over the declaration in full.

Q16 To what extent should the guidance set out examples or methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

The board currently has responsibility for determining how they monitor and assess the effectiveness of the risk management and internal control processes. Given the variety of companies that report under the Code, from those who have multi-national global operations to those that have one business located in the UK we do not consider mandating specific methodologies would be meaningful.

A key strength of the US Sarbanes-Oxley ('SOX') regime is that it provides a clear framework which is understood by companies, auditors, and investors alike in respect of the design and operating effectiveness of financial controls over reporting, internal testing to underpin the directors' declaration and the nature and extent of external assurance provided. Applying a more principles-based approach allows for flexibility but leaves the requirements open to interpretation and it is likely that it will take several years to determine what is acceptable in terms of the level of disclosure and assurance in this area.

The improvement in governance, however, will be directly correlated to the effort and focus directors give to the establishment, maintenance and monitoring of an effective risk management and internal control framework. The inclusion of examples of methodologies or frameworks for both the design and implementation (such as the Committee of Sponsoring Organisations or 'COSO' framework) and the review of effectiveness will provide a

useful 'minimum standard' to set expectations of what is required of the board, and a benchmark for investors to assess individual companies' approaches and the level of assurance provided.

In addition, we consider that the disclosure requirements in Provision 30 should be extended to add a further bullet point which requires disclosure of whether the company has adopted a reputable third-party risk management and internal control system, and if so whether it has been significantly tailored, or whether it has established its own risk management and internal control system. If a bespoke system has been implemented the key components and how they operate should be disclosed.

We also recommend that the provision is expanded to explicitly require explanation of when the monitoring and assessment of effectiveness has been delegated, to whom and for what reason.

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?

In our view, the definition of a material weakness should draw on currently available and accepted definitions where possible. For example, International Standards on Auditing (UK) ('ISA(UK)') currently include a requirement to report significant deficiencies in internal controls over financial reporting to those charged with governance, and is therefore a concept which management, directors and auditors are familiar with. We consider that the definition within the Code should directly reference and be reconcilable to the definition within ISA(UK) and take into account definitions used by the Public Company Accounting Oversight Board ('PCAOB') in their application of the Sarbanes-Oxley Act.

We suggest the following definitions:

A material weakness is a deficiency, or a combination of deficiencies, in the design or operating effectiveness of the risk management and internal controls system, such that there is a reasonable possibility that a material risk to the company's strategic, operational, reporting and compliance objectives will not be prevented or detected on a timely basis.'

Deficiency in internal control - This exists when: (a) A control is designed, implemented, or operated in such a way that it is unable to prevent, or detect and correct, risks to the company's strategic, operational, reporting and compliance objectives on a timely basis; or (b) A control necessary to prevent, or detect and correct, risks to the company's strategic, operational, reporting and compliance objectives on a timely basis is missing.

Significant deficiency—A deficiency or combination of deficiencies in internal control that is less severe than a material weakness but is of sufficient importance to merit the attention of those charged with governance.

Including a definition within the guidance of what constitutes an effective risk management and internal controls system would be useful and should indicate the breadth in scope. We suggest:

'An effective risk management and internal control system provides reasonable assurance regarding the process to identify and mitigate risks to achieving the company's strategic objectives and over the reliability of reporting. If one or more material weaknesses exist, the company's risk management and internal control system cannot be considered effective.'

The third bullet of Provision 30 includes reference to "material weaknesses or failures". If the definition of a material weakness is sufficient the reference to failures should not be required.

In our view, it would be helpful to users of the Annual Report and Accounts if companies explained their judgement in determining what they considered to be a material weakness when reporting these in accordance Provision 30. This will make clear to users what threshold has been applied. A company may have differing materiality levels for different elements of the Annual Report and Accounts. Reporting could therefore reference the overall materiality figure as stated in the audit report for financial matters and explain a more qualitative materiality threshold applied in relation to, for example, ESG matters or controls over strategic, operational or compliance objectives.

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

We consider that it would be helpful if the FRC provided application guidance on the level of detail that companies would be expected to include when setting out how they have complied with Provision 30.

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We also think it would be useful to provide guidance on what could constitute a reportable material weakness in the risk management and internal controls systems over operations and compliance. In addition, guidance on situations where it could be acceptable for disclosure to be withheld based on commercial sensitivity, if any, should be included.

Following on from our response to Question 13 above we consider that implementation guidance will be crucial in reconciling the differences in scope between the Code and the AAP, and in avoiding a further expectations gap in respect of the perceived and actual responsibilities of the statutory auditor in respect of the declaration. There should be clear guidance as to the responsibilities of the auditor with respect to the declaration of effectiveness, the explanation of the basis for the declaration and the disclosures relating to material weaknesses. This should consider and build upon the current guidance in respect of 'Statutory Other Information' as described above, and explicitly cover the scenarios where the board determines that no external assurance is required over the declaration by the statutory auditor (in part or overall), or where that assurance is provided by a third party. This should be clear in the scope of work and include expected procedures. There is a well-documented resource gap in the UK with respect to statutory auditors and being clear in this guidance will help to ensure that procedures performed by auditors are sufficient and appropriate.

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.

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

We agree. The introduction of the viability statement in response to certain well publicised corporate failures has placed more emphasis on boards to disclose details of their assessment of the long-term viability of the company, including incorporating scenario analysis to stress test the board's future planning assumptions. The inclusion of this statement has provided further information to both shareholders and stakeholders which is helpful in assessing the financial impact of the principal risks and uncertainties on the business.

Cross referencing to the legislated Resilience Statement should also improve reporting on key inputs to scenario analyses performed and make clear the expectation to perform and report on a reverse stress test.

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?

We agree.

Section 5 – Remuneration

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

The amendments to existing Principle Q (new Principle P) are clear in the requirement for remuneration outcomes to align to company performance, purpose, and values, and emphasise that this should include successful delivery of the company's strategy including ESG. We agree that the increased reporting should allow investors to determine if there is a clear link and therefore further inform their engagement and voting on remuneration packages.

We suggest the following update to the first bullet in existing Provision 41 (new Provision 43) to: "an explanation of how the strategic rationale for executive directors' remuneration policies, structures and any performance metrics ***is aligned to company performance, purpose and values and*** supports company strategy and environmental, social and governance objectives" and believe that this will result in increased transparency and indirectly result in clearer links between performance and pay.

Further explicit requirements or guidance could also be included to highlight the expected direct linkage of executive director remuneration targets to the disclosed key performance indicators (financial and non-financial) in the business review, these already being the key measure of performance against the company strategic priorities and, by extension, purpose, and values. This will ensure that the executive directors are personally accountable (in terms of remuneration outcomes) for the achievement of these targets.

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 to Provisions 39 and 40 will result in increased transparency in respect of malus and clawback provisions and allow shareholders and stakeholders to assess how a company assesses and addresses 'bad performance'.

Recently, we have seen examples of shareholders in major FTSE companies vote against the remuneration of executive directors as, in their view, remuneration packages have been excessive when compared against the performance of the company. Introducing the changes in Provisions 39 and 40 will help to align future executive director performance with the objectives of a company's shareholders and stakeholders.

In addition, the 2022 Review of Corporate Governance Reporting stated that 'Despite the high number of companies setting out their conditions, there continues to be limited use of these provisions'. The inclusion of a provision which requires companies to explain their rationale for not using malus or clawback provisions when one or more of the conditions has been met in the year (for example a prior period restatement) could provide further transparency in this area.

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

We agree with the proposed changes to Provisions 40 and 41. Existing Provision 40 generally resulted in companies quoting the list of bullet points within the Remuneration Report as a 'tick-box' exercise without providing explanation or rationale as to how each had been addressed in practice. Whilst the provision provided a good overarching set of principles for the remuneration policy, we do not consider that its removal will change how remuneration policies are structured in practice.

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

We do not believe that the requirement to engage with the workforce on how executive remuneration aligns with the wider pay policy and the complementary requirement to disclose and comment on their appropriateness using pay gaps and pay ratios should be removed. Company employees are key stakeholders, and their views should be considered when setting executive pay and provide a key feedback mechanism for remuneration committees. In addition, this information has been helpful in benchmarking companies against their peers and allowing the users of Annual Accounts to track how these metrics change over time.

There are existing legislative requirements to disclose pay gaps and ratios, along with analysis, but we propose that the requirements in this area are retained and in fact strengthened to include specific additional pay ratios, require meaningful explanation of what the metrics are showing, and details of any steps being taken because of the analysis.

As a separate point, the government has decided that it will not be legislating mandatory ethnicity pay gap reporting despite there being support and continued calls on companies to report the data (for example from the Chartered Institute of Personnel and Development which has published guidance for voluntary reporting). Our view is that including a requirement to disclose ethnicity pay gap data on a 'comply or explain' basis would be in line with the focus on diversity throughout the Code and an opportunity to encourage those companies for which this data is meaningful to provide these disclosures. There is precedent for this approach, such as the inclusion of specific workforce engagement requirements within Provision 5 when the proposed legislation to require worker directors was not taken forward.

Appendix – Definitions and references

ISA (UK) 700 - Forming an Opinion and Reporting on Financial Statements

Paragraph 39

(ii) To obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

ISA (UK) 720 - The Auditor’s Responsibilities Relating to Other Information

Paragraph 12

(c) Other information – Financial or non-financial information (other than financial statements and the auditor’s report thereon) included in an entity’s annual report.

(d) Statutory other information – Those documents or reports that are required to be prepared and issued by the entity (including any reports or documents that are incorporated by cross reference) in relation to which the auditor is required to report publicly in accordance with law or regulation. (Ref: Para. A10-1)

In the UK, the statutory other information includes, where required to be prepared:

(i) The directors’ report;
(ii) The strategic report;
(iii) The separate corporate governance statement.

Paragraph 14-1. For entities that are required to prepare statutory other information, the auditor shall read the statutory other information and, in doing so shall consider, based on the work undertaken in the course of the audit, whether the statutory other information appears to be materially misstated in the context of the auditor’s understanding of the legal and regulatory requirements applicable to the statutory other information.

Paragraph 14-2. For entities that are required to prepare statutory other information, as the basis for the consideration required by paragraphs 14(a), 14(b) and 14-1, the auditor shall perform such procedures as are necessary in the auditor’s professional judgment to identify:

a) Any material inconsistencies between the other information and the financial statements;
b) Any material inconsistencies between the other information and the auditor’s knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit; and
c) Whether the statutory other information appears to be materially misstated in the context of the auditor’s understanding of the legal and regulatory requirements applicable to the statutory other information.

Section 496 of the Companies Act 2006

Where the corporate governance statement is provided within the Directors’ Report.

In his report on the company's annual accounts, the auditor must-

a) state whether, in his opinion, based on the work undertaken in the course of the audit—
    (i) the information given in the strategic report (if any) and the directors’ report for the financial year for which the accounts are prepared is consistent with those accounts, and
    (ii) any such strategic report and the directors’ report have been prepared in accordance with applicable legal requirements,
b) state whether, in the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, he has identified material misstatements in the strategic report (if any) and the directors’ report, and
c) if applicable, give an indication of the nature of each of the misstatements referred to in paragraph (b).

Section 497 of the Companies Act 2006

Where the company prepares a separate corporate governance statement in respect of a financial year, the auditor must, in his report of the company’s annual accounts for that year—

a) state whether, in his opinion, based on the work undertaken in the course of the audit, the information given in the statement in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook made by the Financial Conduct Authority (information about internal control and risk management systems in relation to financial reporting processes and about share capital structures)—

    (i) is consistent with those accounts, and

    (ii) has been prepared in accordance with applicable legal requirements,

b) state whether, in the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, he has identified material misstatements in the information in the statement referred to in paragraph (a),

c) if applicable, give an indication of the nature of each of the misstatements referred to in paragraph (b), and

d) state whether, in his opinion, based on the work undertaken in the course of the audit, rules 7.2.2, 7.2.3 and 7.2.7 in the Disclosure Rules and Transparency Rules sourcebook made by the Financial Conduct Authority (information about the company's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees) have been complied with, if applicable.