



Grant Thornton

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CORPORATE GOVERNANCE REVIEW 2016

The future of governance: one small step ...



2016 highlights



All but one of the 249 companies required to provide a viability statement do – but 52% keep it to the bare minimum

41%

48%



48% provide high-quality, forward-looking statements, up from 41%

Wider diversity moves to centre stage as 76% of companies mention aspects of board diversity other than gender, up from 55%

76%



Use of non-financial metrics in executive performance-based remuneration increases to 65% up from 46% in 2015

65%



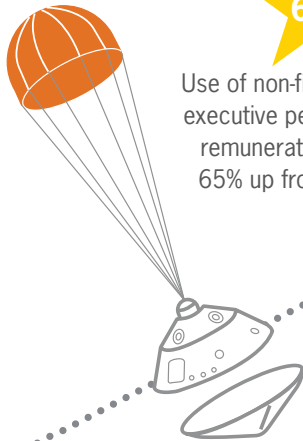
62% of FTSE 350 companies fully comply with the UK Corporate Governance Code, up from 57%

62%



Risk disclosures finally gain traction, as only 4% give the same principal risk disclosures as last year, down from 24%

4%



The average length of the annual report continues to grow: 162 pages, up from 157

162
157



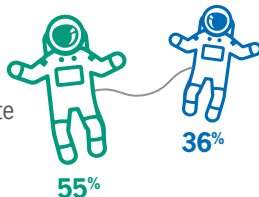
Only 19% of companies provided insight into how they review the effectiveness of their internal controls



Only 15% of companies provide any real insight into considerations and plans for future succession



Shareholder engagement is on the slide, as only 36% of businesses clearly demonstrate how they engage with shareholders, down from 55%



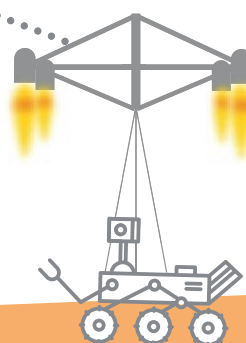
36%

55%



Only 20% of companies provide good or detailed discussion on organisational culture

20%





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Methodology

This review, now in its fifteenth year, comprises a comprehensive analysis of the annual reports of the FTSE 350 companies. In addition to assessing compliance, the review assesses the quality and detail of annual reporting, and draws attention to best practice.

The review assesses compliance with:

- The UK Corporate Governance Code 2014
- The narrative reporting requirements as set out in S414c of the Companies Act 2006 as amended.

This year's review covers 308 of the FTSE 350 companies (as of May 2016) with years ending between June 2015 and June 2016. Investment trusts are excluded from the review, as they are permitted to follow the AIC code of Corporate Governance. This year's review therefore covers 100 companies from the FTSE 100 and 208 from the FTSE 250. In 2015, our FTSE 350 sample included 312 companies; 100 from the FTSE 100 and 212 from the FTSE 250. The FTSE 250 is defined as the next 250 companies after the FTSE 100.

Key findings are discussed in the body of the report; full details of the supporting data can be found in the appendix, which can be provided on request from Alex Worters (alex.j.worters@uk.gt.com).

Simon Lowe would like to thank Scarlett Brown, Claire Fargeot, Yaryna Kobel, Kul Shokar, Nicholas Speechley, Sergio Lopez Varela, Kirsty Walker and Alex Worters, for their work in preparing this report.

Investor viewpoint



Simon would also like to give special thanks to Saker Nusseibeh for providing investor viewpoints throughout this year's review. Saker is Chief Executive of Hermes Investment Management.

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The regulator's perspective



“Much has happened in the year since I last contributed to this influential analysis of UK corporate governance and there has been increased political interest in corporate governance.”

Sir Win Bischoff, Chair, Financial Reporting Council

In July, the FRC published ‘Corporate Culture and the Role of Boards’: a report of observations which followed an 18-month collaborative project to engage companies, investors and a wide range of stakeholders in considering culture. The report urged companies not to wait for a crisis before reflecting on their culture, to focus on culture as a driver of long-term value and in doing so, have greater regard to a wide set of stakeholders. Grant Thornton reports that 86% of companies have mentioned culture in their annual reports this year. Next year, we expect to see more consideration of the role culture plays in companies.

Our report was closely followed by the Prime Minister’s comments on executive pay, large private companies, and widening board composition. The FRC looks forward to working with the government over the coming months, to determine how to develop and implement practical solutions to address the areas of concern.

This year was the first full year of viability reporting; and while companies have complied, the FRC would like to see more constructive reporting in line with the spirit of the requirement. Our initial assessment of statements suggests that there is

little variation in disclosures between business sectors, and this report finds that 52 per cent of companies provide only a basic explanation. We encourage companies to provide: clear rationale for their choice of timeframe, what qualifications and assumptions were made, and how the underlying analysis was performed.

Succession planning was another area of focus for the FRC this year. Grant Thornton’s report shows that most companies are providing only basic descriptions of their policy and practice. It also highlights that companies may not be spending enough time considering board and senior management succession. In May we published a Feedback statement on our UK Board succession planning discussion paper which shared some practical examples of how companies can approach succession.

It is encouraging to see increasing levels of compliance with the UK Corporate Governance Code. Good quality and distinctive reporting has an important role to play in differentiating the approaches companies take in giving confidence to investors. Also important is investors’ responsibility to monitor and engage with the companies they invest in,

and to report to their clients on their stewardship activities. It has been six years since the Stewardship Code was launched. This year we undertook an exercise to encourage signatories to improve their reporting against the seven principles of the Code. This has resulted in signatories being tiered according to the quality of their reporting.

The way in which companies and investors adhere to our two Codes is an important element of maintaining the UK’s ability to attract economic investment. Definitely progress has been made but there is still much to be done to rebuild public trust in companies. The FRC looks forward to seeing continued high levels of compliance and increasing engagement with the spirit, not just the letter, of the requirements.

I want to thank Grant Thornton once again for continuing this important and useful analysis of the UK Corporate Governance landscape.



Foreword

Welcome to Grant Thornton's 15th annual analysis of the governance practices of the UK's FTSE 350 companies.

Simon Lowe, Chair,
The Grant Thornton
Governance Institute

This year's research revealed interesting insights and developments across all sectors; not least how the economic and commercial environment continues to drive improved practice, with investors maintaining pressure on companies to do and say 'the right thing'.

In terms of regulation, it was another quiet year with only minor tweaks, arising from the EU Audit Regulation and Directive. However, the effects of previous regulation were significant as companies implemented the major changes in the 2014 UK Corporate Governance Code (the Code). Meanwhile, the Financial Reporting Council (FRC) focused on three challenges identified in our previous reviews: culture, board succession planning, and stewardship.

Compliance levels return to growth

This year saw a rise in full compliance with the Code among FTSE 350 companies, to reach a new high of 62%. The areas of greatest non-compliance remained the independence of directors and chairs.

The average FTSE 350 annual report continues to expand, and is now 162 pages (2015: 157 pages). The narrative front end is growing in particular, taking up an average of 98 pages – a new high. But the average figures hide a wide range in length for the full document, which this year varied from 490 pages to just 43. This illustrates the different interpretations of the requirement for “comprehensive but concise” reporting that is “fair, balanced and understandable”. Despite the intention of the strategic report to encourage concision, the majority of companies are not using it as an opportunity to rethink how they present information, rather, choosing to add to what they had before.

A clearer future perspective

Following the introduction of the strategic report requirements in 2014, the number of FTSE 350 companies that now fully comply with all strategic report provisions has risen to 57% (2015: 50%), with more board directors taking accountability for this reporting and signing off strategic reports. Also encouraging is the improved reporting on principal risks; all FTSE 350 companies stated what their principal risks are, and 99% report mitigating actions. Only 4% of companies gave the same risk disclosures as last year, a big improvement on 2015. There has been a decline in the number of principal risks being reported. On average companies state 10.8 principal risks (2015: 11.1). This may suggest that companies are focusing attention on the more significant risks, rather than seeking to cover every possible one in less detail. This is alongside a shift in the number of companies giving better explanations: 79% provide good or detailed accounts of their principal risks and note the year's revisions (2015: 65%).



“The board – including its composition and performance – is central to corporate governance and since the evaluation provision was introduced in 2010, there has been a steady improvement in its reporting.”

That said, the quality of strategic reports still varies considerably, and only 16 companies achieve the goal of providing high-quality, strategy-linked reporting, that provides informative insights to readers. To do this requires the provision of a holistic, connected insight into the business model, strategy, operational risks, and internal controls. It also demands clearer, relevant KPIs, in recognition of the broader criteria – including gender and environmental concerns – which stakeholders increasingly take into account when judging performance.

The most recent reporting requirement, the long-term viability statement, is intended to provide an improved and broader assessment of a company’s long-term solvency and liquidity; by considering various scenarios, and stress testing the impact of key risks and opportunities, for a period significantly longer than 12 months. In this first full year of implementation, over half of the companies required to provide a statement made only basic or general statements as to their ability to continue operating in the longer term; little new insight was provided for investors, with limited detail on the assessment methodologies, people responsible for the process, and the assumptions made and impact of possible scenarios. As with similar new provisions we have seen in the past,

it takes an average of four years for a majority of companies to move from ticking the box, to openly addressing the underlying intent. Perhaps this explains why only 19% of companies provide good or detailed explanations of how they have monitored the effectiveness of their internal controls throughout the year. Future-reporting is notably difficult; while nearly three quarters of companies provide a detailed business model and over 80% provide a comprehensive and balanced analysis of their business, less than half provide high-quality statements around the likely future development of their business.

Improved board insights

Also noticeable was the improved insight offered into companies’ triennial external board evaluations. The board – including its composition and performance – is central to corporate governance and since the evaluation provision was introduced in 2010, there has been a steady improvement in its reporting. Most recently, 34 companies have gone beyond transparency about the process of board evaluations to expand on the outcomes too. It is early days, but this trend is to be encouraged, so that the practice and tools of evaluation can be further refined, enabling boards to identify and surmount barriers to strategic effectiveness.

The most important benefit of such wider disclosure may be succession planning; with 78% of companies providing only a basic or general description of succession planning and processes, much room for improvement remains. By shining a spotlight on this issue, board evaluations might prompt more proactive engagement and preparation of future leaders.

Gender diversity has been the subject of much focus and debate in recent years. The proportion of women on boards has continued to improve, with the increasing appointment of female non-executive directors (NEDs). Although anecdotally this is seen to be bringing about change in the boardroom, it is recognised as just a stepping stone: real impact will only be achieved when a similar level of representation is achieved among executive directors, where there has been much slower progress. This year’s findings suggest that the focus of the debate may have shifted, with detailed gender diversity reporting declining, in favour of other types of diversity. 76% of companies mention different kinds of diversity such as ethnicity, race, cultural background and sexuality, as well as focusing on skills and experience.

Cultural reticence

The topic of corporate culture, that is, organisational behaviour and values, has kept the FRC busy of late. In 2015 the regulator launched a year-long consultation project into the relationship between corporate culture and long-term business success in the UK. The project explored the board's role in establishing and embedding a positive and sustainable corporate culture, and has so far culminated in key findings which will inform the (soon to be revised) guidance on board effectiveness. Our research finds that although 86% of FTSE 350 companies refer to culture in their annual reports, only 20% provide meaningful discussion and 48% do not clearly communicate their organisational values. The FRC consultation was well advanced when the current crop of accounts were being finalised, and so we will look to next year's reporting to see if the findings of the FRC July 2016 publication¹ will influence how culture is addressed.

The remuneration debate

Following the 2014 Code changes, boards of listed companies are required to ensure that executive remuneration promotes long-term business success, and to show how this is being achieved. This year's analysis illustrates that reporting on remuneration and related decision-making processes is of high quality for 93% of the FTSE 350. Furthermore, a little under two-thirds include non-financial metrics in their executive performance-based remuneration for 2016, compared to just under half in the previous year.

Shareholder engagement

Shareholder engagement has been an area of increasing concern for the regulator. The most recent changes have seen companies being asked to explain voting outcomes on resolutions of significant issues, as well as encouraging dialogue, even when business is going well. In spite of this encouragement, our research demonstrates that only 36% of FTSE 350 companies clearly explain how they engaged with shareholders, a significant drop (2015: 55%). Overall, the quality of shareholder engagement disclosures has decreased year on year since 2010. The same obligations are placed on boards in terms of engagement with their debt holders, yet less than 3% of companies discuss their approach in their annual reports.

In conclusion

While Code compliance is back up and we see positive trends in outputs from board evaluations, clearer risk reporting, and more comprehensive strategic reports, there still remain significant numbers of companies who opt for the bare minimum; complying with the rules but not embracing the principles.

In this post-Brexit period of uncertainty, with the Government turning the heat up on wider employee engagement and corporate accountability, the boards of our largest companies need to start taking an honest view as to whether they truly embrace the Code's principles. In the early years of this decade, the FRC were able to head off the European regulator's inclination to introduce more prescriptive, US-style governance regulation. The irony is that if more companies do not start to fully embrace the Code as it stands, recognising their responsibility to a wider audience than just shareholders, and giving more informative disclosures, then we may well find that it is our own government who steps in to replace principles with prescription.

¹ Corporate Culture and the Role of Boards: Report of Observations, FRC, July 2016.

The strategic report

“The strategic report should be comprehensive but concise.”
 (FRC Guidance on the Strategic Report, 6.7)

A company’s strategic report, like its entire annual report, is intended to contain information material to shareholders. Companies frequently complain about the growing length of annual reports and yet continue to add to them rather than using the opportunity to rethink how they might provide clearer information to the users. Meanwhile investors largely accept what is given to them and often ask for more rather than better. This is no more apparent than in the strategic report.

Following the introduction of the strategic reporting requirements, first reflected in our 2014 review, all companies now include a strategic report section in their annual report. While the chair’s introduction remains at a constant length – below two pages – the rest of the section continues to grow. The average strategic report is now 44 pages long (2015: 42.5 pages).

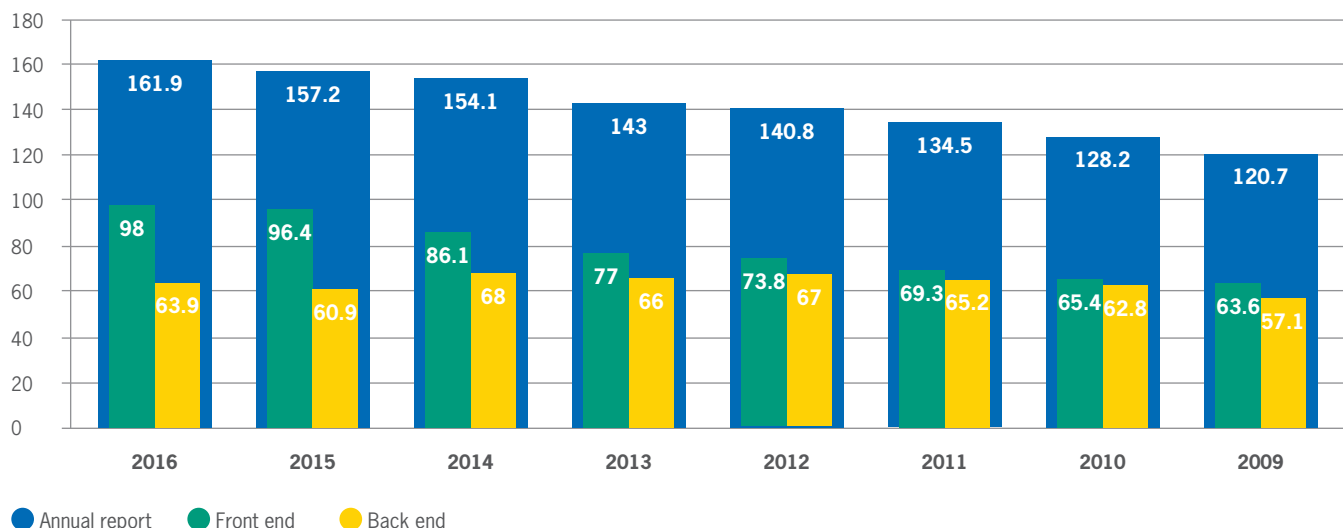
Indeed, since we first starting monitoring this, the length of annual reports as a whole has continued to grow steadily, with the average reaching 162 pages in 2016 (2009: 121 pages). Unsurprisingly, the eight banks in the FTSE 350 had some of the longest, averaging 371 pages (2015: 336 pages); compared with an average of 199 pages for the FTSE 100 (2015: 194 pages) and 144 for the FTSE 250 (2015: 140). In 2016 HSBC had the longest report in the FTSE 350, with 490 pages; it takes over from last year’s leader, RBS, which this year succeeded in removing 85 pages – most notably by optimising its risk reporting. By comparison, Softcat had the shortest report, which ran to just 43 pages.

FAST FACTS



- ★ The average strategic report is 44 pages long
- ★ 57% of companies applied all the Strategic Report Regulations, with varying quality and approach.
- ★ Only 16 companies implement all regulatory requirements in a connected, transparent and informative way.
- ★ The length of annual reports continues to rise: the average is now 162 pages long.
- ★ 82% of the FTSE 350 provide details about their past performance, business and the external environments
- ★ 28% of the FTSE 350 provide only generic, basic or no explanation of their business model.
- ★ 52% of companies do not provide a high-quality forward-looking statement

Average page length of annual report



Front-end growth continues

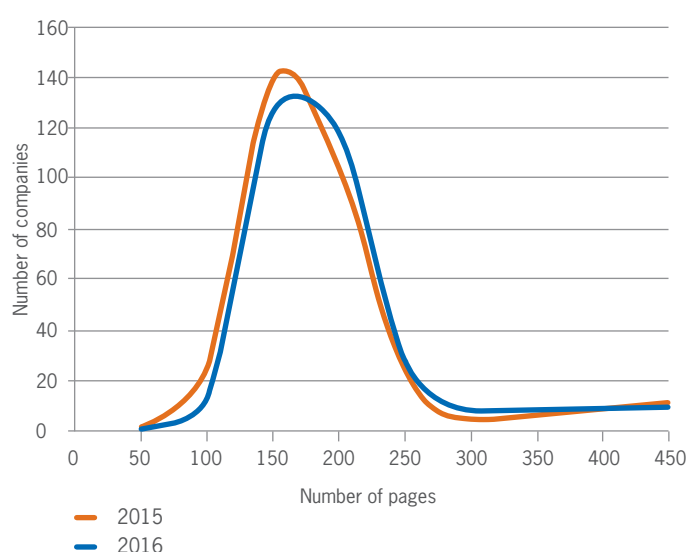
“Each component of the annual report should focus on the communication of the information relevant to meeting the objectives of that component.”

(FRC Guidance on the Strategic Report, 3.12)

While both ends of the report have become longer, the front-end narrative has, at 98 pages, reached a new high. In 2009 the annual report consisted of 121 pages and was more evenly split, with financial statements representing just under half of the content; the difference has become more noticeable every year since. The governance report has contributed most to this year’s rise, now averaging 40 pages (2015: 38 pages). Within the governance report, the audit committee section has grown the most; adding half a page on average over the year, to stand at five pages. Meanwhile the remuneration report, which saw a jump in length in 2014, has remained static at 18.2 pages on average for the past three years.

Overall, companies are opting to use a wider range of content formats within annual reports – including providing the option to offer personalised copies, featuring only sections of interest, and by providing higher quality, integrated online formats of their annual reports. Infographics are becoming more popular, particularly to illustrate board composition, diversity, business model, and performance. However, the level of linkage in annual reports remains weak. Although many cross refer between different parts of the report (most often to risks), only a small number show how different elements are connected in a meaningful way.

Length of annual reports for the FTSE 350



“Overall, companies are opting to use a wider range of content formats within annual reports.”

Business model, business context and future business development

“The strategic report has three main content-related objectives: to provide insight into the entity’s business model and its main strategy and objectives; to describe the principal risks the entity faces and how they might affect its future prospects; and to provide an analysis of the entity’s past performance.”

(FRC Guidance on the Strategic Report, 4.4)

Fifty-seven per cent of companies comply with all strategic report provisions (2015: 50%). This increase is mostly due to organisations meeting the requirement for the strategic report to be signed by a board director or company secretary, and also by fully meeting environmental and gender disclosure requirements (which some companies only partially complied with in 2015).

Companies’ approaches to, and placement of, strategic report disclosures still varies considerably: this year only 16 companies achieved the FRC’s goal of providing high-quality, business model-led, strategy-linked reporting, giving informative insight to readers.

The business model is an important way for companies to demonstrate how they create and sustain value. In 2016, the number of FTSE 350 members providing good and detailed insights about their business model was broadly flat at 72% (2015: 73%).

Rising numbers of FTSE 350 companies showed well developed thinking with regard to their future

business developments: 48% provided high-quality forward-looking statements (2015: 41%). This improvement was evident in both the FTSE 100 and the FTSE 250. Despite this improvement, the majority of organisations still only provided basic insights into their future developments, and details of how such developments are linked to strategy, or how they may affect shareholder value, are rare.

There is, however, more detailed insight about business context – that is, how companies take advantage of strategic opportunities and where they are better positioned to do so than their peers. Overall, 82% of companies provide detailed explanations about their business in 2016 (2015: 80%). These areas of reporting are strongly correlated: 94% of FTSE 350 companies that provide meaningful disclosures about future developments also tend to give comprehensive analysis of their business, suggesting that an overall commitment to quality strategic reporting is connected to future development reporting.

FAST FACTS

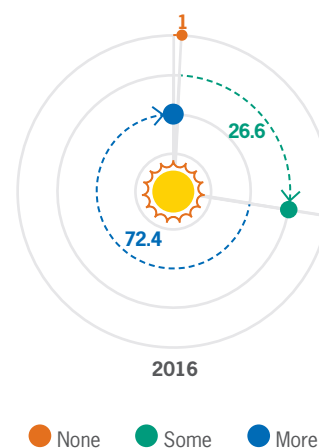


- ★ 43% of companies provide good or detailed disclosures about how their strategy links to other elements. Only 7% provide no details at all.
- ★ 79% of companies provide good or detailed accounts of their principal risks
- ★ Companies state an average of 10.8 principal risks.
- ★ More than half of the companies required to provide a viability statement this year gave generic or basic insights into how they assessed viability. Only 5% gave detailed disclosures and entered into the full spirit of the statement.
- ★ 35% of FTSE 350 companies provide only a passing reference to culture in their annual reports.
- ★ 48% of companies do not express their values.
- ★ While the CEO is seen as having primary responsibility for embedding the desired culture throughout the organisation, only 21% of company CEOs refer to culture in their introduction to the report.

CORRELATION BETWEEN DESCRIPTION OF FUTURE DEVELOPMENTS AND OVERALL ANALYSIS OF BUSINESS (%)



TO WHAT EXTENT DO COMPANIES DESCRIBE THEIR BUSINESS MODEL? (%)



★ *“The business model is an important way for companies to demonstrate how they create and sustain value.”*

Investor viewpoint



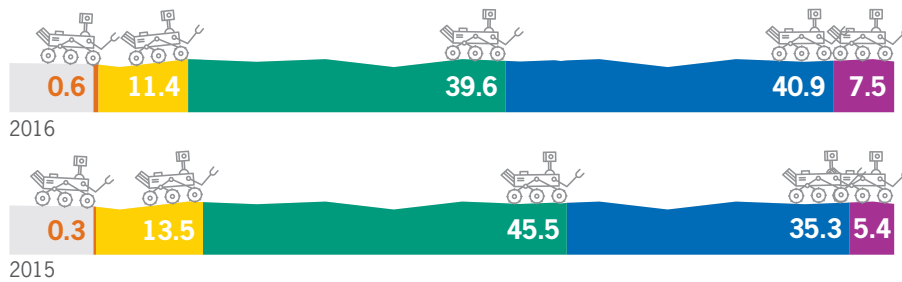
Strategic report

As investors, we welcome the new format of reporting, which is less about numbers and more about presenting the purpose of and strategic outlook for the business. With the integrated reporting initiative, companies are being asked to explain in their own words how they are holistically meeting the needs of different stakeholders and not just the investor. Whilst strategic reporting is improving year on year and there is a growing set of best practice, there is still much work to be done; there are some which seek to adhere too closely to a generic template diluting the essence of its own business. The best ones are those that can be braver, focusing succinctly on what is relevant and material to its business activity, being open about the mistakes they have made and how they have learned from them.

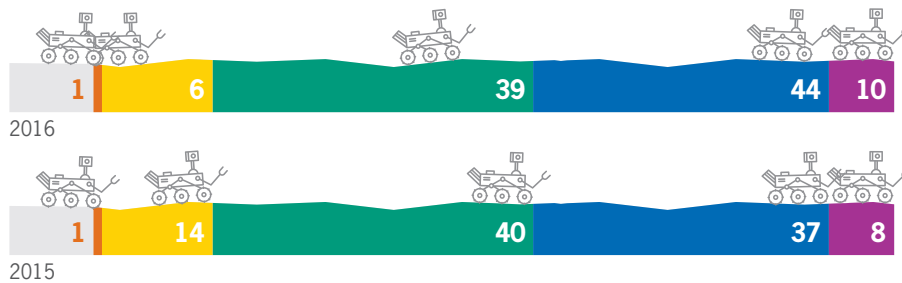
TO WHAT EXTENT DO COMPANIES DESCRIBE THE LIKELY FUTURE DEVELOPMENT OF THE BUSINESS? (%)

None Basic General Good Detailed

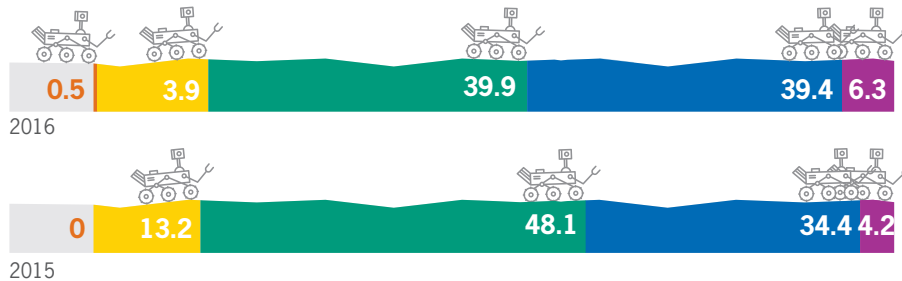
FTSE 350



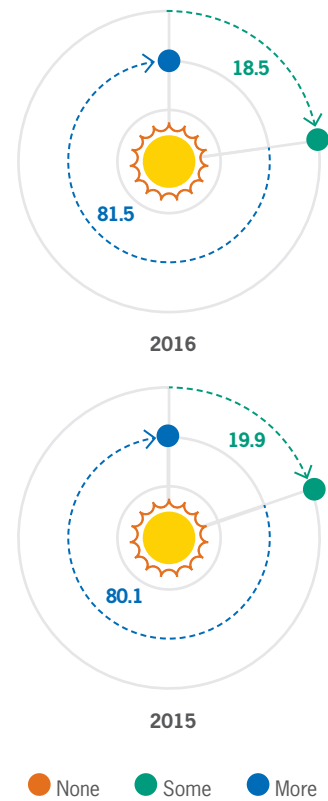
FTSE 100



FTSE 250



TO WHAT EXTENT DO COMPANIES PROVIDE BALANCED AND COMPREHENSIVE ANALYSIS OF THEIR BUSINESS? (%)



Improving KPI disclosures

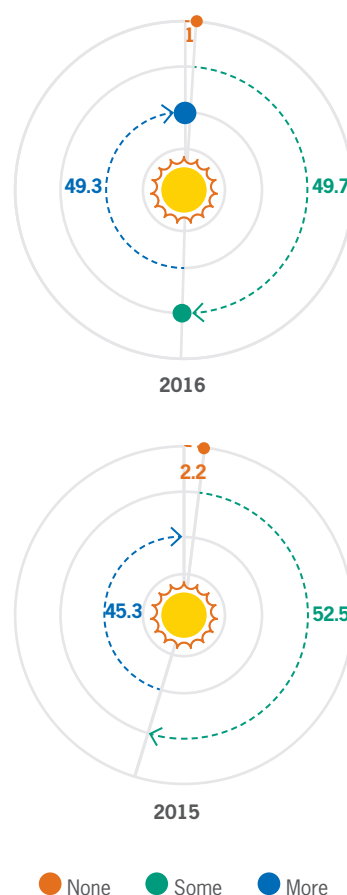
"The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include (a) analysis using financial key performance indicators, and (b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters."

(Companies Act 2006, s414C (4))

We also see a correlation between good disclosures of business context and external environment and robust discussion of the key performance indicators (KPIs) that frame performance. 47% of FTSE 350 companies do a good job of reporting on both elements. Disclosure of KPIs improved somewhat from 2015, which was affected by weak disclosures from new entrants: disappointingly, last year's newcomers showed little improvement in the quality of disclosures in 2016.

While financial KPIs remain more prevalent than non-financial KPIs, there was an increased focus on shareholders' return, operational matters and – after a lull in 2013 – regulation and compliance. Almost half of FTSE 350 companies only state what KPIs they use, failing to explain such points as why these are relevant indicators of strategic progress, how they are calculated, what next year's targets will be and, most importantly, how they link to strategy and associated risks.

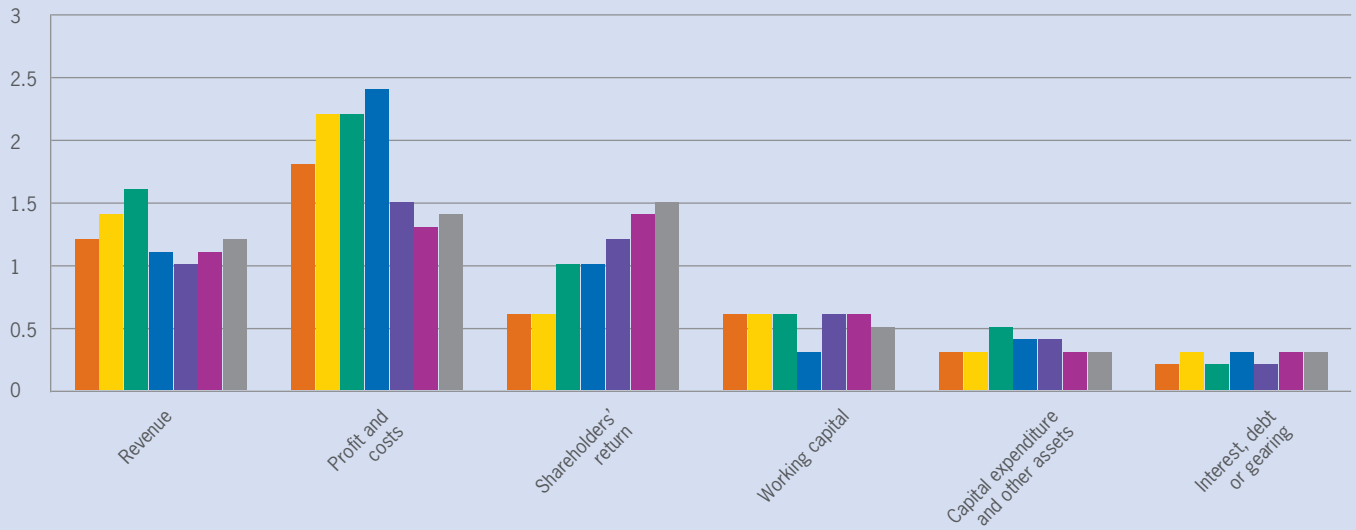
TO WHAT EXTENT DO COMPANIES DESCRIBE KPIs WHICH MEASURE THE PERFORMANCE OF THE BUSINESS? (%)



★ *"47% of FTSE 350 companies do a good job of reporting their business context and their KPIs."*

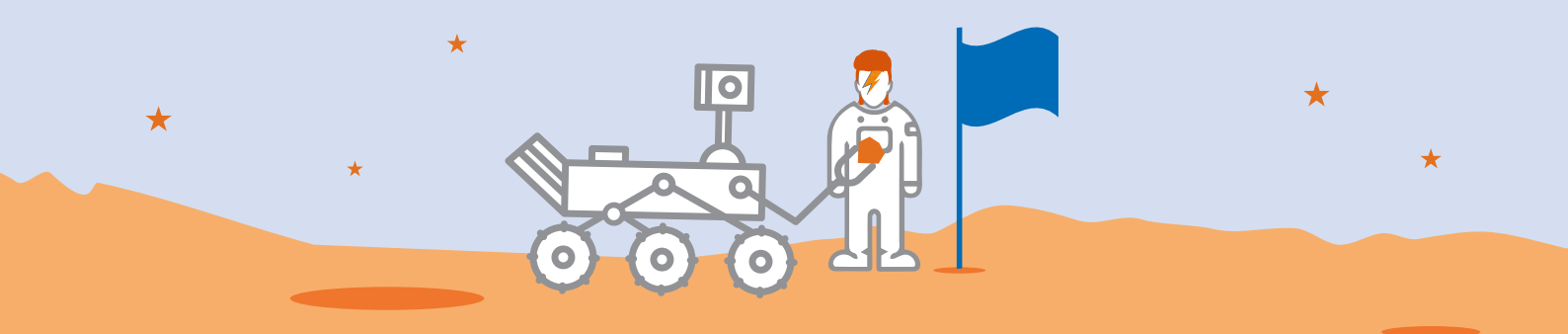
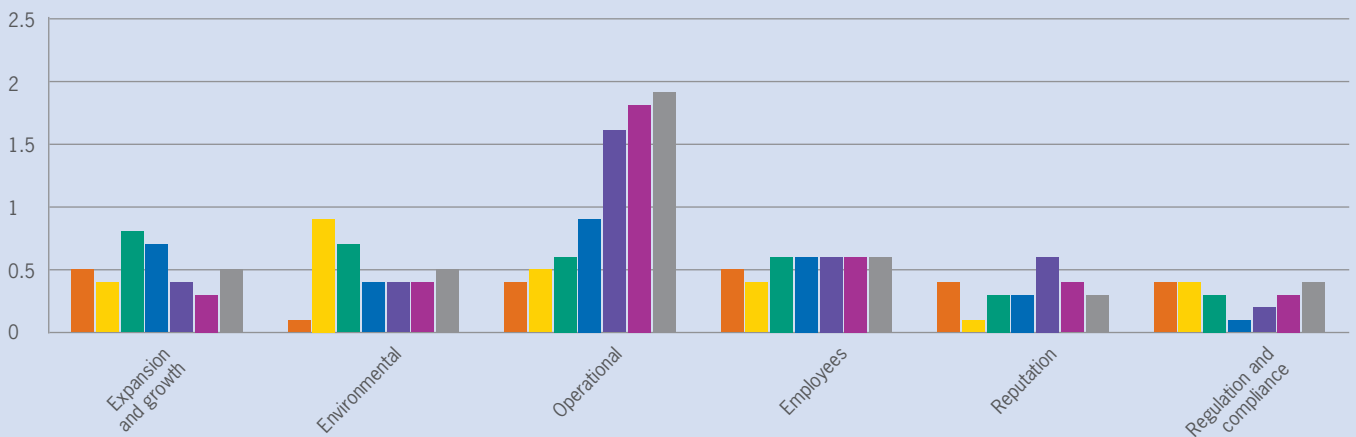
Average number of financial KPIs disclosed

2010 2011 2012 2013 2014 2015 2016



Average number of non-financial KPIs disclosed

2010 2011 2012 2013 2014 2015 2016



Disclosing strategic links

“Where relevant, linkage to and discussion of key performance indicators (KPIs) should be included ... in order to allow an assessment of the entity’s progress against its strategy and objectives. Similarly, emphasising the relationship between an entity’s principal risks and its ability to meet its objectives may provide relevant information.”

(FRC Guidance on the Strategic Report, 7.10)

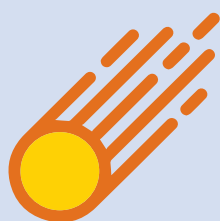
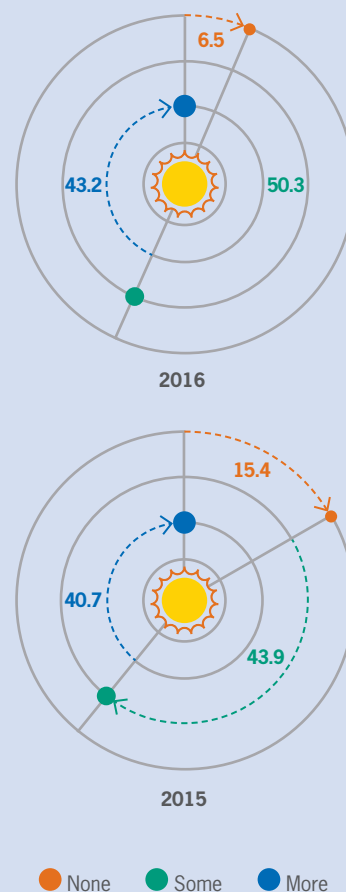
2016 saw more FTSE 350 companies provide good or detailed annual report disclosures of how their strategy links to other strategic elements, rising to 43% (2015: 41%). At the other end of the scale, there was a significant fall in the number providing no details at all, to 7% (2015: 17%). Generally speaking, companies explain well the links between their strategy, KPIs and opportunities, while the bridges from strategy to risks and remuneration are mentioned less frequently.

Explaining the links between strategy, KPIs and directors’ remuneration can provide meaningful insight into executive incentives and support the long-term sustainability of a business. While 95% of companies discuss the link between executive remuneration and company strategy in their annual report, this largely remains the domain of the remuneration report; only 11% of the FTSE 350 highlight these connections in their strategic reports. Credible links between corporate strategy and risks are rare; the number of companies that manage to provide strong risk reports and successfully link them to their strategy, remained almost flat, at 27%.



“Explaining the links between strategy, KPIs and directors’ remuneration can provide meaningful insight into executive incentives and support the long-term sustainability of a business.”

TO WHAT EXTENT DO THE COMPANY’S STRATEGY/STRATEGIC OBJECTIVES LINK TO SPECIFIC RISKS, OPPORTUNITIES AND KPIs? (%)



Better risk disclosures

“An explanation of how the principal risks and uncertainties are managed or mitigated should also be included to enable shareholders to assess the impact on the future prospects of the entity.”

(FRC Guidance on the Strategic Report, 7.26)

Company disclosures on principal risks and their mitigation improved overall. All FTSE 350 companies now state what their key risks are, with only 6 companies providing no further details. There has also been a notable shift in the number of companies giving better explanations: 79% provide good or detailed accounts of their principal risks and note the year’s revisions

(2015: 65%). In addition, 99% of the FTSE 350 now explain how they actively mitigate such risks (2015: 94%).

Principal risks might not change dramatically from year to year, but given the volatile nature of the economic environment, one might expect to see evidence that principal risks and mitigating actions were reviewed, and emerging issues considered. This year the impact of the FRC’s ‘Guidance on Risk Management, Internal Controls and Related Financial and Business Reporting’, issued in September 2014, is perhaps most evident from the fact that only 13 companies (4%) did not change their risk reporting discernibly from the previous year, a sharp fall (2015: 81 companies, or 24%).

There has also been a gradual decline in the number of principal risks being reported: on average companies state 10.8 principal risks (2015: 11.1). This may suggest that companies are focusing on the more significant risks, rather than seeking to cover every possible one, in less detail. The introduction of viability statements may also have contributed to this trend, with the board spending more time evaluating key business risks and paying more attention to their risk reporting. In general, a trend towards stating fewer risks – while at the same time improving disclosure about why they are considered significant, how they are mitigated, and what change occurred during the year – is a positive development; especially when coupled with better quality disclosure of risk management processes (see audit committee section on page 50).

PRINCIPAL RISKS AND UNCERTAINTIES DESCRIPTIONS (%)

None Basic General Good Detailed

Principal risks



Emerging risk trends

“Directors should consider the full range of business risks, including both those that are financial in nature and those that are non-financial.”

(FRC Guidance on the Strategic Report, 7.25)

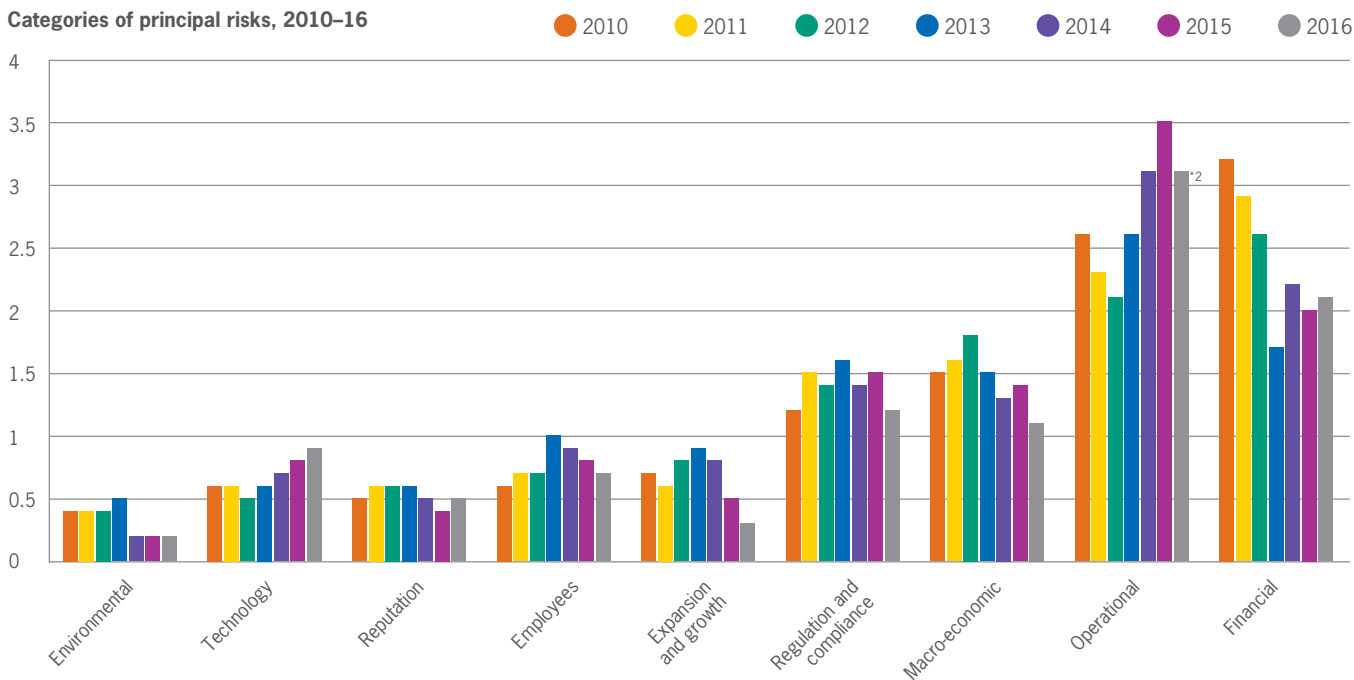
Scrutiny of the categories of principal risk cited in recent years reveals certain emerging trends. Perhaps a little surprisingly, given the then pending EU referendum, and sustained political and market uncertainty, there has been a reduction in the reporting of macro-economic risks, which decreased in importance by 21%.

In 2016, operational risk remained top of the agenda, although it decreased in importance by 11% compared to last year. There has been a greater focus on the need

for operational efficiencies and the associated risk of not achieving them, particularly in the last four to five years, and away from financial risk as concerns over recession recede. At the same time, there has been a reduced focus on the risks associated with expansion and growth.

There is also an evident swing away from employee-based risks although – in the light of the recent Brexit vote – this risk might be expected to come back on the radar for this year’s reporting, towards those linked to technology. This is unsurprising, given the current emphasis on developments in technology. However, there is no corresponding increase in the number of directors appointed to the board with technology expertise.

Categories of principal risks, 2010–16



² There was a change in methodology. If calculated in line with previous years’ methodology, the number of average operational risks would be 3.8. This figure is used for calculation of average principal risks.

The viability statement

“Taking account of the company’s current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have 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.”

(UK Corporate Governance Code, C.2.2)

The long-term viability statement provision was introduced in the 2014 Code and applies to companies with year-ends after 30 September 2015. A few early adopters introduced short viability statements in their annual report in 2015 but most FTSE 350 companies preferred to wait until this year to report on the new requirement.

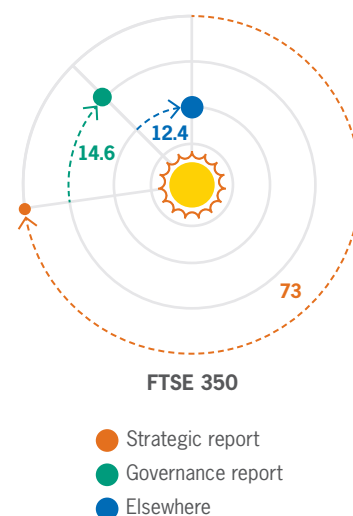
Almost half (48%) of the 249 companies required to provide a viability statement this year gave good or detailed insight into how their boards assess viability and what key risks were evaluated, mentioning modelling scenarios and/or stress testing. However, of this group, only 13 (5% of those required to produce a viability statement) went further and, in the spirit of what the FRC was encouraging, gave greater detail, adding sufficient qualitative and quantitative analysis to their risks assessment so as to enable the reader to appreciate the effect of such an occurrence. Ten of the 13 were FTSE 250 companies, most from the technology and utilities sectors.

Most companies (52%) that had to produce a viability statement did not report explicitly on their methodology, giving only basic or general disclosure about their period of assessment and why they felt this timing was appropriate. While some would relate this reluctance to the sensitivity of the information, it could be inferred that some boards are yet to be convinced as to the benefits of investing greater time and resource in an area which many believe is covered sufficiently by their work on going concern.

According to FRC guidance, the period considered must be longer than 12 months. Seventy-nine percent of FTSE 350 companies decided a three-year time period, while some chose longer periods of up to six years.

Seventy-three per cent of companies placed the viability statement in the strategic report, after the risk disclosures. Fifteen per cent put it in the governance report, mostly cross-referencing it in their strategic report to bring it within the safe harbour provision.

WHERE IS THE VIABILITY STATEMENT PLACED IN THE ANNUAL REPORT? (%)



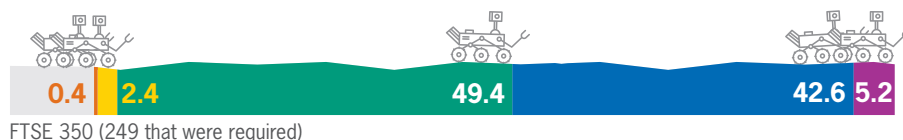
DO COMPANIES PROVIDE A SATISFACTORY VIABILITY STATEMENT? (%)

None Basic General Good Detailed

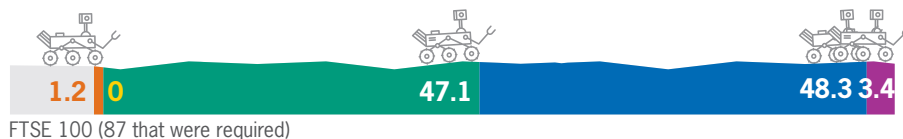
2016



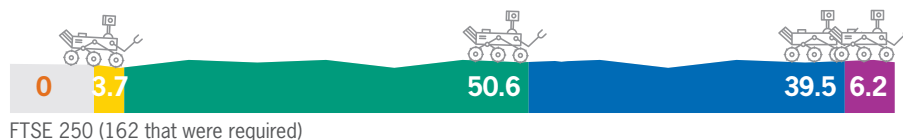
FTSE 350 (all 308 companies)



FTSE 350 (249 that were required)



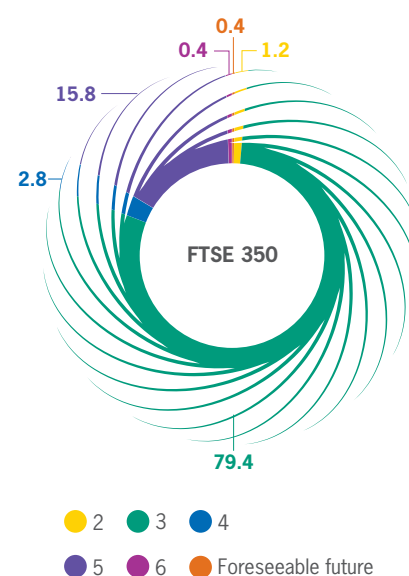
FTSE 100 (87 that were required)



FTSE 250 (162 that were required)

WHAT PERIOD OF TIME ARE THEY ASSESSING FOR THE VIABILITY STATEMENT? (NUMBER OF YEARS)

249 companies



Investor viewpoint

Viability statements

The introduction of the long term viability statement is an important development: taking the kind of disclosures we would already be expecting to see from the financial institutions, applied to and used by other kinds of companies. This is especially the case where it actually forces companies to think about the longer term scenarios its businesses face. It's disappointing therefore to see only half talk about it in detail. And what that may tell you, is that either the board is not thinking far enough ahead or that it is reticent to be open about the scenarios they face. Difficult as it can be to put a meaningful viability statement together, we believe there needs to be a shift in more boards' mind-set to embracing the viability statement as a way of enhancing its investor communications and where relevant, its own risk management.



Toolkit for long-term viability statement



ELEMENTS/ CONTENT	THINGS TO CONSIDER	REPORTING TIPS
Positioning	Use the safe harbour provisions of the Companies Act 2006 by including or referencing the viability statement in the strategic report	Include or reference the viability statement in the strategic report, while including links and connections to it from other parts of the annual report
Accountability	<p>Who is responsible, and who is accountable?</p> <p>The process may involve: the chief finance officer, company secretary, financial controller, head of risk, head of business planning, treasury manager, head of investor relations, the audit committee</p> <p>The viability statement can be modelled and validated by internal audit or external consultants</p> <p>Meetings with major investors and analysts may help inform the process</p> <p>The board should confirm whether they believe the assessment is robust in order to reflect accountability to stakeholders</p>	Report details of the people or roles involved in the process, and demonstrate ownership and accountability over the process
Time period	<p>Agree a specific and definite period significantly longer than 12 months, to match the duration and board thinking around the long term planning cycle (current practice uses three to six years)</p> <p>The time frame should be relevant to your organisation, it should also align to your stated strategy, investment period and business lifecycle</p> <p>The time period should be re-assessed annually in light of developments</p>	Outline why the period is appropriate to your company and business model, and ensure it is aligned with your strategy and business life cycle
Methodology	<p>The board should base the statement on a robust assessment of key risks – particularly solvency or liquidity. Consider their mitigation, and what approach you have taken to qualifying the impact of these risks, and their likelihood</p> <p>Methods should also include modelling of a number of scenarios, and stress testing for sensitivity to all key variables</p>	<p>Provide high level insight into the approach taken to develop the statement, and detail of how the board came to its conclusions</p> <p>Avoid simply repeating risk disclosures, but ensure risk is at the heart of the statement, is focused on a few principal risks and cross referenced to more detailed report disclosures</p> <p>Also include discussion on modelled scenarios and, where possible, quantified assumptions and impacts</p>
Linkages	Consider the specific needs of your business, and ensure the drafting of the viability statement is informed by the business model and strategy	<p>Show linkages to other sections of the reporting and governance</p> <p>Include reference to risk management, external and internal controls, and risk mitigation</p> <p>Show how your statement is specific to your company by making specific reference to your business model and strategy</p> <p>Check back that the conclusion aligns, as appropriate, with the going concern statement</p>

Fair, balanced and understandable

“The board should present a fair, balanced and understandable assessment of the company’s position and prospects.”

(UK Corporate Governance Code, Main principle C.1)

Best practice annual reporting needs to be user-friendly, with information that helps readers understand the organisation. The 2012 revision of the Code emphasised the importance of a report being easy to understand – and required boards to explicitly assess, and then state, whether it considered the entire document to be fair, balanced and understandable. The FRC also launched a Clear & Concise³ programme of activities, aiming to ensure that annual reports provide only relevant and easily understandable information for investors, eliminating boilerplate text and immaterial information. Whether its recommendations have been heeded will not be known until next year.

This year, all but six FTSE 350 companies state that they consider their report to be fair, balanced and understandable. The quality of explanations in this area remain similar to last year: only a few companies have embraced the Code’s intent that they supply information about the criteria used to support their statement, while two-thirds give little or no insight into what arrangements are in place to ensure that the information is fair, balanced and understandable or how the board came to this conclusion.

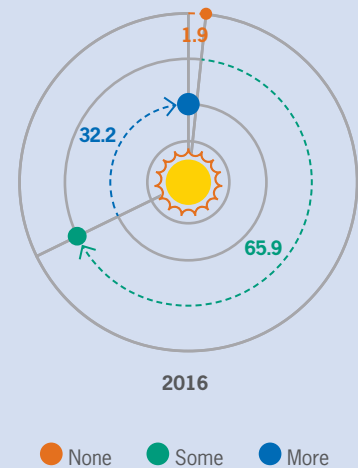
Reporting on culture

“One of the key roles for the board includes establishing the culture, values and ethics of the company. It is important that the board sets the correct ‘tone from the top’. The directors should lead by example and ensure that good standards of behaviour permeate throughout all levels of the organisation. This will help prevent misconduct, unethical practices and support the delivery of long-term success.”

(UK Corporate Governance Code, Preface, paragraph 4)

At the end of 2015, the FRC launched its Culture Coalition initiative with a consultation project to gather information on organisational culture and behaviour. The report of observations, published in July 2016 will help inform the anticipated review of the Guidance on Board Effectiveness. The report came too late to influence the reports in our review, so it is encouraging that the number of FTSE 350 companies referring to efforts to embed a healthy culture increased by 13 percentage points compared to 2015. But when looking at the quality of this reporting, the number providing good or detailed insights remains constant at 20%, while 35% (2015: 28%) provide only passing reference to culture. Most (56%) of the FTSE 350 companies that provide good descriptions of their business model, do not address culture at all or only make passing reference. Only 52% of the FTSE 350 communicate their values.

DOES THE BOARD EXPLAIN THE BASIS ON WHICH IT CONSIDERS THE ANNUAL REPORT IS FAIR, BALANCED AND UNDERSTANDABLE? (%)

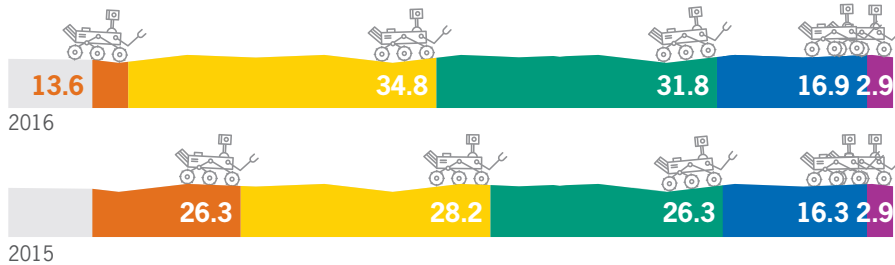


³ Clear & Concise: Developments in Narrative Reporting, FRC, December 2015.

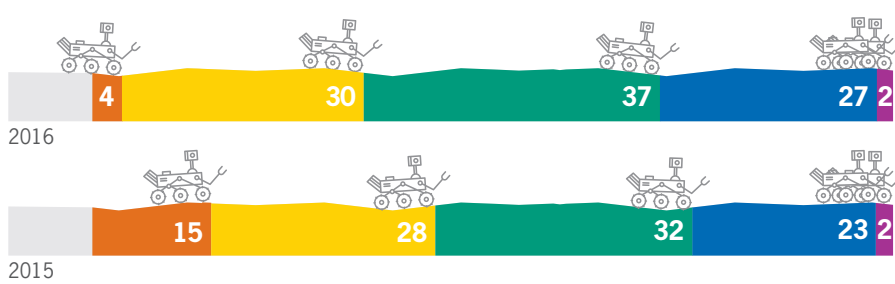
DOES THE ANNUAL REPORT ADDRESS CULTURE AND VALUES? (%)

None Basic General Good Detailed

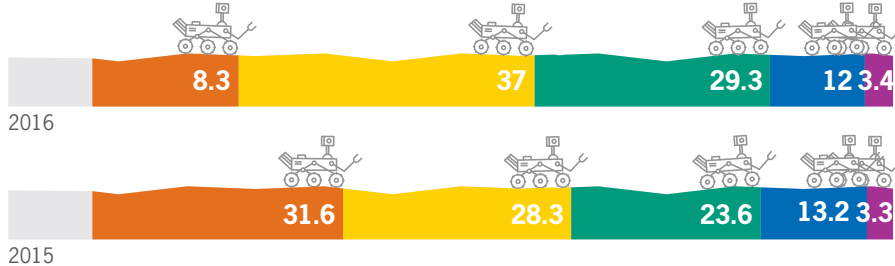
FTSE 350



FTSE 100



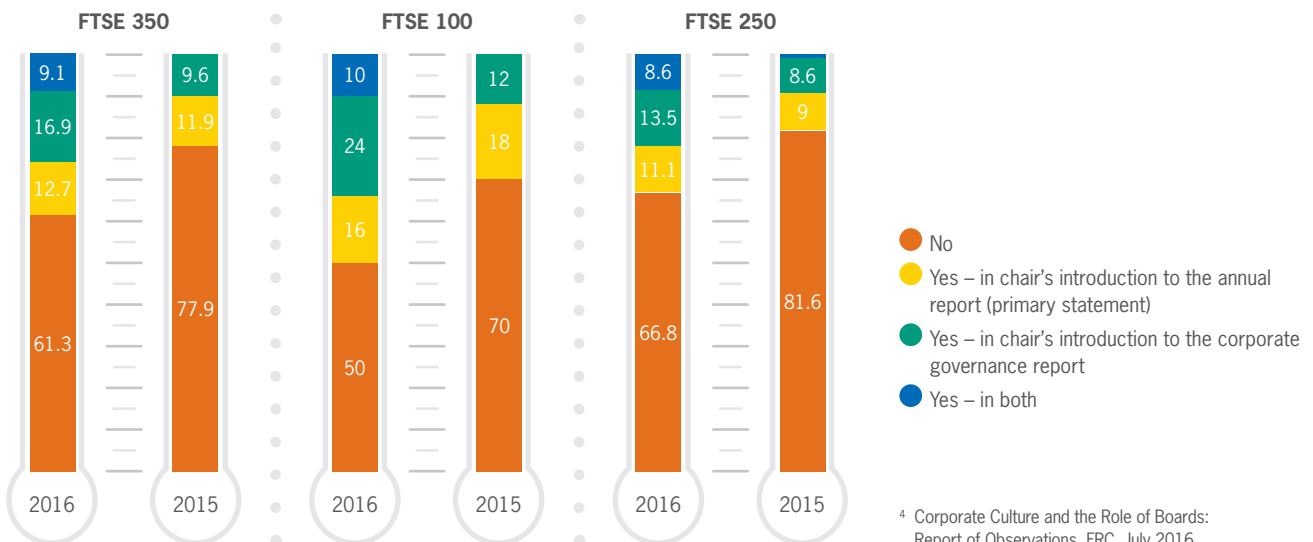
FTSE 250



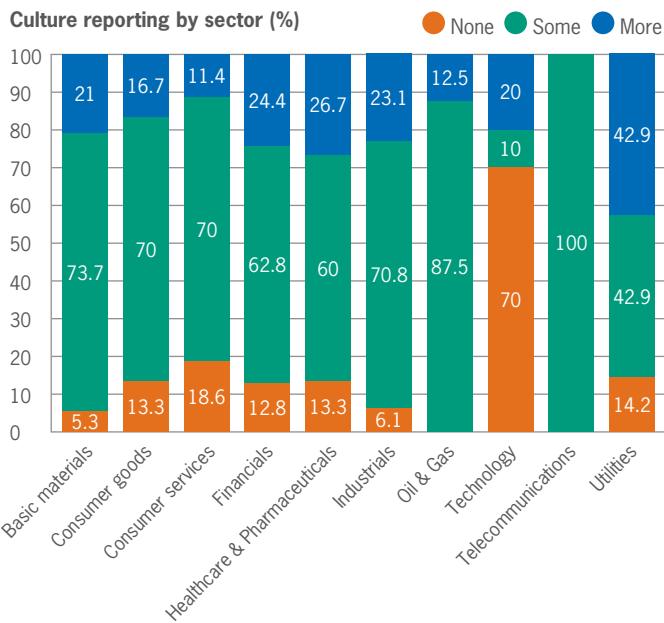
This year 39% of FTSE 350 chairs (2015: 22%) discuss culture and values in the annual report, either in their primary statement or – more commonly – within the introduction to the governance report. There is a significant difference between FTSE 100 and FTSE 250 companies: 50% of FTSE 100 chairs discuss culture, compared with 33% of the FTSE 250. While ‘the tone’ comes from the board, it is widely acknowledged that the CEO is responsible for embedding the desired culture throughout an organisation⁴. Yet, surprisingly, only 21% of FTSE 350 CEOs refer to culture in their introduction to the annual report.

Analysing culture reporting by sector offers further insight. Technology companies seem to struggle to report on culture (or deem it unimportant), with 70% making no reference to it at all. Utilities companies, on the other hand, provide the greatest insight: almost half (43%) of FTSE 350 companies in this sector acknowledge that culture is embedded at every level of their organisation, as part of their approach to responsible business. The financial sector improved the most compared to 2015, with 87% of companies (2015: 70%) discussing culture in their annual reports, perhaps reflecting the focus on this area by the Financial Conduct Authority (FCA).

DOES THE CHAIR DISCUSS THE CULTURE AND VALUES OF THE COMPANY? (%)



⁴ Corporate Culture and the Role of Boards: Report of Observations, FRC, July 2016.



Investor viewpoint

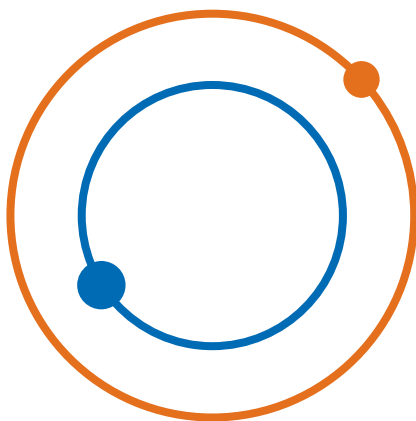


Culture

To us, at the heart of good governance and good business must be the right culture. You can mechanically have the right boards, and you can theoretically have the right remuneration structure, but if you don't have the right culture leading to appropriate behaviours across the organisation, then the company is unlikely to be fit for purpose. Culture has to be at the heart of what governance is about.

The behaviours at a company cannot be simply in the interests of the C-Suite. To be sustainable and deliver valued and affordable goods and services over the long term, businesses should be run for all key stakeholders not only shareholders. A business needs a social licence to operate to be successful. And we're seeing a shift now: there is a wider acceptance that a business should have a purpose beyond just making money. That is the change that will make businesses stronger.

Changing a company's culture and its behaviours can be its biggest challenge. Change in culture is hard to measure but when successful, is clear to all. To effectively do so, requires a clear tone from the top, "walking the walk" by all in the organisation, especially at the top and zero tolerance of poor conduct. Reporting structures and processes need to be put in place which engender the right behaviours. Investors need to have patience and recognise that meaningful change can take time.



"The financial sector improved the most compared to 2015, with 87% of companies (2015: 70%) discussing culture in their annual reports, perhaps reflecting the focus on this area by the Financial Conduct Authority (FCA)."

Sustainability reporting

“To the extent necessary for an understanding of the development, performance or position of the entity’s business, the strategic report should include information about: environmental matters (including the impact of the business of the entity on the environment); the entity’s employees; and social, community and human rights issues.”

(Companies Act 2006, s414C (7)(b))

Discussions regarding sustainability reporting – of the environment, employees, social and community activities, and human rights – has become common practice. However, some companies still struggle to report effectively in this area. There has been little improvement in recent years and there remains a core of just under half of companies where either the content or quality of disclosures remains at best, basic.

Best practice in sustainability reporting demonstrates integration with, or connection to, wider strategic delivery and the very best shows clear linkage to management remuneration. However only 55% of companies have sustainability policies integrated into their business models, although we note an improving trend (2015: 47%).

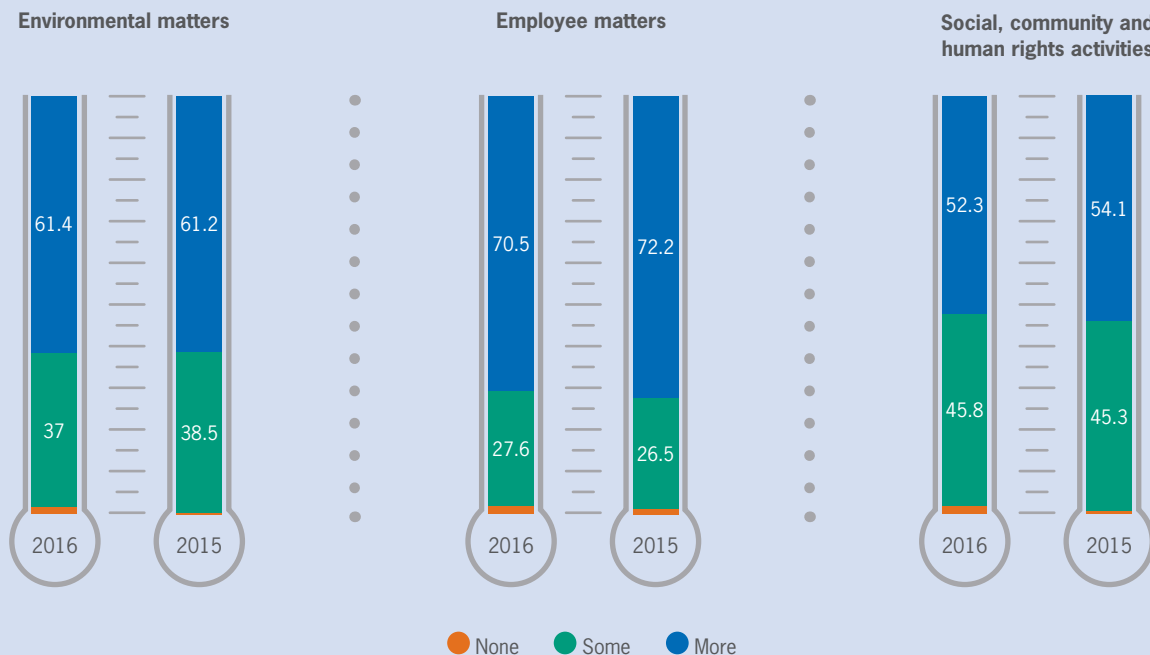
Immediate change tends to follow regulatory direction. Over the past two years, companies have paid more attention to the correct reporting of greenhouse gas emissions, with 91% doing so in 2016 (2015: 85%; 2014: 76%). There has also been a notable shift in the number disclosing the gender split in the workforce as required by the Companies Act: this year, 74% complied with this requirement (2015: 70%; 2014: 48%). This will become an even more significant area given the implementation of gender pay gap legislation⁵.

Currently, sustainability reporting is dominated by a number of requirements – from regulation and a variety of reporting frameworks – and while greater harmonisation will follow, in the meantime the wide variety of management models limits effective comparison.

“Sustainability reporting is fundamental... in providing input into the organization’s identification of its material issues, its strategic objectives, and the assessment of its ability to achieve those objectives and create value over time.”

G4 Sustainability Reporting Guidelines, Global Reporting Initiative.

TO WHAT EXTENT DOES THE COMPANY EXPLAIN ENVIRONMENTAL MATTERS, EMPLOYEE MATTERS AND SOCIAL, COMMUNITY AND HUMAN RIGHTS ACTIVITIES? (%)



⁵ Subject to the approval of Parliament, the regulations will require employers to calculate gender pay gaps using data from a specific pay period, expected to be 30 April, commencing from 2017.

Toolkit for culture reporting



ELEMENTS/ CONTENT	THINGS TO CONSIDER	REPORTING TIPS
<p>Setting the tone from the top</p>	<p>The board and management is responsible for setting the 'tone from the top'; understanding and articulating the desired culture of the organisation</p> <p>Behaviours which the company encourages should be consistent with the company's strategy, business model and also its purpose – why the company exists beyond financial gain and what it is there to do. Company values should support the achievement of this purpose. While 'the tone' comes from the board, the chief executive is responsible for promoting the desired culture throughout an organisation</p> <p>Focus on culture should be continuous, not just in times of crisis</p>	<p>Chairs should consider discussing the organisation's culture, both in their opening statement to the annual report, and their introduction to the governance report</p> <p>Ensure that there is consistency between the chief executive and chair's views on culture within the annual report, to demonstrate leadership and tone from the top. While culture should be articulated particularly in these statements, it should also be clearly articulated throughout the strategic report</p> <p>Show how your values align with your organisation's purpose and strategic objectives</p>
<p>Embedding</p>	<p>Think how you are embedding culture and behaviours at every level of an organisation:</p> <ul style="list-style-type: none"> • recruitment should be aligned with company culture and values, at employee and board level • reward should incentivise desired behaviours • embed strategy and values within HR policies and performance appraisals • training and communication should be consistent, and deliver the board's message • culture should be part of risk management or internal control systems • middle management should be involved in the process. 	<p>Highlight the link between your organisation's purpose, strategy, values, KPIs, business model, risks and reward, and show how these act as embedders of culture</p> <p>Discuss how company and board culture is included in recruitment and reward, and connect it within the nominations, audit and remuneration committee reporting</p> <p>Culture should be referred to in risk management disclosures, and reference to internal controls</p> <p>Show how culture and behaviours are embedded via training and other activities, such as culture change programmes</p> <p>Ensure that culture and values are consistent within the CSR section, and connectivity is shown between this section and the rest of the report</p>
<p>Monitoring</p>	<p>The board has also a responsibility to evaluate culture and challenge the executives</p> <p>Devote sufficient time and resources to evaluating and monitoring culture, to assure that:</p> <ul style="list-style-type: none"> • senior management are clear and supportive of the culture • values are well defined and understood • actions and behaviours at different levels of the firm are in line with culture. <p>Measuring culture is notoriously tricky, but consider gathering quantitative and qualitative information from different sources, for instance through staff surveys, or by conducting interviews or focus groups with different stakeholders</p>	<p>Explain how the board seeks to assure itself that behaviours at different levels are in line with the culture</p> <p>Show how culture is considered when assessing the effectiveness of risk management and internal control systems</p> <p>Disclose some practical illustrations and numerical metrics, such as employee turnover or how you gauge effectiveness of the culture programmes. It is important to show how those indicators are relevant for your company and what you want to achieve</p>

Governance

“The Code is not a rigid set of rules... It is recognised that an alternative to following a provision may be justified in particular circumstances if good governance can be achieved by other means.”

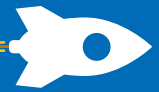
(UK Corporate Governance Code, Comply or Explain, paragraphs 2 and 3)

Full compliance returns to growth

Since the inception of the original Combined Code, companies have enjoyed the flexibility of the ‘comply or explain’ approach, which leaves them free not to comply, if they provide a reasonable explanation. In 2015, a significantly higher number of companies, mostly new entrants to the FTSE 350, opted to explain rather than fully comply with the Code provisions. This year saw a return to the longer-term trend of growing compliance, with the full compliance rate reaching a new high of 62%.

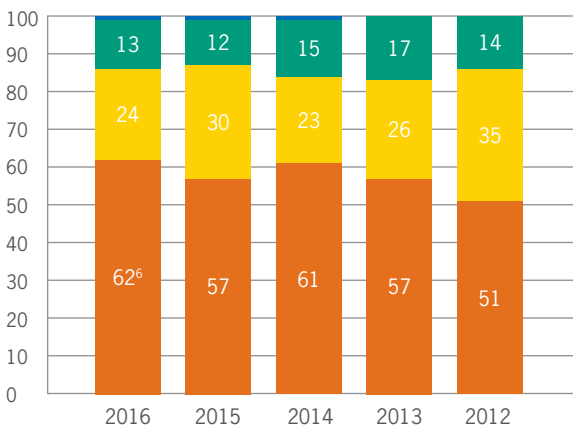
In 2016, the number of companies neither disclosing compliance nor providing much detail about their non-compliance stayed relatively flat. However, some previously non-complying organisations that provided good quality explanations in 2015 moved to full compliance in 2016. This caused a drop in the overall quality of explanations for non-compliance: of those who did not comply, 62% of FTSE 350 companies gave good explanations, compared with almost 70% in 2015. Six per cent of the FTSE 350 made it clear that non-compliance was temporary.

FAST FACTS



- ★ The number of companies claiming full compliance with the Code reaches a new high of 62%.
- ★ 90% of the FTSE 350 comply with all but one or two provisions of the Code.
- ★ The highest rate of non-compliance relates to board independence (B 1.2.). The Code requires half the board excluding the chair to be independent NEDs. 9.4% of the FTSE 350 do not comply with this provision.
- ★ Disclosure quality around company engagement with shareholders has decreased year on year since 2010. This year only 36% of companies provided good or detailed explanations of how they understand the views of shareholders.
- ★ 58% of board chairs state that they discuss strategy and governance with major shareholders.
- ★ Only 12% of companies specifically mention dialogue or face-to-face contact with investors. 41% mention one-way engagement such as investor presentations.
- ★ Only 3% of companies discuss engagement with their debt holders.

Do they claim full compliance with the UK Corporate Governance Code? (%)



- Complies
- Does not comply; explains with more detail
- Does not comply; explains with some detail
- Does not discuss compliance

⁶ In 2016 our FTSE 350 sample includes 308 companies: 100 from the FTSE 100 and 208 from the FTSE 250. In 2015 our FTSE 350 sample included 312 companies; 100 from the FTSE 100 and 212 from the FTSE 250. In 2014 it included 303 companies: 99 from the FTSE 100 and 202 from the FTSE 250.



Do companies claim full compliance with the UK Corporate Governance Code? (%)

	2016	2015	2014
FTSE 350	62.0	57.1	60.6
FTSE 100	72.0	64.0	74.0
FTSE 250	57.2	53.8	54.1

The FTSE 100 saw a jump in those claiming full compliance, up to 72% (2015: 64%). Of two new entrants, one claimed full compliance with the Code. Of the 98 FTSE 100 companies that were present in both 2015 and 2016, 20 (2015: 17) used the Code’s flexibility to change their compliance status in 2016 to reflect their current situation. Thirteen companies (2015: four) moved to full compliance from either non-compliance or part-year compliance.

Compliance has also been growing among the FTSE 250, with 57% (2015: 54%) claiming full compliance. The previous year’s performance was affected by lower levels of compliance among the new entrants. Interestingly, six out of 20 non-compliant 2015 entrants left the FTSE 250, while another 12 continued not to comply with the Code. Most of the 2016 new entrants underwent a recent initial public offering (IPO), as in 2015, but they appeared to have invested greater effort into developing governance arrangements prior to listing, compared to last year’s newcomers. Just over half of the 11 companies that joined the FTSE 250 in 2016 demonstrated full compliance. Perhaps most encouraging was that of the 183 companies present in the FTSE 250 for the past two years, levels of full compliance improved to 52% (2015: 46%).

Reasons for non-compliance

“...reasons should be explained clearly and carefully to shareholders, who may wish to discuss the position with the company and whose voting intentions may be influenced as a result.”

(UK Corporate Governance Code, Comply or Explain, paragraph 3)

The most significant area of non-compliance, as last year, arose from directors’ lack of independence. In the FTSE 350, there was a small decrease in non-compliance with provision B.1.2, which requires that at least half of a board is made up of independent NEDs. Somewhat surprisingly, non-compliance with provision A.3.1, requiring the chair to be independent on appointment, went up to 6.5% (2015: 4.8%).

In 2016, companies tended to be more transparent about the audit tendering process in their annual reports, possibly due to the 2014 EU Audit Regulation and Directive, which became effective in June 2016. Fewer companies declared non-compliance with provision B.6.2, requiring triennial external board evaluations, with just 3.2% (2015: 7.4%) doing so in 2016, effectively full compliance. These evaluations are already well adopted throughout the FTSE, and – with 4% more FTSE 350 businesses now complying – only 10 organisations opted to conduct evaluations less frequently. Notably, companies are growing more confident in giving insight into the outcomes and actions of board reviews. There was also better compliance with provision A.2.1, relating to the division of the roles of chair and chief executive, with just 2.9% (2015: 4.5%) not complying.

Some businesses also fail to report non-compliance with provision B.2.4, despite failing to provide information or detail about their policy on board diversity and the process in relation to board appointments. The Code specifically requires companies to include this information within the nomination committee report⁷.

⁷ Provision B.2.4 of the Code states: “A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.”

The other main reasons for non-compliance involve either failure to meet audit, remuneration or nomination committee membership criteria, or shareholder engagement. Both non-compliance with provision E.1.1 (see table below) and decreasing reporting around shareholder engagement give cause for concern as satisfactory engagement between company boards and investors is crucial to the effectiveness of corporate governance.

Areas companies list as non-compliant

Code provision	Requirement	% of non-compliant FTSE 350 companies only	% of all FTSE 350 companies		
			2016	2016	2015
B.1.2	At least half the board should be independent non-executive directors	28.7	10.7	12.8	9.8
C.3.1	Failure to meet audit committee membership criteria	25.2	9.4	8	7.5
D.2.1	Failure to meet remuneration committee membership criteria	21.7	8.1	8	9.1
A.3.1	The chair should be independent on appointment	17.4	6.5	4.8	3.3
B.2.1	Failure to meet nomination committee membership criteria	14.8	5.5	4.5	3.6
E.1.1	The chair should discuss governance and strategy with major shareholders; the senior independent director should attend a sufficient number of meetings with a range of major shareholders	11.3	4.2	3.8	1.6
D.1.1	Failure to include clawback or other specific provisions to the schemes of performance-related remuneration for executive directors	11.3	4.2	2.9	N/A
C.3.7	FTSE 350 companies should put the external audit contract out to tender at least every 10 years	10.4	3.9	5.8	4.6
B.6.2	The board evaluation should be externally facilitated at least every three years	8.7	3.2	7.4	5.5
A.2.1	The roles of chair and chief executive should not be held by the same individual	7.8	2.9	4.5	3.6

How new entrants complied

We reported last year that governance disclosures and processes were notably poorer in new market entrants, which were generally weaker on compliance with the Code, board independence and board effectiveness. In many cases this highlighted a lack of preparation before going to market; with a failure to ensure governance is in order pre-IPO frequently the explanation given for not completing many key aspects, which is stating the obvious, rather than a justifiable explanation.

Re-visiting the 2015 entrants

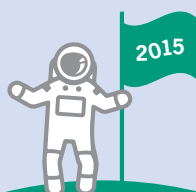
Of last year's 23 new entrants, 18 are still in the FTSE and covered by our review. Of the other five, two fell out of the FTSE 350 and three were acquired by other companies. Of the companies that remained in the FTSE 350, some improvement to governance arrangements can be observed (see page 27).

Overall, these new entrants have begun to address some of the issues absent at the time of their IPOs. However, disclosures remain poor for a number of these new entrants, particularly in relation to their risk management, internal controls, and their engagement with shareholders.

2016 entrants

In 2016, however, companies (and perhaps their sponsors) seem to have made more effort to ensure their governance and reporting is in place before going to market. The new entrants are notably stronger in their reporting and give better disclosures across a number of key markers.

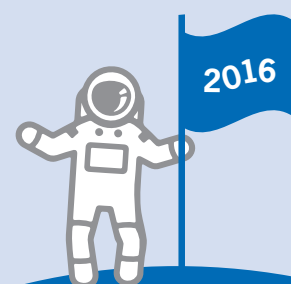
This year there were 16 new entrants to the FTSE 350 (see page 27). Overall we see similar issues, particularly with board evaluation and independence, both areas we might have expected boards to focus on prior to the process of IPO.



How 2015 entrants complied in 2016

Of the 18 remaining new entrants from 2015:

- ★ **33%** (six companies) complied with the Code this year or part year, up from 13%⁸ (three companies) in 2015
- ★ **28%** did not have at least half of the board as independent (2015: 48%)
- ★ **22%** had an external board evaluation in the year (2015: 9%)
- ★ All but one (**94%**) described their board evaluation processes (2015: 64%)
- ★ All but one (**94%**) provided detailed remuneration policy information (2015: 78%)
- ★ **50%** gave good or detailed disclosures on their future development (2015: 35%)
- ★ **61%** reported good or detailed risk management disclosures (2015: 48%)
- ★ **61%** provided strong internal controls disclosures (2015: 52%)
- ★ **22%** outlined good or detailed disclosures on shareholder engagement (2015: 30%).



How 2016 entrants complied

Of the 16 new entrants:

- ★ **38%** complied with the Code for all or part of the year
- ★ **31%** did not have at least half of the board as independent
- ★ **18%** provided good or detailed disclosures on board evaluation, but 31% had no disclosures on their board evaluation – either conducting board evaluation as part of the IPO process and not disclosing it or, more likely, failing to undertake a board evaluation at the IPO stage.
- ★ **13%** conducted an externally facilitated board review in the year
- ★ **56%** gave good or detailed risk management procedures, and 44% provided good or detailed internal controls
- ★ **25%** provided good or detailed descriptions of their future development
- ★ **13%** provided good or detailed descriptions of relations with shareholders
- ★ **56%** provided good or detailed remuneration policy information.

⁸ Percentage is of the 23 new entrants last year.

Personal accountability from the top

“Chairmen are encouraged to report personally in their annual statements how the principles relating to the role and effectiveness of the board ... have been applied.”

(UK Corporate Governance Code, Preface, paragraph 8)

Increasing personal accountability – measured through the quality and detail of the respective chairs’ personal introductions – has been a consistent trend over the last few years. The lead, not surprisingly, came from remuneration committee chairs but the other two principal committees have increasingly followed their example, providing informative, personal commentary.

The proportion of governance reports providing good and detailed descriptions of board duties, having improved significantly over each of the last few years, has now levelled out; 70% of companies give good or detailed levels of insight and explanation of the work and focus

of the board. In the FTSE 100, 85% of businesses provided good and detailed insights while in the FTSE 250 there were 63%. Some 84% of chairs discussed governance in their primary statement in 2016 (2015: 85%), while 85% give a personal introduction to the corporate governance report (2015: 83%). Two-thirds of these chairs gave informative descriptions of their governance arrangements.

There can be little doubt that institutional pressure has been an effective driver of change in this area. This is evident in the increased accountability of remuneration committee chairs over the past five years: in 2016, 96% of remuneration committees’ reports opened with a personal statement from the chair compared to as recently as 2012 when only 48% did so. Of these personal introductions, we judged 84% to be good or detailed, providing personal views on their company’s remuneration policy, main issues addressed and giving insight into changes made during the year.

The audit and nomination committees have been slower to respond, but the trend has been clear and has mirrored a growing focus from external parties. Among audit committee chairs, 69% made individual, personal introductions to the committee report (2015: 66%), with 54% of nomination committee chairs doing the same (2015: 48%). This is a significant increase over the last 5 years, when the figures were 23% and 17% respectively.

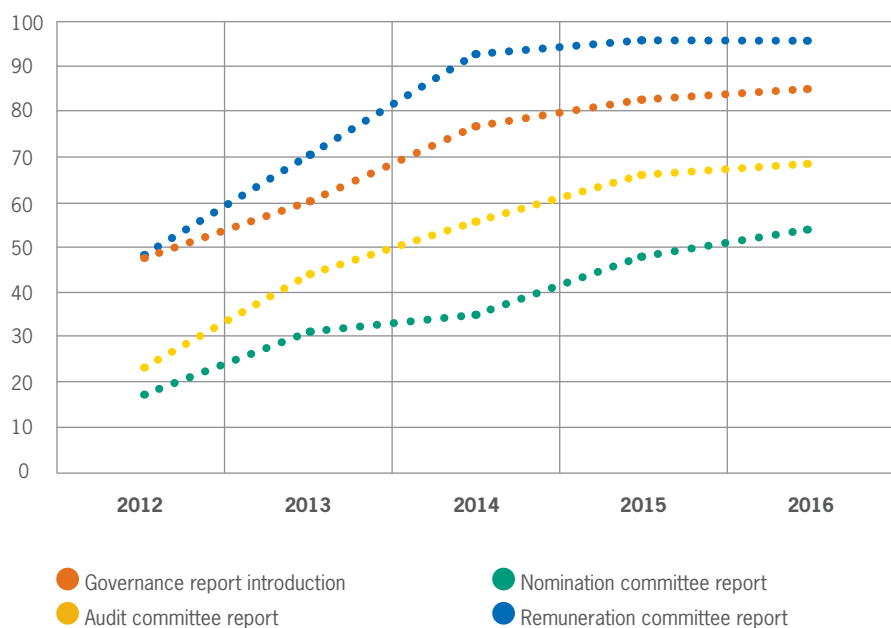
Relations with investors

“There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.”

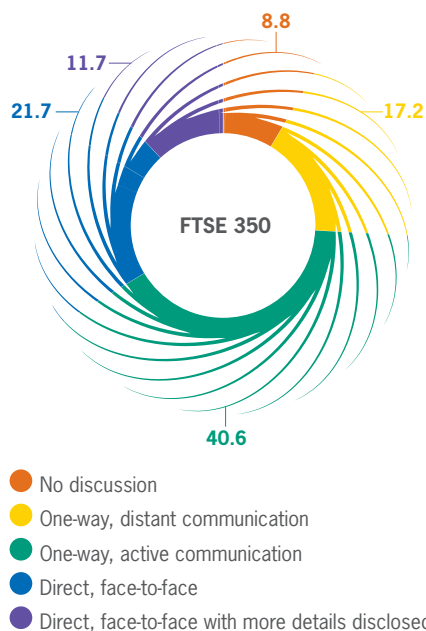
(UK Corporate Governance Code, Main principle E.1)

Shareholder engagement has been a growing concern for the regulator. Legislation has been introduced to address the issue – for example, requiring companies to state in their annual reports if they have had significant minority votes on remuneration and triennial approval of remuneration policy. The Code also encourages greater engagement: the most recent changes require companies to explain, when publishing general meeting results, how they intend to engage with shareholders in cases where a significant percentage have voted against any other resolution. Institutional investors and investee companies are also directed to form open and constructive shareholder dialogue through the Stewardship Code.

Is there any personal commentary from the chair? (% Yes)



WHAT METHODS DO BOARDS USE TO UNDERSTAND THE VIEWS OF MAJOR SHAREHOLDERS? (%)



The FRC is clearly trying to encourage greater shareholder engagement, although the research found that the quality of dialogue remained the same between 2014 and 2015⁹. The regulator continues to state that it is important for companies to approach their shareholders, and for shareholders to maintain dialogue with companies when the business is going well as well as when there are specific issues to be addressed¹⁰. This has been an increased area of focus this year for the FRC, which will be engaging with investors individually to ensure they meet the requirements of the Stewardship Code.

Nevertheless, based on what is disclosed in the annual reports, there is no evidence that this guidance is being heeded. In recent years all companies have provided some insight into the steps taken to understand the views of shareholders, although in 2016 only 36% of the FTSE 350 provided good or detailed explanations (2015: 55%), while 62% gave generalised disclosure with no mention of specific issues discussed. Most concerning, particularly given the focus the regulator has on this important topic, the quality of disclosures companies provide around relations with shareholders has decreased year-on-year since 2010.

Our research shows that 33% of companies provided specific information about direct face-to-face communication between shareholders and directors. This supports the conclusion – as outlined in our 2015 review – that investors are primarily interested in dialogue only when there

are issues to address, but appears at odds with chairs’ views – as expressed to Sir Win Bischoff and observed in last year’s foreword to our report – that it is just as important to maintain dialogue when business is going well as it is when there are specific issues to be addressed.

Only 16% of companies state that their senior independent directors (SIDs) met with shareholders; 61% report they were available for meetings but none were reported. Similarly, 13% of company NEDs met with shareholders; most commonly the chair of the remuneration committee, suggesting, unsurprisingly, that remuneration is the key issue for investors, on which they feel they should engage. Some 43% say NEDs were available but no meetings occurred. Meanwhile, 58% of FTSE 350 chairs state that they discuss strategy and governance with major shareholders, again suggesting that the key issues for shareholders, where engagement is occurring, are governance, strategy and remuneration.

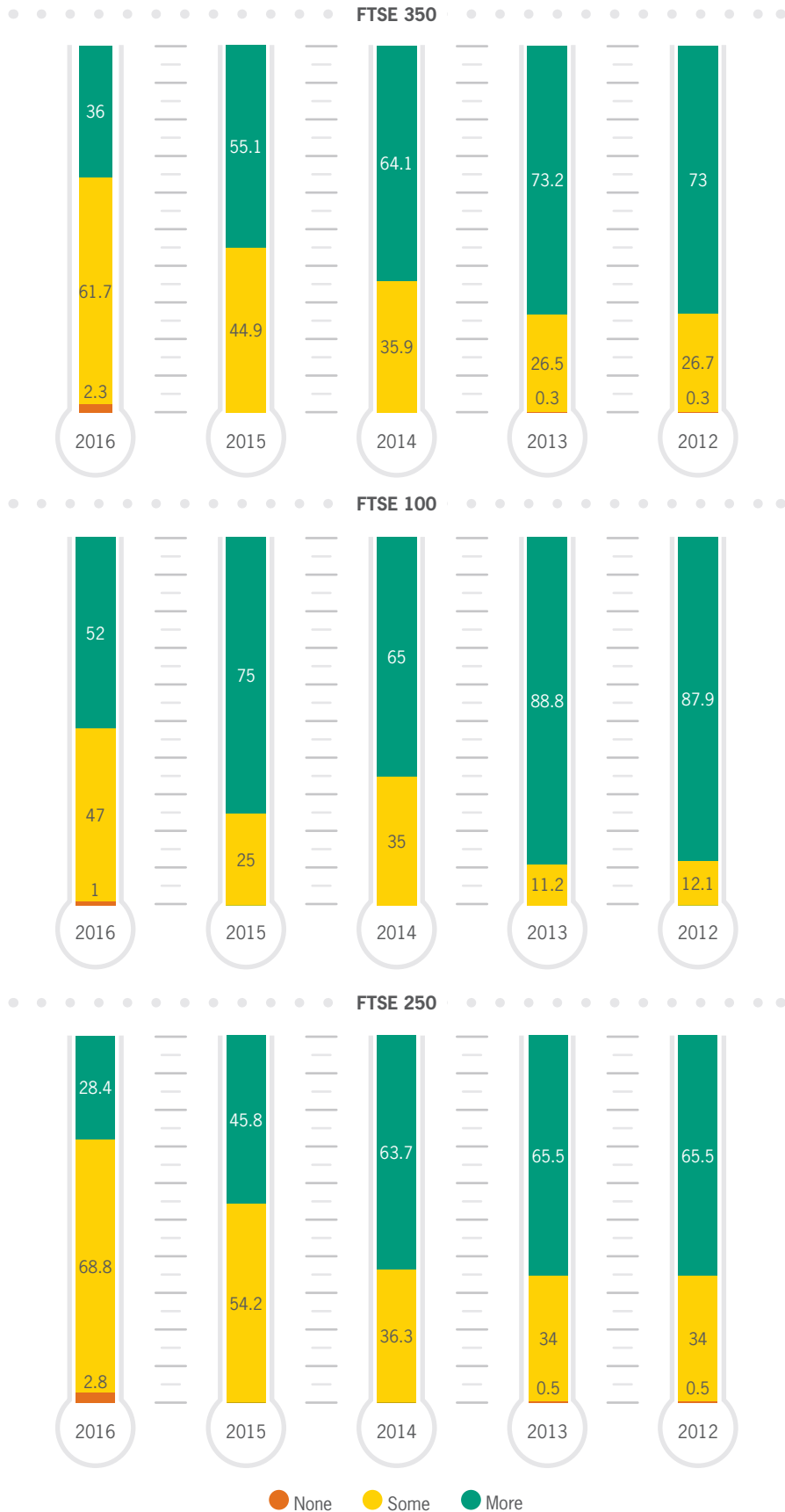
The most common kind of engagement with shareholders (41% of companies) is one-way, direct engagement, such as investor presentations, with only 12% of companies specifically stating dialogue or face-to-face communication.

The same requirement for greater engagement is placed on boards in relation to their debt holders; however, most companies make very little effort to discuss this in their annual reports (just 3% do).

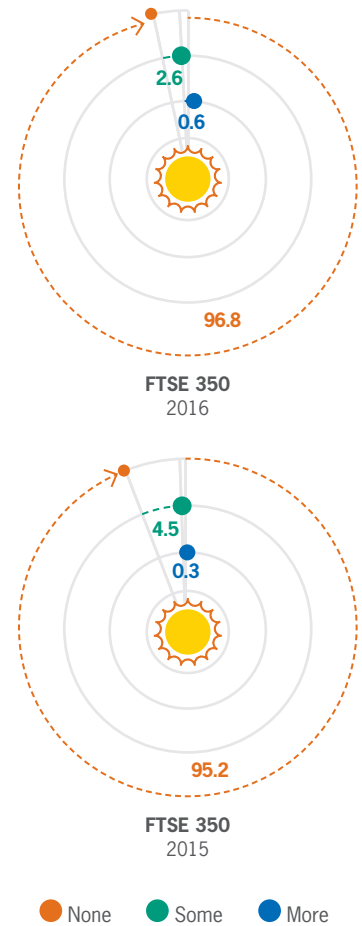
⁹ Adherence to the FRC’s Stewardship Code, The Investment Association, June 2015.

¹⁰ Developments in Corporate Governance and Stewardship 2015, FRC, January 2016.

TO WHAT DEGREE DOES THE BOARD DEMONSTRATE THE STEPS TAKEN TO UNDERSTAND THE VIEWS OF MAJOR SHAREHOLDERS? (%)



TO WHAT DEGREE DOES THE BOARD DEMONSTRATE THE STEPS TAKEN TO UNDERSTAND THE VIEWS OF MAJOR DEBT HOLDERS? (%)



Investor viewpoint



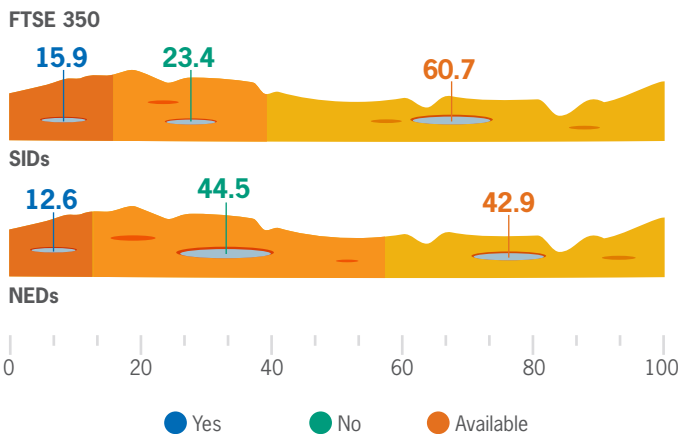
Relations with shareholders

It's clear from the research and from our own experience that investor engagement is still not widespread or incisive enough, and this is an issue because where there is a lack of effective investor engagement, it leaves a disconnect between the owners of the companies and the companies themselves.

We would like to see the annual report provide detail on the level and nature of investor engagement at the company: on what topics, with whom at the company and how often? By doing so, this will help hold investors and companies alike accountable for developing a constructive relationship for the sake of the beneficiaries they are serving. This encourages investors to take their ownership responsibilities seriously and engage, and urges companies to demonstrate to investors the alignment of their business activities to the holistic objectives of the savers the investors represent.

Most importantly, effective engagement is much more than registering dissent through voting, participating in a company's investor roadshow, or even one or two meetings between the CEO and fund manager that only discusses the financial aspects of the company. To act as responsible stewards of savers' investments, investors need to address the company's corporate governance, the composition of boards including relevant skills, independence and diversity, the alignment of executive remuneration, and crucially the company's long-term strategic issues. Good engagement occurs when investors sit down with the board and ask about the ten-year plan, what problems they see coming down the road in five or six years, and how they are going to mitigate them. It is about asking the board to explain how it is going to meet the needs of all relevant stakeholders including customers, employees, suppliers and society at large and how by doing so, it will be sustainable over the long term. That's a very different kind of engagement and one that we need to see more of going forwards.

DO SIDs AND OTHER NEDs ATTEND MEETINGS WITH MAJOR SHAREHOLDERS? (%)



“The most common kind of engagement with shareholders (41% of companies) is one-way, direct engagement, such as investor presentations, with only 12% of companies specifically stating dialogue or face-to-face communication.”

Toolkit for shareholder relations



ELEMENTS/ CONTENT	THINGS TO CONSIDER	REPORTING TIPS
Calendar	Summarise the shareholder engagement programme for the past year as well as the main planned events of the forward looking calendar	Where possible, include the financial reporting calendar and any upcoming events
Methods	Take time to reassess your engagement with shareholders: <ul style="list-style-type: none"> • how information is communicated? • how participation is encouraged? • how often? 	Provide details on day-to day processes and interactions that take place outside the planned programme of events. Identify all forms of engagement throughout the year – surveys of shareholders' opinion, the annual report, other reports, formal presentations, AGM, conferences, meetings with brokers and analysts
People engaged	Consider who is engaged in the dialogue, and who should be engaged The Code requires the chair to discuss governance and strategy with major shareholders. Other non-executive directors should be available for meetings and the senior independent director should attend sufficient meetings with a range of major shareholders	Disclose roles of individuals involved as well as explaining the role of your investor relations team State the timing and rationale for chair-attended meetings, and include information on how the chief executive, company secretary, senior independent, chairs of committees or other directors engaged with shareholders
Key features/ topics of engagement	Reassess feedback from shareholders regarding specific issues, including how this is garnered and utilised	Specify key issues that investors raised and were invited to engage on. Disclose how many meetings took place, what directors were engaged and what issues were discussed. Reference how previous matters were resolved
Outcomes and other considerations	Reassess the board's understanding of shareholder concerns and if those issues are being allocated sufficient time in board meetings When appropriate consider changes in your investor profile – geographic split, investment rationale and whether there are unintended consequences for the company	Provide details on the feedback and any outcomes arising. Explain if any actions/decisions were taken as a result of board/management consideration and how your shareholders were made aware of the outcomes

Nomination committee

“A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments.”

(UK Corporate Governance Code, B.2.4)

The nomination committee is still seen as the poor relation to the other committees. It meets less regularly than either the audit or the remuneration committee, with an average of just 3.3 meetings a year, compared to 4.8 and 4.7 respectively for the other two committees.

In the FTSE 350 overall, the quality of nomination committee reporting has not seen much change. Some 44% of companies (2015: 48%) offer a good or detailed description of the committee’s work, while 54% (2015: 52%) provide only a basic or general description, which outlines nomination committee responsibilities but is largely generic. Five companies have no description; as they have no nomination committee.

Further analysis reveals that the more detailed descriptions tend to be found among the better and bigger companies. A reflection perhaps of the increased focus and public scrutiny on these companies, for example, around the debate on gender which has now broadened to encompass wider issues of diversity, skills and succession. Further analysis reveals that 60% of the FTSE 100 provide good or detailed nomination committee disclosures (2015: 64%). In contrast, in the FTSE 250, only 37% provide good or detailed disclosures (2015: 41%).

In 2016, 14 companies (2015: 12) in the FTSE 350 either did not have a nomination committee, or had a committee that did not meet during the year, and yet seven of these appointed new directors in that period (2015: four companies). Although it is more understandable for young and fast-growing companies, it is surprising, given the increasing investor and regulator focus on future skills and succession, that any members of the FTSE 350 are without a nominations committee.

FAST FACTS



- ★ 54% of companies provide only a basic or general description of the nominations committee responsibilities.
- ★ FTSE 100 nominations committees have more detailed reporting than the FTSE 250: 60% of the FTSE 100 provide good or detailed disclosures, compared to 37% of the FTSE 250.
- ★ 14 companies either have no nominations committee or had no nominations committee meetings in the year. Of these, seven appointed a new director.
- ★ Most of the FTSE 350 (78%) have only basic or general descriptions of succession planning.
- ★ Over two-thirds of companies appointed a new director in the year, but just under half of these named a specialist search firm. The Code states that the use of an external search firm should be reported.
- ★ Six major search firms conduct three quarters of searches for new directors in the FTSE 350.
- ★ 76% of companies now discuss other kinds of diversity at board level, such as ethnicity, race, cultural backgrounds, sexuality and religion, as well as a breadth of skills and experience. This is a 20% increase on last year.

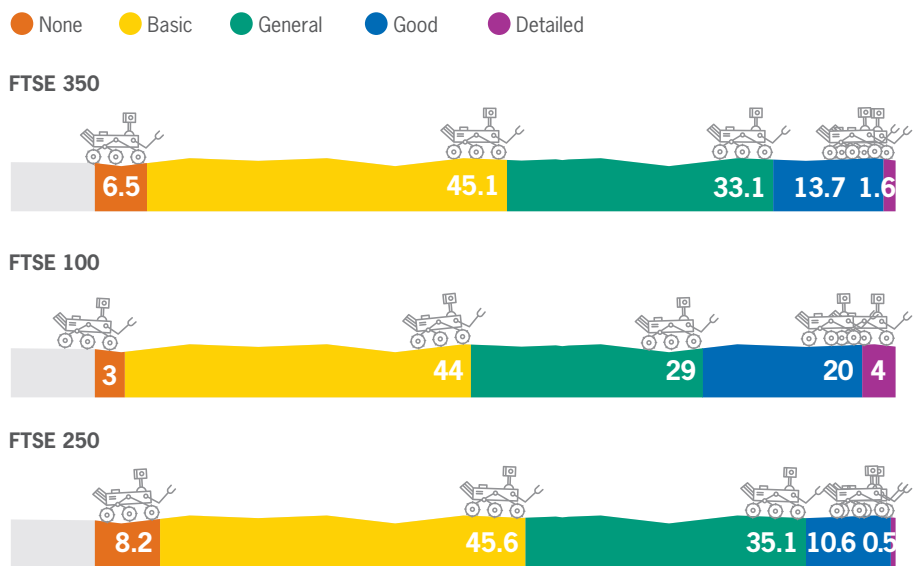
More focus on succession planning
“The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.”

(UK Corporate Governance Code, Supporting principle B.2)

As succession planning is a growing focus for the regulator, in 2016, we examined this area as a specific part of the work of the nomination committee. Overall, most companies (78%) have basic or general descriptions of succession planning, often mentioning it as part of the role of the nomination committee, but with little specific detail provided about how it occurs. This might in part be due to imbalances in reporting: succession is a necessarily delicate area, and boards may not feel able to describe it transparently at times.

The most common reason for non-compliance with the Code is the imbalance of executive and non-executive directors which suggests that, despite such delicacies, many have simply not prepared sufficiently for contingencies or emergency successions. When we look at explanations for this, boards often state it is a temporary imbalance due to the exit of an NED, or to the arrival of an additional executive director. In most cases, it is unlikely to be unmanageable if a board is not in balance for a short period of time, however, it does suggest some are spending insufficient time thinking about succession planning to address gaps before they occur.

TO WHAT EXTENT DO COMPANIES DESCRIBE THEIR SUCCESSION PLANNING? (%)



That said, a decrease in non-compliance in the balance of independent directors gives some grounds for optimism: it might be inferred that companies are starting to improve their short-term succession planning albeit slightly. When it comes to the longer term, the FRC is right to keep the issue firmly on its radar.

Search firm naming remains patchy
“An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.”

(UK Corporate Governance Code, B.2.4)

Over two-thirds of companies (212, 69%) appointed a new director in the year and 11% (34) a new chair. Of these, just under half (103, 49%) named a specialist search firm used. Open

advertising is rarely, if ever, used for FTSE 350 board appointments¹¹, so this means more than half of companies that appoint directors do not comply with the Code, by either not using or not reporting on their use of search firms.

Of the search firms mentioned, nearly three quarters (74%) were one of six organisations, with the other 26% made up of an additional 15 companies working with one to five companies each. The most common search firm accounts for nearly a quarter of mentions which begs the question as to whether companies and search firms are continuing to draw candidates from too limited a pool, and as a consequence whether the objectives of true diversity (and thereby competitive advantage) can ever be achieved.

¹¹ Equality and Human Rights Commission, 'An inquiry into fairness, transparency and diversity in FTSE 350 board appointments'

Gender diversity: momentum may be slowing

“This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.”

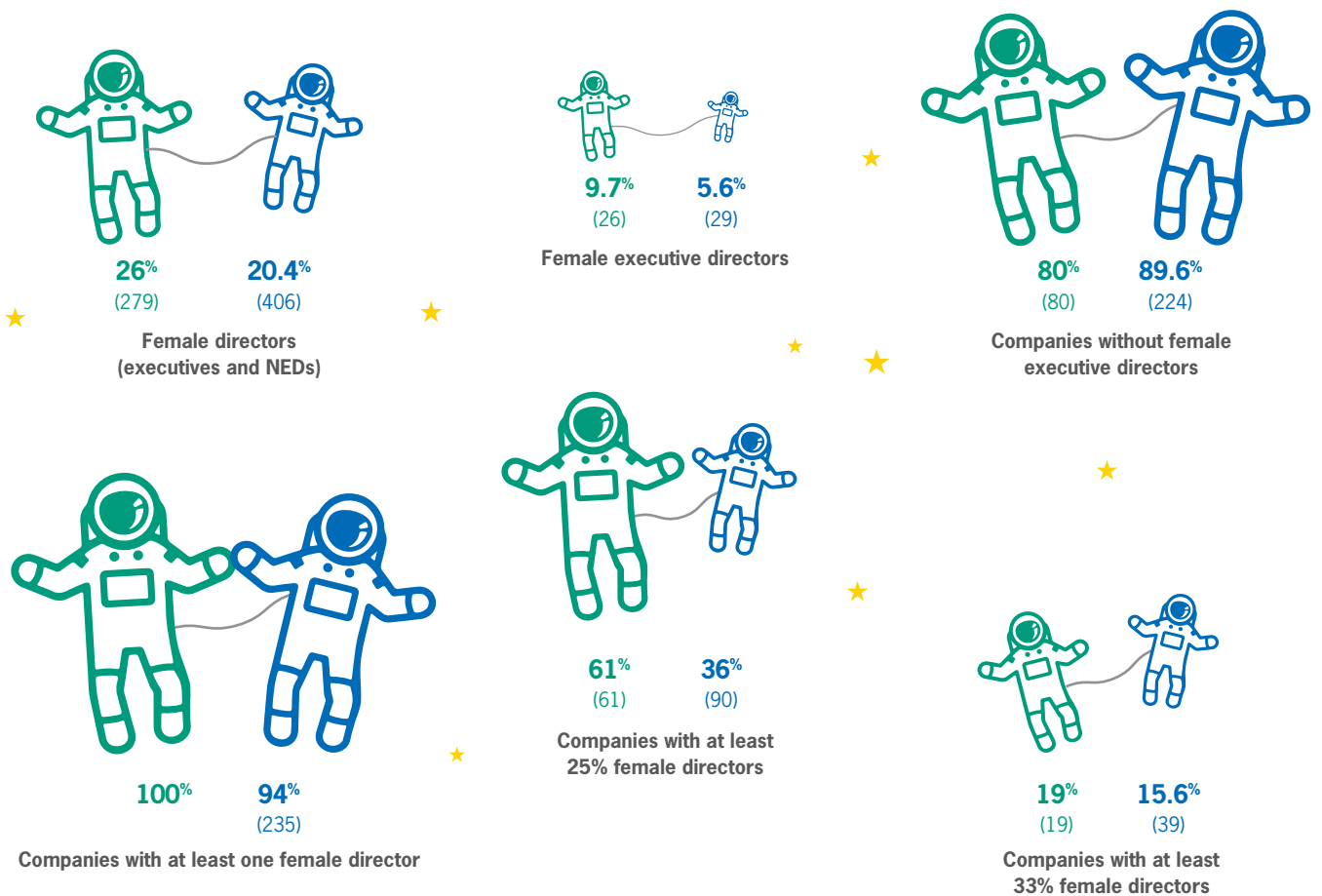
(UK Corporate Governance Code, B.2.4)

The proportion of women on FTSE 100 boards has doubled since the 2011 Davies report, with the FTSE 100 now meeting Lord Davies’ target of 25% female representation. Some 20% of FTSE 250 roles are also now filled by women. However, as the Female FTSE Board Report 2016 notes¹² (see table), the proportion of new appointments going to women this year was 24.6%, the lowest since 2011. While the target of 25% was met in 2015, it has only

increased to 26% since then. This suggests that the revised goal of 30% women on boards by 2020 may be a much more stretching target. However, the focus and increasing concern has quite rightly now turned to executive representation. Here, only a very small number of women occupy the top C-suite positions with 80 companies in the FTSE 100 and 224 in the FTSE 250 having no women in main board roles.

REPRESENTATION OF WOMEN ON FTSE 350 BOARDS, JUNE 2016

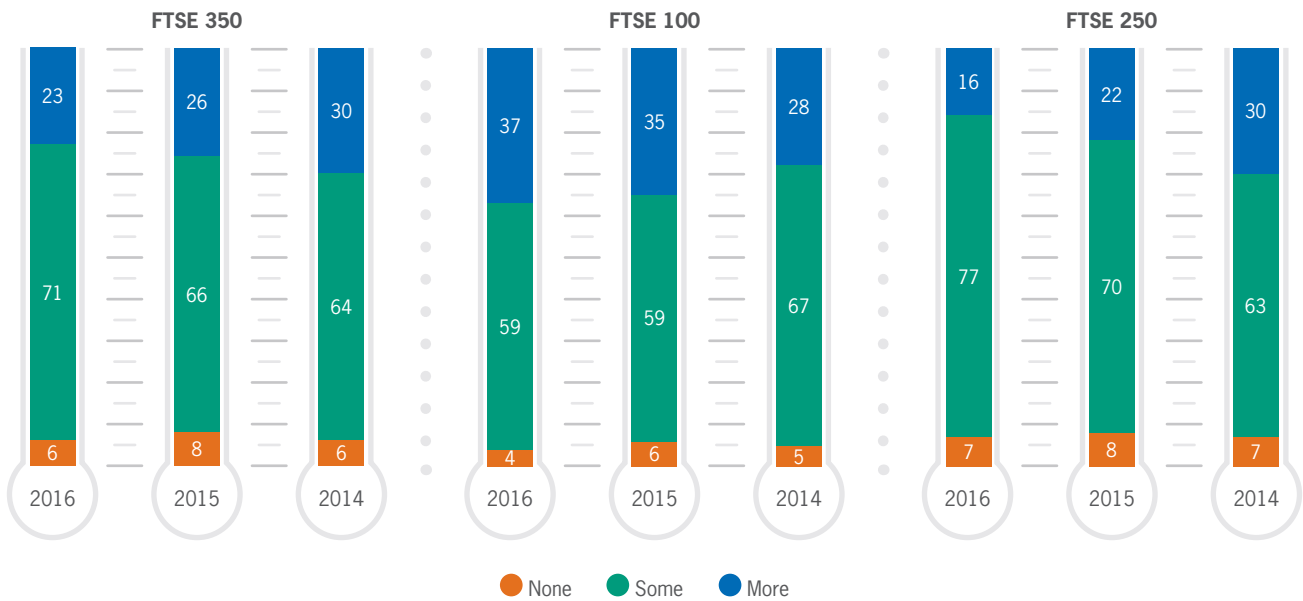
● FTSE 100 ● FTSE 250



★ *“The proportion of women on FTSE 100 boards has doubled since the 2011 Davies report, with the FTSE 100 now meeting Lord Davies’ target of 25% female representation.”*

¹² The Female FTSE Board Report 2016, Cranfield University.

HOW MUCH EXPLANATION IS THERE OF THE COMPANY'S POLICY ON GENDER DIVERSITY IN THE BOARDROOM? (%)



Reporting on gender diversity has increased in quality and scope in the past four years, no doubt in response to Lord Davies' 'Women on Boards' report. Overall there has also been an increase in the number of companies providing basic or general gender diversity statements since 2015; this includes companies that state that gender diversity is not something they consider when making appointments.

However, the number of companies with detailed and best practice disclosures, suggesting true commitment to gender diversity at board level, has reduced again, having peaked in 2014. While gender diversity is not off the agenda – the number of companies with no mention of gender diversity remains low – the increase in generic descriptions and the fall in detailed reporting suggests it has perhaps lost some of the focus and commitment shown in the first flush of enthusiasm. It could be that the arguably more difficult task of finding executives has curbed enthusiasm. Companies are therefore reverting to saying less, rather than expanding on what they are doing to nurture and develop talent, even if it may take longer.

CORRELATION BETWEEN DISCLOSURES ON GENDER DIVERSITY AND OTHER DIVERSITY (%)

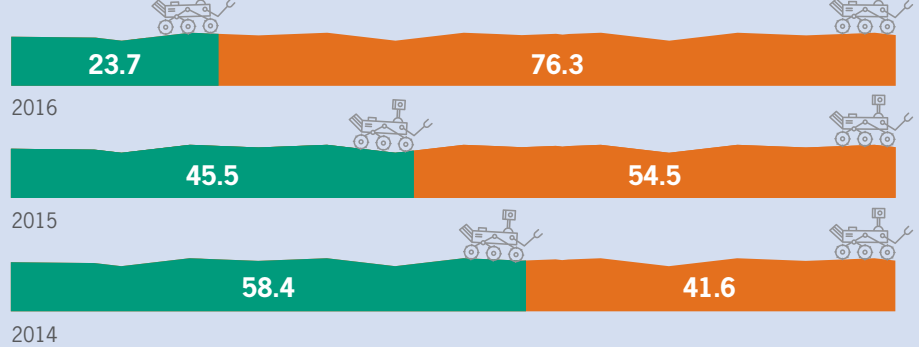


The percentage of companies describing other kinds of diversity, such as ethnicity, race, cultural background, sexuality and religion – as well as breadth of skills and experience – significantly increased in 2016, to 76% (2015: 56%). This suggests that attention and debate is moving from gender diversity to wider diversity on boards. Our research also shows that there is a clear correlation between those companies with higher quality gender diversity disclosures and those showing commitment to other areas of diversity. This suggests that where companies are committed to gender diversity, a focus on other diversity will likely follow; conversely, those companies reluctant to discuss diversity are unlikely to be focusing on wider aspects of diversity that might strengthen their business.

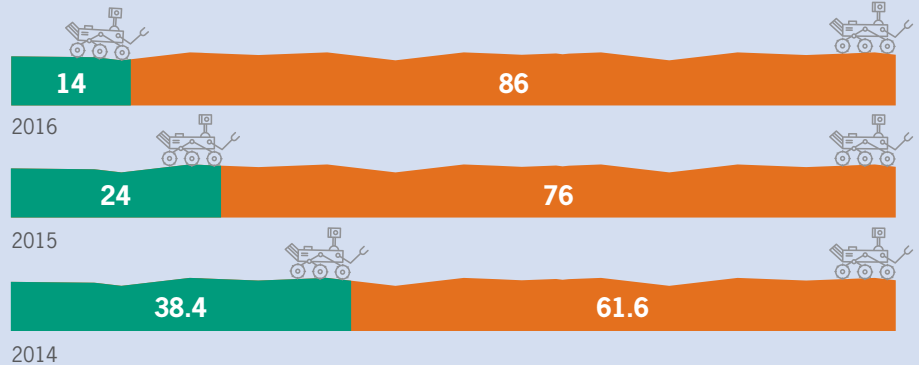
DO THEY DISCUSS OTHER ASPECTS OF BOARDROOM DIVERSITY? (%)

● Yes ● No

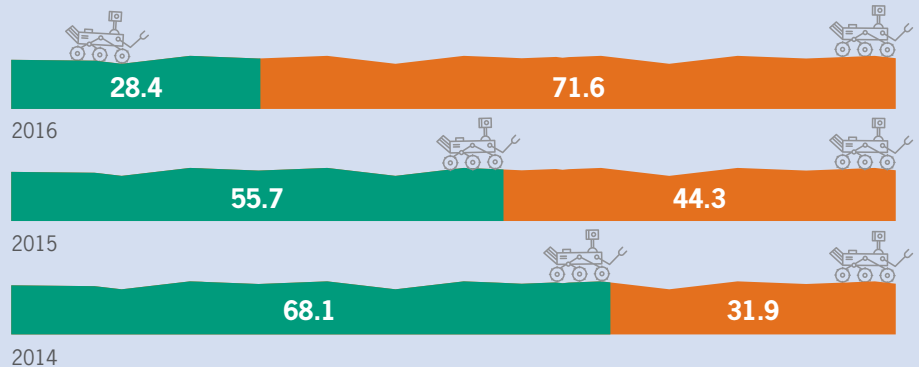
FTSE 350



FTSE 100



FTSE 250



Toolkit for nomination committee report



ELEMENTS/ CONTENT	THINGS TO CONSIDER	REPORTING TIPS
Work of the committee	<p>Establish how the actions of the committee align to company needs and strategy, and to the interests of shareholders</p> <p>A high-level overview of key activities of the committee should be provided. Although the work of the committee centres primarily on new director appointments, this should also include short, medium and long-term succession planning, and ensuring the board has the relevant skills and experience mix to carry out its duties effectively</p>	<p>The nomination committee chair should personally introduce a separate section within the annual report – as is more commonly provided for the remuneration and audit committees. A personal introduction from the chair, with discussion of the committees' work and priorities promotes ownership and accountability</p> <p>Relate the commentary to strategy, and refer to any key events or changes that occurred during the year making it personalised, detailed and specific to your company</p> <p>Clear disclosures often include a timeline of meetings and key activities during the year</p>
Board composition and diversity	<p>The board should establish the appropriate balance of skills, experience, independence and knowledge; the nominations committee should identify how this was evaluated and what conclusions were made</p> <p>Establish and articulate the board's policy on diversity. It should include gender and acknowledgement of the women on boards targets recently set by the Government</p> <p>It may also include nationality, ethnicity, age, professional background and industry, culture, and personal attitudes</p>	<p>The best companies disclose infographics which clearly map the skills, experience and diversity of board members, in line with strategic needs</p> <p>Include reference to the Government's target for women and ethnic representation and discussion of other kinds of diversity and how they align with your company strategy. It should be specific and relevant to the company</p> <p>Discuss any measurable objectives/targets in relation to the policy on diversity, and progress made</p>
Board appointments	<p>Establish and articulate how the board appointment process promotes effective governance, and supports the delivery of the company's strategy. Good reporting in this area demonstrates accountability – providing explanation as to how the committee came to their decisions</p> <p>Think if there is a clear process of how potential directors are identified, evaluated and appointed. Consider if the current rate of female and ethnic appointments are sufficient to meet your targets</p> <p>The Code states that either open advertising or search firms should be used in all appointments</p> <p>The committee should consider the re-appointments of directors. Any non-executive director's term beyond six years should be subject to rigorous review, and should take into account the need for progressive refreshing of the board</p>	<p>Provide a description of the board appointment process, including whether or not an external search firm was used, which one was used, and how and why that search firm was chosen</p> <p>If no search firm is used, the report should provide explanation as to how directors were identified</p> <p>Outline the steps of the process, and high level criteria used to assess candidates</p> <p>Consider whether and how soundings are taken with investors</p>



ELEMENTS/ CONTENT	THINGS TO CONSIDER	REPORTING TIPS
<p>Succession planning</p>	<p>The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management</p> <p>Greater attention should be paid to female and ethnic pipeline. Consider if there is the shortage of women in top senior roles. Think how you can develop talented women more effectively and encourage more of them to take up operational roles</p> <p>The process of new appointments should be continuous and proactive, not just reactive</p> <p>Other potential sources of recruitment outside of the normal pool</p>	<p>Separate out short, mid and long-term succession planning</p> <p>Include reference to executive pipeline and how you develop talented employees, including executive mentoring, training and encouraging external appointments</p> <p>Link the perceived needs of the board composition to evolving strategic priorities. This area could also include cross-reference to board evaluation, to demonstrate how the committee identifies gaps in the skills or experience mix of the board</p> <p>Refer to diversity as a factor in succession planning – this should include balance and diversity of gender, ethnicity and other demographic traits, as well as skills, experience, knowledge and independence</p>

Investor perspective



Board Diversity

The main thing we as investors want to see in the composition of the board is diversity of experience. Our experience in meeting hundreds of company board members every year is that board diversity reflecting the nature and needs of the business beneficially taps into the widest talent base and leads to more informed and innovative business decisions. A problem can arise if you're drawing board candidates from the same pool, who are 'white, male and stale', and it should not be surprising that you're going to come out with the same ideas.

However, diversity of gender (which rationally should stand at 50%), ethnicity, LGBT and mix of ages are all important to tap into the maximum talent pool. Equally key is for consideration to be given to sector, geographic and functional experience to be able to look at business issues from a number of different and relevant perspectives. The longstanding practice in a number of continental European countries of having employee representation on the board is one we believe the UK should embrace. Diversity of course brings the worthwhile challenge for the chair in particular to ensure that the board works well together by effectively harnessing and integrating the different capabilities around the boardroom table.

We want to see imagination and bravery being used by the nominations committee, to go beyond safe appointments. It's encouraging to see more companies talking about diversity issues beyond gender – in all boards, there is a benefit to recruiting people who are outside the box.

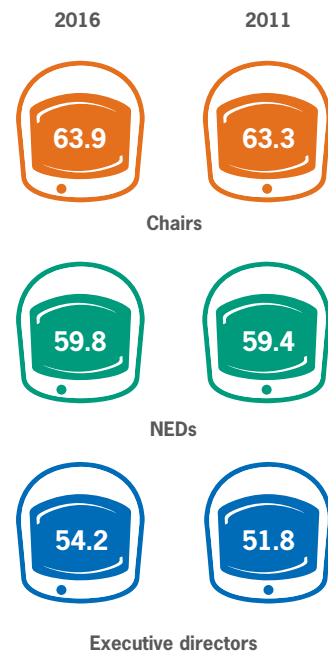
Director age, skills and experience
“The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.”
(UK Corporate Governance Code, Main principle B.1)

The average age of chairs and NEDs is little changed with only a marginal increase on last year. However, the average age of executive directors has increased significantly, and is now above 54 for the first time.

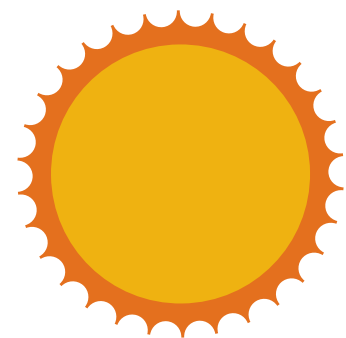
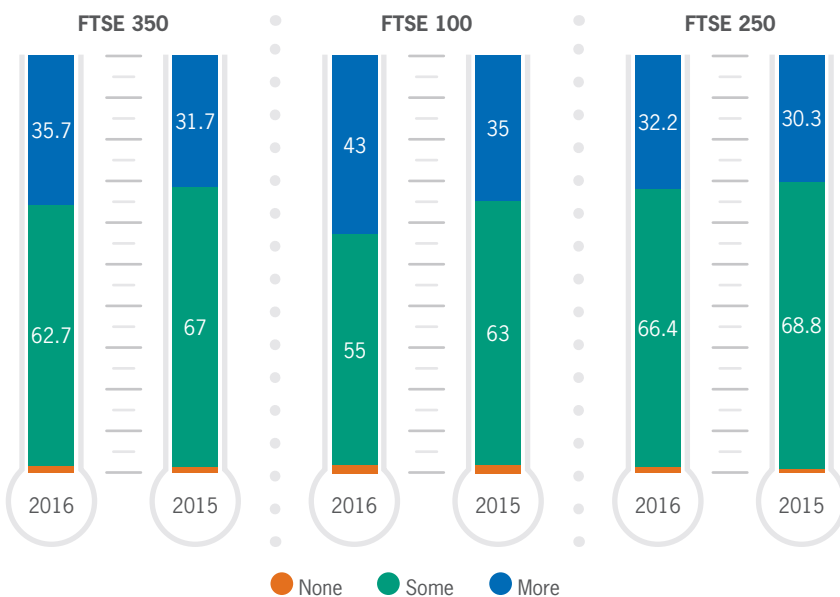
Some 36% of FTSE 350 companies provide good and clear information on board members’ skills and experiences, for example, by discussing how the balance of skills and experience aligns to the strategic needs of the business. Best practice disclosures most often give insightful explanations of issues of board diversity and balance of skills, including an assessment of the current range of experience and diversity on the board and how this contributes to the board’s plans for future succession.

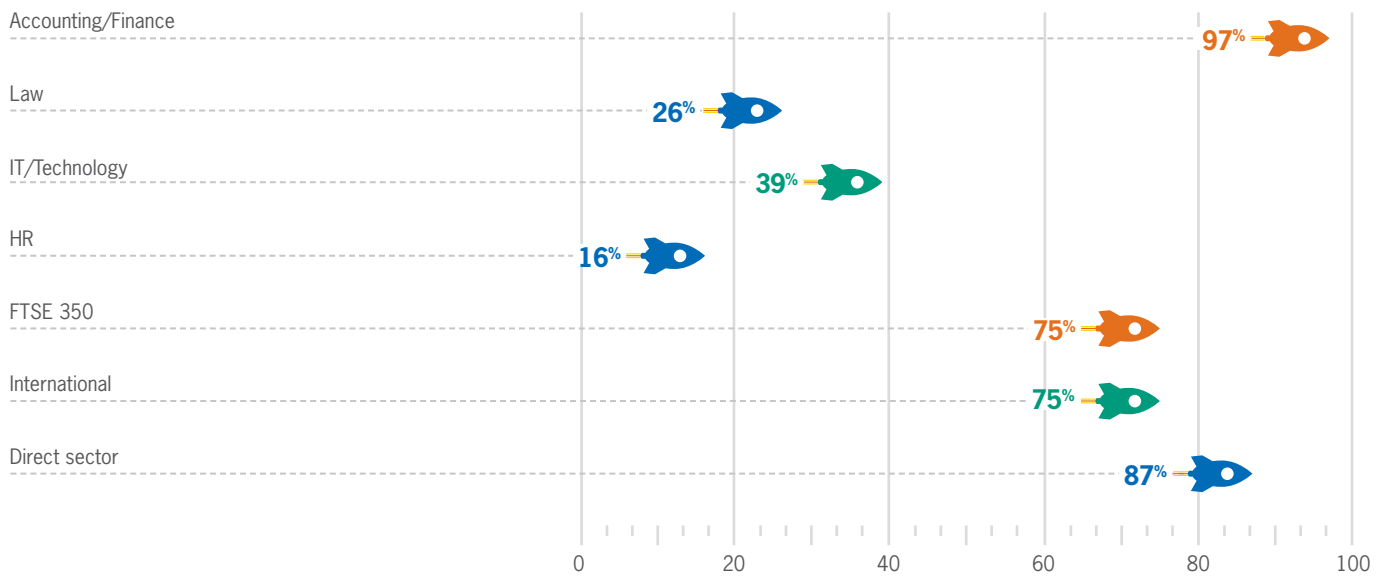
AVERAGE AGE OF DIRECTORS (years)

FTSE 350



HOW MUCH INFORMATION IS PROVIDED ABOUT BOARD MEMBERS' SKILLS AND EXPERIENCE? (%)



HOW MANY FTSE 350 COMPANIES DISCLOSE HAVING BOARD MEMBERS WITH PRIOR EXPERIENCE/EXPERTISE IN THE FOLLOWING AREAS? (%)

Board member experience in technology, law and HR is relatively scant; however, most boards have at least one member with an accounting or finance background, and with prior board experience. Three-quarters of companies have directors with previous FTSE 350 board experience. Three per cent of companies do not disclose their directors' background experience. Directors with experience in law and HR are in relatively short supply, along with technology, which, given the increasing reliance on technology, must be a concern for nomination committees.

There are some industry differences: companies in basic materials and healthcare and pharmaceuticals are far more likely to have board members with international experience, probably reflecting the global focus of these sectors. Utilities businesses, meanwhile, are significantly more likely to have board members with risk management and regulation backgrounds; again representing the needs of this industry.

Independence

“The board should determine whether the director is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director’s judgment.”

(UK Corporate Governance Code, B.1.1)

Fifteen companies in the FTSE 350 have an executive chair (2015: 27) and five have a joint chief executive and chair – one person fulfilling both roles (2015: 10). Only three companies with a joint chief executive and chair describe this as a temporary measure, with the rest choosing to go against best practice by not ensuring this important division between strategic and operational decision-making.

Although the role of the non-executive director is typically expected to bring independence, this year, 78 (2015: 79) companies state that they have non-independent non-executive directors. The most common reason for this is the director being representative of a significant shareholder; 54 (2015: 51) companies declared this. Only three (2015: 10) companies stated they had a non-independent director, but failed to disclose why this director’s independence is compromised.

This year, 38 (2015: 51) companies had directors who they considered to be independent, despite the director failing to comply with the criteria outlined in B.1.1 of the Code. Of these, 31 companies (2015: 44) had directors who had been on the board for more than nine years. Twenty one percent did not provide any explanation, while 24% gave good or detailed insight as to why they considered the director to still be independent. The best examples of explanation in this area explain, for example:

- the rationale behind why the director is important to the board (for instance their skills and experience)
- why the director is believed to be independent in their judgment
- how the board has mitigated any potential risk arising from their lack of independence
- the board’s timeline for addressing the issue or plans for the director to step down.



“There are still few directors with a background in technology; this is a concern when technology risks are increasing year on year.”

Mixed performance on board evaluation

“The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.”

(UK Corporate Governance Code, B.6.1)

Some 52% of FTSE 350 companies provide good or detailed explanations of how their board and directors are formally evaluated. But there is a split between the FTSE 100 and the FTSE 250: 71% of companies in the FTSE 100 provide such good or detailed accounts, compared to only 42% of the FTSE 250.

Further, led by the FTSE 100, the quality of reporting on the results and actions of board evaluations is improving, with 37% of FTSE 350 companies providing good or detailed disclosures on evaluation outcomes; a notable increase on 2014 (25%). This suggests increasing confidence in providing information about the key strengths and weaknesses and/or issues identified along with next steps, actions and timescales. Previously such disclosures were perhaps considered to be a sign of weakness.

Triennial external evaluations

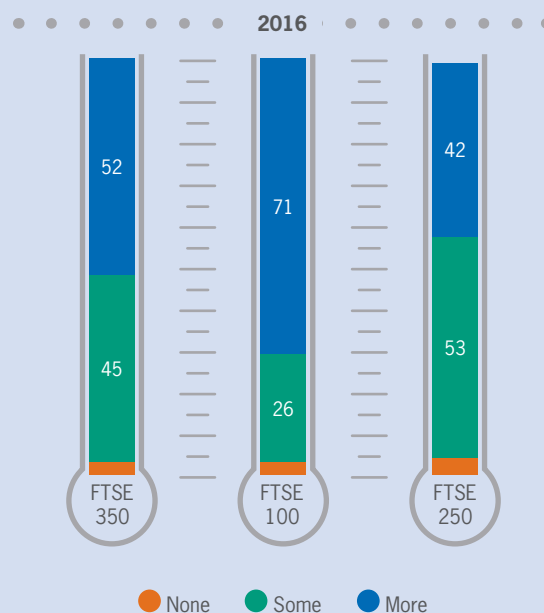
“Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company.”

(UK Corporate Governance Code, B.6.2)

Just over one-third of companies had an externally facilitated board evaluation during the year. Looking at 2014, 2015 and 2016 together suggests that most companies are now conducting board evaluations triennially, with only 3% of companies declaring non-compliance with the Code under provision B.6.2 (2015: 7%).

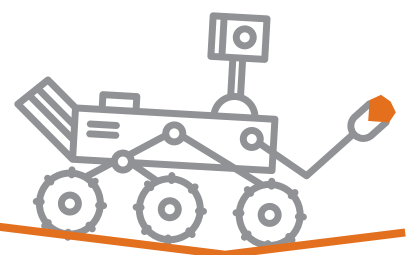
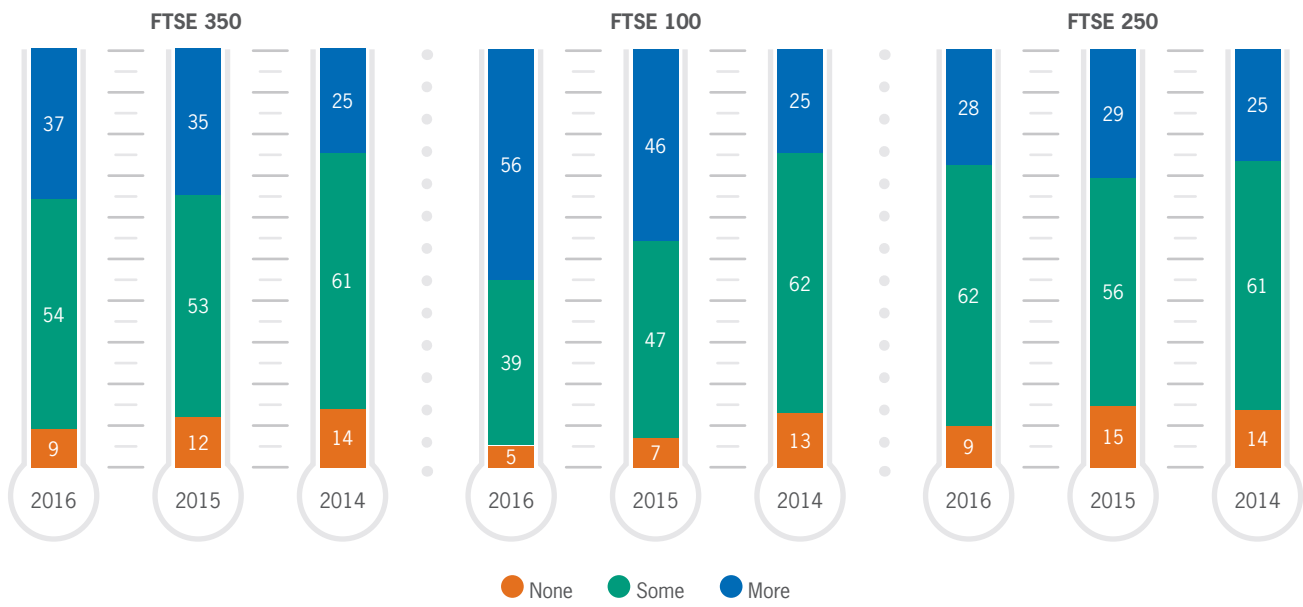
In 2016, 38 independent evaluators of FTSE 350 companies were named, with more than half of evaluations being conducted by just four of these firms, as has been the case for the past three years. The remaining evaluators work with, on average, two companies each. Looking at 2015 and 2016 board evaluators together, there was a total of 57 named evaluators, with four firms conducting more than half of all FTSE 350 board evaluations each year.

HOW MUCH EXPLANATION IS THERE OF HOW THE BOARD, COMMITTEES AND INDIVIDUAL DIRECTORS ARE ANNUALLY FORMALLY EVALUATED FOR THEIR PERFORMANCE?



TO WHAT EXTENT ARE THE RESULTS AND ACTIONS ARISING FROM THE BOARD EVALUATION DISCLOSED? (%)

Board evaluation outcomes and actions



Board induction and training

“The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and on board committees.”

(UK Corporate Governance Code, Supporting principle B.4)

Reporting on board induction and training remains of similar quality to previous years. Around a third of FTSE 350 companies give detailed insight, while just under two thirds provide basic or general commentary, and 4% provide no insight at all. Perhaps unsurprisingly, those companies who appointed a new director in the year tended to provide greater detail on their director induction. This suggests that ongoing director training – including how training needs are identified and provided throughout the year, for example as a result of a board evaluation – is given less priority in reporting than director induction.

Investor perspective



Board Diversity

Effective succession planning and collaboration across industries are as, if not more, key than having a good diversity policy at board level. Other aspects of diversity are important, but we have to make sure that they don't become a deflection from looking at gender diversity, or stop us talking about it. It's important to understand the issue of gender diversity in context. The issue underlying low representation of women on boards is not that boards are not under enough pressure to hire women, it's because often when you look at the next level down there aren't enough women; they're not being recruited into, or retained in the business. If questions around diversity are only looking at the top level, you won't see that, because it's easy for boards to report that they are believers in board diversity, without getting to the heart of why gender diversity is an issue.

HOW MUCH EXPLANATION IS THERE OF DIRECTOR TRAINING AND INDUCTION?

FTSE 350

Director training and induction



Companies who appointed a new director



Companies who did not appoint a new director



● None ● Some ● More



Toolkit for board duties and operations



ELEMENTS/ CONTENT	THINGS TO CONSIDER	REPORTING TIPS
<p>Powers and responsibilities of the board</p>	<p>An outline of powers and authorities retained by the board, and those delegated to management</p> <p>Consider the board and committee structure, and how information feeds from top level management and the board and its committees</p> <p>Think about what the organisation stands for, what it is seeking to achieve, and what your aspirations are. It will help to inform a clear understanding of how the board need to operate and prepare for the future</p>	<p>Include company specific information about differentiation between roles and responsibilities of chair, senior independent director and chief executive</p> <p>Provide discussion of/differentiation of the roles and responsibilities of the executive directors and non-executive directors, including decision making differences</p> <p>Provide explanation of the company's reporting lines and monitoring structures, and how they are embedded within the company</p> <p>Outline the key tasks/matters considered by the board during the year, and the key priorities for the next year</p>
<p>Board composition</p>	<p>Identify all executive and non-executive directors; chair and senior independent director, and your perspectives on the independence of directors</p> <p>Assess whether at least half the board, excluding the chair, comprise non-executive directors determined by the board to be independent</p> <p>Evaluate how non-executive directors' contribution to the board is maximised, and how it relates specifically to your company and its strategy</p> <p>Assess the current range of experience within the board, identify what each director brings to the board and if there are any skill gaps. This can be connected to succession planning, and to company strategy</p>	<p>The best disclosures include infographics on executive and non-executive directors, tenure, gender split etc</p> <p>Disclose specifics around independence in terms of character and judgement, recognising where relevant, any issues which may affect independence. If the board deem that a director is independent despite not meeting the criteria set by the Code, explain which criteria the director does not meet and why they are, nevertheless, considered independent. Disclose how any potential risks are mitigated (eg the director does not participate in certain votes or discussions)</p> <p>Information on directors should be relevant and valuable, connected to your company strategy, and understandable for the reader</p> <p>Provide information on board members' education, skills, experiences, qualifications, prior and current appointments as a part of a discussion on how that brings value, drives strategy achievement, and brings challenge to the board</p>
<p>Induction, training and development</p>	<p>Ensure you are identifying and addressing director induction and training throughout the year, not only for new appointments</p> <p>Think what are the training needs of each director based on their experience and skills and company strategy and how they can be addressed. This often relates to board evaluation reviews</p> <p>Consider how board members can interface with the business</p>	<p>Outline what is included in the director's induction process and what form this takes (training, site visits, briefing, shareholder meetings, etc)</p> <p>Specify how on-going training needs are identified, and indicate what training has been provided during the year and/or will be provided next year. Explain how it links back to the strategy and/or business model</p> <p>The best disclosures include case studies along with the details of all other events, trainings and site visits</p>



ELEMENTS/ CONTENT	THINGS TO CONSIDER	REPORTING TIPS
<p>Evaluation</p>	<p>As every company is unique, there is no one-size-fits-all-model to promote an effective board. Use board evaluation to identify areas of excellence and improvement in line with your goals</p> <p>The evaluation summary should address:</p> <ul style="list-style-type: none"> • relevance of the mix of skills, experience, knowledge and diversity on the board, in the context of the challenges facing the company • the working relationship between key board members, particularly chair/chief executive, chair/senior independent director, chair/company secretary and executive/non-executive • effectiveness of individual non-executive and executive directors • effectiveness of board committees, and how they are connected with the main board • performance evaluation of the chair by the non-executive directors led by the senior independent director. <p>A clear plan is needed for addressing areas of improvement, including actions planned, timescales, and connection to board training and development and succession planning, where appropriate. Taking actions based on the plan, ensure that they add value to the workings and effectiveness of the board</p> <p>Board evaluations should be externally facilitated triennially</p> <p>Consider formal tender for appointment of evaluator</p> <p>Determine scope of review before tender</p> <p>Consider early on likely areas for external reporting</p> <p>Consider follow-up with your external evaluator to discuss your progress on agreed outcomes</p>	<p>The description of evaluation should explain the mechanism and/or approach used (eg surveys, face-to-face interviews, external facilitation) and the criteria for assessment</p> <p>Do not include only a general statement that the board operates effectively. Show that you place sufficient value on the evaluation process and be specific and honest about the outcomes, areas of excellence and areas of improvement. Identify the outcomes, actions taken and their timeline</p> <p>Best practice reporting also makes reference to previous years' evaluations and demonstrates how the board have met previous years' actions</p> <p>Provide the name and details of an independent organisation if board evaluation was externally facilitated, and an explanation as to why this organisation was chosen</p> <p>If you do not conduct a triennial board evaluation, provide the reasons why</p>

Audit committee

“A separate section of the annual report should describe the work of the committee in discharging its responsibilities.”

(UK Corporate Governance Code, C.3.8)

The average audit committee report is 4.4 pages long, with committees meeting on average 4.8 times through the year.

Disclosures of the significant issues that the audit committee considered in relation to the financial statements, and how these issues were addressed, remain relatively consistent: 69% of FTSE 350 companies provide good or detailed disclosures (2015: 72%; 2014: 65%).

The quality of personal introductions continues to improve with 69% (2015: 66%) providing good or detailed introductions to their committee reports.

Audit and non-audit services

“The main role and responsibilities of the audit committee should be set out in written terms of reference and should include... to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm.”

(UK Corporate Governance Code, C.3.2)

The average amount spent on audit fees in 2016 was £2.66m, while the average amount of non-audit work awarded to auditors across the FTSE 350 was £0.82m. The highest average spends on non-audit fees were, unsurprisingly, by the largest companies: FTSE 100 businesses spent on average £1.74m on non-audit fees.

Excluding three FTSE companies with unusually high amounts of non-audit work – which skew the data – non-audit fee spend in the FTSE 100 was 31% (2015: 31%) of audit fees. The highest ratio of audit fees to non-audit fees still lies in the smallest companies: average non-audit fees were 80% of audit fees in the FTSE 201–350, where the greatest number of IPOs, acquisitions and merger-related activities occur relative to smaller audit fees.

The average audit fee for the UK's largest companies, the FTSE 30, is £15.6m (2015: £13.6m), with average non-audit fees in 2016 of £3.8m. Non-audit fees represented an average of 28% of audit fees¹⁶. The largest non-audit fee was £15.8m (2015: £13.9m).

FAST FACTS



- ★ 69% of audit committee chairs provide good or detailed introductions to their committee reports.
- ★ 58% of companies committed to putting their external audit contract out to tender at least every 10 years, last year it was 50%.
- ★ Compared to 26% last year, only 18% do not state clearly in their annual report when their auditor was last changed
- ★ Nearly a third of companies in the FTSE 350 have not rotated their auditor for more than a decade.
- ★ Just over half of the FTSE 350 provide only basic or general disclosures on how their audit committee reaches its recommendation about external auditors.
- ★ Only 19% of companies give good or detailed explanations of how they review the effectiveness of the internal controls.

¹⁶ This excludes one FTSE 100 company, where non-audit fees were 687% of audit fees, increasing the FTSE 30 average to 50%.

Average non-audit fees as % of audit fees (%)

	2016	2015	2014	2010
FTSE 100	45.6*	30.5	37	54
FTSE 101-200	52	61.6	49	80
FTSE 201-350	80	83.3	91	88

* This figure includes high percentages from three companies that have 490%, 687% and 425%, average non-audit fees as percentage of audit fees which between them distort the average. Without these three companies, the average would be 30.5%.

★ *“Sixty-one percent of companies provide good or detailed explanations about how auditors’ objectivity and independence is safeguarded.”*

Average non-audit fees and audit fees (£m)

	2016		2015		2014		2010	
	Audit	Non-audit	Audit	Non-audit	Audit	Non-audit	Audit	Non-audit
FTSE 100	6.26	1.74	5.88	1.52	6.24	1.7	6.34	2.48
FTSE 101-200	1.31	0.49	1.24	0.59	1.11	0.52	1.14	0.66
FTSE 201-350	0.59	0.29	0.62	0.35	0.43	0.31	0.51	0.39

Auditor independence commitment rises with legal mandate

“The report should include ... if the auditor provides non-audit services, an explanation of how auditor objectivity and independence is safeguarded.”

(UK Corporate Governance Code, C.3.8)

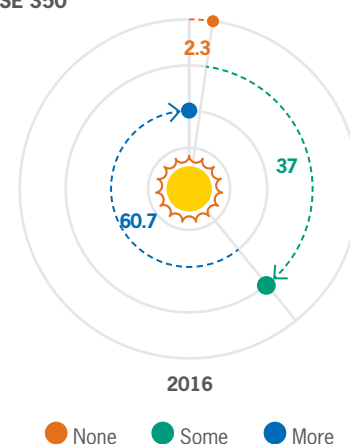
Sixty-one percent of companies provide good or detailed explanations about how auditors’ objectivity and independence is safeguarded. The EU Audit Directive and Regulation was introduced on 17 June 2016. Although it had been widely promoted, many companies have chosen not to early adopt. As a consequence, the current information available regarding audit tenure and rotation is mixed.

In 2016, 58% of companies committed to putting their external audit contract out to tender at least every 10 years, another rise (2015: 50%; 2014: 41%).

In anticipation of this new regulation, which has also introduced the requirement for mandatory rotation of auditors after 20 years, there is an increasing number of audit tenders taking place, although reporting in this area is patchy. Based on the information disclosed, many companies (28%) in the FTSE 350 have had their auditor for more than 10 years (2015: 34%), and 14% have not tendered the external audit in the same period. However reporting is unclear in this respect, as 18% (2015: 26%) do not state clearly in their annual report when their auditor was

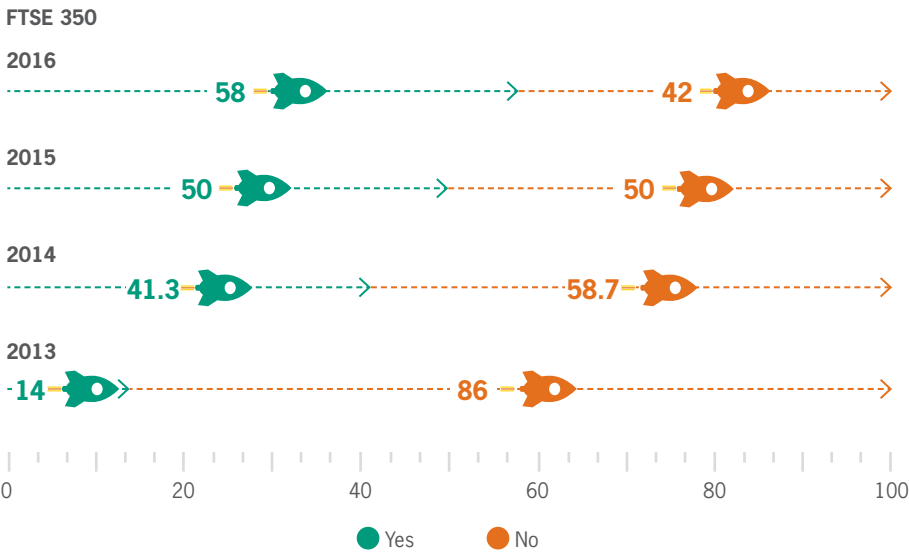
IF THE AUDITOR PROVIDES NON-AUDIT SERVICES, IS THERE A STATEMENT AS TO HOW THE AUDITOR’S OBJECTIVITY AND INDEPENDENCE IS SAFEGUARDED? (%)

FTSE 350



● None ● Some ● More

DO THEY STATE A COMMITMENT TO PUT THE EXTERNAL AUDIT CONTRACT OUT TO TENDER AT LEAST EVERY 10 YEARS (%)



last changed, while 33% more do not give the date of their last tender. This year 47 companies in the FTSE 350 put their audit contract out to tender and 43 changed auditors, although it should be noted this includes some companies that changed auditors without reporting details of their tender process, and others that went out to tender but did not change their auditors.

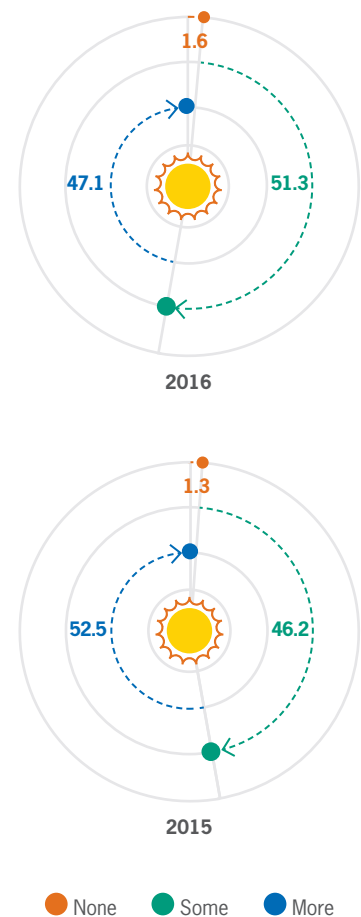
There is little change in how much detail companies provide on how their audit committee reaches its recommendation about external auditors. Just over half (51%) of companies across the FTSE 350 provide basic or general disclosures and just under half (47%) provide good or detailed disclosures.

Risk management reporting improves
“The directors should confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity.”

(UK Corporate Governance Code, C.2.1)

After a decrease in the quality of risk management disclosures in 2015, the proportion of companies providing good or detailed disclosures increased again, returning to levels similar to 2014. Nearly 75% of companies in the FTSE 350 provide good or detailed disclosures in relation to risk management in the audit committee report; this includes 84% of the FTSE 100 and 74% of the FTSE 250.

HOW MUCH INFORMATION IS PROVIDED ON HOW THE AUDIT COMMITTEE REACHED ITS RECOMMENDATION ON THE APPOINTMENT, REAPPOINTMENT OR REMOVAL OF THE EXTERNAL AUDITORS? (%)



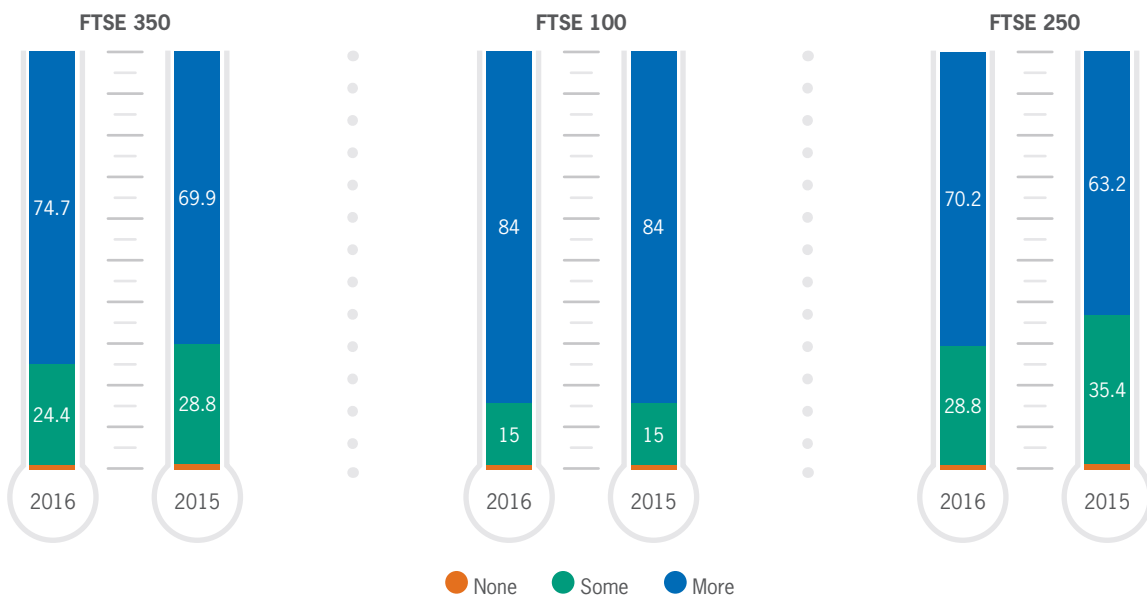
This is in line with an overall increase in the quality of principal risks and mitigation reporting, as discussed on page 14.

We found that risk management as considered by the audit committee and risk disclosures as considered by the board, are strongly correlated. Looking at the two together, 63% of FTSE 350 companies have good or detailed disclosures in both areas, while less than 10% have basic or general reporting in both. The corollary is that where disclosures are weak in one of these areas, there is a strong probability that all other related activities will be weak.

CORRELATION BETWEEN RISK MANAGEMENT DISCLOSURES AND DISCLOSURES OF PRINCIPAL RISKS (%)



HOW MUCH INFORMATION IS THERE SURROUNDING THE COMPANY'S RISK MANAGEMENT PROCESS? (%)



Internal controls' trends

“The board should maintain a sound risk management and internal control systems.”

(UK Corporate Governance Code, Main principle C.2)

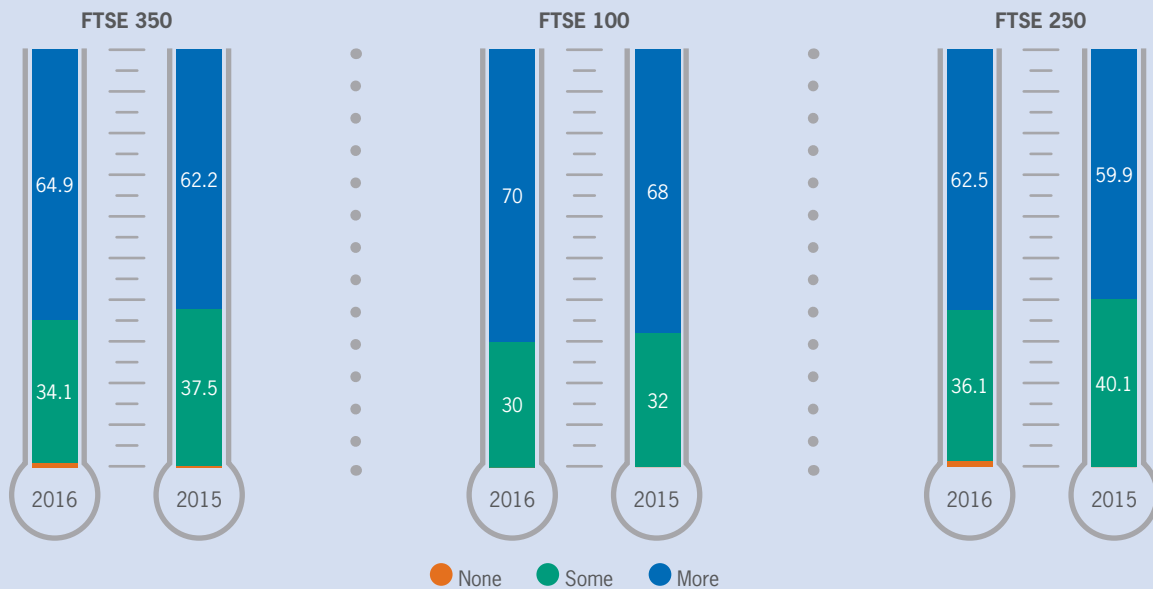
The quality of internal controls reporting improved marginally from last year, with 65% of the FTSE 350 providing good or detailed descriptions of their internal controls, organisational structure and reporting lines, along with corporate policies on internal controls. A similar trend is evident in risk management, where the FTSE 100 demonstrated slightly stronger reporting in this area, with 70% providing good or detailed disclosures, compared with 63% in the FTSE 250.

The quality of both internal controls and risk management processes reporting is consistent; where one

is strong so tends to be the other. While risk management disclosures are generally better than those on internal controls across the FTSE 350 (75% offer good or detailed risk disclosures, compared to 65% for internal controls), 57% of FTSE 350 companies give good or detailed accounts of both internal controls and risk management processes.

We also see a strong correlation between internal controls reporting and principal risk disclosures. The correlations between risk management, internal controls and risk disclosures show a connectedness between companies' understandings of their principal risks, and the internal processes through which they manage and mitigate these risks. Where one such disclosure is weaker, there is therefore a stronger likelihood that less attention is being given to the other related areas within the risk management framework.

HOW MUCH INFORMATION IS THERE SURROUNDING THE COMPANY'S INTERNAL CONTROL SYSTEMS? (%)



Review of internal controls' effectiveness

“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 and compliance controls.”

(UK Corporate Governance Code, C.2.3)

2015 saw the introduction of the requirement for boards to demonstrate how they have monitored the effectiveness of their risk management and internal controls throughout the year, as opposed to simply stating that they have carried out a review.

The quality of disclosures regarding the review of effectiveness of internal controls is poor with 78% providing basic or general explanations, and only 19% giving good or detailed explanations.

Risk committees

Sixty-three companies in the FTSE 350 have a separate risk committee: 23 from the FTSE 100 and 40 from the FTSE 250. Thirty-nine of these are from financial industries (of a total of 78 financial industry companies), 11 from consumer goods and services, nine from industrials, three from oil and gas and one from healthcare. These companies tend to give significantly better disclosures on risk management and internal controls, perhaps reflecting the additional time and focus being given by those companies to management and mitigation of their risks.

CORRELATION BETWEEN INTERNAL CONTROLS AND PRINCIPAL RISKS (%)



★ *“Sixty-three companies in the FTSE 350 have a separate risk committee: 23 from the FTSE 100 and 40 from the FTSE 250.”*

INTERNAL CONTROLS, RISK DISCLOSURES AND RISK MANAGEMENT OF COMPANIES WITH RISK COMMITTEES (%)



Remuneration committee

“The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments.”

(UK Corporate Governance Code, D.2.2)

The remuneration committee tends to provide detailed disclosures across the FTSE 350, likely to be reflecting the increased attention remuneration and executive pay has had in the years since the financial crisis.

Over 90% of companies provide high-quality remuneration policy disclosures, with more than half giving good explanations in line with Code guidance, and 36% providing very detailed explanations.

Remuneration policy disclosures

“There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors.”

(UK Corporate Governance Code, Main principle D.2)

Some 96% of remuneration committee chairs provide a personal introduction to their remuneration report, very similar to last year. Of those, 86% – slightly fewer than last year – gave good or detailed insights, including a clear description and overview of company policy with highlights of any changes to the policy, a detailed overview of the committee’s work, and matters considered during meetings. The most informative also include personal views on the issues faced by the committee. Typically, remuneration committees meet between four and five times a year.

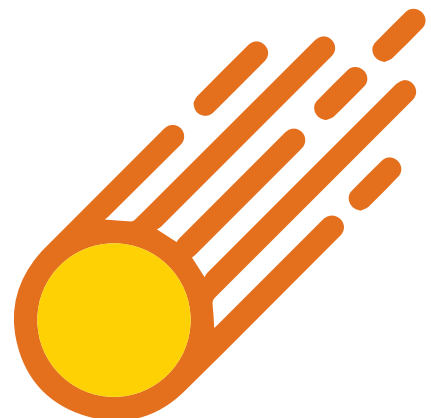
In general, utilities and healthcare and pharmaceutical companies have the clearest and most complete remuneration policy disclosures, and consumer services the poorest. New entrants performed significantly poorer in this area, compared to more established FTSE 350 companies.

Recent guidance has started to shift the emphasis from salary pay to performance-related pay, tying it to long term performance. As a consequence, we saw a significant increase in the awarding of share-based payments in 2015.

FAST FACTS



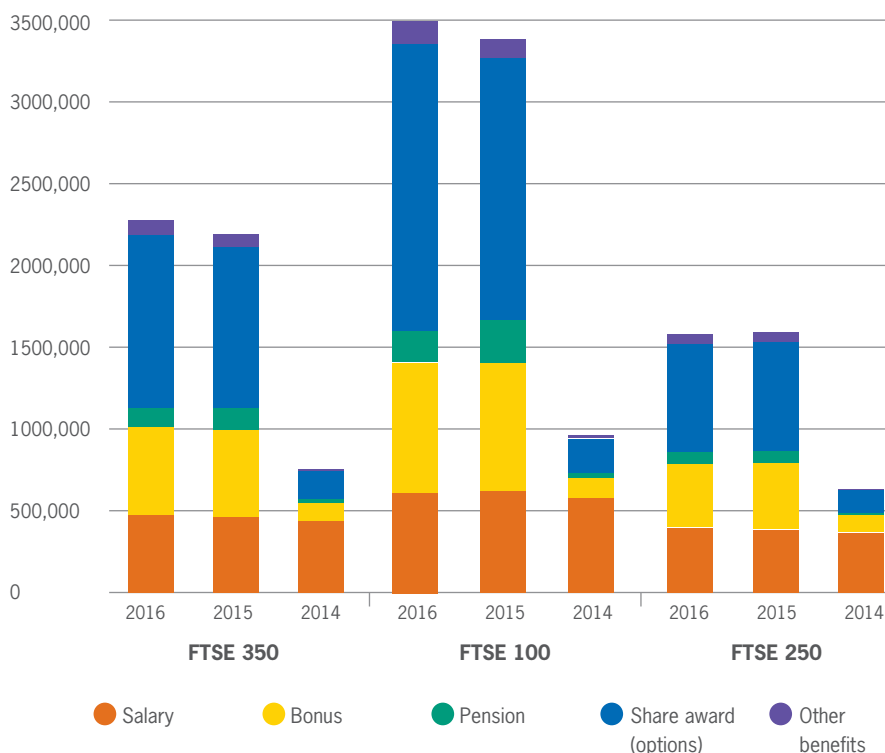
- ★ Over 90% of companies provide high-quality remuneration policy disclosures.
- ★ Just over half of companies’ state that the remuneration committee recommend and monitor the remuneration of senior management, but only 13% of these provide a clear explanation of how they define senior management.
- ★ 90% of companies now state they have a clawback provision but, as in previous years, no company has invoked this provision.
- ★ 96% of companies include a long term incentive plan.
- ★ 35% of companies use solely financial metrics for their executive performance-based remuneration.
- ★ 95% of companies discuss the link between remuneration and company strategy, but only 30% include strategic (non-financial) metrics in their executive performance-based remuneration.



Both the total and average remuneration received by directors in the FTSE 350 increased in 2016 with the increase coming both in the base salary of directors and in the awarding of share options. The average salary was £478,413 (2015: £465,706); this is split unevenly across the FTSE 100 and FTSE 250, and while the average FTSE 250 salary increased, the average FTSE 100 salary went down.

The most significant change was a significant increase in the awarding of share options. Directors in the FTSE 100 received on average 284% of their salary through share awards, up from 257% last year. We cannot determine from these figures if this is due to share price appreciation or an increase in the number of share options granted, but the rise since last year dramatically outweighs all other changes across remuneration, particularly in the FTSE 100.

COMPONENTS OF EXECUTIVE PAY (£000)¹⁷



Clawback provisions

“In designing schemes of performance-related remuneration for executive directors, the remuneration committee should ... include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so.”
(UK Corporate Governance Code, D.1.1)

The number of companies with a clawback provision for bonuses in place increased again this year, with 90% now stating they have one (2015: 86%; 2014: 75%). This year, like last, no company invoked the clawback provisions.

Shareholding guidelines and long-term investment

“For share-based remuneration the remuneration committee should consider requiring directors to hold a minimum number of shares and to hold shares for a further period after vesting or exercise, including for a period after leaving the company, subject to the need to finance any costs of acquisition and associated tax liabilities.”

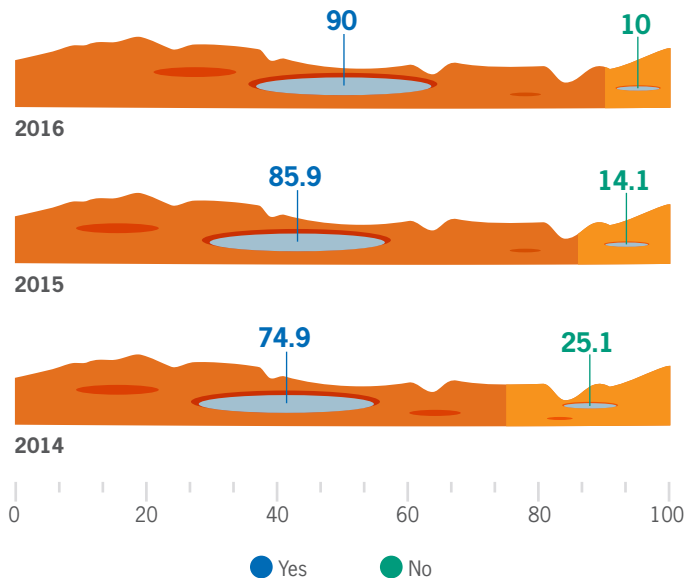
(UK Corporate Governance Code, Schedule A)

Ninety-six per cent of companies in the FTSE 350 align remuneration with the longer-term interests of the company, and report a long-term incentive plan. Of these, 45% state the retention period of shares after vesting, which is typically two or three years.

¹⁷ Data collected from Morningstar, May 2016

IS THERE A CLAWBACK PROVISION? (%)

FTSE 350



RETENTION PERIOD OF SHARES AFTER VESTING: FTSE 350 COMPANIES (%)

Number of years	Number of companies	Percentage of companies	Percentage of companies (2015)
0	0	0	3.5
0.5	3	1.8	1.8
1	6	3.7	5.3
2	78	47.9	42.5
3	56	34.4	35.4
4	5	3.1	2.7
5	13	8	8.8
6	1	0.6	0
7	1	0.6	0

Performance-based remuneration metrics

“The remuneration committee should determine an appropriate balance between fixed and performance-related, immediate and deferred remuneration. Performance conditions, including non-financial metrics where appropriate, should be relevant, stretching and designed to promote the long-term success of the company.”

(UK Corporate Governance Code, Schedule A)

The number of companies using only financial metrics for executive performance-based remuneration continued to decline in 2016, standing at 35% (2015: 54%). The majority of companies now use a broader range of metrics including non-financials; just over 40% of companies include personal metrics, nearly a third use strategic metrics, and 21% use other non-financial metrics not directly connected to strategy.

Connecting remuneration to strategy

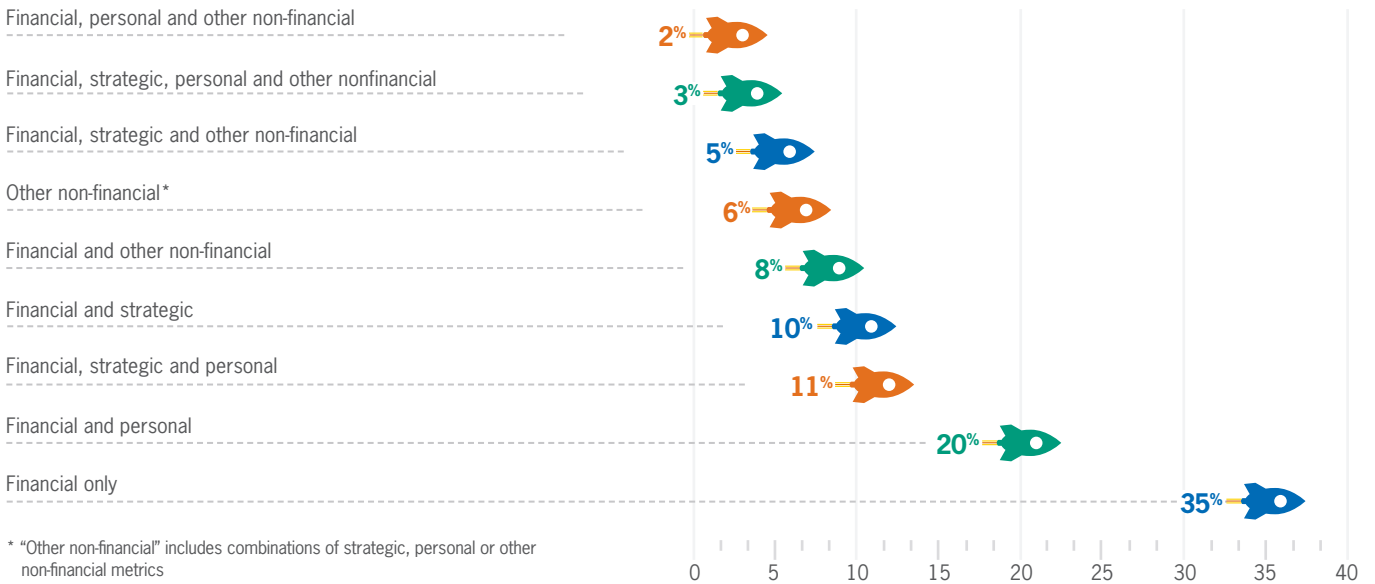
“Executive directors’ remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.”

(UK Corporate Governance Code, Main principle D.1)

Ninety-five per cent of companies discuss the link between executive remuneration and company strategy in their annual report, a slight fall (2015: 96%). It is covered most often in the remuneration report, but 11% of companies (2015: 14%) also expand on the connection between

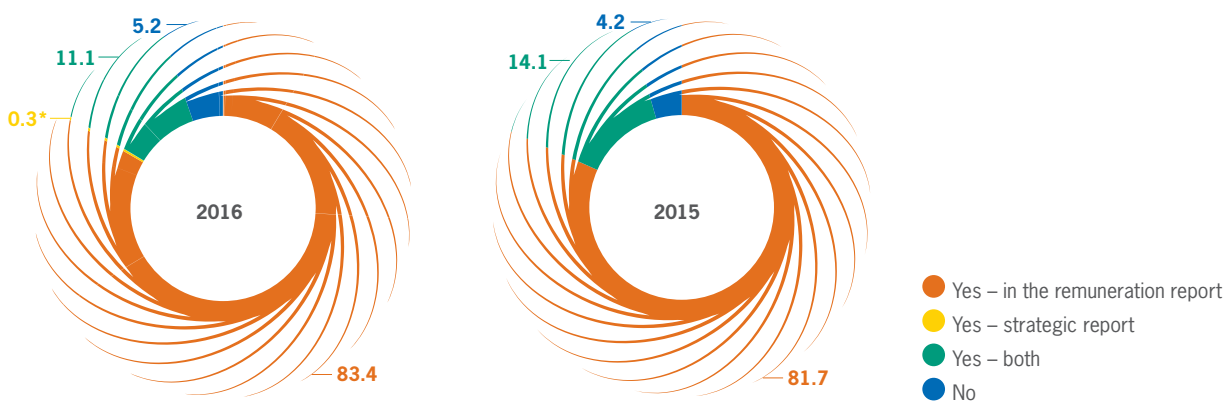
remuneration and strategy in their strategic report. In the face of increasing scrutiny from investors, politicians and the public on reward for performance, it is perhaps surprising that more companies do not reinforce the link between the execution of strategy and remuneration by including specific reference in their strategic report. Further, given the increasing focus on performance being linked directly to strategy, it is also surprising that 70% of companies do not disclose strategic metrics for executive performance-based remuneration in their annual report.

WHAT METRICS ARE USED IN EXECUTIVE PERFORMANCE-BASED REMUNERATION?



DOES THE ANNUAL REPORT DISCUSS THE LINK BETWEEN EXECUTIVE REMUNERATION AND THE COMPANY’S STRATEGY? (%)

FTSE 350



Recent and forthcoming governance developments



	Comments	Timing	Mandatory reporting in the Annual Report?
Governance of companies			
The UK Corporate Governance Code	<p>The Financial Reporting Council (FRC) published the most recent edition of the UK Corporate Governance Code (the Code) in April 2016 along with an updated Guidance on Audit Committees. This followed consultations to reflect UK legislative changes needed to implement the EU Audit Directive and Regulation on audit committees and auditor appointments, and as a result of the FRC being designated the UK Competent Authority for audit, with responsibility for the regulation of statutory audit; including setting auditing and ethical standards, monitoring and enforcement.</p> <p>The FRC has recently completed an extensive market-led project on company culture and published a report of their observations and activity. The results of this will be used to inform future changes to the Code and the Guidance on Board Effectiveness, to encourage greater focus on culture as part of the work of the board. This year they also conducted a consultation on succession planning, releasing a feedback statement of their summary findings in May 2016.</p>	The current version of the Code is in effect as the EU Audit Directive and Regulation became law on 17 June 2016 and applies to financial years starting on or after that date.	Yes, by virtue of the Code and its 'comply or explain' principle.
Viability Statement	This is the first year the requirement for boards to produce a viability statement has come into full effect. A majority of companies have referred to a forward looking three-year view of managing risks and meeting liabilities, and produced a statement that meets the basic requirements. In the future, the FRC will be looking to companies to improve on this statement, and provide more detail regarding key risks and quantify their impacts in the spirit of the statement.	Viability statements are required for companies with accounting periods beginning on or after 1 October 2014.	Yes – in the Code.
FRC Guidance and The Lab	<p>The Financial Reporting Lab (the Lab) was set up by the FRC to improve the effectiveness of corporate reporting in the UK. These reports do not form new reporting requirements; they summarise observations and promote better disclosures around reporting practices, in line with investor needs.</p> <p>A series of projects was announced by the Lab, to cover business model, principal risk and viability reporting. The first Lab report on business model reporting outlines good business model disclosures and practices.</p> <p>The FRC also recently released their Annual Review of Corporate Reporting, providing assessment of corporate reporting in the UK, and outlining good practice examples.</p> <p>They also issued guidance in the form of a letter to preparers of annual reports, highlighting key issues and improvements that can be made to annual reports in the 2016 reporting season. This focused particularly on clear and concise reporting, principal risks, and the production of the long term viability statement.</p>	<p>The series was announced in Summer 2015, and the Lab report on business model reporting was released in October 2016.</p> <p>The Lab is currently conducting two additional projects, one on Corporate reporting in a digital world, and the other on clear and concise reporting.</p> <p>The review was released in October 2016.</p> <p>The letter was released by the FRC in October 2016.</p>	No.



	Comments	Timing	Mandatory reporting in the Annual Report?
Government inquiry on corporate governance	The Business, Energy and Industrial Strategy Committee (previously Business Innovation, and Skills (BIS) Committee) has launched an inquiry on corporate governance, focusing on executive pay, directors' duties, and the composition of boardrooms, including worker representation and gender balance in executive positions. This inquiry is likely to inform the Government's approach to corporate governance reform.	The deadline for written submissions closed on 26th October 2016 with oral evidence now being taken. The results are expected early 2017.	Not yet.
Legislative changes			
Audit Policy	<p>The European Council recently adopted new wide-ranging audit legislation that applies to all Public Interest Entities (PIEs) – companies with transferable securities traded on an EU-regulated market; a credit institution (ie a bank or building society), insurance companies and other financial entities; or designated by a Member State as a public interest entity.</p> <p>The EU legislation includes the imposition of a mandatory audit firm rotation at least every twenty years, and significant restrictions on the amount of non-audit services that can be provided to these entities by their statutory auditors. Audit committees will need to approve each permissible non-audit services provided by the auditor, and there is a 70% cap on fees for those services.</p>	The EU Audit Directive and Regulation became law on 17 June 2016 and applies to financial years starting on or after that date.	Yes.
EU Directive on Non-Financial Reporting	<p>On 22 October 2014 the EU Directive on non-financial reporting was adopted, requiring large companies (more than 500 employees) to disclose in their management report, information on policies, risks and outcomes as regards environmental matters, social and employee aspects, respect for human rights, anti-corruption and bribery issues, and diversity in their board of directors.</p> <p>The majority of the disclosures in the Directive are already reflected in the strategic report requirements in the Companies Act. The Directive leaves significant flexibility for companies to disclose relevant information in the way that they consider most useful, or in a separate report. Companies may use international, European or national guidelines which they consider appropriate (for instance, the UN Global Compact, the OECD Guidelines for Multinational Enterprises, ISO 26000, etc).</p>	Despite the Brexit vote, this will still be implemented in the UK, applying to companies with financial years commencing on or after 1 January 2017.	Yes.



	Comments	Timing	Mandatory reporting in the Annual Report?
Diversity			
Board diversity	<p>Since the FTSE 100 reached the Davies' target of 25% women on boards in 2015, Sir Philip Hampton and Dame Helen Alexander are leading a new review on improving female representation in leadership positions of British business. This broadens the ambition to the entire FTSE 350, and raises the target to 33% of women on boards by 2020. The focus for the work on the gender pipeline will be on representation on executive committees and direct reports to the executive committee.</p> <p>The Parker Review committee, led by Sir John Parker, recently released their consultation report: Beyond One by '21: examining the ethnic diversity of FTSE 350 boards. This recommends that FTSE 100 boards should have at least one director of colour by 2021, and those in the FTSE 250 by to have one by 2024. Nominations committees will be expected to acknowledge this target and discuss in their annual reporting.</p>	In 2016 the increased target was brought in, aiming for 33% women on boards by 2020 for all FTSE 350 companies.	Yes – reporting on board diversity should address this target.
Gender Pay Gap reporting	<p>Employers with more than 250 employees will be required to publish the difference between the average pay of their male and female employees.</p> <p>The information must be accompanied by a statement that it is accurate, signed by a director or equivalent, and published on the company website. This will also need to be uploaded to a designated website (to be announced), and will be reviewed by the Secretary of State.</p>	The proposed timeframe has not yet been confirmed, but the Government Equalities Office remains committed to enacting the regulation. This will require companies to present their pay gap data in April 2017, and publish in April 2018.	No.
Other narrative reporting			
Modern Slavery Act	<p>The Modern Slavery Act came into force on 29 October 2015 and while it is chiefly concerned with criminalising forced labour and human trafficking, Section 54 of the Act is aimed at corporate transparency in the supply chain.</p> <p>Companies that carry on business in the UK, with a global annual turnover of more than £36m must publish a statement, outlining the steps they have taken to ensure that they (and their supply chain, where applicable) are free from slavery. This statement has to be available on the company's website, and signed by a company director or equivalent. Outright failure to comply with S54 will result in an unlimited fine.</p> <p>Although, under the Act, it is possible for companies to declare that they have not taken any steps, in an age where business is under increased public scrutiny there is a reputational risk for doing so.</p>	<p>Companies that need to comply with the Modern Slavery Act were required to produce a disclosure statement for financial years ending on or after 31 March 2016.</p> <p>The statement must be produced within six months of year end.</p>	No. The statement is to be provided on the home page of the company website or made readily accessible from the home page of the website.



	Comments	Timing	Mandatory reporting in the Annual Report?
Payment practices	Large companies will be required to publish a report on their payment practices, policies and terms (Small Business, Enterprise and Employment Act 2015). Companies are to produce a report every six months and publish this on their website.	Regulations are expected to be laid before Parliament early 2017 and apply to financial years beginning on or after 6 April 2018.	No.
Executive remuneration			
Director's Pay: Revised Remuneration Reporting Regulations	<p>The regulations (effective from 2013) introduced a binding vote by shareholders on remuneration policy once every three years. The regulations specify that the remuneration report should contain two distinct parts:</p> <ul style="list-style-type: none"> • When there is a shareholder vote on remuneration policy, a policy report setting out all elements of a company's remuneration policy and key factors taken into account in setting the policy • An annual report on how the policy was implemented in the last financial year, setting out actual payments to directors and details on the link between company performance and pay 	Currently in effect and third year anniversary of regulation is approaching.	Yes.
GC100 and Investor Group Directors' Remuneration Reporting Guidance	<p>The GC100 and Investor Group published updated guidance in August 2016, on how the new directors' remuneration regime should be implemented. This encourages remuneration committees to consider:</p> <ul style="list-style-type: none"> • shareholder feedback on the last report, and their impressions on the clarity of disclosures • how they could make it easier to understand and assess the report • whether it is clear how and why the committee came to their decisions. 	Currently in effect.	
Governance of investors			
The Stewardship Code	The UK Stewardship Code (2012) is currently effective with no changes imminent, however the FRC is moving to promote best practice. To ensure signing up is a true marker of commitment, they have assessed signatories' commitment to the principles of the Code and tiered them according to the quality of their reporting with reference to best practice reporting across the three signatory categories.	The lists of those in each tier will be published in November 2016.	

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Governance matters



Corporate Governance Review
2016



Charities Governance
Review 2016



Housing Governance Review
2016



Global Governance Review
2016, GTIL

For further information, visit: www.grantthornton.co.uk/governancematters

Advising on governance



Corporate reputation

When is it relevant – Perceived value gap between corporate and investor stakeholders' informational needs

Value add to client – Independent investor and stakeholder relations advisory services to boards and executive teams

Types of solutions enabled with management

- Tailored investor and stakeholder relations training for all levels
- Undertake full capital markets perception audit skewed towards investors but also to include analysts and press if needed
- Refine investment case and update investor toolkit materials as and where necessary
- Best practice Investor and stakeholder disclosure and reporting (websites/presentations/investor documents)
- Shareholder and debt holder register analysis with targeting, access and roadshow management – UK, Europe and globally



Governance diagnostics

When is it relevant – Organisations seek to understand whether existing governance reflects good practice

Value add to client – Detailed and insightful comparison to a database of peers enables gap analysis of As-Is structures and identification of solutions

Types of solutions enabled with management

- Benchmark reporting to market good practices
- Identification of areas for improvement (in annual report and/or issues with internal framework and approach) dependent on appetite and suggested solutions prioritised
- Development of implementation plans and change programmes
- Peer and sector comparison



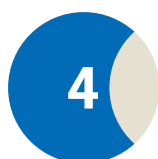
Governance renewal

When is it relevant – A significant change event has occurred which means that the current governance framework is no longer fit for purpose

Value add to client – We facilitate the design and implementation of corporate frameworks which support value creation

Types of solutions enabled with management

- Strategic reviews, integration and organisational design
- Development of frameworks, policies and procedures
- Group risk appetite identification and embedment
- Internal control reviews and redesign
- Internal audit effectiveness reviews
- Performance and incentivisation measures, restructuring and implementation



Strategic sustainable reporting

When is it relevant – Performance is focused on short term or unbalanced targets

Value add to client – Ensures that performance and reporting is aligned to sustainable, long term value creation

Types of solutions enabled with management

- Review of and advice on corporate reporting
- Integration of internal performance reporting with strategy
- Creation of sustainability and compliance reporting methodology
- Non-statutory reporting assurance



Leadership and culture

When is it relevant – Culture needs to be aligned to strategy in order to realise corporate purpose

Value add to client – Cultural change can be achieved more efficiently when values and behaviours are considered alongside strategy, systems and processes

Types of solutions enabled with management

- Cultural audit
- High potential assessment and development programmes
- Executive and board level coaching



Board evaluation

When is it relevant – assessment of board practices or restructuring of board governance

Value add to client – External assurance over board and/or structure, capability and function.

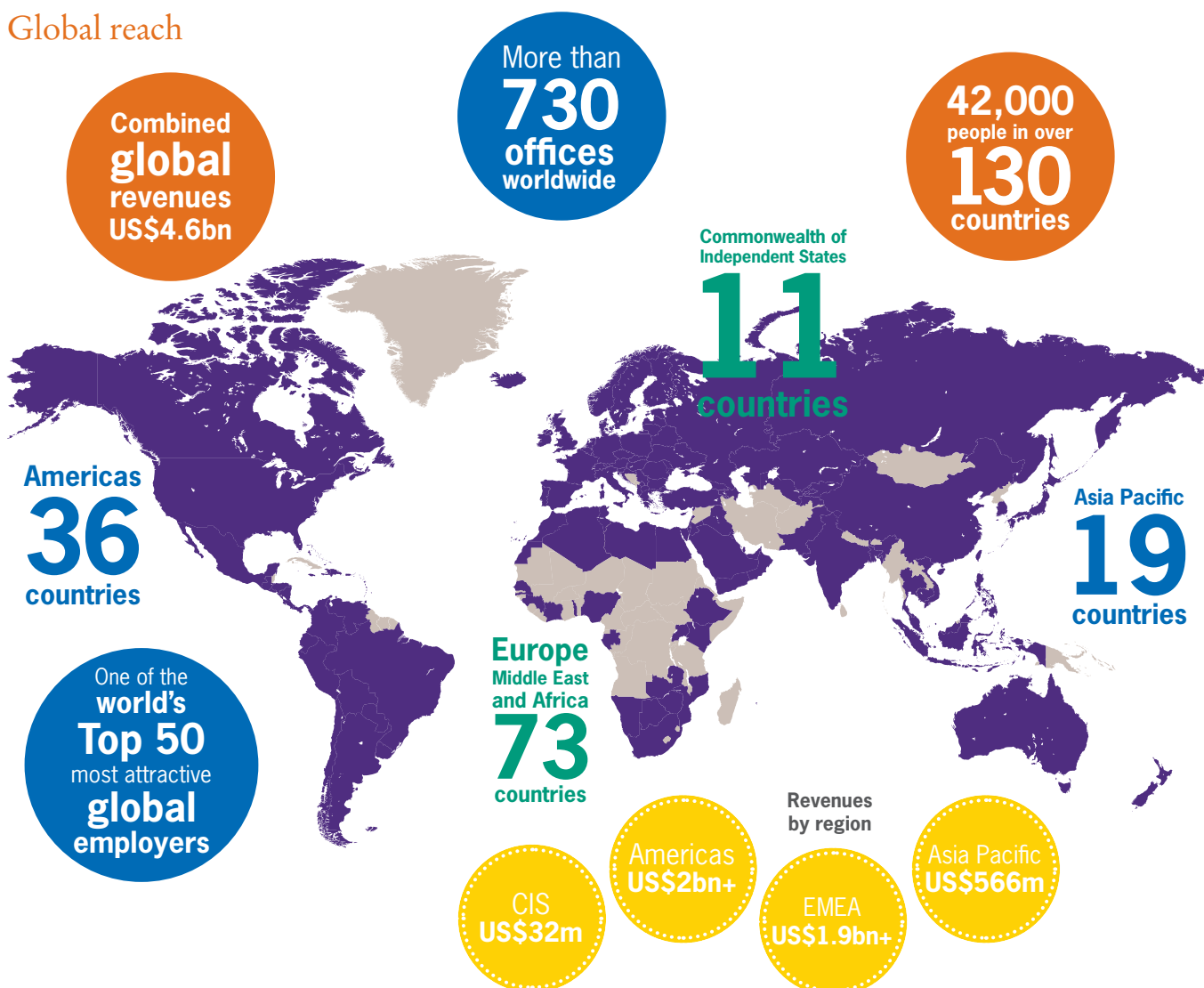
Types of solutions enabled with management

- Board effectiveness reviews
- Committee effectiveness reviews
- Committee structure and terms of reference design
- MI quality and effectiveness assessments



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