



Financial Reporting Council

UK Corporate Governance Code

Consultation document

May 2023

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Foreword

This consultation on the UK Corporate Governance Code focuses largely on internal control, assurance, and resilience. Our proposals have been developed, following significant stakeholder engagement, to address the policy issues asked of the FRC by the Government in its response to the consultation: Restoring Trust in Audit and Corporate Governance.

In recent years it is arguable these subjects have not attracted the attention they deserve, but they are of course crucial in terms of governing the quality of auditing and reporting, and the effective management of risk. All these issues inevitably require greater attention in times of economic stress – when creating sustainable value in stable capital markets becomes even more important. When the new Code is issued it will be part of a wider framework of measures that will improve accountability, build trust and support investment and stewardship decisions in the UK.

The Government recommended that there should not be a legislative approach to reporting on internal controls. Our consultation includes an approach which makes clear the board's accountability for this issue, yet reflects the need for flexibility, proportionality and consideration of the particular circumstances of individual companies in a way that will enhance transparency and investor confidence.

The new proposals in the Government's response for a resilience statement and an audit and assurance policy for Public Interest Entities (PIEs) require further changes to Section 4 of the Code, and consideration of how these issues are addressed for those Code companies which are not PIEs.

Finally – in relation to the White Paper – we propose changes to improve transparency of malus and clawback provisions in relation to directors' remuneration.

The FRC is also taking this opportunity to improve the functioning of comply-or-explain through a new Principle in section 1, and to improve reporting on diversity (particularly in relation to the success of diversity policy initiatives) in Section 3.



David Styles

Director,
Corporate
Governance
and
Stewardship

The Code's success relies on companies, investors and a wide range of stakeholders engaging to improve the quality of governance and stewardship, and to embrace the comply-or-explain nature of the Code. Boilerplate statements, playing back the words within the Code rather than applying the spirit of the Code, do not deliver the transparency that the market needs. Equally, investors and their advisors must consider explanations for departures from the Code thoughtfully, taking full account of company circumstances.

We hope that a wide range of stakeholders will engage with this consultation and as always, we welcome views which will seek to improve the functioning of the Code still further.

David Styles

Director, Corporate Governance and Stewardship
Financial Reporting Council

Introduction

General approach

- 1 The UK Corporate Governance Code (the Code) is a highly effective driver of good governance in the companies that adopt it, either as a requirement of the Listing Rules, or because they choose to do so voluntarily. The Code has been emulated in other jurisdictions and has been successful because it is principles-based and flexible, rather than being prescriptive.
- 2 Unlike the wide-ranging review in 2018, this consultation is focused on the legislative and governance reforms the Government proposes, which support the FRC's transition into the Audit, Reporting and Governance Authority (ARGA). These reforms are set out in [Restoring trust in audit and corporate governance](#). In July 2022, we published a [position paper](#) which sets out how we will support the Government's reforms. The proposed revisions described below build on the themes set out in this paper.
- 3 The main proposed changes concern those parts of the Code which deal with the need for a more robust framework of prudent and effective risk management and internal controls. They are aimed at providing a stronger basis for reporting on, and evidencing the effectiveness of, the framework during the reporting period.
- 4 Revisions also reflect the wider responsibilities of the board and audit committee for expanded environmental, social and governance reporting and, where commissioned by the company, appropriate assurance in accordance with a company's Audit and Assurance Policy. The proposed introduction of the [Audit Committees and the External Audit: Minimum Standard](#), on which the FRC consulted earlier this year, has led to some proposed amendments to remove duplication, and to highlight the importance of audit tendering in the context of expanding audit market diversity.
- 5 New draft legislation is being prepared which will include a requirement for companies with a high number of employees and a high level of turnover to produce a Resilience Statement. These companies are defined in the draft legislation as companies which have 750 or more employees and a turnover of £750 million or more, and are referred to as Public Interest Entities (PIEs) in the remainder of this document. The Resilience Statement requirement has implications for the Provisions in the Code which relate to a going concern basis of accounting and company viability. Although this legislation has not yet been laid, a summary of the draft proposals has been made available as Annex C to this consultation.
- 6 We are also consulting on areas where reporting can be improved, as identified in our latest [Review of Corporate Governance Reporting](#). In areas where reporting is weaker, we propose adapting the existing Code provisions. We have included a proposed new Principle to emphasise that reporting should demonstrate the outcomes of governance activities where possible, as our Review of Corporate Governance Reporting has indicated that is an area where improvement is needed.

Structure of the Code

- 7 One of the Code's strengths is the fact that it is clear and concise. In making the proposed changes, we have sought to maintain this clarity, and have removed duplication where possible. There have been no changes to the structure of the Code and the five sections remain as they were. Although some amendments have been made to all sections, most of the changes are in section 4 on Audit, Risk and Internal Control.
- 8 Also unchanged is the approach to having principles, which companies must apply, supported by provisions to which a 'comply or explain' approach is taken. In our most recent [Review of Corporate Governance Reporting](#) we found that more companies are using the flexibility of the 'comply or explain' nature of the Code, with 27 companies out of the 100 reviewed claiming full compliance with the Code this year, compared to 58 companies last year. The fact that more companies are willing to use the flexibility the Code offers demonstrates the benefits of the Code's approach to governance, which allows companies to choose bespoke governance arrangements most suitable to their circumstances in both the short and long-term.
- 9 We continue to emphasise, however, the importance of clear and meaningful explanations for departures from the Code. Such explanations should clearly demonstrate that the proposed departure still ensures effective governance arrangements, maintaining the application of the Code's principles.

Guidance and application date

- 10 The revised Code will be supported by updated guidance, and work is currently underway to revise the Guidance on Audit Committees and Guidance on Board Effectiveness so that these can be aligned with the revised Code and Audit Committee Standard. We are also amending the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting specifically to take account of changes to principles and provisions on risk management and internal control. In this consultation document, we indicate some of the key changes which we are considering in guidance, and we ask for input in these areas. The process of finalising the revised guidance will continue alongside the consultation, and we plan to have the new guidance available when the new Code becomes applicable.
- 11 Our intention is that the revised Code will apply to accounting years commencing on or after 1 January 2025 to allow sufficient time for implementation.

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- ¹² On 3 May 2023 the Financial Conduct Authority (FCA) issued a consultation on Primary Market Effectiveness. Amongst other matters, the FCA's consultation proposes a move from standard and premium listing to a single category for listed companies. This means that more companies would potentially be required by the Listing Rules to follow the Code. We support the FCA consultation, which fits with our flexible and proportionate Code. The proposals have the potential to increase the number of companies who use the Code to drive high-quality corporate governance and its reporting, and improve market confidence. We encourage companies to respond to the FCA [consultation](#), and we welcome any further views on the changes to the Code in the context of potential changes to the Listing Rules.

Responding to the consultation

- ¹³ We welcome comments on the revised Code. A full list of consultation questions can be found at the end of this paper. If you wish to make general comments not relating to a specific question, please clearly state the Principle or Provision the comment relates to, so that these can be more effectively captured as part of the post-consultation review.
- ¹⁴ To support your review of the proposed changes, please see attached to this consultation document the following appendices:
- Appendix A: Draft revised UK Corporate Governance Code (tracked changes version);
 - Appendix B: Draft revised UK Corporate Governance Code (clean version); and
 - Appendix C: Summary of draft secondary legislation on corporate reporting.
- ¹⁵ Comments on the questions set out in this consultation document are requested by **Wednesday 13 September 2023**. Responses should be sent by email to codereview@frc.org.uk.

Section 1 – Board leadership and company purpose

- 16 Section 1 of the Code sets out the overarching role of the board, covering areas such as the purpose of the company, its long-term sustainable success, generating value for shareholders and contributing to wider society. These matters are of great importance and companies generally report well on them, meaning the changes proposed to this section are limited.
- 17 Some of the amendments in this Section are consequential to changes made elsewhere in the Code. For example, we propose combining Principles C and O into a single Principle N on risk and internal controls, and this led to changes in Section 1 of the Code.
- 18 In addition, we are proposing some clarifications and adjustments informed by our research and assessment of reporting against the Code over the past three years. Most significantly, we plan to introduce a new Principle which sets out our expectation that companies should, when reporting on their governance activity, focus on activities and outcomes to demonstrate the impact of governance practices. Reporting has been lacking in this respect and, while we have previously drawn attention to this, for example in our [Reviews of Corporate Governance Reporting](#), we hope that introducing a Principle which covers this expectation will help companies make greater progress in this area, and better meet the needs and expectations of their stakeholders.
- 19 The order of some principles in Section 1 has been adjusted, and we propose adding a reference to policies and practices in current Principle C (part of Principle A in the new Code). We have also made some small amendments to the provisions in this section. These are intended to bring more focus to environmental and social matters, including climate ambitions and transition planning, to encourage companies to report on the effectiveness of embedding their culture in line with findings of our 2021 report: '[Creating Positive Culture – Opportunities and Challenges](#)'. A reference to investing in and rewarding the workforce has been moved to Section 5 of the Code on Remuneration.

Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

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?

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

Section 2 – Division of responsibilities

- 20 There is increased concern from investors about the number of board positions held by executive and non-executive directors of companies listed in the UK, as evidenced by changes to voting guidelines in this area to limit the number of directorships a director can hold. As the environment in which companies operate becomes more complex, it is important that those in leadership positions can devote sufficient time to their responsibilities. This applies when organisations experience challenging situations which demand more intensive consideration and action, or when new issues arise such as cybersecurity, artificial intelligence or the interpretation of environmental data.
- 21 The Code recognises this through current Principle H, which specifies that non-executive directors should have sufficient time to meet their board responsibilities. In current Provision 15, the Code states that demands on directors' time should be considered when making appointments or agreeing to additional external appointments. In addition, this Provision states that full-time executive directors should not take on more than one non-executive directorship in a FTSE 100 company or other significant appointment.
- 22 We propose strengthening the Code in this area in recognition of the increasing demands on directors' time, and as a way of further supporting diversity of skills and experience on boards. To safeguard high quality decision making in a complex world, boards will need to attract candidates who bring new experience and skills to the table.
- 23 However, we do not believe it is helpful to specify in the Code (or in guidance) a maximum number of board appointments which can be held by a director, beyond the existing reference to full-time executive directors. This is because it is difficult to be precise about how much time each board position demands. For example, such a limit would not take into account varying committee membership requirements, the size and complexity of the organisations involved and other constraints on directors' time not related to board appointments.
- 24 We are therefore interested in receiving feedback on two proposals. The first, which relates to Section 3 of the Code but is set out here for convenience, concerns a possible change to current Code Principle L (Principle K in the revised Code), to specify that the annual board performance review should consider each director's commitments to other organisations, and how directors are able to make sufficient time available to discharge their role effectively. We are inviting views on whether giving the issue more prominence in a board's discussions on its own performance is likely to lead to positive changes.
- 25 The second proposal, in Provision 15, is that annual reports should include more information on directors' other commitments and how they manage these. This should include setting out not only board positions but also committee roles and the potential number of commitments each year. We would welcome views on whether this increased transparency might have a positive impact on how directors determine that they have sufficient time available for their roles.

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?

Section 3 – Composition, succession and evaluation

Diversity and inclusion

- 26 The importance of diversity and inclusion in the composition of the board, executive management and in succession planning, is already highlighted in the Code, in current Principles J and L, and Provisions 17, 19 and 23. There are also a number of mandatory requirements and voluntary initiatives outside of the Code about diversity and inclusion. These requirements are somewhat fragmented, and rather than adding to an already complex reporting landscape, the changes we propose are designed to facilitate a more joined-up approach.
- 27 In April 2022, the Financial Conduct Authority (FCA) published its [Policy Statement](#) on diversity and inclusion for company boards and executive management. From this date, the Listing Rules require certain listed companies to include a ‘comply or explain’ statement in their annual report on whether they have achieved targets for women and ethnic minority representation on their board. Annual reports should also include a standardised numerical disclosure on the ethnic background and gender identity or sex of their board, key board positions and executive management team.
- 28 Our revisions are intended to strengthen the Code in this area and support the FCA’s policy without introducing additional, duplicative targets or regulations. We propose an amendment to current Principle J (Principle I in the new Code) to include a reference to inclusion, and to give equal weight to all protected and non-protected characteristics, to encourage companies to consider diversity beyond gender and ethnicity.
- 29 In terms of the provisions in this section, we propose to split current Provision 17 into two new Provisions, 17 and 18. We have included an additional sentence at the end of Provision 18 to support companies working towards the FCA targets and any additional voluntary targets and initiatives. We also propose amendments to current Provision 23 (which becomes Provision 24 in the new Code), in order to provide improved clarity on company approaches to succession planning and board and senior management appointments. Our annual reviews continue to identify poor reporting on companies’ approaches to succession plans, with reporting in most cases suggesting that succession arrangements are reactive as opposed to proactive.
- 30 Additional changes to Provision 24 (formerly Provision 23) are aimed at improving transparency to understand the role of any targets or initiatives companies have chosen to use to achieve greater diversity and inclusion in their boards and executive management.
- 31 We hope this will encourage companies to think about specific approaches that suit their individual circumstances, instead of using ‘boilerplate’ statements in their reporting.

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- Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?**
- Q7: Do you support the changes to Principle 1 moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?**
- Q8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?**

Board performance reviews

- 32 In 2021, the Chartered Governance Institute (CGI) published its [Review of the effectiveness of independent board evaluation in the UK listed sector](#). This review was commissioned by the Government in response to consultation feedback from stakeholders, including institutional investors, indicating that the standards or thoroughness of board evaluations can vary significantly, as can a company's approach to dealing with any issues identified. The FRC has considered this review, as well as the responses received by CGI on the associated consultation.
- 33 One of the conclusions of the CGI review is that, while it is possible to identify some elements of what would be widely recognised as good practice in the way independent reviews of boards are conducted, it would not be appropriate to be overly prescriptive. However, it is legitimate for shareholders and others to seek greater accountability from both companies and reviewers as to how reviews are conducted. A total of 15 recommendations are made in the review, some of which have implications for the Code.
- 34 An important recommendation from the review is that the FRC should consider adopting the term 'board performance review' instead of 'board evaluation' in the next Code update. This is because the CGI review has found that use of the term 'evaluation' has contributed to the erroneous perception that externally facilitated reviews are intended as a backwards-looking assurance function, whereas the value of such reviews is in informing a continual process of self-improvement for boards. We propose to adopt this change wherever 'board performance review' is referenced specifically, although we will retain more general references to evaluation of performance and effectiveness where appropriate.
- 35 A further recommendation of the CGI review is that the FRC should issue guidance to listed companies on how to report against Provisions 21 and 23 of the current Code, which require companies to make certain disclosures relating to board performance reviews. [Draft guidance](#) has been produced by CGI, and this guidance was consulted on in 2019. We propose to incorporate many aspects of the CGI's guidance in our revised guidance.
- 36 We propose amending Provision 21 (22 in the new Code) to clarify that the chair should commission, rather than consider having, a board performance review. This is to reflect the increased maturity of the board performance review market. We also propose an amendment to Principle L around directors' time commitments (see section 2).

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?

Section 4 – Audit, risk and internal control

Audit and Assurance Policy

- 37 In '[Restoring trust in audit and corporate governance](#)', the Government set out its plans to introduce an Audit and Assurance Policy (AAP) for PIEs. The detail of the requirements of the AAP will be set out in regulations, but it is expected that it will require PIEs to set out:
- Their internal auditing and assurance arrangements.
 - What external assurance, if any, the company proposes to seek beyond the statutory auditor's duties.
 - A description of the policy in relation to the tendering of external audit services.
 - Whether any external assurance proposed will be 'limited' or 'reasonable' assurance.
 - Whether any external assurance beyond the statutory audit will be carried out according to a professional standard.
 - How the AAP has taken account of shareholder and other stakeholder views.
 - Whether and how the company intends to seek external assurance over any part of the Resilience Statement or over reporting of its internal controls in relation to financial reporting.
- 38 The Government has confirmed, in '[Restoring trust in audit and corporate governance](#)', that PIEs which are required to produce an audit committee report should include a triennial AAP and an annual implementation report on the AAP within the annual report. While the Government does not specify that the audit committee should have responsibility for developing the AAP, we propose this in the revised Code, due to this committee's experience of oversight of external audit matters and wider understanding of assurance. Of course, this work would not be undertaken in isolation, and we expect that the audit committee will engage with the board and other board committees such as the risk committee, if the company has one. We have also proposed that the audit committee takes the lead in engaging with shareholders and other stakeholders in relation to the AAP.
- 39 We recognise that the legislation on the AAP statement will apply to PIEs only. Nevertheless, in our view all companies reporting against the Code should consider producing an AAP on a 'comply or explain' basis, using the legislation as a guide to what should be included. This approach will ensure that there is consistency in the matters that audit committees consider as part of the AAP, which is particularly important to stakeholders who have called for the provision of consistent and comparable reporting. Our proposal is, therefore, designed to meet stakeholder needs better, and we believe that a single requirement covering all Code companies is easier to comply with and monitor against.

40 We have also noted in our annual '[Reviews of Corporate Governance Reporting](#)' that there appears to be little engagement between shareholders and audit committees. The Government consultation response noted that "Investors have made clear in consultation responses that they place increasing importance on the reliability of company reporting beyond the financial statements."¹. Therefore, we have included an additional point in relation to the audit committee engaging with shareholders.

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

Audit Committees and the External Audit: Minimum Standard

41 Between November 2022 and February 2023, the FRC consulted on a draft Minimum Standard for Audit Committees in relation to external audit (the Standard). The final Standard is available [here](#).

42 The Standard was developed following a recommendation from the Competition & Markets Authority that the FRC "should have the power and a requirement to mandate minimum standards for both the appointment and oversight of auditors", initially applied to the audit committees of all FTSE 350 companies. The Government incorporated this recommendation into '[Restoring Trust in Audit and Corporate Governance](#)'.

43 The Standard contains several sections which are identical to aspects of Provisions 25 and 26 (26 and 27 in the new Code), specifically where these Provisions cover the work of the audit committee in relation to external audit, and the requirement for the audit committee to report on this. To avoid duplication, we propose that these aspects of Provisions 25 and 26 (which become Provisions 26 and 27 in the new Code) are removed, and that the new Code instead refers companies to the Standard.

44 We recognise that, as the Code applies to premium listed companies, there will be some non-FTSE 350 companies who will be brought into the scope of the Standard because of this proposal. However, two sections of the Standard were previously already included in the Code so they are not new, and the majority of the remaining sections has been developed using existing legislation and guidance which many companies already follow. Non-FTSE 350 companies can approach the Standard including these new sections on a 'comply or explain' basis.

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?

1 See paragraph 3.2.9 in 'Restoring trust in audit and corporate governance'

Sustainability reporting

- 45 Environmental, Social and Governance (ESG) factors and sustainability have become essential considerations for companies throughout the world. The current reporting landscape is fragmented with investors, regulators and stakeholders seeking more information, some of which is linked to regulations or targets. Companies are also setting out sustainability-related plans and strategies based on their own internal assumptions and business models. The FRC continues to work closely with both UK and international regulators and standard setters to develop frameworks which support consistent and comparable high-quality reporting underpinned by robust evidence.
- 46 Issues related to greenwashing or insufficient transparency as to how environmental targets have been set, and how these relate to financial planning and financial outcomes, are a concern for many investors and stakeholders. This information increasingly influences capital allocation decisions, and therefore, needs to be as reliable as financial information. In our last [Review of Corporate Governance Reporting](#) we found wide ranging differences in how companies report on and seek assurance, in relation to their sustainability-related disclosures.
- 47 Companies are now introducing expertise on these matters in various ways, including at senior management levels, or via ad hoc specialist advice to boards. It is important that boards consider their longer-term approach to being able to form an independent judgement in the area of ESG.
- 48 We have found that companies are beginning to seek external assurance regarding some, or all, of their disclosures related to sustainability, but the market is still at a comparatively immature stage. We expect that both standards and assurance in this area will continue to develop further in the medium term. Therefore, the Code should reflect the importance of these matters and recognise that good governance will play an essential role in assessing sustainability-related risks, opportunities and impacts, setting targets, using appropriate internal controls and commissioning assurance where necessary.
- 49 We considered whether it might be necessary to recommend that Code companies should have sustainability committees. However, as already explained, companies are building experience in different ways and the issues related to sustainability and ESG might be dealt with by risk committees, people committees, management teams or external experts. It is important for all these areas to work together to support the board.
- 50 The audit committee has experience in setting policies and frameworks which could be adapted to ESG metrics, and as such it is best positioned to oversee ESG disclosures, controls, processes, and assurance. The audit committee's expertise in financial reporting enables it to understand and assess the soundness of the methodologies and policies management it is using to develop its metrics and other ESG disclosures. A connection between the oversight of financial and ESG reporting is likely to be helpful, and the introduction of both the Resilience Statement and the Audit and Assurance Policy will mean that the audit committee will have new responsibilities that will make it necessary to consider wider sustainability-related matters.

51 Our Position Paper, published in July 2022, outlined our intention to make necessary revisions to the Code to reflect the wider responsibilities of the board and audit committee for expanded sustainability and ESG reporting and, where commissioned by the company, appropriate assurance in accordance with a company's Audit and Assurance Policy. We have incorporated these proposals in Provisions 26 and 27 (in the new Code) which give the audit committee a new responsibility for monitoring the integrity of narrative reporting, including sustainability reporting, and for describing its work in this area in the annual report (where these matters have not been reserved for the board). We also propose that the annual report should describe, where commissioned by the company, the assurance of ESG metrics and other sustainability-related information.

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?

Risk Management and Internal controls

- 52 The FRC was invited by the Government, in '[Restoring trust in audit and corporate governance](#)', to make amendments to the Code which strengthen board accountability and reporting in relation to internal controls. Specifically, the Government requested the inclusion of a requirement for an explicit directors' statement about the effectiveness of the company's internal controls, including those over financial reporting, but also about wider operational and compliance risks and the basis for that assessment.
- 53 In our Position Paper we set out our intention to revise those parts of the Code which deal with the need for a framework of prudent and effective controls, to provide a stronger basis for reporting on, and evidencing of, the effectiveness of internal controls (including those operating over financial reporting), but also wider operational and compliance risks. As part of our ongoing engagement with stakeholders, we have taken the opportunity to consider how the Code can be strengthened in this area.
- 54 As a result of this initial engagement, the approach we are proposing is one that fits within a principles and provisions based 'comply or explain' Code. It is designed to strengthen board accountability for the effectiveness of the risk and internal controls framework by confirming that the board has put in place and maintains effective systems that deliver the expected outcomes. We consider that the approach provides improved accountability and transparency, while avoiding disproportionate burdens on business and allowing flexibility for companies to tailor their arrangements to their own circumstances.

- 55 Our work in this area has focused on existing Principles C and O and existing Code Provision 29. We have merged the requirements of these two Principles in relation to establishing risk management and internal control systems. The new Principle will go further by making the board responsible not only for establishing, but also for maintaining the effectiveness of, the risk management and internal control framework. This emphasises the board's accountability for monitoring and reviewing the effectiveness of the framework. As the Listing Rules require companies to explain in the annual report how they have applied the Principles of the Code, the new Principle ensures boards are responsible for reporting to the shareholders on their work to maintain the effectiveness of this framework during the reporting period.
- 56 Provision 29 (30 in the new Code) already states that companies should monitor their risk management and internal control systems and, at least annually, carry out a review of their effectiveness. Companies should report on this review in the annual report. Our Annual Reviews of Corporate Governance Reporting have found that some companies report on the effectiveness of their risk management and internal control framework in their annual reports by providing a statement that their systems have been effective during the year or that no material weaknesses have been identified. However, these are a minority.
- 57 From those that do report on effectiveness, only a small number explain the basis for their statement, such as the work that has been undertaken by the board and other individuals to monitor and review these systems. Currently there is a lack of information about the risk management and internal control systems operated by companies, and the work carried out during the reporting period to maintain their effectiveness.
- 58 The Government's consultation demonstrated strong support for strengthening the UK's internal control framework based on requirements for more explicit reporting from the board on the effectiveness of risk management and internal control. Increased transparency on how effectively the board manages risks to the company's objectives, including operational, reporting and compliance objectives, increases investor and stakeholder confidence.
- 59 We propose to amend Provision 29, which will become Provision 30, in order to build on the current requirements of the Code by setting out clearer reporting expectations and, in particular, on the evidence gathered by the company in support of its reporting. The current Provision already requires that the monitoring and the review of the effectiveness of risk management and internal control systems should include all material controls, including financial, operational and compliance controls.
- 60 The scope of the new Provision will remain the same with one exception. We propose replacing the word 'financial' with 'reporting'. This is an important change; we know from stakeholder engagement that narrative reporting increasingly includes materially important information, in the context of each company, which is used by investors for capital allocation decisions. Such a change will bring the Code in line with current practices and standards, recognising the importance of narrative reporting on for example strategy, principal risks, corporate governance and environmental and social matters. These are important for investors to make investment allocation and stewardship decisions.

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- 61 Having effective controls which provide reasonable assurance over the quality and accuracy of such reporting contributes to better decision-making about capital allocation, investor engagement, exercise of shareholder rights, and overall market confidence.
- 62 Provision 30 will ask the board to declare whether they can reasonably conclude that the company's risk management and internal control systems, including material operational, reporting and compliance controls, have been effective throughout the reporting period and up to the date of the approval of the annual report by the directors.
- 63 The revised Provision will also ask the board to explain the basis for its declaration, which should include an explanation of how it has monitored and reviewed the effectiveness of these systems during the period and any other relevant information. Finally, the Provision will ask the board to report any material weaknesses identified in these systems during the reporting period and the actions taken by the board to address these.
- 64 The objective of our proposed approach is to avoid a situation where the review of effectiveness is seen as a one-off exercise, and which only assesses the effectiveness of the company's systems at one point in time. Companies already have processes in place for continuous monitoring of their risk management and internal control systems and the current Provision 29 states that the board is responsible for the monitoring and review of these systems.
- 65 Reporting on how the risk management and internal control systems have performed throughout the year reinforces directors' accountability for these systems and strengthens their focus on maintaining their effectiveness. It also gives shareholders and other investors a clearer picture of a company's ability to manage risk and the board's capability to address any shortcomings, contributing to enhanced investor confidence in the reporting and resilience of the company.
- 66 We do not envisage that companies will report on all weaknesses identified during the reporting period but be transparent about those weaknesses considered by that company to be material, such as those events which could have a significant impact on a company's strategy, operations, reporting or compliance objectives. The revised Guidance will discuss what may constitute a material weakness, but it will ultimately be for the board to determine which weaknesses are material to their specific situation and should be reported in the annual report.
- 67 The Code will not ask for reporting on whether the board intends to obtain external assurance over the effectiveness of the company's risk management and internal control framework. That will be a matter for companies to determine when setting their Audit and Assurance Policy. However, the revised Guidance may set out circumstances in which external assurance might be considered appropriate, to aid the development of that policy.

Risk and Internal Controls Guidance

- 68 An update to our [Guidance on Risk Management, Internal Control and Related Financial and Business Reporting](#) will be developed later in the year and finalised once we know the outcome of this consultation. It will build on the current guidance and its predecessor, the [Internal Control – Revised Guidance for Directors on the Combined Code](#) (October 2005).
- 69 We expect the updated guidance to set out possible structures, responsibilities, actions and recommendations but allow companies flexibility to adapt it to their unique circumstances and characteristics (e.g. industry, size, geography etc). Ultimately the board will need to be comfortable that the internal controls framework is sufficiently effective to enable them to make the declaration.

70 We propose that the guidance will not be prescriptive but will cover at least the following matters:

- The role of the risk management and internal control framework in achieving the company's objectives and its key elements (i.e. risk assessment, control environment and control activities, information and communication processes, and processes for monitoring the continuing effectiveness of these systems).
- Issues and areas that the board will need to consider in establishing and maintaining the risk management and internal control framework, for example, skills and experience, delegation of duties and responsibilities and so on.
- Duties and responsibilities of management, including their day-to-day responsibility for risk management and internal control systems.
- The role of the internal audit function as an internal independent source of assurance within the company and its reporting to the board and the management on the design and effectiveness of the framework.
- The role of the external audit or other external advisors or providers of independent assurance and examples of circumstances when external advice/opinion/assurance may be beneficial or necessary.
- The difference between continuous monitoring and a review. A review of the effectiveness will cover the risk management and internal control framework as a whole, including the ongoing processes for monitoring.
- The board's decisions on the frequency of reviews, for example, quarterly, biannually or annually, based on the circumstances and needs of the company.
- Areas that the board should particularly consider when carrying out a review of the effectiveness, for example, the design, implementation and operation of the risk management and internal control systems, the risk appetite, management's reporting to the board and so on.
- What constitutes an effective risk management and internal control framework, and what is considered a material weakness. In this context:
 - > The working definition of material weakness we are currently considering is: "A fault, deficiency or failure in the design or operation of the risk management and internal control framework, 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".

- > A deficiency could be a shortcoming in the design, implementation or operation of any of the components of the risk management and internal control systems. It could affect any of the company's strategic, operational, reporting or compliance objectives. The board will use their professional judgement in determining which deficiencies constitute a material weakness.
- > This definition is in line with other existing definitions of material weakness by other standards or guidelines, for example, from the Public Company Accounting Oversight Board (PCAOB); the Committee of Sponsoring Organizations (COSO); or the International Standard on Auditing (ISA (UK)).
- Questions that the board may consider when reviewing the effectiveness of the framework. These may be similar to the questions in the appendix of the [Internal Control – Revised Turnbull Guidance for Directors on the Combined Code](#). For example:
 - > "Does the company have clear objectives and have they been communicated so as to provide effective direction to employees on risk assessment and control issues?"
 - > "Are authority, responsibility and accountability defined clearly such that decisions are made and actions taken by the appropriate people?"
- Procedures to identify and manage emerging risks, emphasising the importance of the risk assessment being a continuous and dynamic process rather than a one-off exercise during the year.

71 In addition, we propose that the updated guidance will provide assistance on how to report against the Code's amended requirements, including:

- Explaining the basis for the declaration, including how these systems have been monitored and reviewed during the reporting period, and how the board is content that their conclusion regarding the effectiveness of the systems is appropriate. This may include:
 - > A description of the processes undertaken.
 - > The role and work of the board.
 - > The work of other units (e.g. audit and other board committees, management, internal audit); or other individuals (e.g. Chief Financial Officer, Chief Risk Officer, General Counsel) within the company.
 - > Identifying the framework or standard used to evaluate the effectiveness of the systems and why the board has considered that appropriate for the company's circumstances.
- Explaining material weaknesses identified during the reporting period and actions taken by the board to address them.
- Describing principal risks and management or mitigating actions.
- Describing procedures to identify and manage emerging risks.

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?

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?

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?

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?

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

Going concern

- 72 Following the consultation on '[Restoring trust in audit and corporate governance](#)', the Government has prepared draft legislation which, among other things, requires PIEs to set out information on the company's decision whether to adopt the going concern basis of accounting in the relevant period. A summary of the draft legislation is attached to this consultation document as an annex. This requirement is similar to Provision 30 in the current Code. However, as there are many companies which follow the Code but which do not meet the PIE definition, we propose retaining current Provision 30 (Provision 31 in the new Code) without change. Companies which have complied with the going concern element of the Resilience Statement requirement (see below) will also be compliant with this Provision. For Code companies which report on future prospects without following the whole Resilience Statement requirements, we propose that retaining the Provision on going concern will support additional narrative on longer term future prospects.

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)?

Resilience Statement

- 73 In '[Restoring trust in audit and corporate governance](#)', the Government outlined its plans to introduce a Resilience Statement for PIEs, requiring these entities to set out their approach to managing risk and developing resilience over the short, medium and long-term (the Resilience Statement requirement).
- 74 This development has implications for the Code, particularly Provision 32 (previously Provision 31). This Provision, sometimes referred to as the viability statement, was introduced into the Code in 2016, following significant engagement with stakeholders. It currently states that, taking account of the company's current position and principal risks, the board should explain in the annual report how it has assessed the prospects of the company, over what period it has done so and why it considers that period to be appropriate. The board should also state whether it has a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.
- 75 We are of the view that applying Provision 32 (previously Provision 31) to PIEs would duplicate the Resilience Statement requirement, and we propose that this Provision no longer applies to these entities. However there are many companies which apply the Code but do not meet the PIE definition. Removing Provision 31 altogether would leave a gap in reporting on future prospects. We are aware that this area is of great interest to investors, and the future prospects of a company play an important role in ongoing engagement and future investment.
- 76 In developing our proposals for amending current Provision 31, we have considered the 2021 [review](#) conducted by the FRC of reporting against this Provision. This review noted that disclosures currently lack sufficient qualitative and quantitative detail in respect of the inputs and assumptions used. The [Kingman review](#) also highlighted the viability statement as an area where effectiveness of reporting could be improved. We have included a revised Provision which asks the board to explain in the annual report how it has assessed the future prospects of the company. Companies that have complied with the Resilience Statement requirement will be compliant with this Provision. For Code companies that choose not to have a Resilience Statement and explain why not, the board should report in a proportionate way to the requirement or set out the basis for the assessment in the annual report.
- 77 We hope that these proposals, and particularly the suggestion that Code companies are directed to the Resilience Statement requirement, will help simplify the regulatory landscape, by removing the need for different standards to be applied to companies depending on whether they are new PIEs, existing premium listed PIEs or both. The fact that companies can approach the Code Provision on a 'comply or explain' basis ensures proportionality.

Q20: Do you agree that all Code companies should 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

Changes to strengthen links to overall corporate performance

- 78 We are proposing amendments to current Principles P, Q and R to strengthen the links between companies' remuneration policies and corporate performance in the wider sense, including ESG objectives. In doing so, we have also made some changes to the order in which these Principles are presented to ensure a logical flow. Further to findings from our most recent [Review of Corporate Governance Reporting](#), we hope that the proposed adjustments will also address the issue of companies basing their pay structures only on market benchmarking methods or the advice of remuneration consultants.
- 79 New Principle O sets out the overarching expectations of directors' remuneration policies, including an emphasis on the importance of transparency and a link to long-term sustainable success. The reference to ensuring directors are not involved in setting their own remuneration is now included here. New Principle P highlights the importance of remuneration outcomes being clearly aligned to company performance, purpose, and values and now includes a specific mention of ESG objectives. We have made new Principle Q more specific by including a reference to company and workforce pay and conditions as a factor which remuneration committees should have regard to in determining executive pay.

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

Malus and clawback

- 80 The Government has invited the FRC to consult on changing the Code to provide greater transparency around the malus and clawback arrangements that companies have in place, so remuneration can be withheld or recovered from directors for misconduct, misstatements, and other serious failings. These proposed changes are being developed alongside measures elsewhere in the Code and in regulations, to increase the accountability of directors for adhering to their statutory duties in corporate reporting and audit.
- 81 We believe that executive director remuneration should aim to promote the long-term sustainable success of the company and be aligned with the company's purpose and values. This section of the Code is concerned with the role of the remuneration committee and governance around pay structures and not with pay structures themselves. While the proposed changes are not expected to have a direct impact on the overall quantum of executive remuneration, we do expect that, through additional reporting on the use of malus and clawback arrangements, investors will have greater visibility of the mechanisms available to address scenarios involving serious failings, and whether and how companies are making use of these.

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- 82 In [Restoring trust in audit and corporate governance](#), the Government invited views on several aspects of malus and clawback arrangements, including a proposed minimum list of malus and clawback conditions. The FRC has taken the responses to this consultation into consideration, noting the desire for increased clarity in the Code, and the risks in prescribing a one-size-fits-all approach for every remuneration committee to follow. We have also considered the enforceability of malus and clawback arrangements, although there are limitations on what can be achieved through the Code in this area.
- 83 The proposed changes to the Code introduce a specific mention of malus and clawback in current Code Provision 37, which becomes Provision 39. Since malus and clawback arrangements, like bonus arrangements, are often set out in remuneration policy documentation outside of employment contracts, we have included a reference to "other remuneration agreements". In addition, we propose a new Provision 40, which sets out a requirement for additional information to be included in companies' remuneration reports. This includes a statement on whether the company has malus and clawback arrangements in place, the minimum conditions in which these would apply, the minimum period for applying them and why the selected minimum period is best suited to the organisation, as well as whether they have been used in the last financial year.
- 84 Many companies already make disclosures in the areas above, particularly in relation to the minimum circumstances in which malus and clawback apply and the minimum period for the arrangements, but there is scope for improvement. Clarity and a consistent approach to reporting should provide greater transparency for investors, without placing unnecessary constraints on remuneration committees in determining the arrangements most suited to their company's circumstances.

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

Changes to improve the quality of reporting

- 85 As part of our work on the remuneration section of the Code, we have taken a close look at former Provisions 40 and 41. Provision 40 describes factors which remuneration committees should address in setting executive remuneration, and Provision 41 sets out the aspects of the remuneration committee's work which should be reported in company annual reports. In our annual Reviews of Corporate Governance Reporting, we have found that there is room for improvement in the reporting against these Provisions. In 2021, we commissioned [research](#) from the University of Portsmouth on the topic of remuneration policy disclosures and the impact of the Code. This research found that while there had been improvements in the quantity of reporting, many companies provide brief or generic information on each element of Provision 40, often using wording directly from the Code. In relation to Provision 41, companies and their advisers have commented that the current approach in the Code does not make it clear what is expected, and in many cases reporting did not include specific and meaningful examples.

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- 86 To help companies improve the quality of their reporting in these areas, we propose to summarise Provision 40, removing the detail which is often used by companies as template language in annual reports and instead listing the factors which remuneration committees should address in an amended Provision 33. We hope that companies will report on these factors in a way that is specific to their own circumstances. In addition, we propose to remove some elements of Provision 41, and to take a more direct approach in asking how a company's executive remuneration policies, structures, and performance metrics support company strategy, including ESG objectives.
- 87 These changes have given us the opportunity to look again at the reference to pay ratios and pay gaps in Provision 41. With increased access to gender pay gap reports and disclosures on company websites, we suggest removing this reference from the Provision, to prevent duplicate disclosures within annual reports.
- 88 However, it is important that improvements continue to be made in this area and we would welcome views on an alternative approach which may strengthen reporting on pay gaps, for example asking companies to report on what measures have been implemented to reduce and eliminate pay gaps within their organisation.

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

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

Other matters for consideration

Artificial intelligence

89 In March 2023, the Government published a White Paper on artificial intelligence (AI), setting out its vision for an AI-enabled country. It proposes that existing regulators will implement a new AI regulatory framework underpinned by the following five values-focused cross-sectoral principles:

- Safety, security and robustness.
- Appropriate transparency and explainability.
- Fairness.
- Accountability and governance.
- Contestability and redress.

90 As part of our consultation on the Code, we would welcome views from stakeholders as to whether any Code changes would be needed to support progress in this area, if the Government were to implement its proposals.

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](#)?

Full list of consultation questions

Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

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?

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

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?

Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, 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?

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

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?

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

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?

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?

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?

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?

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?

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

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)?

Q20: Do you agree that all Code companies should 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?

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

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

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

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

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?

Appendix A:

Draft revised UK Corporate Governance Code

(with tracked changes)

Moved new position - Blue underlined

Moved old position - ~~Blue strike through~~

Deleted - ~~red strike through~~

New - Green

Section 1 – Board leadership and company purpose

Principles

- A. A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society. The board should ensure that the necessary resources, policies and practices are in place for the company to meet its objectives and measure performance against them.
- B. The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are all aligned. All directors must act with integrity, lead by example and promote the desired culture. The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success.
- C. The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed.
- D.C. In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.
- E.D. The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern. When reporting on its governance activity the board should focus on outcomes in order to demonstrate the impact of governance practices and how the Code has been applied. Where the Board reports on departures from the Code's provisions, it should provide a clear explanation.

Provisions

- 1. The board should assess the basis on which the company generates and preserves value over the long-term. It should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company's business model and how environmental and social matters are taken into account in its governance contributes to the delivery of its strategy, including its climate ambitions and transition planning.
- 2. The board should assess and monitor culture and report on how effectively the desired culture has been embedded. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action. The annual report should explain the board's activities and any action taken. In addition, it should include an explanation of the company's approach to investing in and rewarding its workforce.

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3. In addition to formal general meetings, the chair should seek regular engagement with major shareholders in order to understand their views on governance and performance against the strategy. Committee chairs should **seek engagement** **engage** with shareholders on significant matters related to their areas of responsibility. The chair should ensure that the board **as a whole** has a clear understanding of the views of shareholders, **and report in the annual report on the outcomes of the engagement which has taken place with them during the reporting period.**
 4. When 20 per cent or more of votes have been cast against the board recommendation for a resolution, the company should explain, when announcing voting results, what actions it intends to take to consult shareholders in order to understand the reasons behind the result. An update on the views received from shareholders and actions taken should be published no later than six months after the shareholder meeting¹. The board should then provide a final summary in the annual report and, if applicable, in the explanatory notes to resolutions at the next shareholder meeting, on what impact the feedback has had on the decisions the board has taken and any actions or resolutions now proposed.²
 5. The board should understand the views of the company's other key stakeholders and describe in the annual report how **theseir interests** and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making.³ The board should keep engagement mechanisms under review so that they remain effective.

For engagement with the workforce,⁴ one or a combination of the following methods should be used:

- a director appointed from the workforce;
- a formal workforce advisory panel; **or**
- or a designated non-executive director.

If the board has not chosen one or more of these methods, it should explain what alternative arrangements are in place and why it considers that they are effective.

6. There should be a means for the workforce to raise concerns in confidence and – if they wish – anonymously. The board should routinely review **the effectiveness of these arrangements** **this** and the reports arising from **theirits** operation. It should ensure that arrangements are in place for the proportionate and independent investigation of such matters and for follow-up action.

1 The update should be published on the company's website, the Regulatory Information Service used by the company, or both.

2 Details of significant votes against and related company updates are available on the Public Register maintained by The Investment Association – www.theinvestmentassociation.org/publicregister.html

3 This supports the reporting requirements set out in "The Companies (Miscellaneous Reporting) Regulations 2018. These were introduced to enhance reporting of section 172 of the Companies Act 2006 (Directors' Duties).

4 See the Guidance on Board Effectiveness Section [XXX] for a description of 'workforce' in this context.

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7. The board should take action to identify and manage conflicts of interest, including those resulting from significant shareholdings, and ensure that the influence of third parties does not compromise or override independent judgement.
 8. Where directors have concerns about the operation of the board or the management of the company that cannot be resolved, their concerns should be recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chair, for circulation to the board, if they have any such concerns.

Section 2 – Division of responsibilities

Principles

- F.E. The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information.
- G.F. The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board's decision making. There should be a clear division of responsibilities between the leadership of the board and the executive leadership of the company's business.
- H.G. Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.
- I.H. The board, supported by the company secretary, should ensure that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.

Provisions

9. The chair should be independent on appointment when assessed against the circumstances set out in Provision 10. The roles of chair and chief executive should not be exercised by the same individual. A chief executive should not become chair of the same company. If, exceptionally, this is proposed by the board, major shareholders should be consulted ahead of appointment. The board should set out its reasons to all shareholders at the time of the appointment and also publish these on the company website.
10. The board should identify in the annual report each non-executive director it considers to be independent. Circumstances which are likely to impair, or could appear to impair, a non-executive director's independence include, but are not limited to, whether a director:
 - is or has been an employee of the company or group within the last five years;
 - has, or has had within the last three years, a material business relationship with the company, either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
 - has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;

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- has close family ties with any of the company's advisers, directors or senior employees;
 - holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
 - represents a significant shareholder; or
 - has served on the board for more than nine years from the date of their first appointment.

Where any of these or other relevant circumstances apply, and the board nonetheless considers that the non-executive director is independent, a clear explanation should be provided.

11. At least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent.
12. The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chair and serve as an intermediary for the other directors and shareholders. Led by the senior independent director, the non-executive directors should meet without the chair present at least annually to appraise the chair's performance, and on other occasions as necessary.
13. Non-executive directors have a prime role in appointing and removing executive directors. Non-executive directors should scrutinise and hold to account the performance of management and individual executive directors against agreed performance objectives. The chair should hold meetings with the non-executive directors without the executive directors present.
14. The responsibilities of the chair, chief executive, senior independent director, board and committees should be clear, set out in writing, agreed by the board and made publicly available. The annual report should set out the number of meetings of the board and its committees, and the individual attendance by directors.
15. All significant director appointments should be listed in the annual report, describing how 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. When making new appointments, the board should take into account other demands on directors' time. Prior to appointment, significant commitments should be disclosed with an indication of the time involved. Additional external appointments should not be undertaken without prior approval of the board, with the reasons for permitting significant appointments explained in the annual report. Full-time executive directors should not take on more than one non-executive directorship in a FTSE 100 company or other significant appointment.

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16. All directors should have access to the advice of the company secretary, who is responsible for advising the board on all governance matters. Both the appointment and removal of the company secretary should be a matter for the whole board.

Section 3 – Composition, succession and evaluation

Principles

- J.I. Appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan ~~should be maintained~~ for ~~the~~ board and senior management ~~should be maintained~~⁵. Both appointments and succession plans should be based on merit and objective criteria⁶. They should promote equal opportunity, and diversity and inclusion of protected characteristics and non-protected characteristics including cognitive and personal strengths.~~and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.~~
- K.J. The board and its committees should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the board as a whole and membership regularly refreshed.
- L.K. Annual evaluation of the board should consider its ~~performance~~, composition, diversity and how effectively members work together ~~to achieve objectives~~. Individual evaluation should demonstrate whether each director continues to contribute effectively. ~~The annual performance review should consider each director's commitments to other organisations, and their ability to discharge their responsibilities effectively.~~

Provisions

17. The board should establish a nomination committee ~~to lead the process for appointments, ensure plans are in place for orderly succession to both the board and senior management positions, and oversee the development of a diverse pipeline for succession. A, a majority of members of the committee which~~ should be independent non executive directors. The chair of the board should not chair the committee when it is dealing with the appointment of their successor.
- 17.18. ~~The Committee should lead the process for appointments, ensure plans are in place for orderly succession to both the board and senior management positions, and oversee the development of a diverse pipeline for succession. Diversity and inclusion initiatives, along with any targets set, should contribute to the succession plan.~~
- 18.19. All directors should be subject to annual re-election. The board should set out in the papers accompanying the resolutions to elect each director the specific reasons why their contribution is, and continues to be, important to the company's long-term sustainable success.

⁵ The definition of 'senior management' for this purpose should be the executive committee or the first layer of management below board level, including the company secretary.

⁶ Which protect against discrimination for those with protected characteristics within the meaning of the Equalities Act 2010.

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- 19.**20. The chair should not remain in post beyond nine years from the date of their first appointment to the board. To facilitate effective succession planning and the development of a diverse board, this period can be extended for a limited time, particularly in those cases where the chair was an existing non-executive director on appointment. A clear explanation should be provided.
- 20.**21. Open advertising and/or an external search consultancy should generally be used for the appointment of the chair and non-executive directors. If an external search consultancy is engaged it should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors.
- 21.**22. There should be a formal and rigorous annual evaluation of the performance of the board, its committees, the chair and individual directors. The chair should ~~commission~~consider having a regular externally facilitated board ~~performance review~~evaluation. In FTSE 350 companies this should happen at least every three years. The external ~~reviewer~~evaluator should be identified in the annual report and a statement made about any other connection it has with the company or individual directors.
- 22.**23. The chair should act on the results of the ~~board performance review~~evaluation by recognising the strengths and addressing any weaknesses of the board. Each director should engage with the process and take appropriate action when development needs have been identified.
- 23.**24. The annual report should describe the work of the nomination committee, including:
- succession planning for both board and senior management positions, in order to deliver the company's strategy, including an explanation of how the committee has overseen the development of a diverse pipeline for succession;
 - the appointments for the board and senior management, including the search and nomination procedures and promotion of diversity;
 - the effectiveness of the diversity and inclusion policy, including progress towards company objectives and adherence to established initiatives;
 - ~~the gender balance of those in the senior management⁷ and their direct reports; and~~
 - ~~the process used in relation to appointments, its approach to succession planning and how both support developing a diverse pipeline;~~

⁷ See footnote 5.

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- how the board **performance reviewevaluation** has been conducted, the nature and extent of an external evaluator's contact with the board and individual directors, the outcomes and actions taken, and how it has or will influence **future** board composition;⁸
 - ~~the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the objectives; and~~
 - ~~the gender balance of those in the senior management⁸ and their direct reports.~~

⁸—See footnote 4

Section 4 – Audit, risk and internal control

Principles

- M.L. The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative statements.⁹
- N.M. The board should present a fair, balanced and understandable assessment of the company's position and prospects.
- O.N. ~~The board should also establish and maintain an effective risk management and internal control framework of prudent and effective controls, which enable risk to be assessed and managed. The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.~~

Provisions

- 24.25. The board should establish an audit committee of independent non-executive directors, with a minimum membership of three, or in the case of smaller companies, two.¹⁰ The chair of the board should not be a member. The board should satisfy itself that at least one member has recent and relevant financial experience. The committee as a whole shall have competence relevant to the sector in which the company operates.
- 25.26. The main roles and responsibilities of the audit committee should include:
- monitoring the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, and reviewing significant financial reporting judgements contained in them;
 - monitoring the integrity of narrative reporting, including sustainability matters, and reviewing any significant reporting judgements;
 - providing advice (where requested by the board) on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy;
 - developing, implementing, and maintaining the audit and assurance policy¹¹;

9 The board's responsibility to present a fair, balanced and understandable assessment extends to interim and other price-sensitive public records and reports to regulators, as well as to information required to be presented by statutory instruments.

10 A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

11 As discussed above, this requirement is currently set out in a draft statutory instrument which is yet to be introduced. Under the provisions of that draft legislation, companies that meet the definition set out in the new proposed section [xxx] of the Companies Act 2006 should follow the approach set out in [xxx]. Companies not subject to this regulation should determine the content of their policy taking this regulation into account.

- engaging with shareholders and other stakeholders on the role of the audit committee, the scope of work of the external auditor, and the approach to the audit and assurance policy;
- following the Audit Committees and the External Audit: Minimum Standard;
- promoting effective competition during the tendering for an external auditor, to support audit market diversity;
- 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;
- reviewing the company's ~~internal financial controls and risk management~~ and internal control ~~and risk management~~ systems, unless expressly addressed by a separate board risk committee composed of independent non-executive directors, or by the board itself;
- monitoring and reviewing the effectiveness of the company's internal audit function, or where there is not one, considering annually whether there is a need for one and making a recommendation to the board;
- ~~conducting the tender process and making recommendations to the board, about the appointment, reappointment and removal of the external auditor, and approving the remuneration and terms of engagement of the external auditor;~~
- ~~reviewing and monitoring the external auditor's independence and objectivity;~~
- ~~reviewing the effectiveness of the external audit process, taking into consideration relevant UK professional and regulatory requirements;~~
- ~~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; and~~
- reporting to the board on how it has discharged its responsibilities.

26.27. The annual report should describe the work of the audit committee, including:

- ~~the significant issues that the audit committee considered relating to the financial statements, and how these issues were addressed;~~

- an explanation of how it has assessed the independence and effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans;
 - in the case of a board not accepting the audit committee's recommendation on the external auditor appointment, reappointment or removal, a statement from the audit committee explaining its recommendation and the reasons why the board has taken a different position (this should also be supplied in any papers recommending appointment or reappointment);
 - the matters set out in the Audit Committees and the External Audit: Minimum Standard;
 - the significant issues that the audit committee considered relating to narrative reporting, including sustainability matters, and how these issues were addressed;
 - where commissioned by the board, the assurance of environmental, social and governance metrics and other sustainability matters;
 - where there is no internal audit function, an explanation for the absence, how internal assurance is achieved, and how this affects the work of external audit; and
 - its approach to developing the triennial audit and assurance policy and the annual implementation report an explanation of how auditor independence and objectivity are safeguarded, if the external auditor provides non-audit services.
- 27.28. The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's position, performance, business model and strategy.
- 28.29. The board should carry out a robust assessment of the company's emerging¹² and principal risks.¹³ The board should confirm in the annual report that it has completed this assessment, including a description of its principal risks, what procedures are in place to identify emerging risks, and an explanation of how these are being managed or mitigated. The board should explain in the annual report what procedures are in place to identify and manage emerging risks and describe these risks.

¹² Emerging risks should include those whose impact and probability are difficult to assess and quantify at present, but there is a reasonable probability of affecting the company over a longer time horizon.

¹³ Principal risks should include, but are not necessarily limited to, those that could result in events or circumstances that might threaten the company's business model, future performance, solvency or liquidity and reputation. In deciding which risks are principal risks companies should consider the potential impact and probability of the related events or circumstances, and the timescale over which they may occur

29.30. The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including ~~financial~~, operational, **reporting** and compliance controls. **The board should provide in the annual report:**

- A declaration of whether the board can reasonably conclude that the company's risk management and internal control systems have been effective throughout the reporting period and up to the date of the annual report;
- An explanation of the basis for its declaration, including how it has monitored and reviewed the effectiveness of these systems; and
- A description of any material weaknesses or failures identified and the remedial action being taken, and over what timeframe.

30.31. In annual and half-yearly financial statements, the board should state whether it considers it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

31.32. Taking account of the company's current position and principal risks, the board should explain in the annual report how it has assessed the **future** prospects of the company¹⁴ including its ability to ~~over what period it has done so and why it considers that period to be appropriate. The board should state whether it has a reasonable expectation that the company will be able to continue in operation and~~ meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.

¹⁴ Companies that have complied with the requirements of section [xxx] of the Companies Act 2006 ("the Resilience Statement") will also be compliant with Provision 32. For companies not subject to section [xxx], the board should report in a similar and proportionate way to the requirements of this section or set out the basis for the assessment in the annual report.

Section 5 – Remuneration

Principles

- P.O. A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management¹⁵ remuneration should be established. Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company's long-term strategy. No director should be involved in deciding their own remuneration outcome.
- Q.P. Remuneration outcomes should be clearly aligned to company performance, purpose and values, and the successful delivery of the company's long-term strategy including environmental, social and governance objectives. A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management¹⁶ remuneration should be established. No director should be involved in deciding their own remuneration outcome.
- R.Q. The remuneration committee Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking into account of company and individual performance, workforce pay and conditions and wider circumstances.

Provisions

- 32.33. The board should establish a remuneration committee of independent non-executive directors with a minimum membership of three, or in the case of smaller companies, two¹⁷. In addition, the chair of the board can only be a member if they were independent on appointment and cannot chair the committee. Before appointment as chair of the remuneration committee, the appointee should have served on a remuneration committee for at least 12 months.
34. The remuneration committee should have delegated responsibility for determining the policy for executive director remuneration and setting remuneration for the chair, executive directors and senior management.¹⁸ The policy should be clear, identify and mitigate risks associated with remuneration, and ensure outcomes are proportionate and do not reward poor performance.
- 33.35. The remuneration committee It should review workforce¹⁹ remuneration and related policies and the alignment of incentives and rewards with culture, taking these into account when setting the policy for executive director remuneration. The committee In addition, it should include in the annual report an explanation of the company's approach to investing in and rewarding its workforce.

¹⁵ See footnote 5.

¹⁶ See footnote 4.

¹⁷ See footnote 108.

¹⁸ See footnote 5

¹⁹ See [Guidance on Board Effectiveness] Section XXX for a description of workforce in this context.

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- 34.**36. The remuneration of non-executive directors should be determined in accordance with the Articles of Association or, alternatively, by the board. Levels of remuneration for the chair and all non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for all non-executive directors should not include share options or other performance-related elements.
- 35.**37. Where a remuneration consultant is appointed, this should be the responsibility of the remuneration committee. The consultant should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors. Independent judgement should be exercised when evaluating the advice of external third parties and when receiving views from executive and senior management²⁰.
- 36.**38. Remuneration schemes should promote long-term shareholdings by executive directors that support alignment with long-term shareholder interests. In normal circumstances, share awards granted for this purpose should be released for sale on a phased basis and be subject to a total vesting and holding period of five years or more. The remuneration committee should develop a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares.
- 37.**39. Remuneration schemes and policies should enable the use of discretion to override formulaic outcomes. Director contracts and/or other agreements or documents which cover director remuneration should include malus and clawback ~~They should also include~~ provisions that would enable the company to recover and/or withhold sums or share awards, and specify the circumstances in which it would be appropriate to do so.
40. The annual report on remuneration should include a description of its malus and clawback provisions, including:

- the minimum circumstances in which malus and clawback provisions could be used
- a description of the minimum period for malus and clawback and why the selected period is best suited to the organisation; and
- whether the provisions have been used in the last reporting period. If provisions have been used, a clear explanation of the reason should be provided in the annual report.

Companies should set out the use of their malus and clawback provisions in the last five years²¹.

²⁰ See footnote 3

²¹ See the [Guidance in Board Effectiveness] paragraph [XXX] for further guidance on the suggested format.

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- 38.41.** Only basic salary should be pensionable. The pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce. The pension consequences and associated costs of basic salary increases and any other changes in pensionable remuneration, or contribution rates, particularly for directors close to retirement, should be carefully considered when compared with workforce arrangements.
- 39.42.** Notice or contract periods should be one year or less. If it is necessary to offer longer periods to new directors recruited from outside the company, such periods should reduce to one year or less after the initial period. The remuneration committee should ensure compensation commitments in directors' terms of appointment do not reward poor performance. They should be robust in reducing compensation to reflect departing directors' obligations to mitigate loss.
- 40.** When determining executive director remuneration policy and practices, the remuneration committee should address the following:
- clarity—remuneration arrangements should be transparent and promote effective engagement with shareholders and the workforce;
 - simplicity—remuneration structures should avoid complexity and their rationale and operation should be easy to understand;
 - risk—remuneration arrangements should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated;
 - predictability—the range of possible values of rewards to individual directors and any other limits or discretions should be identified and explained at the time of approving the policy;
 - proportionality—the link between individual awards, the delivery of strategy and the long-term performance of the company should be clear. Outcomes should not reward poor performance; and
 - alignment to culture—incentive schemes should drive behaviours consistent with company purpose, values and strategy.
- 41.43.** There should be a description of the work of the remuneration committee in the annual report, including:
- an explanation of how the strategic rationale for executive directors' remuneration policies, structures and any performance metrics supports company strategy and environmental, social and governance objectives;
 - reasons why the remuneration is appropriate using internal and external measures, including pay ratios and pay gaps;

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- a description, with examples, of how the remuneration committee has addressed the factors in Provision 40;
 - whether the remuneration policy operated as intended in terms of company performance and quantum, and, if not, what changes are necessary;
 - what engagement with shareholders and the workforce has occurred ~~has taken place with shareholders~~ and ~~what the~~ impact this has had on remuneration policy and outcomes, including the alignment with executive remuneration and the overall company pay policy;
 - ~~what engagement with the workforce has taken place to explain how executive remuneration aligns with wider company pay policy;~~ and
 - to what extent discretion has been applied to remuneration outcomes and the reasons why.

Appendix B:

Draft revised UK Corporate Governance Code

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Section 1 – Board leadership and company purpose

Principles

- A. A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society. The board should ensure that the necessary resources, policies and practices are in place for the company to meet its objectives and measure performance against them.
- B. The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are all aligned. All directors must act with integrity, lead by example and promote the desired culture. The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success.
- C. In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.
- D. When reporting on its governance activity the board should focus on outcomes in order to demonstrate the impact of governance practices and how the Code has been applied. Where the Board reports on departures from the Code's provisions, it should provide a clear explanation.

Provisions

- 1. The board should assess the basis on which the company generates and preserves value over the long-term. It should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company's business model and how environmental and social matters are taken into account in the delivery of its strategy, including its climate ambitions and transition planning.
- 2. The board should assess and monitor culture and report on how effectively the desired culture has been embedded. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action. The annual report should explain the board's activities and any action taken.
- 3. In addition to formal general meetings, the chair should seek regular engagement with major shareholders in order to understand their views on governance and performance against the strategy. Committee chairs should engage with shareholders on significant matters related to their areas of responsibility. The chair should ensure that the board has a clear understanding of the views of shareholders, and report in the annual report on the outcomes of the engagement which has taken place with them during the reporting period.

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4. When 20 per cent or more of votes have been cast against the board recommendation for a resolution, the company should explain, when announcing voting results, what actions it intends to take to consult shareholders in order to understand the reasons behind the result. An update on the views received from shareholders and actions taken should be published no later than six months after the shareholder meeting¹. The board should then provide a final summary in the annual report and, if applicable, in the explanatory notes to resolutions at the next shareholder meeting, on what impact the feedback has had on the decisions the board has taken and any actions or resolutions now proposed.²
 5. The board should understand the views of the company's other key stakeholders and describe in the annual report how these and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making³ The board should keep engagement mechanisms under review so that they remain effective.

For engagement with the workforce,⁴ one or a combination of the following methods should be used:

- a director appointed from the workforce;
- a formal workforce advisory panel; or
- or a designated non-executive director.

If the board has not chosen one or more of these methods, it should explain what alternative arrangements are in place and why it considers that they are effective.

6. There should be a means for the workforce to raise concerns in confidence and – if they wish – anonymously. The board should routinely review the effectiveness of these arrangements and the reports arising from their operation. It should ensure that arrangements are in place for the proportionate and independent investigation of such matters and for follow-up action.
7. The board should take action to identify and manage conflicts of interest, including those resulting from significant shareholdings, and ensure that the influence of third parties does not compromise or override independent judgement.
8. Where directors have concerns about the operation of the board or the management of the company that cannot be resolved, their concerns should be recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chair, for circulation to the board, if they have any such concerns.

- 1 The update should be published on the company's website, the Regulatory Information Service used by the company, or both.
- 2 Details of significant votes against and related company updates are available on the Public Register maintained by The Investment Association – www.theinvestmentassociation.org/publicregister.html
- 3 This supports the reporting requirements set out in "The Companies (Miscellaneous Reporting) Regulations 2018. These were introduced to enhance reporting of section 172 of the Companies Act 2006 (Directors' Duties).
- 4 See the Guidance on Board Effectiveness Section 1 for a description of 'workforce' in this context.

Section 2 – Division of responsibilities

Principles

- E. The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information.
- F. The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board's decision-making. There should be a clear division of responsibilities between the leadership of the board and the executive leadership of the company's business.
- G. Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.
- H. The board, supported by the company secretary, should ensure that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.

Provisions

- 9. The chair should be independent on appointment when assessed against the circumstances set out in Provision 10. The roles of chair and chief executive should not be exercised by the same individual. A chief executive should not become chair of the same company. If, exceptionally, this is proposed by the board, major shareholders should be consulted ahead of appointment. The board should set out its reasons to all shareholders at the time of the appointment and also publish these on the company website.
- 10. The board should identify in the annual report each non-executive director it considers to be independent. Circumstances which are likely to impair, or could appear to impair, a non-executive director's independence include, but are not limited to, whether a director:
 - is or has been an employee of the company or group within the last five years;
 - has, or has had within the last three years, a material business relationship with the company, either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
 - has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;

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- has close family ties with any of the company's advisers, directors or senior employees;
 - holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
 - represents a significant shareholder; or
 - has served on the board for more than nine years from the date of their first appointment.

Where any of these or other relevant circumstances apply, and the board nonetheless considers that the non-executive director is independent, a clear explanation should be provided.

11. At least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent.
12. The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chair and serve as an intermediary for the other directors and shareholders. Led by the senior independent director, the non-executive directors should meet without the chair present at least annually to appraise the chair's performance, and on other occasions as necessary.
13. Non-executive directors have a prime role in appointing and removing executive directors. Non-executive directors should scrutinise and hold to account the performance of management and individual executive directors against agreed performance objectives. The chair should hold meetings with the non-executive directors without the executive directors present.
14. The responsibilities of the chair, chief executive, senior independent director, board and committees should be clear, set out in writing, agreed by the board and made publicly available. The annual report should set out the number of meetings of the board and its committees, and the individual attendance by directors.
15. All significant director appointments should be listed in the annual report, describing how 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. When making new appointments, the board should take into account other demands on directors' time. Prior to appointment, significant commitments should be disclosed with an indication of the time involved. Additional external appointments should not be undertaken without prior approval of the board, with the reasons for permitting significant appointments explained in the annual report. Full-time executive directors should not take on more than one non-executive directorship in a FTSE 100 company or other significant appointment.
16. All directors should have access to the advice of the company secretary, who is responsible for advising the board on all governance matters. Both the appointment and removal of the company secretary should be a matter for the whole board.

Section 3 – Composition, succession and evaluation

Principles

- I. Appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan for the board and senior management should be maintained.⁵ Both appointments and succession plans should be based on merit and objective criteria⁶. They should promote equal opportunity, and diversity and inclusion of protected characteristics and non-protected characteristics including cognitive and personal strengths.
- J. The board and its committees should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the board as a whole and membership regularly refreshed.
- K. Annual evaluation of the board should consider its performance, composition, diversity and how effectively members work together. Individual evaluation should demonstrate whether each director continues to contribute effectively. The annual performance review should consider each director's commitments to other organisations, and their ability to discharge their responsibilities effectively.

Provisions

- 17. The board should establish a nomination committee, a majority of the members of which should be independent non-executive directors. The chair of the board should not chair the committee when it is dealing with the appointment of their successor.
- 18. The committee should lead the process for appointments. Plans should be in place for orderly succession to both the board and senior management positions, and diverse pipelines should be developed for succession. Diversity and inclusion initiatives, along with any targets set, should contribute to the succession plan.
- 19. All directors should be subject to annual re-election. The board should set out in the papers accompanying the resolutions to elect each director the specific reasons why their contribution is, and continues to be, important to the company's long-term sustainable success.
- 20. The chair should not remain in post beyond nine years from the date of their first appointment to the board. To facilitate effective succession planning and the development of a diverse board, this period can be extended for a limited time, particularly in those cases where the chair was an existing non-executive director on appointment. A clear explanation should be provided.

⁵ The definition of 'senior management' for this purpose should be the executive committee or the first layer of management below board level, including the company secretary.

⁶ Which protect against discrimination for those with protected characteristics within the meaning of the Equalities Act 2010.

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21. Open advertising and/or an external search consultancy should generally be used for the appointment of the chair and non-executive directors. If an external search consultancy is engaged it should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors.
 22. There should be a formal and rigorous annual evaluation of the performance of the board, its committees, the chair and individual directors. The chair should commission a regular externally facilitated board performance review. In FTSE 350 companies this should happen at least every three years. The external reviewer should be identified in the annual report and a statement made about any other connection it has with the company or individual directors.
 23. The chair should act on the results of the board performance review by recognising the strengths and addressing any weaknesses of the board. Each director should engage with the process and take appropriate action when development needs have been identified.
 24. The annual report should describe the work of the nomination committee, including:
 - succession planning for both board and senior management positions, in order to deliver the company's strategy, including an explanation of how the committee has overseen the development of a diverse pipeline for succession;
 - the appointments for the board and senior management, including the search and nomination procedures and promotion of diversity;
 - the effectiveness of the diversity and inclusion policy, including progress towards company objectives and adherence to established initiatives;
 - the gender balance of those in the senior management⁷ and their direct reports; and
 - how the board performance review has been conducted, the nature and extent of an external reviewer's contact with the board and individual directors, the outcomes and actions taken, and how it has or will influence future board composition;

⁷ See footnote 5.

Section 4 – Audit, risk and internal control

Principles

- L. The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative statements.⁸
- M. The board should present a fair, balanced and understandable assessment of the company's position and prospects.
- N. The board should establish and maintain an effective risk management and internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

Provisions

- 25. The board should establish an audit committee of independent non-executive directors, with a minimum membership of three, or in the case of smaller companies, two.⁹ The chair of the board should not be a member. The board should satisfy itself that at least one member has recent and relevant financial experience. The committee as a whole shall have competence relevant to the sector in which the company operates.
- 26. The main roles and responsibilities of the audit committee should include:
 - monitoring the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, and reviewing significant financial reporting judgements contained in them;
 - monitoring the integrity of narrative reporting, including sustainability matters, and reviewing any significant reporting judgements;
 - providing advice (where requested by the board) on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy;
 - developing, implementing, and maintaining the audit and assurance policy¹⁰;

⁸ The board's responsibility to present a fair, balanced and understandable assessment extends to interim and other price-sensitive public records and reports to regulators, as well as to information required to be presented by statutory instruments.

⁹ A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

¹⁰ As discussed above, this requirement is currently set out in a draft statutory instrument which is yet to be introduced. Under the provisions of that draft legislation, companies that meet the definition set out in the new proposed section [xxx] of the Companies Act 2006 should follow the approach set out in [xxx]. Companies not subject to this regulation should determine the content of their policy taking this regulation into account.

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- engaging with shareholders and other stakeholders on the role of the audit committee, the scope of work of the external auditor, and the approach to the audit and assurance policy;
 - following the Audit Committees and the External Audit: Minimum Standard;
 - promoting effective competition during the tendering for an external auditor, to support audit market diversity;
 - 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;
 - reviewing the company's risk management and internal control systems, unless expressly addressed by a separate board risk committee composed of independent non-executive directors, or by the board itself;
 - monitoring and reviewing the effectiveness of the company's internal audit function, or where there is not one, considering annually whether there is a need for one and making a recommendation to the board; and
 - reporting to the board on how it has discharged its responsibilities.

27. The annual report should describe the work of the audit committee, including:

- the matters set out in the Audit Committees and the External Audit: Minimum Standard;
- the significant issues that the audit committee considered relating to narrative reporting, including sustainability matters, and how these issues were addressed;
- where commissioned by the board, the assurance of environmental, social and governance metrics and other sustainability matters;
- where there is no internal audit function, an explanation for the absence, how internal assurance is achieved, and how this affects the work of external audit; and
- its approach to developing the triennial audit and assurance policy and the annual implementation report.

28. The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's position, performance, business model and strategy.

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29. The board should carry out a robust assessment of the company's emerging¹¹ and principal risks.¹² The board should confirm in the annual report that it has completed this assessment, including a description of its principal risks, and an explanation of how these are being managed or mitigated. The board should explain in the annual report what procedures are in place to identify and manage emerging risks and describe these risks.
 30. The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including operational, reporting and compliance controls. The board should provide in the annual report:
 - A declaration of whether the board can reasonably conclude that the company's risk management and internal control systems have been effective throughout the reporting period and up to the date of the annual report;
 - An explanation of the basis for its declaration, including how it has monitored and reviewed the effectiveness of these systems; and
 - A description of any material weaknesses or failures identified and the remedial action being taken, and over what timeframe.
 31. In annual and half-yearly financial statements, the board should state whether it considers it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.
 32. Taking account of the company's current position and principal risks, the board should explain in the annual report how it has assessed the future prospects of the company¹³ including its ability to meet its liabilities as they fall due, over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.

¹¹ Emerging risks should include those whose impact and probability are difficult to assess and quantify at present, but there is a reasonable probability of affecting the company over a longer time horizon.

¹² Principal risks should include, but are not necessarily limited to, those that could result in events or circumstances that might threaten the company's business model, future performance, solvency or liquidity and reputation. In deciding which risks are principal risks companies should consider the potential impact and probability of the related events or circumstances, and the timescale over which they may occur

¹³ Companies that have complied with the requirements of section [xxx] of the Companies Act 2006 ("the Resilience Statement") will also be compliant with Provision 32. For companies not subject to section [xxx], the board should report in a similar and proportionate way to the requirements of this section or set out the basis for the assessment in the annual report.

Section 5 – Remuneration

Principles

- O. A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management¹⁴ remuneration should be established. Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. No director should be involved in deciding their own remuneration outcome.
- P. Remuneration outcomes should be clearly aligned to company performance, purpose and values, and the successful delivery of the company's long-term strategy including environmental, social and governance objectives.
- Q. The remuneration committee should exercise independent judgement and discretion when authorising remuneration outcomes, taking into account company and individual performance, workforce pay and conditions and wider circumstances.

Provisions

- 33. The board should establish a remuneration committee of independent non-executive directors with a minimum membership of three, or in the case of smaller companies, two¹⁵. In addition, the chair of the board can only be a member if they were independent on appointment and cannot chair the committee. Before appointment as chair of the remuneration committee, the appointee should have served on a remuneration committee for at least 12 months.
- 34. The remuneration committee should have delegated responsibility for determining the policy for executive director remuneration and setting remuneration for the chair, executive directors and senior management.¹⁶ The policy should be clear, identify and mitigate risks associated with remuneration, and ensure outcomes are proportionate and do not reward poor performance.
- 35. The remuneration committee should review workforce¹⁷ remuneration and related policies and the alignment of incentives and rewards with culture, taking these into account when setting the policy for executive director remuneration. The committee should include in the annual report an explanation of the company's approach to investing in and rewarding its workforce.
- 36. The remuneration of non-executive directors should be determined in accordance with the Articles of Association or, alternatively, by the board. Levels of remuneration for the chair and all non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for all non-executive directors should not include share options or other performance-related elements.

14 See footnote 5.

15 See footnote 8.

16 See footnote 5.

17 See Guidance on Board Effectiveness Section [xxx] for a description of workforce in this context.

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37. Where a remuneration consultant is appointed, this should be the responsibility of the remuneration committee. The consultant should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors. Independent judgement should be exercised when evaluating the advice of external third parties and when receiving views from executive and senior management.
 38. Remuneration schemes should promote long-term shareholdings by executive directors that support alignment with long-term shareholder interests. In normal circumstances, share awards granted for this purpose should be released for sale on a phased basis and be subject to a total vesting and holding period of five years or more. The remuneration committee should develop a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares.
 39. Remuneration schemes and policies should enable the use of discretion to override formulaic outcomes. Director contracts and/or other agreements or documents which cover director remuneration should include malus and clawback provisions that would enable the company to recover and/or withhold sums or share awards, and specify the circumstances in which it would be appropriate to do so.
 40. The annual report on remuneration should include a description of its malus and clawback provisions, including:
 - the minimum circumstances in which malus and clawback provisions could be used
 - a description of the minimum period for malus and clawback and why the selected period is best suited to the organisation; and
 - whether the provisions have been used in the last reporting period. If provisions have been used, a clear explanation of the reason should be provided in the annual report.

Companies should set out the use of their malus and clawback provisions in the last five years.¹⁸

41. Only basic salary should be pensionable. The pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce. The pension consequences and associated costs of basic salary increases and any other changes in pensionable remuneration, or contribution rates, particularly for directors close to retirement, should be carefully considered when compared with workforce arrangements.

¹⁸ See the [Guidance on Board Effectiveness] paragraph [X] for further guidance on the suggested format.

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42. Notice or contract periods should be one year or less. If it is necessary to offer longer periods to new directors recruited from outside the company, such periods should reduce to one year or less after the initial period. The remuneration committee should ensure compensation commitments in directors' terms of appointment do not reward poor performance. They should be robust in reducing compensation to reflect departing directors' obligations to mitigate loss.
 43. There should be a description of the work of the remuneration committee in the annual report, including:
 - an explanation of how the strategic rationale for executive directors' remuneration policies, structures and any performance metrics supports company strategy and environmental, social and governance objectives;
 - whether the remuneration policy operated as intended in terms of company performance and quantum, and, if not, what changes are necessary;
 - what engagement with shareholders and the workforce has occurred and what impact this has had on remuneration policy and outcomes, including the alignment with executive remuneration and the overall company pay policy; and
 - to what extent discretion has been applied to remuneration outcomes and the reasons why.

Appendix C:

Summary of draft secondary legislation on corporate reporting

Summary of Government's proposals on new reporting

1. The Government's Response of 31 May 2022 to its consultation on the March 2021 White Paper on 'Restoring Trust in Audit and Corporate Governance' confirmed proposals to introduce the following new reporting requirements:
 - i. an annual Resilience Statement, setting out how a company is managing risk over the short, medium and long-term;
 - ii. a triennial Audit and Assurance Policy, explaining how the company proposes to assure non-financial reporting over the following three years;
 - iii. an annual statement about distributable profits and the company's policy on distributions; and
 - iv. an annual statement on steps taken to prevent and detect material fraud.

The Response stated that the new reporting would apply to UK public and private companies with more than 750 employees and an annual turnover greater than £750m.

2. The main disclosures within this new reporting are set out below.
 - i. Resilience Statement
 - A summary of the company's strategic approach to managing risk, and building or maintaining resilience, including with regard to relevant internal governance processes
 - Identification of the company's principal risks, and how these are being managed (including likelihood, impact and mitigating action in place)
 - A summary of why the directors believe the company remains a going concern
 - An assessment of the company's prospects over the medium-term (with this period to be defined and explained by the directors), including with regard to its stated principal risks
 - A reverse stress test (identifying a combination of circumstances in which the company's business plan would become unviable and setting out any mitigating action put in place as a result of the test)

ii. Audit and Assurance Policy

- A description of the company's internal auditing and assurance processes, including how management conclusions and judgements in the annual report and accounts may be challenged
- An explanation of the company's plans for obtaining internal assurance over the annual report and accounts over the following three years
- An explanation of whether the company intends to seek any external assurance of any parts of its annual report over the next three years in addition to the statutory audit
- Whether any external assurance over the next three years will be sought in respect of the resilience statement and/or the effectiveness of the company's internal controls over financial reporting

iii. Statements on Distributions

- Annual audited disclosure of a company's distributable profits (that is, the company's accumulated realised profits less its accumulated realised losses) which must be available before a dividend or other distribution is made.
- A statement of the company's forward-looking policy on the distribution of profits, including dividends and purchase of own shares.

iv. Statement on Material Fraud Risks

- An assessment of the risks of material fraud to the company's business operations
- A description of the main measures put in place to prevent or detect material fraud

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