Tesco PLC
Tesco House, Shire Park,
Kestrel Way,
Welwyn Garden City,
AL7 1GA

T: +44 (0) 800 505555

Email to: codereview@frc.org.uk

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For the attention of the Financial Reporting Council (FRC)

UK CORPORATE GOVERNANCE CODE

Following the consultation on Restoring Trust in Audit and Corporate Governance, last year, Tesco welcomes the opportunity to participate in the FRC consultation on proposed revisions to the UK Corporate Governance Code.

Tesco has been active contributors to a number of industry responses to the Consultation, including through the GC100, 100 Group and Corporate Governance Institute. Whilst broadly supportive of the proposed changes to the Code, we are concerned that:

- the current proposals lack a clear description of how they will fit with existing and other corporate governance reform initiatives the proposed changes will result in significant extra time and cost being incurred, which would be disproportionate to the benefit to shareholders and other stakeholders;
- the majority of the proposals are additive to the disclosures already made by companies, which would increase the length of already lengthy annual reports. There has been little focus on removing existing requirements or moving information onto company websites, providing the opportunity to create shorter and more meaningful annual reports;
- there are several instances of duplication with other requirements, most notably the FCA's Listing Rules;
- the declaration on the effectiveness of risk management and internal controls potentially involves considerable change and significant resource and costs. Without guidance on the application of the proposals, companies may view the changes in a variety of different ways. This would lead to the adoption of different standards between sectors and between comparator companies; and
- there is ambiguity of how proposals are to be implemented due to the lack of clear definitions.

As such, we would ask that further thought be given to the following: i) greater consistency with other regulatory disclosure requirements; ii) more clarity around definitions; and iii) the removal of over prescriptive language, recognising the Board's role in determining appropriate governance structures for their business. Specifically, we would like to raise the following comments:

Section 1 – Board leadership and company purpose

Tesco is supportive of proposals to create more outcomes-based reporting on governance activity but seeks clarity on what would be considered as 'governance outcomes'. Such guidance should define expectations in relation to the scope of 'governance activities', illustrative examples being helpful.

In the proposed Provision 2, further guidance on the assessment and monitoring of culture and expectations for reporting on how effectively it has been embedded is required. This is important to ensure that issuers report in a consistent and comparative manner.

The existing language requiring committee chairs to seek engagement from shareholders should be retained (Provision 3). Any requirement for engagement should be determined by the nature of current issues to ensure insightful feedback. In our experience, shareholders generally do not engage with companies on many issues and rarely on audit and assurance matters. We feel shareholder engagement could be more efficiently strengthened through the Stewardship Code rather than by a new requirement to consult with shareholders.

Section 2 – Division of responsibilities

Tesco is supportive of encouraging greater transparency on directors' external commitments and ensuring the consistent application of Provision 15. However, the FRC should define what constitutes a 'significant' appointment or external commitment to ensure consistency of approach. Such disclosures could also encourage proxy advisors to recommend votes against more non-executive directors. In practice, there is a risk that proxy advisors will do a simple sum of the number of mandates without taking account of any explanation provided. Tesco would welcome a review of the Stewardship Code and the responsibilities of proxy advisors to ensure a consistent approach to what is deemed an acceptable number of appointments and a clear definition of what would constitute over-boarding. We believe that it is the Board who is best placed to make a judgement as to whether a director is over-boarded, based upon the specific needs and circumstances of the business.

Section 3 – Board Composition, succession, and evaluation

Tesco agrees that assessing the ability of a director to commit sufficient time to the role should form part of the annual board review (Principle K). However, in practice Tesco undertakes this assessment throughout the year – not just at the time of the annual board review but also in advance of appointment and when an existing director requests approval to take on an additional appointment. Tesco's Nominations and Governance Committee also regularly reviews each director's additional appointments to ensure they continue to contribute effectively. Therefore, we consider the requirement to consider external appointments is already adequately covered by the requirement in Principle K to evaluate whether each director continues to contribute effectively.

Tesco supports the promotion of diversity and inclusion beyond gender, social and ethnic backgrounds – particularly as boards need to reflect the wider organisation and communities they serve. However, we would be concerned that the reference to protected characteristics and non-protected characteristics is too broad and risks being regarded as meaningless in this context. The emphasis should be on boards promoting equal opportunity and contributing to a diverse and inclusive board and senior management team.

Section 4: Audit, Risk Management and Internal Control

In respect of the proposed amendments to strengthen risk management and internal controls, it is unclear what additional expectations the revisions place on companies and what would constitute "effectiveness". To this end, companies will require some clarity on the minimum baseline of activities and processes that must be undertaken in order to declare that risk management and internal control systems are effective. Whilst we understand and support that the proposals are not attempting to replicate the full requirements of SOX, such as mandated external assurance, without such a baseline, the ambiguity faced by companies trying to determine how much is enough could lead to unnecessary cost and effort, which could impact on resource and capital allocation. As such, it is difficult to comment on whether the proposed amendments strike the right balance in terms of strengthening risk management and internal controls and maintaining proportionality as they are open to a number of different interpretations.

Tesco advocates that the board's declaration should be based on control effectiveness as at the balance sheet date and prefer reference to "regular monitoring" as opposed to a continuous monitoring throughout the reporting period. For short-term control deficiencies arising during the year that are appropriately remediated by the year-end or those that arose in the period between the balance sheet date and the publication of the preliminary results or annual report, and which do not create a risk to year-end reporting, should not result in an overall conclusion that controls were ineffective.

The following further clarifications are sought:

- definitions for "material weakness", materially adversely affected", "continuous" rather than "a point in time", and what these mean collectively and from an assurance, cost and board liability perspective.
- a definition of what constitutes narrative reporting and whether non-financial reporting is limited to the content of annual reports or whether it also includes other statutory and non-statutory reporting. The scope of the Audit and Assurance Policy is clearly set out in legislation to include the non-financial disclosures within the annual report. We recommend that a consistent approach is applied.

Whilst broadly supportive of the removal of "financial" and replacement with "reporting", we are concerned that this should not considerably broaden the nature of the declaration being given by directors, which in turn expands the obligations of directors as regards "monitoring and reviewing". In particular we don't believe that external assurance should be a requirement. In our view, the value added would be disproportionate to the considerable undertaking and significantly increase the resources and costs involved. Tesco supports the integration of environmental and social matters within the broader strategy. However, it should be for the board to determine the most appropriate governance structures for its organisation. To mandate that the remit of audit committees include sustainability reporting and ESG metrics is overly prescriptive and does not recognise the other board committees with environmental and social responsibilities. If this provision is maintained, we would suggest that the additional wording "*where such matters are not reserved for the board or delegated to another board appointed committee*" be included.

Resilience statement

Clarity on the interaction between the resilience statement and the going concern (Provision 30) and viability (Provision 31) is required. We support the proposal to combine the current going concern statement and viability statements into a single Resilience Statement. However, we do not agree with the mandating of the minimum content requirement, believing this could result in boilerplate disclosure. To avoid unnecessary costs and efforts, we believe the medium-term assessment period should be aligned to our planning processes of three years and disclosure should be driven by our own risk assessments. Owing to the extensive nature of TCFD and other narrative reporting and its overlap with other environmental reporting obligations, we believe we should retain the flexibility to determine its location in the annual report.

Section 5 – Remuneration

We support proposals to strengthen reporting on malus and clawback. However, there is an inconsistency in whether disclosure of the use of malus and clawback is required over a five year look back period or just over the last reporting period. As remuneration reports remain available on a company's website, a five year look back should be unnecessary. We would also ask the FRC to consider guidance for specific circumstances in which companies may not be permitted to precisely report on the use of malus and clawback provisions due to legal restrictions.

Additional comments

It is intended that the Code changes apply for periods commencing on or after 1 January 2025, however, as there are interdependencies with the wider governance reforms, we would encourage a review of the implementation timetable to ensure that all changes come into effect in tandem with the formation of ARGA and other legislation. This will support the one-time development of appropriate governance structures which would be more cost effective for companies.

Yours faithfully

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