Corporate Governance Review

2017

2017 highlights

66%

66% of FTSE 350 companies declare full compliance with the UK Corporate Governance Code – a new high

62%

The front end breaches the hundred-page mark with a new high of 104 pages – a 62% increase since 2009

62%

62% of the FTSE 350 comply with all strategic report requirements but just 14% provide high-quality, informative insights

61%

61% of companies connect strategic priorities and KPIs in their strategic report but only 20% go one step further and include clear linkage to executive remuneration

33%

The slide continues – only 33% of companies provide good or detailed explanations of how they work to understand shareholders' views – down 22% in two years

55%

Macroeconomic risk reporting increases by 55% as Brexit challenges hit home but despite climate change threats, environmental risk continues to fall

27%

27% of the FTSE 350 do not consider technology to represent a significant risk to their business

51%

All but one FTSE 350 company delivers a viability statement but 51% give little insight and only 6% cover all areas in the guidance

39%

Culture reporting gathers momentum as 39% of companies provide good or detailed disclosures, up from 20%, but only 29% of CEOs discuss culture

30%

30% of companies fail to show a comprehensive employee gender split, up from 26%

14%

Only 14% of companies provide genuine insight into their succession planning

22%

Only 22% provide insightful disclosures on the review of effectiveness of internal controls

Methodology

This review, now in its 16th year, comprises a comprehensive analysis of the annual reports of the companies in the FTSE 350.

It assesses compliance with:

- the disclosure requirements of the UK Corporate Governance Code (the Code) 2016, and 2014 where applicable
- the narrative reporting requirements set out in S414c of the Companies Act 2006, as amended.

As well as assessing compliance with the Code, the review considers the quality and detail of explanations, and draws attention to best practice and emerging trends in narrative reporting.

This year's review covers 305 FTSE 350 companies (as of March 2017) with years ending between April 2016 and April 2017. Investment trusts are excluded from our analysis, as they are able to follow the AIC Code of Corporate Governance. The 2017 review therefore covers 305 companies, 99 from the FTSE 100 and 206 from the FTSE 250. Where we compare to previous years' data, in 2016, our FTSE 350 sample included 308 companies – 100 from the FTSE 100 and 208 from the FTSE 250; in 2015, it included 312 companies – 100 from the FTSE 100 and 212 from the FTSE 250.

Key findings are discussed in the body of the report. Full details of the questions covered are in the appendices, which can provided on request from Alex Worters (alex.j.worters@uk.gt.com).

Simon Lowe would like to thank Amit Bagga, Scarlett Brown, Rebecca Dowman, Yaryna Kobel, Nash Matinyarare, Nicholas Speechley, Rupi Thind and Alex Worters for their work in preparing this report. Thank you also to Ben Mathews, Group Company Secretary, HSBC Holdings plc for his contribution.

Investor viewpoint

Simon would like to give special thanks to Abigail Herron for providing investor viewpoints throughout this year's review. Abigail is Global Head of Responsible Investment at Aviva Investors.

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The regulator's perspective

2016 and 2017 have been years of particular focus on corporate governance in the UK, with a great deal of scrutiny from government, businesses and the wider public.

Sir Win Bischoff, Chair, Financial Reporting Council

It has been 25 years since the publication of the Cadbury Report (the first iteration of a UK Corporate Governance Code) and the quality of corporate governance reporting has continued to improve over that period. A key reason why global investors commit their capital to UK listed companies is the trust and confidence the Code engenders, thereby benefiting UK society in the long term through jobs, growth and prosperity.

The Code's 'comply or explain' approach, significantly, has allowed the UK to respond positively and effectively to evolving market circumstances, which hard rules often cannot. Compliance with Code provisions has improved and this year's report by Grant Thornton confirms a new high of 66% of the FTSE 350 reporting full compliance with the Code. Good quality and distinctive reporting remains vital in differentiating the approaches companies take and provides confidence to investors.

It is pleasing to see that a year on from our publication – *Corporate Culture and the Role of Boards: A report of observations* – there have been improvements in reporting on corporate culture. Grant Thornton found that 39% of companies, up from 20%, now provide a good or detailed disclosure, that 65% name their values and only 6% make no reference to culture. However, disappointing is the fact that there has been no real progress in the quality of reporting on viability. Around half of companies producing statements that give little or no insight into their viability means that the FRC's Financial Reporting Lab project on risk and viability reporting should help companies on how to provide better disclosures.

As we look to the next 25 years, it is important that our framework of corporate governance continues to evolve. The demands are growing – both from the Government's Corporate Governance reform agenda and what a post-Brexit future will hold. There continues to be an expectation that investors will look to the UK as a destination of choice. Businesses too, need to see the merit in being listed in the UK. A proportionate, principles-based framework for corporate governance will help to achieve these outcomes. During 2017, the FRC will carry out a comprehensive review of the Code to consider its content structure, and the role of guidance. The results will be published in a consultation later this year and will include suggestions to the FRC by the Government's green paper.

The FRC once again owes thanks to Grant Thornton for its ongoing analysis and insight into the UK's corporate governance framework. It will prove helpful in informing our work on revising the Code.

Foreword

As the UK's Corporate Governance Code (the Code) approaches an inflection point in its evolution, this year's research reveals some interesting findings.

Simon Lowe, Chair, the Grant Thornton Governance Institute

Corporate governance in the UK has been in the spotlight more in the past two years than at any time since the years immediately preceding the Cadbury Report's publication in 1992.[1] Sir Adrian Cadbury's committee's report introduced the then radical concepts of the separation of the chief executive (CEO) and chair, the need for boards to have at least three non-executive directors (NED), two of whom should be wholly independent, and the instigation of board audit committees made up of NEDs.

In the 25 years since Cadbury, the increasing adoption of the principle that companies comply with the Code or explain why not has increased explanations exponentially. More and more organisations are embracing compliance and the spirit of the Code, as exemplified through informative explanations.

Despite these positive trends, corporate scandals and escalating executive pay have eroded trust in business. Governance practices are again subject to intense scrutiny from government, politicians and the wider public, as they were in the early 1990s. What may be different this time is the growing demand for an acknowledgement of businesses' wider societal responsibility.

This increasing clamour for wider engagement, transparency and accountability underpins the Government green paper, Corporate Governance Reform[2], the response to which came out in August[3]. The consultation paper focuses on employee and wider stakeholder engagement, executive pay and the development of a code for larger private companies, and contributed to the Financial Reporting Council's (the FRC) decision to fundamentally review the Code in 2017. Although these initiatives may prove significant, as the embodiment of evolving best practice, the core guidance in the current Code is likely to remain the guiding light for some time to come.

Compliance continues to rise

Once again, this year our research brings with it both encouraging and frustrating findings. Pleasingly the former outweighs the latter, with more companies complying with the Code and a continuing improvement in overall reporting quality.

Sixty-six per cent of FTSE 350 companies declare full compliance – a new high, with 36 companies moving from non-compliance to compliance. The independence of directors and chairs remains the largest area of non-compliance, with a knock-on effect on committee membership.

Annual reports continue to grow: the average front-end of the report is now over 100 pages, 62% longer than in 2009 when the mean pagination was 64. Although this growth could reflect a bid for greater transparency, we found little correlation between the number of pages and the quality of disclosures, suggesting that longer reports do not lead inevitably to greater insight.

In the past few years, report expansion has largely reflected the new strategic report requirements. This year, however, the biggest increase is in the governance report, particularly the remuneration report, which now takes up an average of 20 pages. Given the recent scrutiny of executive pay, it is unsurprising that remuneration is getting greater coverage;

[1] The Financial Aspects of Corporate Government (the 'Cadbury Report'), The Committee on the Financial Aspects of Corporate Governance, December 1992.

[2] https://www.gov.uk/government/consultations/corporate-governance-reform

[3] https://www.gov.uk/government/news/world-leading-package-of-corporate-governance-reforms-announced-to-increase-boardroom-accountability-and-enhance-trust-in-business

> “Unfortunately, we found no improvement in the quality of reporting for either viability statements or internal controls – areas closely linked to risk management.”

yet there is still little disclosure of the specific metrics that underpin reward nor its clear linkage to strategy.

Future-focused strategy

The strategic report was introduced to allow companies to tell their story – from their business model and strategy to their principal risks and challenges. Sixty-two per cent of the FTSE 350 now comply with all strategic report requirements (2016: 57%). However, the overall quality of strategic report disclosure varies considerably: just 14% of companies achieve the Government’s goal of providing high quality, business model-led components, interlinked reporting and informative insight.

The quality of individual aspects of the report also differs significantly. Disclosures around the business model increased this year: 80% (2016: 72%) of FTSE 350 companies’ business models give helpful insights into what product or service they provide, their key relationships, resources and outputs, and their competitive advantage. This may reflect the October 2016 publication of the Financial Reporting Lab project that summarises good business model reporting.[4]

The most significant development in strategic reporting this year is in discussion of the future. Sixty-four per cent of companies provide good insights into their future development, up from 48% in 2016. There are also improvements in reporting around key performance indicators (KPIs). Fifty-seven per cent of companies now provide very informative disclosures on KPIs, up from 49%, and 61% show clearly how they link to strategy. While shareholder funds remain the most commonly disclosed KPI, on average companies now provide almost as many non-financial KPIs as financial ones, a helpful and broader measure of success. Demonstration of how remuneration links to KPIs – that is, to the achievement of clear strategic goals – is less impressive. Only 20% of the FTSE 350 show how KPI achievement aligns with remuneration and how specific strategic priorities connect with performance-based remuneration metrics.

Risks and risk management

The positive impact of the FRC’s 2014 Guidance on Risk Management, Internal Control and Related Financial and Business Reporting[5] continues. While in 2015, 81 companies made no discernible change to their risk disclosures, this year all but 19 address and update their principal risk disclosures.

A further advance is evident in the 80% of companies – the highest-ever level – that provide good or detailed disclosures around risk management.

A closer look at types of risk reveals certain trends. In 2016 we identified a decline in macroeconomic risks, which was surprising given the then pending EU referendum; this suggested business did not anticipate an exit result. This year the reporting of macroeconomic risks increased by 55%, along with an increase in employee risks. Despite climate change threats, environmental risk reporting continues to wane, with only 34 companies naming an environmental factor as a key threat.

Unfortunately, we found no improvement in the quality of reporting for either viability statements or internal controls – areas closely linked to risk management. While all but one company provides a viability statement, just over half (51%) give little or no insight into their viability in the face of key strategic risks. The FRC aims to publish the results of its Financial Reporting Lab project on risk and viability reporting in time to inform December 2017 year-end annual reports. This guidance should provide a greater steer to companies that are struggling to use the viability statement as an opportunity to inform their stakeholders, and are instead resorting to boilerplate text.

Thirty-four per cent of companies still keep their internal controls disclosures to a minimum, giving few insights into internal control policies and systems, organisational structures and reporting lines. Following various well-publicised frauds and accounting failures this year arising from inadequate internal controls, this should be fertile ground for investor enquiries of management and audit committees. Similarly, while the FRC’s 2014 guidance states that boards need to say how they monitored and reviewed the effectiveness of their internal control system throughout the year, the quality of disclosure remains weak. Seventy-eight per cent of companies provide basic or general explanations, with only 22% giving good or detailed descriptions that might genuinely reassure an investor.

Culture reporting improves

Following the FRC’s July 2016 publication of Corporate Culture and the Role of Boards[6], there are significant improvements in culture-related reporting, particularly in the chair’s and CEO’s statements. Thirty-nine per cent of FTSE 350 companies now

[4] Business Model Reporting, FRC, October 2016 (www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/FRC-Lab-Business-model-disclosure.pdf).

[5] https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf

provide good or detailed disclosures, up from 19% in 2016. Sixty-five per cent communicate their values, up from 52%, with only 6% making no reference to culture. Twenty-nine per cent of CEOs now discuss culture in their opening statements, up from 21%. In their report, the FRC concludes that while the chair and non-executive directors are influential, the CEO has most responsibility for setting and embedding a company's culture and values. This direction of travel is therefore encouraging but, given the great influence of CEOs, their relatively low cultural 'participation' is disappointing.

Investor engagement remains patchy

Despite the increasing emphasis on shareholder engagement, disclosures are not getting any better. For the sixth year, the number of companies providing detailed accounts of how they engage with shareholders fell, a particularly strong trend among the FTSE 250. Only 33% of the FTSE 350 provide good or detailed explanations (2016: 36%; 2015: 55%), while 67% give generalised disclosures with no mention of the specific issues discussed. With the FRC planning to review the Stewardship Code next year, this will need to be on companies' radars. Careful analysis of the forms of engagement do reveal some signs of improvement: 40% of companies discuss face-to-face communication between shareholders and directors, up from 33% in 2016. Surprisingly – given the increasing shareholder focus on executive remuneration – only 13% of the FTSE 350 report that the chair, or other members of the remuneration committee, held face-to-face meetings with shareholders.

Board diversity

Surprisingly, 59% of Financial Services companies report technology in one form or another as being a significant risk, but only a quarter of them had discernible expertise on the board. Generally, however, companies are strengthening their expertise. Forty-five per cent of the FTSE 350 now have directors with expertise in technology/IT, up from 39%, as boards respond to technological disruption and cyber risk. This is matched by an increase in recognition of technology as a significant risk. Company explanations do not reveal whether such responses are sufficient but, as a belated step in the right direction, this is a welcome trend. Investors should be aware, however, that there can be a significant delay between introducing expertise to a board and a risk being mitigated.

Board composition stays relatively static elsewhere, with a stagnation in gender diversity. While 26% of FTSE 100 board roles are filled women, 38 FTSE 100 companies have less than 25% female representation on their boards. This includes two FTSE 100 companies with under 10% of board roles held by women and – for the first time in several years – one all-male board.

In the FTSE 250, the picture is similarly mixed. While 95% of companies have at least one woman board director, the proportion with more than 25% has reduced; just over a quarter have 25% women on their boards, compared to more than a third last year. The situation in executive and chair roles is similarly frozen: 77% of the FTSE 100 and 85% of the FTSE 250 still do not have a woman in an executive role on their boards. If the largest companies are to address the targets set by the 2016 Hampton-Alexander review[7], executive search firms will have to broaden their contact pools significantly, and nomination committees redouble their efforts to look further ahead – and down into their organisations. With Brexit increasing the need to penetrate and engage with new international markets, the focus, role and workload of nomination committees is likely to increase significantly over the next few years.

Conclusion

The FRC's current review of the UK Corporate Governance Code coincides with on-going improvements to the Code's provisions, the embracing of its principles by new advocates, and the 25th anniversary of the Cadbury Report.

Is it now time for the Code to be completely rewritten? Or is it more a matter of refreshing the existing guidance, stripping out accepted practice, providing a little more targeted 'encouragement' and reminding companies and investors of their common interest in upholding the principles of good governance?

Whatever the conclusion, the wider debate about who directors are responsible to and how one should interpret Section 172 of the Companies Act 2006, which emphasises directors' wider circles of accountability, will inevitably continue to drive debate and reporting requirements in the future. For the meantime, we will have to wait until the end of the year to find out what the FRC has in mind.

[6] Corporate Culture and the Role of Boards, FRC, July 2016 (http://www.frc.org.uk/getattachment/3851b9c5-92d3-4695-aeb2-87c9052dc8c1/Corporate-Culture-and-the-Role-of-Boards-Report-of-Observations.pdf)

[7] Improving Gender Balance in FTSE Leadership/Hampton-Alexander Review, Department for Business, Energy & Industrial Strategy, November 2016.

The strategic report

Front-end growth continues

"The annual report is a medium of communication between the company's directors and its shareholders… In general, information should only be placed in the annual report when it is relevant to shareholders."

(FRC Guidance on the Strategic Report, 3.11)

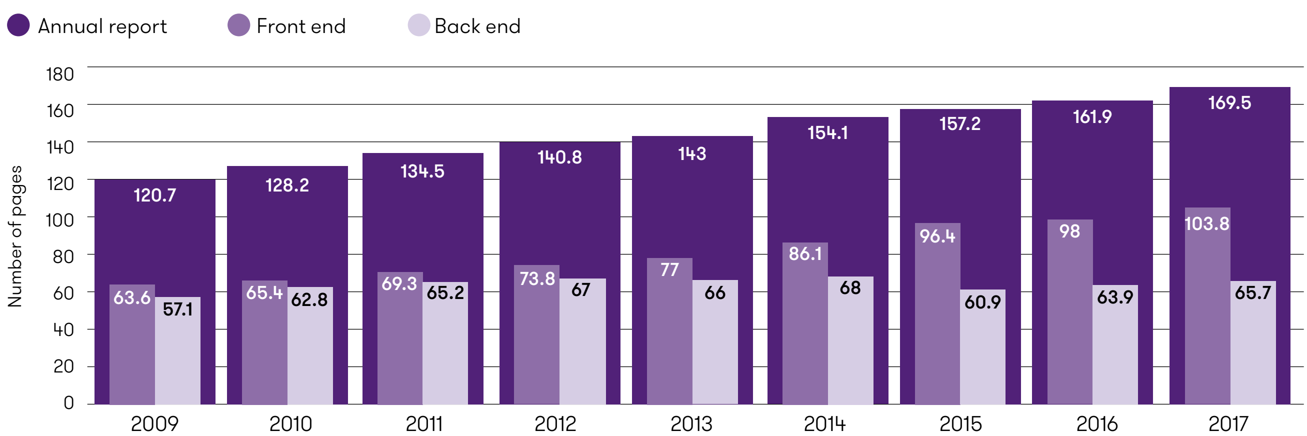
Every year companies try to make their annual reports easier to read and navigate, using features ranging from personalised formats to infographics. However, debatably, few companies have ever truly embraced the concept that an annual report should only contain information material to shareholders. Over the past 16 years, reports have consistently lengthened, with the average now reaching 170 pages (2016: 162 pages).

While both the front-end narrative and the financial statements have grown, this year the front end has breached the hundred-page mark with a new high of 104 pages. This is a 62% increase since 2009, when it consisted of 64 pages. In comparison, the financial section, which made up just under half of the average annual report in 2009, has grown by just 16%.

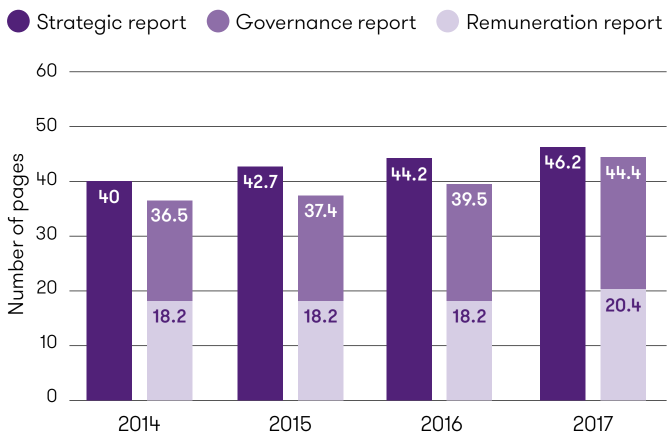
FAST FACTS

- The average FTSE 350 strategic report is now 46 pages long and the front end comprises 104 pages
- All but two companies now include a strategic report in their annual report
- 62% of companies comply with all strategic report requirements but just 14% deliver high quality, business model-led content
- 57% of the FTSE 350 provide informative KPI disclosures
- Only 20% show clear linkage between KPIs, strategy and executive remuneration in the strategic report
- The average company lists 11 principal risks, with macroeconomic risk reporting increasing by 55%
- 51% of FTSE 350 long-term viability statements give little insight into the company's ability to continue operating in the longer term
- The number of companies failing to show a comprehensive employee gender split increases from 26% to 30%
- 56% of chairs discuss culture and values in the annual report, against 29% of CEOs
- 80% of FTSE 350 members provide good or detailed insights about their business model.

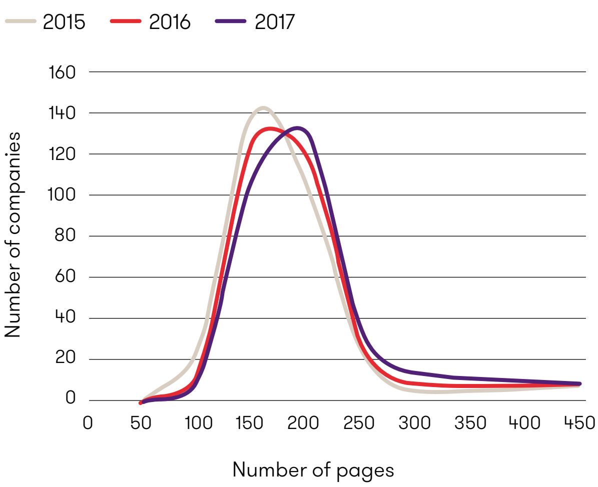
Average page length of annual report



Average page length of front end



Length of annual reports for the FTSE 350



Increases in the length of the front section of the annual report, especially of the strategic report, are often linked to the implementation of new national or EU reporting requirements. This year the governance report – which now averages 44 pages (2016: 40) – contributes most to the growth of the front end.

Within the governance report, the remuneration report grew most, adding more than two pages on average to reach 20 pages, after three years at 18. The Government's green paper[8] issued in November 2016 and discussions around executive remuneration may have contributed to this rise. Meanwhile, the average audit committee report increased by 0.2 pages to 4.8, while the nomination committee report remains at two pages.

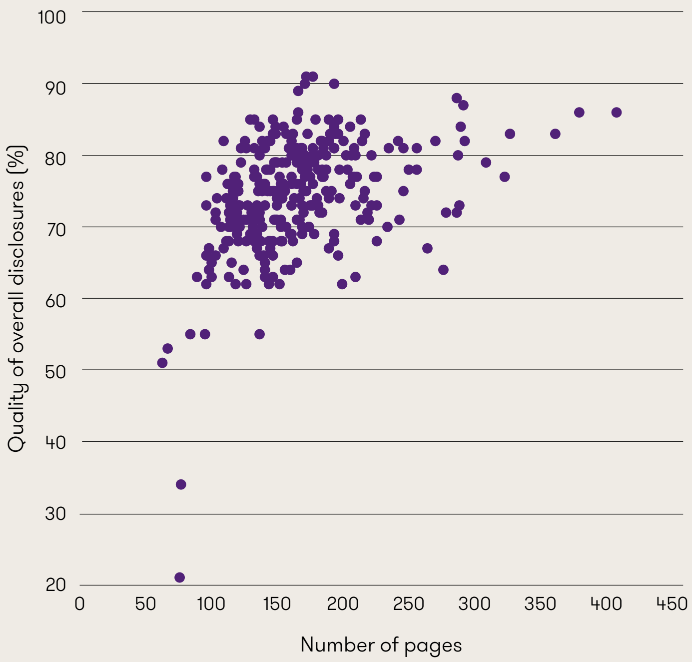
The average FTSE 100 annual report is now 206 pages (2016: 199 pages), with the FTSE 250 at 152 (2016: 144). Unsurprisingly, five FTSE 100 banks have some of the longest, averaging 352 pages. Technology companies have the shortest reports, with an average of 136 pages.

This year RBS retook the top spot from last year's leader, HSBC (2016: 502 pages), with the longest report in the FTSE 350 at 480 pages, up by 49. In contrast, HSBC impressively succeeded in removing 220 pages – mainly by optimising its risk reporting within the financial review and remuneration report. By comparison, F&C Commercial Property Trust Ltd had the shortest report, at just 67 pages (2016: Softcat, 43).

The expansion in average length may reflect a bid for greater transparency. However, our analysis casts doubt on the premise that longer annual reports lead to greater insight. We found little correlation between disclosure quality and pagination, with good annual reports evenly spread between 130 and 280 pages, and the five best being between 169 and 196.

[8] Corporate Governance Reform green paper, Department for Business, Energy & Industrial Strategy, November 2016 (www.gov.uk/government/consultations/corporate-governance-reform).

Length of annual reports and quality of disclosures



"HSBC is a complex business, operating in 67 jurisdictions, with two primary stock exchange listings and is required to produce its annual report in both English and Chinese. It is essential therefore, that we communicate our key messages as clearly as possible. With the aim of achieving clear communication with our shareholders, we successfully reduced the length of our annual report from 502 pages in 2015, to 282 pages in 2016. In doing so, we still had to ensure that we had robust processes to ensure compliance with our disclosure obligations. We went through every sentence and note in the report to understand what drove it. This way we made sure we did not remove any disclosures required by regulation or law. The key was to highlight what was material to our stakeholders, whilst bringing out the story of a complex group in simple terms.

"The Group Audit Committee oversaw the exercise to ensure that the annual report remained relevant and useful as well as complying with all applicable requirements".

Ben Mathews, Group Company Secretary – HSBC Holdings plc

Increasing strategic reporting compliance

"The strategic report should be comprehensive but concise."

(FRC Guidance on the Strategic Report, 6.7)

Following the introduction of the strategic reporting requirements, first reflected in our 2014 review, all but two FTSE 350 companies now include a strategic report in their annual report. The average section continues to grow, up two pages over the past year to 46. The chair's introduction, which now averages slightly above two pages, contributes to this increase; growing by almost half a page.

The strategic report was introduced to allow companies to tell their story – from their strategy and business model to their principal risks and challenges[9] – as the financial crisis highlighted the need for clearer, more coherent reporting. Sixty-two per cent of the FTSE 350 now comply with all strategic report requirements for quoted companies (2016: 57%). However, the approach to strategic report disclosure still varies considerably: just 14% of companies (2016: 7%) achieve the Government's goal of providing high quality, business model-led components, interlinked reporting, and informative insight.

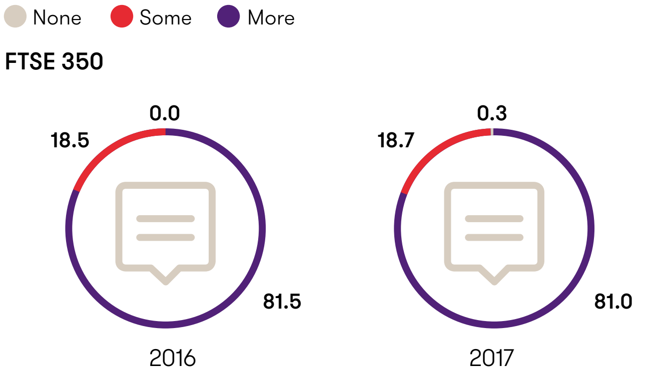
Looking back

"The strategic report must contain… a fair review of the company's business."

(Companies Act 2006, s414C (2))

Companies do a good job in reporting on their 'past and present' – celebrating successes or reflecting on challenges that influenced their performance. Eighty-one per cent (2016: 82%) provide good or detailed reviews of their business and past performance. They explain well their external environment, how markets trends influence them and how they take advantage of strategic opportunities. Some also set out planned actions linked to each strategic priority and report on their achievements.

To what extent do companies describe their business and the external environment in which they operate? (%)



Over the past year, there has been a significant increase in the number of FTSE 350 companies providing information about the present and how they create value. Eighty percent of FTSE 350 members (2016: 72%) provide good or detailed insights about their business model.

While the quality of disclosures improved throughout the FTSE 350, an interesting shift happened within the FTSE 100: almost 12% of companies which gave general disclosures last year, now provide a good level of detail. These businesses explain both what product or service they provide, and demonstrate the key relationships and resources they depend upon. They also give insightful explanations of their outputs and competitive advantage.

This advance may reflect the October 2016 publication of the Financial Reporting Lab[10] project that summarises good business model reporting to encourage better practice. The report emphasises that the business model should be at the heart of the annual report and connect with other elements. Seventy-three per cent of the FTSE 350 and 80% of the FTSE 100 link their business model to strategy, compared to 70% of the FTSE 250.

[9] Better and simpler company reporting, Department for Business, Innovation & Skills, June 2013 (www.gov.uk/government/news/better-and-simpler-company-reporting).

[10] Business Model Reporting, FRC, October 2016 (www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/FRC-Lab-Business-model-disclosure.pdf).

To what extent do companies describe their business model? (%)

FTSE 350	None	Some	General	Good	Detailed
2017	1.0	2.0	17.3	47.2	32.5
2016	1.0	3.5	23.4	42.2	29.9

FTSE 100	None	Some	General	Good	Detailed
2017	1.0	1.0	9.1	45.5	43.4
2016	1.0	1.0	21.0	34.0	43.0

FTSE 250	None	Some	General	Good	Detailed
2017	1.0	2.4	21.4	48.1	27.2
2016	1.4	4.3	24.5	46.2	23.6

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))

FTSE 350 companies are getting better at mapping their progress: in 2017, the percentage providing particularly informative key performance indicator (KPI) disclosures rose to 57% (2016: 49%).

However, 42% still only state what KPIs they use and do not explain, for example, why the chosen indicators are relevant yardsticks of strategic progress, how they are calculated, what next year's targets will be and, most importantly, how they link to their strategy and associated risks. There are, however, positive signs of improvement: 61% show linkage between strategic priorities and KPIs, up from 43% in 2016.

While each component of the annual report is useful; using the strategic report to highlight and explain linkages between the directors' remuneration and business strategy can offer particularly valuable insights.[11] Although most companies indicate this link in the remuneration report, they often acknowledge that some reward elements are linked to strategy but provide no further detail. Only 20% of the FTSE 350 (2016: 11%) provide clear links between KPIs, strategy and remuneration in their strategic report. Best practice would see explanations of why specific KPIs are chosen and how executive remuneration is designed to align executives' and shareholders' interests.

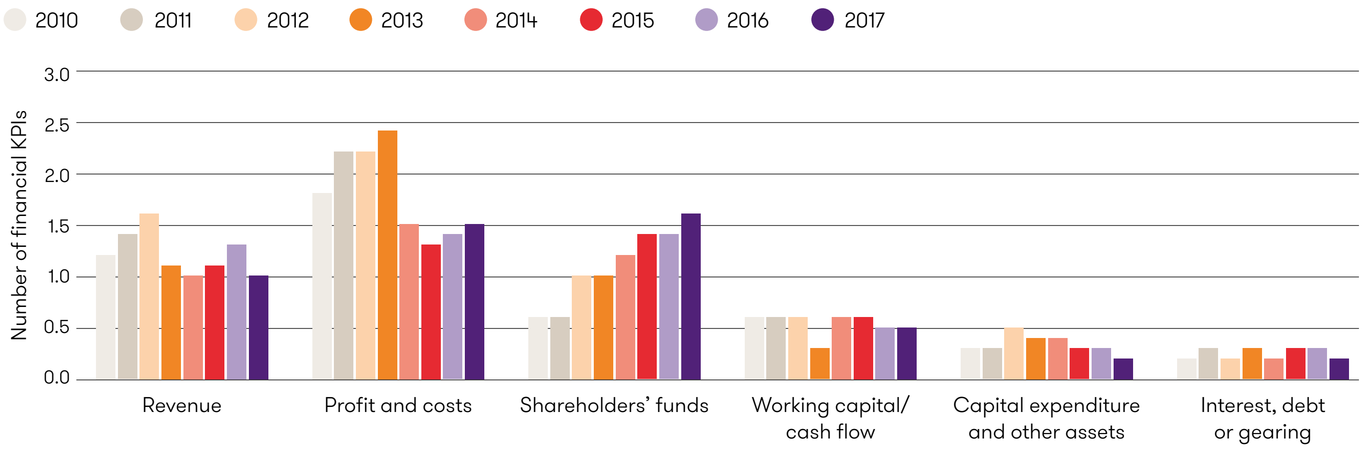
[11] Guidance on the Strategic Report, FRC, June 2014, section 6.18.

On average companies cite 9.5 KPIs: 5 financial and 4.5 non-financial. Some companies provide too many KPIs for them to be considered as material metrics: two FTSE 350 companies disclose more than 25. While financial KPIs are still most common, non-financial indicators are being used more frequently: in 2009, companies typically had 2.3 non-financial KPIs out of a total of seven. This shift reflects the increased focus on operational matters since the financial crisis and mirrors the trend in key risk reporting as outlined on page 15. That said, shareholders' funds – such as shareholder return, dividend per share and return on equity – remain the most commonly disclosed KPIs.

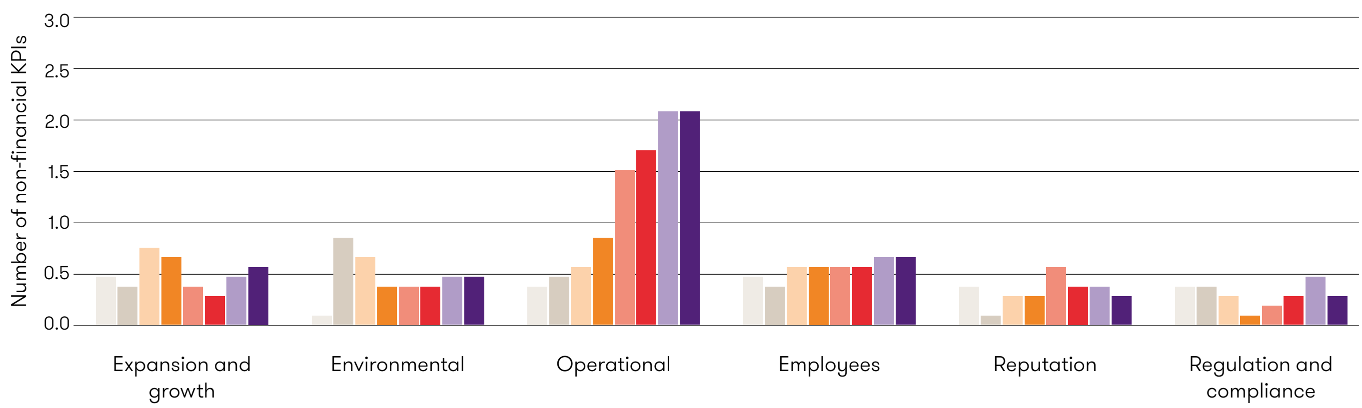
To what extent do companies describe KPIs which measure the performance of the business? (%)

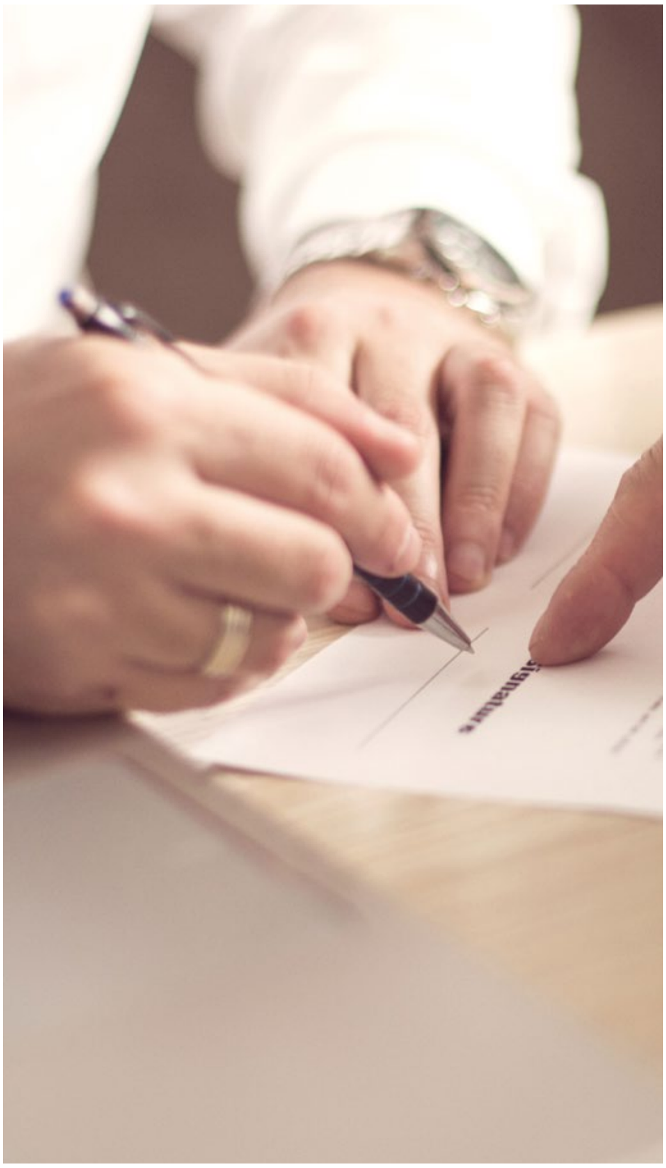
FTSE 350	None	Some	General	Good	Detailed
2016	1.0	16.9	32.8	33.1	16.2
2017	0.7	10.2	32.1	42.0	15.1

Average number of financial KPIs disclosed



Average number of non-financial KPIs disclosed





Looking ahead

"In the case of a quoted company the strategic report must, to the extent necessary for an understanding of the development, performance or position of the company's business, include…the main trends and factors likely to affect the future development, performance and position of the company's business."

(Companies Act 2006, s414C (7))

FTSE 350 companies are increasingly showing well-developed thinking around strategy and future business development: 64% provide high-quality forward-looking statements (2016: 48%). From a sector perspective, two industries stand out: 86% of utilities and 80% of telecommunications companies provide good or detailed disclosures in this area.

This improvement is evident across both the FTSE 100 and the FTSE 250. Annual reports now provide more specific information about planned exits, mergers and acquisitions, and the market outlook. Additionally, more organisations quantify how future market drivers shape their strategy and KPIs and may affect shareholder value. Some companies also provide specific timeframes for all strategic priorities.

To what extent do companies describe the likely future development of the business? (%)

FTSE 350	None	Some	General	Good	Detailed
2016	0.6	11.4	39.6	40.9	7.5
2017	0.3	4.9	30.5	49.2	15.1

[12] Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, FRC, September 2014 (https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf).

Disclosing principal risks

"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)

All FTSE 350 companies now state what their key risks are, with only two companies providing no further details. All but one company now explain how they actively mitigate such risks.

The average number of principal risks reported remains constant at 11, with most companies disclosing between eight and 13. Of the outliers, four report more than 20, with one company giving 25. Those organisations that disclose such a large number may benefit from a fresh review of what constitutes a key risk. When it comes to how companies' key strategic risks might impact their future viability, the picture is less clear. See the viability statement section on page 17.

There is a slight increase in the quality of risk reporting: 33% of companies now provide detailed accounts of their principal risks (2016: 27%). This improvement is due largely to greater disclosure of how principal risks are connected to strategy, why these risks are considered significant, and how exposure to them has changed during the year. Credible links between corporate strategy and risks are becoming more apparent; 59% of companies provide both strong risk reports and link them to strategy.

The positive impact of the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting[12] continues. In 2015, there was no clear sign that 81 companies had reviewed their principal risks and mitigating actions; in 2016, this dropped to 13 companies, and this year is at 19.

To what extent do companies describe their principal risks and uncertainties?

	None	Some	General	Good	Detailed
2016	0.0	1.9	19.2	52.3	26.6
2017	0.0	0.7	18.0	48.1	33.2

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."

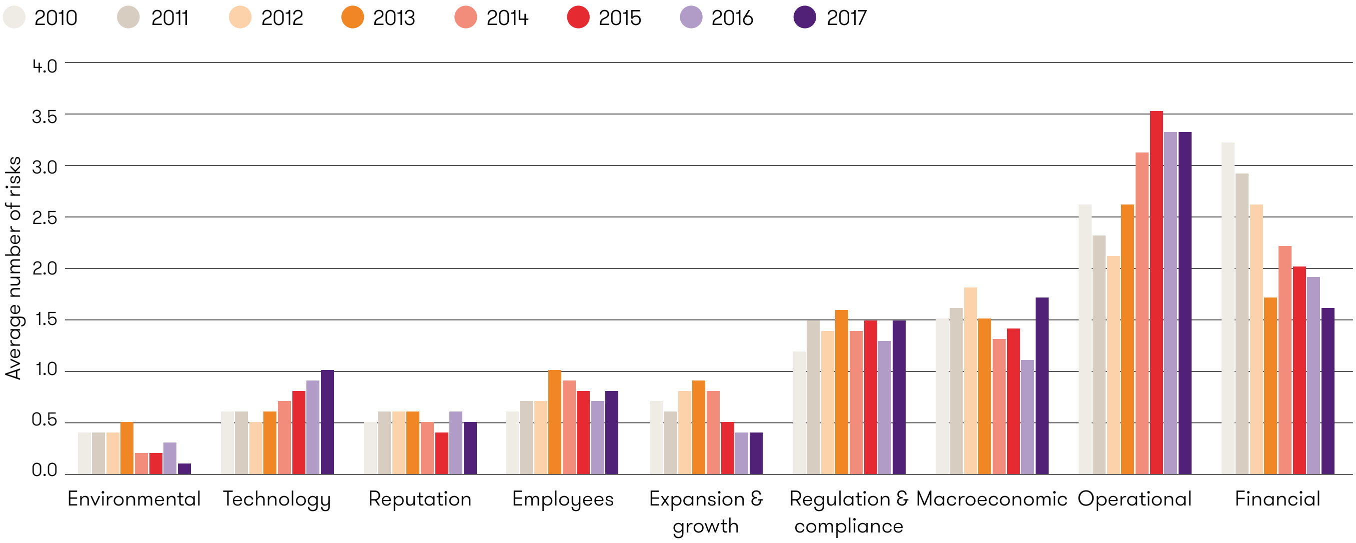
(FRC Guidance on the Strategic Report, 7.25)

A closer look at the different types of risks reveals certain trends. In 2017, operational risk remains an increasing focus for companies while the average number of financial risks continues to fall. Macroeconomic risk reporting has also shifted: in 2016, we identified a decline in this area, which was surprising given the then pending EU referendum. In hindsight, this was perhaps an indication that business did not anticipate an exit result. This year the reporting of macroeconomic risks increased by 55%, and there is also a slight increase in employee-based risks. In the light of the Brexit vote, it is likely that a focus on the risks associated with these areas will continue for some time yet.

Environmental risk reporting continues to wane. This year only 34 companies – including just five of 77 financial institutions and no technology firms – consider environmental risk to be a key threat. As climate change presents global markets with an escalating threat[13], investors want to see how environmental risks and opportunities are being integrated into mainstream financial decision-making. For the time being, it seems that companies are in denial about the extent of this challenge.

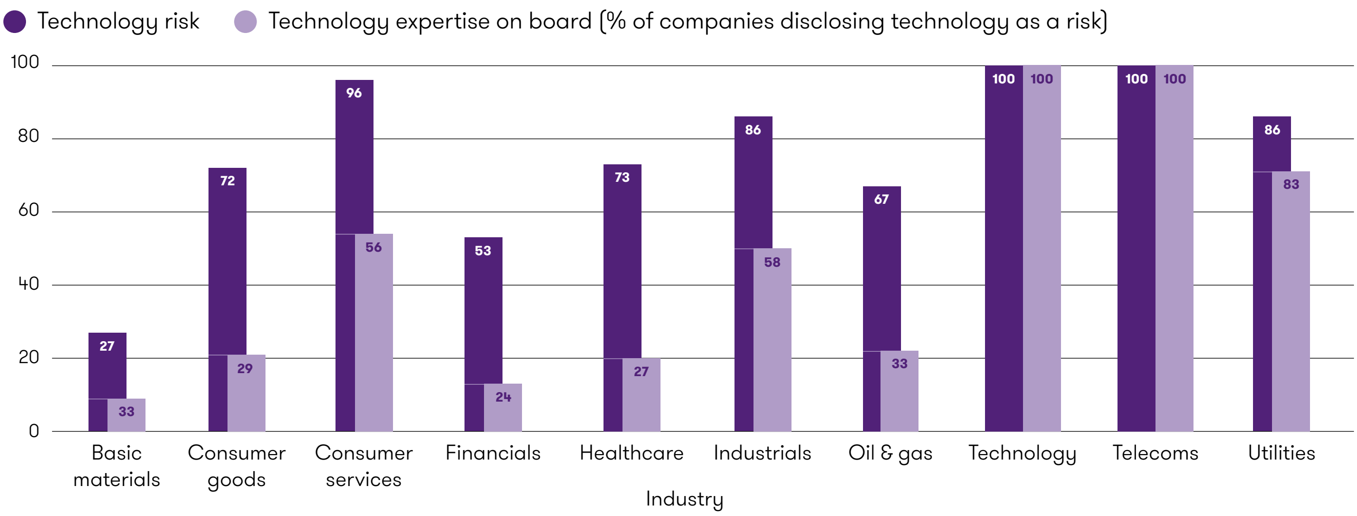
[13] Task Force on Climate-related Financial Disclosures (Financial Stability Board) (www.fsb-tcfd.org/publications/final-recommendations-report).

Categories of principal risks



Technology-related risks increased by 11% this year. Given the current emphasis on technological development, and the recent spate of cyber attacks, it would be disturbing if this focus was not reflected in board thinking. That said, 27% of FTSE 350 (2016: 37%) companies report no technology risks. And, despite an increase in the number of 2017 board appointments of directors with technology expertise, more than half of the 73% of companies that report IT and technology risks do not disclose having technology expertise represented on their board. Of particular concern is the Financial Services sector, where 53% of companies highlight technology related risks but only 24% appear to have technology expertise represented on their boards.

How many companies disclose technology as a key risk? (%)



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. As the development and communication of the statement continues to generate strong debate and a wide range of responses, in March 2017 the FRC Financial Reporting Lab announced a project on risk and viability reporting to obtain the views of the investment community. The Lab began its review in May, aiming to publish its findings in time to inform December 2017 year-end annual reports.[14]

Our research confirms the FRC's concerns that viability reporting needs to improve greatly before it delivers the envisaged level of insight. All but one company provide a viability statement (including an organisation that includes a combined going concern and viability statement without a specified longer-term period). However, just over half (51%) of the FTSE 350 produce statements that gave little or no insight into their viability in the face of key strategic risks.

Almost half, 49%, of companies (2016: 48%) give good or detailed disclosures, providing detail on how they assess viability and what key risks they evaluate, citing modelling scenarios and/or stress testing. There was only a small increase in the number of companies, 17, (2016: 13), mostly financial and consumer services businesses, that go further and add qualitative and quantitative analysis to their risks assessment and key assumptions.

The majority, 51%, (2016: 52%) remain largely disconnected from principal risks and make little specific reference to business strategy. They do not report explicitly on their methodology and give only basic or general disclosure over what period the assessment was made and why this timing is appropriate.

Do companies provide a satisfactory viability statement? (% of companies required to)

FTSE 350	None	Some	General	Good	Detailed
2017 (all were required)	0.3	2.0	49.2	42.9	5.6
2016 (249 were required)	0.4	2.4	49.4	42.6	5.2

FTSE 100	None	Some	General	Good	Detailed
2017 (all were required)	1.0	2.0	43.4	45.5	8.1
2016 (87 were required)	1.1	0.0	47.1	48.3	3.4

FTSE 250	None	Some	General	Good	Detailed
2017 (all were required)	0.0	1.9	52.4	41.3	4.4
2016 (162 were required)	0.0	3.7	50.6	39.5	6.2

[14] www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/March/Lab-calls-for-participants-for-new-project-on-the.aspx

When it comes to the period under assessment, which must be longer than 12 months, 81% of FTSE 350 companies (2016: 79%) opt for three years. Organisations generally select this period to align with their strategy, budgeting and forecasting processes or investment planning. Fifty-seven businesses, including almost half of the utility companies, consider longer periods and one support services firm cited six years. No technology or telecommunications companies look at spans longer than three years.

Seventy-five per cent of companies place the viability statement in the strategic report, adjacent to the risk disclosures. Fifteen per cent put it in the governance report, mostly cross-referencing it in their strategic report to take advantage of the safe harbour provision.

What period of time are they assessing for the viability statement? (%)

	Foreseeable future	2	3	4	5	6
2016	0.4	1.2	79.4	2.8	15.7	0.4
2017	0.3	0	80.5	3.6	15.2	0.3

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)

The requirement for boards to explicitly assess and then state whether their entire annual report is fair, balanced and understandable was viewed as a regulatory response to widespread demands for better corporate reporting. First introduced in the 2012 Corporate Governance Code and then enhanced in 2014, the provision requires directors to ensure that the report 'provides the information necessary for shareholders to assess the company's position and performance, business model and strategy'.

The fair, balanced and understandable process is essential to good quality reporting. By focusing the directors' attention on this overarching responsibility, it helps to ensure that annual reports provide relevant and easily understandable information on a consistent, even-handed basis that eliminates bias and aids analysis and transparency. This is particularly important for the front ends, which are not covered by accounting standards nor, in the main, by the specific audit assurance.

This year, all but three FTSE 350 companies (2016: 6) state that they consider their report to be fair, balanced and understandable. The quality of explanations improved marginally compared to last year: 28% of companies (2016: 23%) embrace the Code's intent that they outline the criteria to support their statement. However, the majority give little or no insight into how they ensure the information is fair, balanced and understandable, and how the board came to this conclusion.

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))

Sustainability reporting – of the environment, employees, social and community activities, and human rights – has progressed greatly over the past 10 years and become common practice. As such, reporting is directed by various regulatory requirements and a number of reporting frameworks and sustainability indices[15], but disclosures within annual reports vary in quality.

The number of companies failing to comply with the mandatory requirement to show a comprehensive employee gender split at the end of financial year increased from 26% in 2016 to 30% this year. This increase is mainly due to companies providing percentages but not actual figures of employee gender. Although companies seem less focused on gender this year, including at board level, this area is gaining more attention, due to both increased government focus, and the implementation of gender pay gap legislation. Although not required to do so, several companies include their gender pay gap information in their annual reports.

Looking at the FTSE 350 overall, companies have on average 25% women and 75% men at senior management level, and 38% women and 62% men in their overall workforce (see more on page 39).

Investor viewpoint

We applaud the companies who include the gender pay gap in their sustainability reporting and those companies that have achieved strong levels of gender diversity on their boards, such as Halfords Group plc which has a female CEO, and an equal balance of men and women on its board.

Against a backdrop of 91% of companies now reporting their greenhouse gas emissions investors are gearing up to quantify climate-related risks and identify those companies who will successful make the transition to the low carbon economy. In December 2016, the Financial Stability Board's Task Force on Climate related Disclosure published its first set of recommendations on disclosure for companies and other financial institutions. The task force suggests companies run scenario analyses that model potential performance under a range of different climate and policy outcomes, and publish the results as part of their mainstream financial filings.

We hope better disclosure will incentivise longer-term thinking among investors and bring to an end what Mark Carney has called the "tragedy of the horizon", a damaging short-termism that fails to take into account risks and opportunities beyond the three-to-five year cycle of most financial-market actors.

[15] For instance CDP, DJSI, GRI, GRESB, SASB, IR.

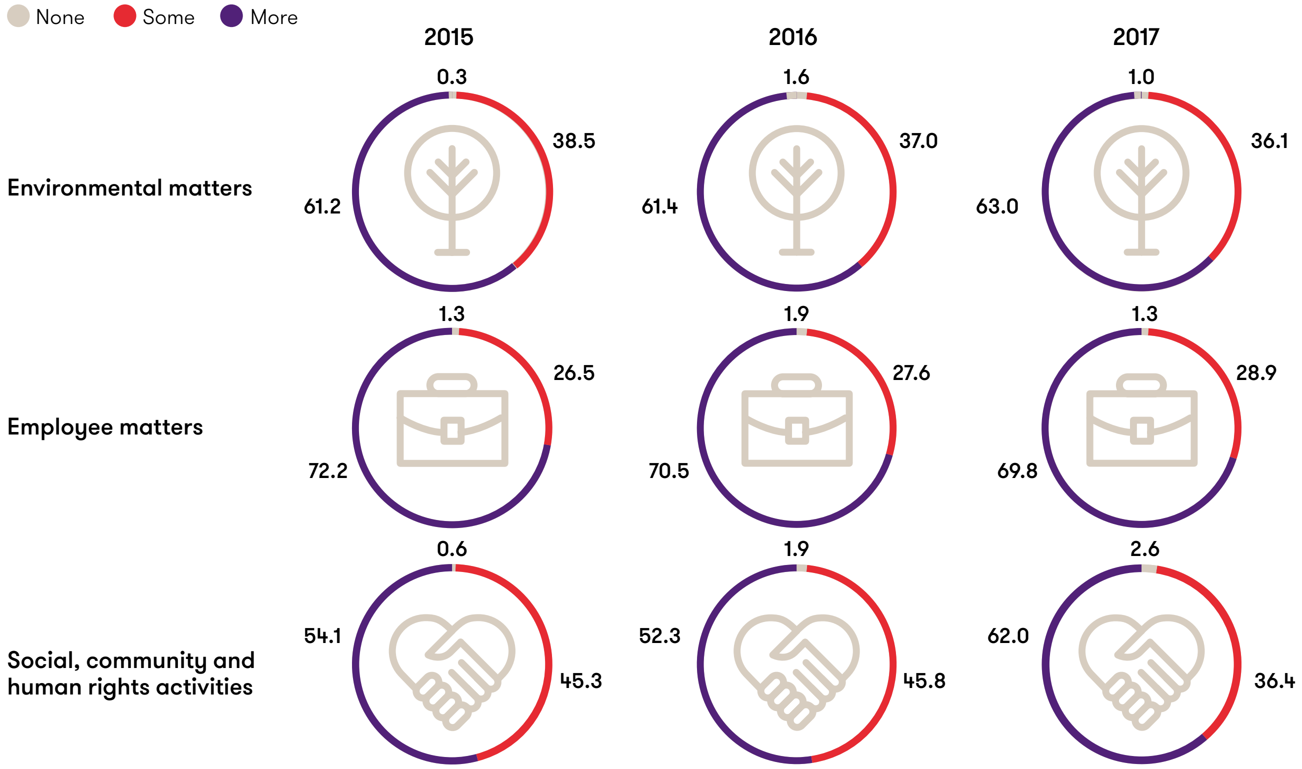
Does the company comply with the gender split reporting requirement? (%)

	Yes	No	Partly complies – percentage only	Partly complies – incomplete	Partly complies – disclosed elsewhere
2016	73.7	7.1	13.3	3.6	2.3
2017	69.5	5.6	18.7	4.6	1.6

Over the past two years, more companies have correctly reported greenhouse gas emissions, with 91% doing so in 2017 (2016: 91%; 2015: 85%). However, there has been little improvement in the content or quality of disclosures around environmental and employee issues in recent years.

In contrast, after several years of little change, 2017 saw an almost 10 per cent improvement in the reporting of social, community and human rights activities. This may be linked to some early adoption of the requirements of the EU non-financial reporting directive[16], which applies to financial years beginning on or after 1 January 2017. Most existing regulatory requirements in the UK are in line with those proposed by the directive. For the first time in the UK, public interest entities are now required to disclose policies, risks and outcomes around anti-bribery and corruption.

To what extent does the company explain environmental matters, employee matters and social, community and human rights activities? (%)



[16] Directive/2014/95/EU, EU, October 2014 (http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN), implemented into UK law as the 'The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016'.

Culture

Reporting on culture

"One of the key roles for the board includes establishing the culture, values and ethics of the company … This will help prevent misconduct, unethical practices and support the delivery of long-term success."

(UK Corporate Governance Code, Preface, paragraph 4)

In July 2016, the FRC launched Corporate Culture and the Role of Boards[17], the observations report of its consultation on organisational culture and behaviour. This report will help inform the anticipated review of the Guidance on Board Effectiveness in 2018, and the review of the Code this year. Last year our review noted only small increases in the focus on culture in annual reports and highlighted significant weaknesses, such as only 21% of CEOs referring to culture in any meaningful way.

2017 is the first year we would expect to see the effects of the FRC's culture push and there are, indeed, significant improvements in culture-related reporting, particularly in the chair's and CEO's statements. Thirty-nine per cent of FTSE 350 companies now provide good or detailed disclosures, up from 20% in 2016. Sixty-five per cent communicate their values, up from 52%, with only 6% making no reference to culture. There is still a disparity between the FTSE 250 and FTSE 100 – nearly half of the latter now provide good insight into their culture and values, compared with 34% in the FTSE 250.

The best examples of culture reporting have clear messaging throughout the report about company values and purpose, and clarity over how the board gets assurance on organisational culture. More information can be found in our reporting toolkits, available on pages 25 and 32 and online at **grantthornton.co.uk/governancematters**.

Does the annual report address culture and values? (%)

FTSE 350	None	Basic	General	Good	Detailed
2017	5.6	26.9	28.9	34.4	4.3
2016	13.6	34.7	31.8	16.9	2.9
2015	26.3	28.2	26.3	16.3	2.9

FTSE 100	None	Basic	General	Good	Detailed
2017	4.0	21.2	25.3	45.5	4.0
2016	4.0	30.0	37.0	27.0	2.0
2015	15.0	28.0	32.0	23.0	2.0

FTSE 250	None	Basic	General	Good	Detailed
2017	6.3	29.6	30.6	29.1	4.4
2016	18.3	37.0	29.3	12.0	3.4
2015	31.6	28.3	23.6	13.2	3.3

[17] Corporate Culture and the Role of Boards, FRC, July 2016 (www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Corporate-Culture-and-the-Role-of-Boards-Report-o.pdf).

Tone from the top

"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."

(UK Corporate Governance Code, Preface, paragraph 4)

It is well understood that an organisation's culture is set from the top, with the board responsible for both setting and monitoring the company tone. This year, 56% of FTSE 350 chairs (2016: 39%; 2015: 22%), discuss culture and values in their annual report, either in their primary statement or in their introduction to the governance report. The biggest increase is in the latter, with 28% of chairs now mentioning culture in their governance report introduction, up from 17% in 2016 and 10% in 2015. However, this improvement should not overshadow the finding that 43.6% of company chairs still make no reference to culture.

The number of FTSE 350 CEOs who discuss culture in their opening review has also increased – up from 21% in 2016 to 29%. While an essential part of good corporate governance is the role played by the chair and non-executive directors, the CEO is arguably the individual most responsible for setting a company's culture and values. This increase is therefore encouraging as a direction of travel but disappointing given the FRC's recent recognition of the CEO as the primary setter of culture.

"A view that came through consistently in our engagement was that the chief executive has the most influence over the culture of the business."

FRC, Culture Report: Corporate Culture and the Role of Boards

Does the chair discuss the culture and values of the company? (%)

FTSE 350	No	Yes – in chair's introduction to the annual report (primary statement)	Yes – in chair's introduction to the corporate governance report	Yes – in both
2015	77.9	11.9	9.6	0.6
2016	61.4	12.7	16.9	9.1
2017	43.6	14.1	27.9	14.4

What metrics are used by the organisation to measure and monitor culture, as outlined in the annual report?

	Percentage of companies with culture-related metrics (N=144)	Percentage of total FTSE 350 (N=305)
Employee survey or engagement	53.5	25.2
Health and safety	32.6	15.4
Employee matters[18]	18.2	8.9
Other	16.0	7.5
Customer satisfaction	8.3	3.9
Employee training	6.9	3.3
Diversity	5.6	2.6
Third party award	2.1	1.0
CSR	2.1	1.0
Culture audit	1.4	0.7

[18] This includes promotion, recruitment, retention, turnover, absenteeism and/or churn rates

Measuring culture

It is notoriously difficult to measure an organisation's culture. Yet it is important for directors – particularly non-executives – to be able to measure company culture, in order to monitor and if necessary challenge management's assertions[19]. This year we looked at how companies report on measuring their culture and what metrics they typically use. Fifty-three per cent of companies made some attempt to disclose how they measure and monitor this particularly 'slippery' subject.

The most common metrics used to measure culture relate to employees, and health and safety. Just over a quarter (25.2%) of the FTSE 350 discuss their employee survey or employee engagement as a way of examining their culture. Of those companies that outline how they address culture, 33% discuss health and safety and 18% examine employee matters such as recruitment, retention, turnover or promotions. When it comes to looking for other sources of confirmation, for example customer satisfaction, the percentage falls away dramatically. The very best seem to use a basket of measures, recognising that there is no absolute target but looking for trends that indicate improvement or consistency over time.

This is borne out in global research where Grant Thornton International[20] found that the most common way for boards to monitor culture is through internal audit assessments, with many using a number of metrics to measure ongoing change rather than over-interpreting a single metric at a set point. In this context, it is surprising that only two FTSE 350 companies discuss using culture audits as a means of tracking and monitoring culture at various levels within their organisations, in their annual report.

Investor viewpoint

Corporate culture has become a critical issue in the dialogue between shareholders and companies, but it is also a new challenge on an already crowded agenda.

Culture is important because it guides the behaviour of all those who work for companies and provides purpose and values to organisations. It can also act to mitigate the risk of inappropriate behaviours.

We will be increasing the focus of our discussions with boards on how they shape, embed and oversee culture in their organisations and will hold directors accountable if we have material concerns regarding conduct of business or of employees. Culture is not static or monolithic. It can vary across a company or weaken over time.

From our perspective, it is not sufficient to look simply at what the company says about its values. It is also necessary to enquire how effectively these are promulgated through the organisation. A big risk lies where there is a disconnect, especially one of which the board is unaware. Another is silos, where a bad culture can thrive in an otherwise strong organisation.

[19] Beyond Compliance: the Building Blocks of Culture, Grant Thornton International Corporate Governance Report, 2017. Corporate Culture and the Role of Boards: Report of Observations, FRC, July 2016.

[20] Beyond compliance: the building blocks of corporate culture, Grant Thornton International (http://www.grantthornton.co.uk/insights/building-blocks-of-corporate-culture/)

Toolkit for culture reporting

Elements/content	Things to consider	Reporting tips
Setting the tone from the top	The board and management are responsible for setting the 'tone from the top'. This means understanding and articulating the desired culture of the organisation and beholding to it in their own working practices and interactions with the company Behaviours that the company encourages should be consistent with the company's strategy, business model and 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. The chief executive has most influence over culture throughout an organisation Focus on culture should be continuous, not just in times of crisis.	Chairs should discuss the organisation's culture both in their opening statement to the annual report and their introduction to the governance report 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 annual report Show how your values align with your organisation's purpose and strategic objectives
Embedding	Think how you are embedding culture and behaviours at every level of an organisation: • recruitment process 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.	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 Discuss how company and board culture is included in recruitment and reward, and connect it within the nominations, audit and remuneration committee reporting Culture should be referred to in risk management disclosures, and reference to internal controls Show how culture and behaviours are embedded via training and other activities, such as culture change programmes Ensure that culture and values are consistent within the CSR section, and connectivity is shown between this section and the rest of the report
Monitoring	The board has also a responsibility to evaluate culture and challenge the executives. Boards should give careful thought to how culture is assessed and reported on Assessing culture means using a wider range of potential indicators, choosing ones that are appropriate to the business and interpreting information sensitively Devote sufficient time and resources to evaluating and monitoring culture, to assure that: • 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. Measuring culture is notoriously tricky, but consider gathering quantitative and qualitative information from different sources, rather than relying on one measure and tracking results over time	Explain how the board seeks to assure itself that behaviours at different levels are in line with the culture Show how culture is considered when assessing the effectiveness of risk management and internal control systems 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

More reporting toolkits available at **grantthornton.co.uk/governancematters**

Governance

FAST FACTS

- 66% of companies declare full compliance with the Code – a new high
- 95% comply with all but one or two of the 55 provisions
- The most widespread non-compliance relates to board composition
- Almost all companies discuss their board gender diversity policies but 13% do not cover other forms of diversity
- Despite FRC emphasis on shareholder relations, only 33% provide good or detailed explanations of how they work to understand investors
- 45% of companies have directors with expertise in technology/IT, up from 39%, as boards respond to technological disruption and cyber risk
- 39% of companies had an externally-facilitated board evaluation, 60% of all evaluations are being conducted by just four firms

Increasing numbers declare full compliance

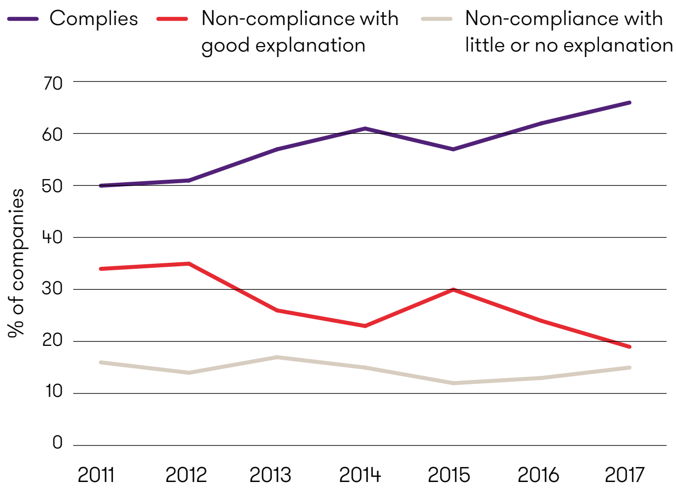
"The Code is not a rigid set of rules ... It is recognised that an alternative to following a provision may be justified in particular circumstances if good governance can be achieved by other means."

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

The strength of the UK Corporate Governance Code lies in the 'comply or explain' principle; this gives companies the flexibility to not meet provisions if they can explain why non-compliance is in the better interests of the company and its stakeholders. In the 16 years we have been reviewing corporate governance there has been a general trend towards compliance. That trend continues this year, with the number of companies declaring full compliance reaching a new high of 66%. Ninety-five percent (2016: 90%) comply with all but one or two of the 55 provisions of the Code.

Since last year, 36 companies have moved from non-compliance to compliance. This mainly relates to provision C.3.7, which requires boards to put their external audit contract out to tender at least every 10 years. This provision is not included in the 2016 version of the Code as it has become law, and is therefore not covered by the comply or explain principle.

Declared compliance with the UK Corporate Governance Code



The FTSE 100 tends to have a higher proportion of companies declaring full compliance; in 2017, 78% of the FTSE 100 comply, compared with 61% of the FTSE 250. There has been a significant increase in FTSE 100 compliance this year, but this is largely due to companies moving in and out of the index rather than a change in their compliance status.

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

	2014	2015	2016	2017
FTSE 350	60.6	57.1	62.0	66.2
FTSE 100	74.0	64.0	72.0	77.8
FTSE 250	54.1	53.8	57.2	60.7

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)

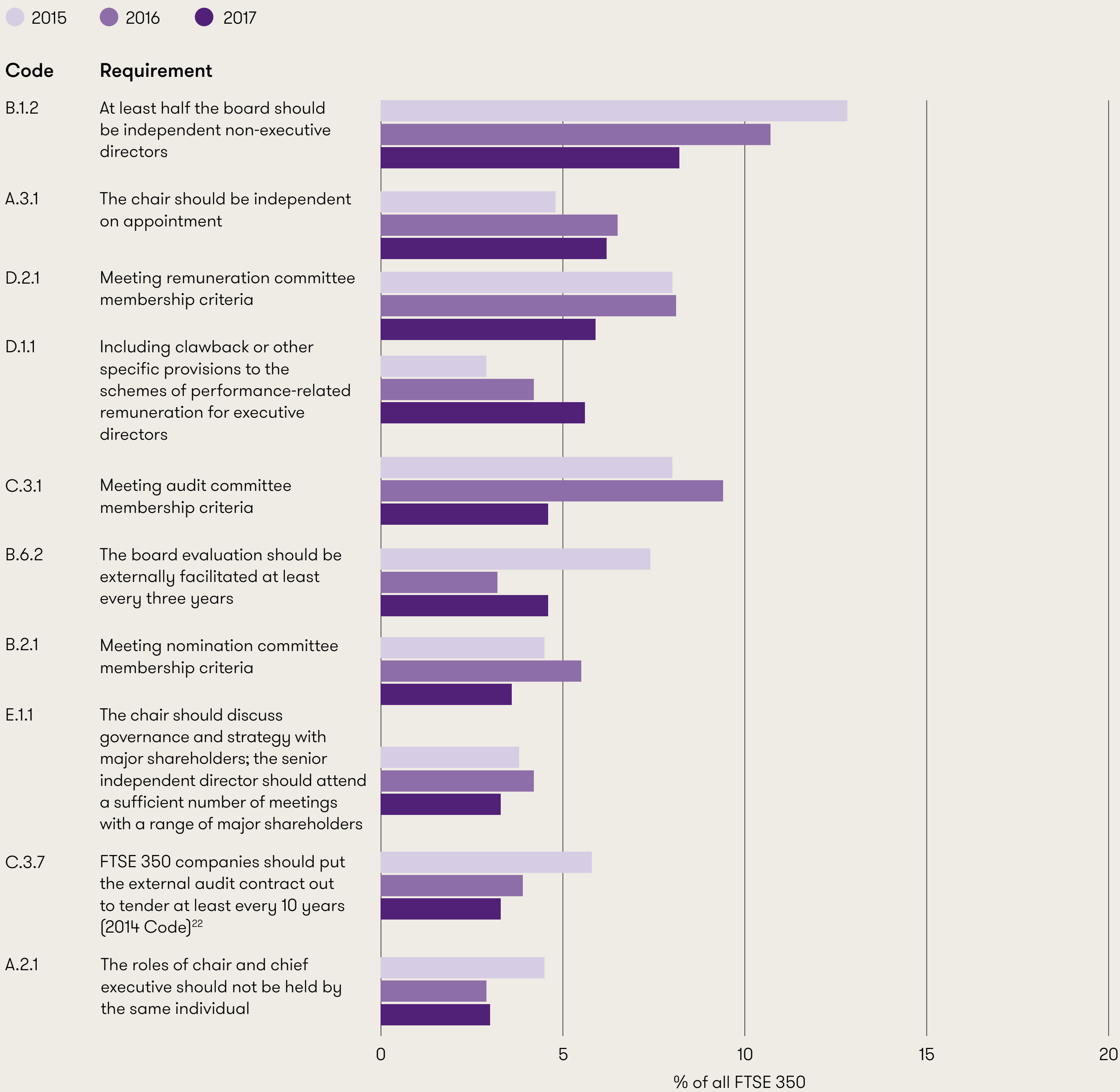
The most widespread non-compliance relates to directors' independence. Twenty-five companies declare non-compliance with provision B.1.2, which requires that at least half of a board is made up of independent non-executive directors. Non-compliance with provision A.3.1, requiring the chair to be independent on appointment, remains the second highest area of non-compliance with 19 companies. Non-compliance is also relatively high around remuneration, with an increasing number of companies declaring non-compliance with D.2.1, which relates to remuneration committee membership criteria, and D.1.1, which covers clawbacks and holding periods of shares after vesting or exercise.

The comply or explain principle remains one of the cornerstones of UK corporate governance, as it allows companies the flexibility to abide only by Code provisions that suit them, provided they explain to stakeholders why this is appropriate. However, our research shows that many companies do not meet certain provisions in the Code, yet fail to declare non-compliance.

Fourteen per cent of companies, for instance, do not state that their non-executive directors (and senior independent director) meet without the chair at least annually to evaluate the chair's appointment, as outlined in provisions A.4.2 and B.6.3. Similarly, of the 212 companies that appointed a new director in the year, 27% either did not use a search firm or do not state which one they used (B.2.4), making them non-compliant with provision B.2.4[21]. Moreover, while the Code requires that the chair should meet with shareholders to discuss governance and strategy and that this should be recorded in the annual report, 22% of companies do not state this explicitly.

[21] Companies could also be compliant with this provision if they chose to use public advertising for their new appointments. While we do not capture this data in this research, other research has highlighted that no company in the FTSE 350 uses public advertising for their appointments. See for example the Equality and Human Rights Commission report 'Inquiry into fairness, transparency and diversity in FTSE 350 board appointments' (https://www.equalityhumanrights.com/en/publication-download/inquiry-fairness-transparency-and-diversity-ftse-350-board-appointments).

Areas they list as non-compliant



[22] These companies were reporting against the 2014 version of the Code, wherein provision C.3.7 refers to the requirement that the external audit contract be put out to tender at least every 10 years. This is the last year that this provision was included in the Code. From 2016 onwards, this became a legal mandate due to the EU directive. See details about this directive on page 57.

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)

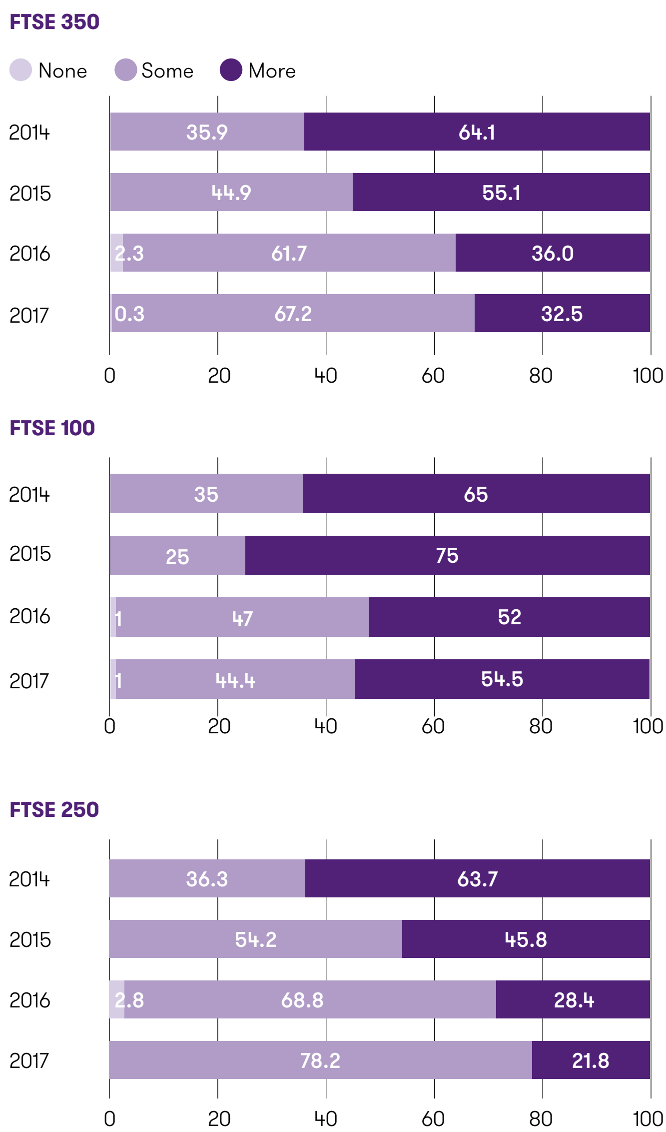
Relations with shareholders has been a key focus for the FRC for several years, most significantly with its revision of the UK Stewardship Code and the tiering of investment managers in respect of their application of this code. To improve the quality of reporting against the Stewardship Code and encourage greater transparency, in 2016 the FRC assessed signatories based on the quality of their Stewardship Code statements. This has led to an improvement in signatories’ statements, and will inform a review of the Stewardship Code in 2018.

Despite this, increasing emphasis on shareholder engagement progress appears patchy. For the sixth year, the number of companies providing good or detailed disclosures on how they engage with shareholders has reduced, most significantly in the FTSE 250. Perhaps this reflects the oft-claimed difficulty of getting investors to engage with any but the largest of companies.

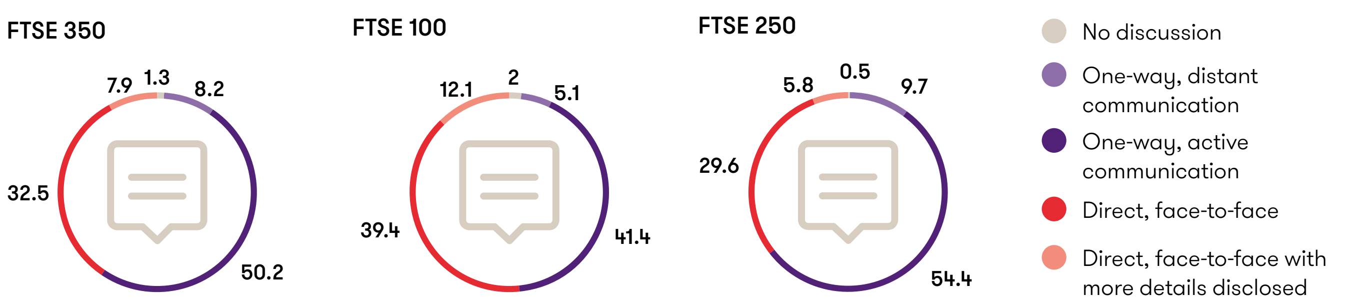
In recent years, all companies have provided some insight into the steps taken to understand shareholders’ views but in 2017 only 33% of the FTSE 350 provide good or detailed explanations (2016: 36%; 2015: 55%), while 67% give generalised disclosures with no mention of the specific issues discussed.

Careful analysis of the forms of engagement used does reveal some improvements. For example, 40% of companies provide specific information about direct, face-to-face communication between shareholders and directors (2016: 33%).

To what degree does the board demonstrate the steps taken to understand the views of major shareholders? (%)



What methods do boards use to understand the views of major shareholders? (%)



Who attends meetings with major shareholders? (%)

FTSE 350

	Yes	No	Available
Chair	52.5	21.6	25.9
SID	16.1	19.7	64.3
NEDs	17.4	45.2	37.9
Chair of remuneration committee	12.5	NA	NA

The percentage of companies that give no information about how the board acts to understand the views of major shareholders has dropped to a nominal level; just 1% give no detail (2016: 9%), and only 8% describe a form of broadcast style (one-way) communication, such as the annual report, as their primary method of communication (2016: 17%). Just over half of companies refer only to active communication, such as the annual general meeting, as the primary method of communication with shareholders, and discuss no other kinds of dialogue or meetings. Just over a third refer to direct, face-to-face meetings between members of the board and major shareholders; however only 8% give more details about what is discussed.

As with shareholder engagement reporting overall, we see a difference between FTSE 100 and FTSE 250. While just over half of the FTSE 100 discuss face-to-face meetings with investors, this drops to 36% for the FTSE 250. This may suggest that investors focus more on meeting with larger companies, and FTSE 250 companies face more of a challenge in increasing their investor relations and engagement.

The percentage of companies stating that their NEDs met with major shareholders increased slightly, from 13% last year to 17%, while 16% say their SIDs met with major shareholders. When NEDs did meet shareholders it was most commonly the remuneration committee chair. However, surprisingly – given the focus on the accountability of this individual – only 12.5% of the FTSE 350 report that the chair, or other members of the remuneration committee, had shareholder meetings. Furthermore, most companies either do not state that their non-executives are available to meet shareholders (45%) or say they are available but did not meet (38%).

While the principles of good governance and engagement also apply to debtholders, historically this area is rarely reported across the FTSE 350. However, there is an increase this year with nearly 10% of companies discussing debtholder engagement, up from just over 3% in 2016.

Investor viewpoint

The biggest gap we see is the belief that reporting equals investor relations. Reporting and disclosure is a foundation activity upon which to build.

We see great benefits when the company secretarial team is well connected to the investor relations team, not just around proxy voting/AGM season. This isn't always the case. Investors communicate on governance matters with both the board and management and may use multiple channels into the business to make their views clear. If Investor Relations and the company secretary aren't talking the business is missing a vital piece of the institutional investor picture.

Increasingly governance engagement and research is on the full spectrum of ESG topics, from human rights to climate change not just governance and remuneration. The company secretary and Investor Relations should ideally connect the dots to ensure they have the whole picture of their investor base. Investors should also reciprocate by explaining how such information feeds into their capital allocation and house view back to their investee companies.

Employee engagement

"The Government intends to: Invite the FRC to consult on the development of a new Code principle establishing the importance of strengthening the voice of employees and other non-shareholder interests at board level as an important component of running a sustainable business."

Corporate Governance Reform response, August 2017[23]

In light of the Corporate Governance Reform green paper response and potential changes to the Code and legislation, this year we assessed how many companies discuss employee engagement. According to the annual reports, only one FTSE 350 company has an employee representative on the board, another has a non-executive director with responsibility for engaging with employees, and two further companies have employee representatives that attend some board meetings.

Seventy-seven FTSE 350 companies mention employee surveys in their annual report, with many doing so in the context of how they measure or address their organisational culture, as discussed on page 21. Twelve companies state that they engage with employees, but do not explain how. A further 12 say that directors met employees to gain feedback, but without detailing what this entailed, and only eight give more detail and describe 'town hall' type meetings with directors and employees.

[23] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/640631/corporate-governance-reform-government-response.pdf

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: • how is information communicated? • how is participation 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 –the annual report, other reports, formal presentations, AGM, conferences, surveys of shareholders' opinion, 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. The senior independent director should meet a sufficient range of major shareholders in order to develop a balanced understanding of their issues and concerns and other non-executive directors should be available for meetings Ensure committee chairs engage on important issues related to their areas of responsibility	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	Assess feedback from shareholders regarding specific issues, including how this is garnered and utilised Consider your company's compliance with the Code and if any deviations from the Code were discussed with shareholders	Report on 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 Include specific reference to any significant votes against a resolution at a general meeting and follow up consultations/feedback outcomes

More reporting toolkits available at **grantthornton.co.uk/governancematters**

Directors' 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 ratio of companies providing detail around their directors' skills and experience fell this year, with nearly three quarters of the FTSE 350 providing only general information. In contrast, the leading companies in this area explain how individuals contribute to the value of the board through their range of skills and experience and how the board as a whole creates value for the organisation.

How much information is provided about board members' skills and experience? (%)

	None	Some	More
FTSE 350			
2016	1.6	62.7	35.7
2017	0.7	72.1	27.2
FTSE 100			
2016	2.0	55.0	43.0
2017	1.0	62.6	36.4
FTSE 250			
2016	1.4	66.4	32.2
2017	0.5	76.7	22.8

How many companies disclose having board members with experience in the following areas? (%)

The professional background of board members changed little during the year. Ninety-nine per cent of companies state they have a director with an accounting or finance background – the remaining 1% do not disclose information about their directors. Seventy-nine per cent of FTSE 350 boards have members from the banking, private equity or venture capital industries.

In one notable change, 45% of FTSE 350 companies now have directors with expertise in technology/IT, up from 39% last year. This suggests that boards are now putting a much-needed emphasis on technological disruption and cyber risk, as also reflected by the rise in disclosure of technology risks as discussed on page 16. As the average number of directors on main boards has remained fairly constant (8.2 this year, compared with 8.3 in 2016), this gradual shift of expertise appears to be taking place at the expense of those from marketing and PR. It may be that these skills are being reserved for executive boards.

Independence

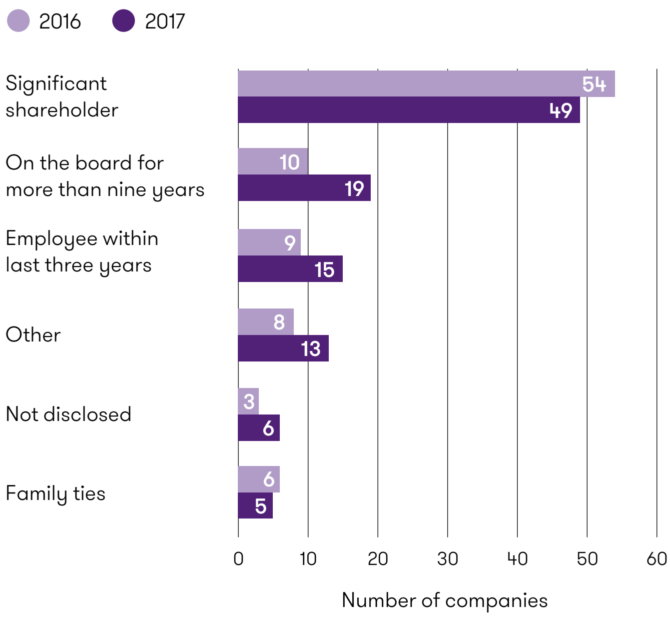
"The board should determine whether the director is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment."

(UK Corporate Governance Code, B.1.1)

Twelve FTSE 350 companies have an executive chair (2016: 15; 2015: 27), and five have a combined chief executive and chair, (2016: 5; 2015: 10). Only three companies with a joint chief executive and chair describe this as a temporary measure, with most choosing instead not to comply with best practice.

Although the non-executive director role is most commonly valued for its independence, this year, 84 (2016: 78) companies state that they have non-independent, non-executive directors. The most common reason for this, given by 49 (2016: 54) companies, is that the individual is representative of a significant shareholder. Six companies do not explain why their stated non-independent director is not independent.

Why are NEDs not considered independent?



This year, 47 (2016: 38; 2015: 51) companies have board members they consider as independent non-executive directors, despite these individuals failing to meet the criteria outlined in B.1.1 of the Code. Of these, 36 companies (2016: 31; 2015: 44) have directors who have been on the board for more than nine years, with the remaining companies having directors that represent significant shareholders.

Five per cent do not provide any explanation, while 11% give good or detailed insight as to why they consider the director to be independent.

The best examples explain, for instance:

- why the director's skills and experience are important to the board
- why the director is believed to be independent in their judgment
- how the board has mitigated any potential risk of their lack of independence.

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)

While board evaluation is a key aspect of board effectiveness, both internally and externally facilitated – this is an area of reporting that has not changed a great deal in terms of disclosures. Some 41% of companies provide good or detailed explanations of how their board, committees and directors are formally evaluated annually. Only 27 companies (8.9%) in the FTSE 350 are outlining in detail the evaluation process, giving insight into how the evaluation is conducted, what criteria are used and indicating the main findings or outcomes. The FTSE 100 are continuing to lead the way in this area: over half provide greater detail on their evaluation process, compared to 36% of the FTSE 250.

How much explanation is there of how the board, committees and individual directors are annually formally evaluated for their performance? (%)

	None	Some	More
FTSE 350	1.6	57.7	40.7
Externally facilitated review	0.8	49.6	49.6
Internally facilitated review	2.2	63.3	34.4

The quality of explanations around the outputs and actions arising from the board evaluation have increased this year, with nearly half (47%) of the FTSE 350 providing oversight around their intentions to improve board effectiveness as a result of their evaluation (2016: 37%). Best practice in this area includes those who explain both the key strengths and issues identified in the evaluation, indicate planned actions, and provide a timescale or plan for implementing changes.

To what extent are the outputs and actions arising from the board evaluation disclosed? (%)

	None	Some	More
FTSE 350	8	46.6	46.9
Externally facilitated review	1.6	24.8	60.0
Internally facilitated review	10.0	52.2	37.8

We also find that companies who have conducted an externally facilitated board evaluation are more likely to provide good detail around their evaluation process and outcomes. This is most marked in relation to outcomes: of those companies who conducted an externally facilitated review in the year, 60% provided good or detailed accounts of the steps they would be taking as a result, and setting a timeline for meeting these steps, compared with less than 38% in those conducting an internally facilitated review. This may suggest that companies are only taking the review process truly seriously when it is undertaken by an independent facilitator and are less likely to demonstrate how they are improving year on year. Given the majority of external reviews are restricted to a very small number of facilitators, this highlights the crucial role these board evaluators may be playing for board effectiveness.

While the board evaluation is typically driven by the Chair, the non-executives and senior independent director meeting annually to review the Chair's performance is also an important part of board effectiveness, as outlined in provisions A.4.2 and B.6.3. This year 42 companies (14%) did not report that this occurred. Given that this is a requirement of the code, these companies could be regarded as non-compliant, even though they fail to declare this as such.

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)

The number of FTSE 350 companies conducting an externally-facilitated board evaluation increased this year, with 39% choosing to do so, up from 36% last year. This increase includes 16 companies that went beyond the Code requirements for an externally facilitated evaluation every three years, and conducted reviews in 2016 and 2017 with a different evaluator.

Fourteen per cent of companies declare non-compliance in completing a triennial board evaluation. The most common reason being that the company or board was going through significant change, such as hiring a new chair, which would have made an evaluation inappropriate. However, a few companies simply did not undertake one.

The external evaluations were led by 34 independent evaluators, with 60% conducted by just four firms – a common theme of the past three years. This year the market narrowed even further, with 50% completed by the top three firms, and 39% of all reviews undertaken by just two.

The majority of the remaining evaluators typically work with one or two companies.

Nomination committee

FAST FACTS

- 53% of companies still provide only basic or general descriptions of the nomination committee's work
- The ratio of women on FTSE boards has stalled at 26%. 38 businesses have less than 25% female representation, including two with under 10% and one with none
- However, 23 companies have more than 33% women on the board, with four having over 40%
- Only 14% of the FTSE 350 provide good or detailed descriptions of succession planning
- Six search firms conduct the majority of board searches across the FTSE 350, with one business accounting for 24%
- Gender diversity policy reporting has fallen, with more focus on wider kinds of diversity, particularly skills and experience
- Only 14% of nomination reports give good or detailed personalised introductions from the nomination committee chair, much lower than for audit and remuneration and remuneration committee chairs

A gradual rise in prominence

"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)

Nomination committees are becoming more active. Although they still meet less than the audit and remuneration committees, the number of their meetings has increased from 3.3 in 2016 to 3.5.

That said, there is little movement in the quality of disclosures. Forty-six per cent of companies in the FTSE 350 (2016: 44%) provide good or detailed descriptions of the nomination committee's work, with 53% still providing basic or general descriptions – outlining the committee's responsibilities but saying little about specific activities, the appointment process for new directors or their succession plans.

The length of the nomination committee report is also shorter than those for audit and remuneration with the average being 1.9 pages. The chairs' introductions are also much weaker. While 66% of nomination committee chairs provide a personal introduction (2016: 60%), only 14% give good or detailed personalised introductions. This compares to 69% for audit committee chairs and 87% for remuneration committee chairs.

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)

Eighty-six percent of companies give only basic or general – and in some cases no – descriptions of succession planning; often just mentioning it as one of the nominations committee's responsibilities. Only 14% provide good or detailed disclosures – the same as last year. The one encouraging trend is a move from basic disclosure to general: last year 33% of companies provided general disclosures while this year 46% do. As few organisations provide the extra detail on succession planning, it may be that more companies are recognising their responsibility for succession planning but are not yet doing much about it and not feeling comfortable about making further disclosure. Overall, the role of the nomination committee is getting more attention than in previous years, but there is still much further to go to put these issues to the top of the agenda.

To what extent do companies describe their succession planning? (%)

FTSE 350	None	Basic	General	Good	Detailed
2017	2.6	36.7	46.2	12.8	1.6
2016	6.5	45.1	33.1	13.7	1.6

FTSE 100	None	Basic	General	Good	Detailed
2017	2.0	34.3	45.5	15.2	3.0
2016	3.0	44.0	29.0	20.0	4.0

FTSE 250	None	Basic	General	Good	Detailed
2017	2.9	37.9	46.6	11.7	0.9
2016	8.2	45.6	35.1	10.6	0.5

Search firm naming improves

"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)

Just under half of FTSE 350 companies appointed at least one new director this year, with 11% appointing a new chair of the board. The proportion naming their search firm increased: while in 2016 less than half of those companies that appointed a new director named the headhunter, as the Code recommends, this year 70% do.

The FTSE 350 used 24 search companies in 2017 but, as has been the case for some time, there was a preference for a small handful of firms. Two-thirds (67%) employed one of six firms, and 80% used one of eight. One firm conducted nearly a quarter of all searches; a possible constraint on company aspirations to access truly diverse sources of skill and expertise.

Little progress to gender diversity

"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 boards has stalled. In the FTSE 100 overall, 26% of board roles are filled by women but 38 of these companies have less than 25% female representation on their boards – below Lord Davies' target set in 2011, and well below the Hampton Alexander target of 33% by 2020[24]. This includes two FTSE 100 companies that have less than 10% of their board roles taken by women and one with only men. On a more positive note, the number of companies with more than 33% women on the board has increased to 23, with four businesses now having more than 40%.

As mentioned above, only 14% of companies provide detailed accounts of their succession planning; this includes those that discuss how their approach is geared to addressing the current gender imbalance. Given the lack of women in executive roles together with the post-Brexit need to look to new international markets, companies should be exploring more innovative ways to identify and nurture a wider diversity of candidates to meet the future needs of the business.

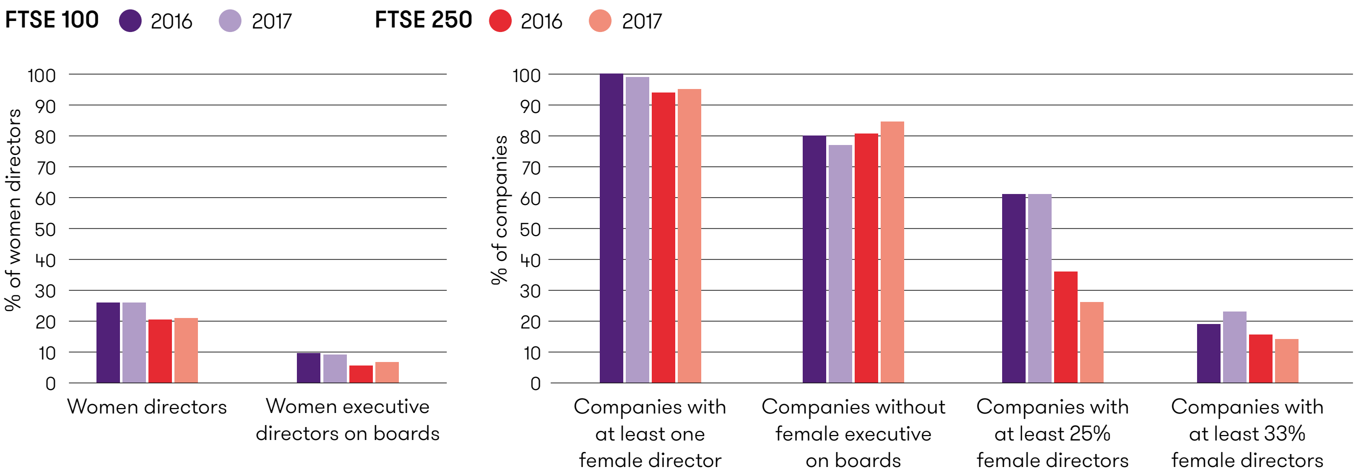
In the FTSE 250, the picture is similarly mixed. The percentage of companies with at least one woman has stayed at around 95%, but the proportion with more than 25% or 33% has declined; just over a quarter of FTSE 250 companies have 25% women on their boards, compared to more than a third last year.

To meet the targets set by Lord Davies in 2011, companies primarily appointed female non-executive directors – and this has been the area of greatest change. The picture in executive and chair roles has changed far less. Seventy-seven per cent of the FTSE 100 and 85% of the FTSE 250 still do not have a woman in an executive role on their board. In the FTSE 100, there are now 23 women in executive roles, down from 26: a concerning result.

In the FTSE 250, there is more positive change, where the number of female executives has increased from 29 to 34 this year, but this still represents less than 7% of all executives in the FTSE 250.

There are now 10 women chairs in the FTSE 350: four in FTSE 100 companies and six in the FTSE 250.

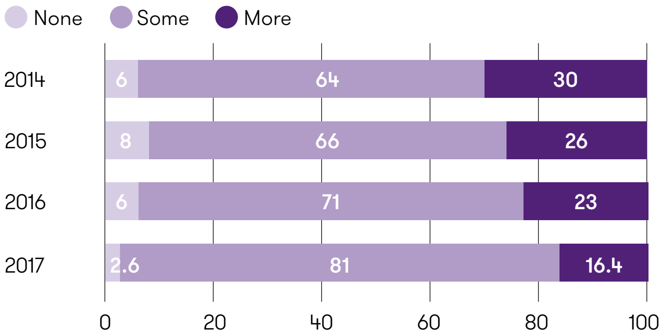
Representation of women on FTSE 350 boards



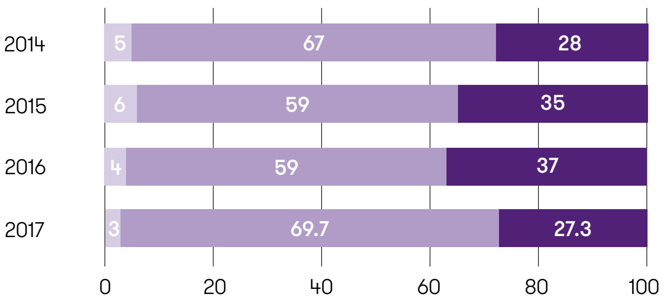
[24] Hampton-Alexander Review FTSE Women Leaders: Improving gender balance in FTSE Leadership, November 2016 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/613085/ftse-women-leaders-hampton-alexander-review.pdf).

How much explanation is there of the company's policy on gender diversity in the boardroom? (%)

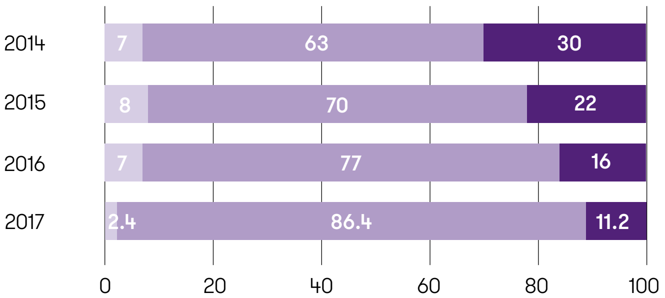
FTSE 350



FTSE 100



FTSE 250



The level of detailed reporting on board gender diversity policies dropped again this year, having peaked in 2014. Only 16% of companies provide good or detailed explanations as to their commitment to gender diversity. This may be due to the previous increase of women on boards. It could also represent 'gender fatigue', with companies less focused on gender diversity and not so pressured to appoint women since the Davies' review achieved its goal and published its final report[25]. Detailed analysis of those companies that provide only basic or generic descriptions of their gender diversity policy shows evidence of both. Of these 247 companies, 107 have more than 25% female board representation. This is perhaps an indication that the external pressure for such reporting has eased and this in turn has led to it being given less attention in the annual report. Certainly among the FTSE 250, the focus on gender policy in the annual report does appear to have diminished. This trend raises concerns about the likelihood of companies meeting the Hampton-Alexander target of 33% of women on boards by 2020[26]. Of particular concern are the 140 companies that have less than 25% female board representation and poor disclosure in this area, and are thus showing minimal commitment to addressing their board imbalance.

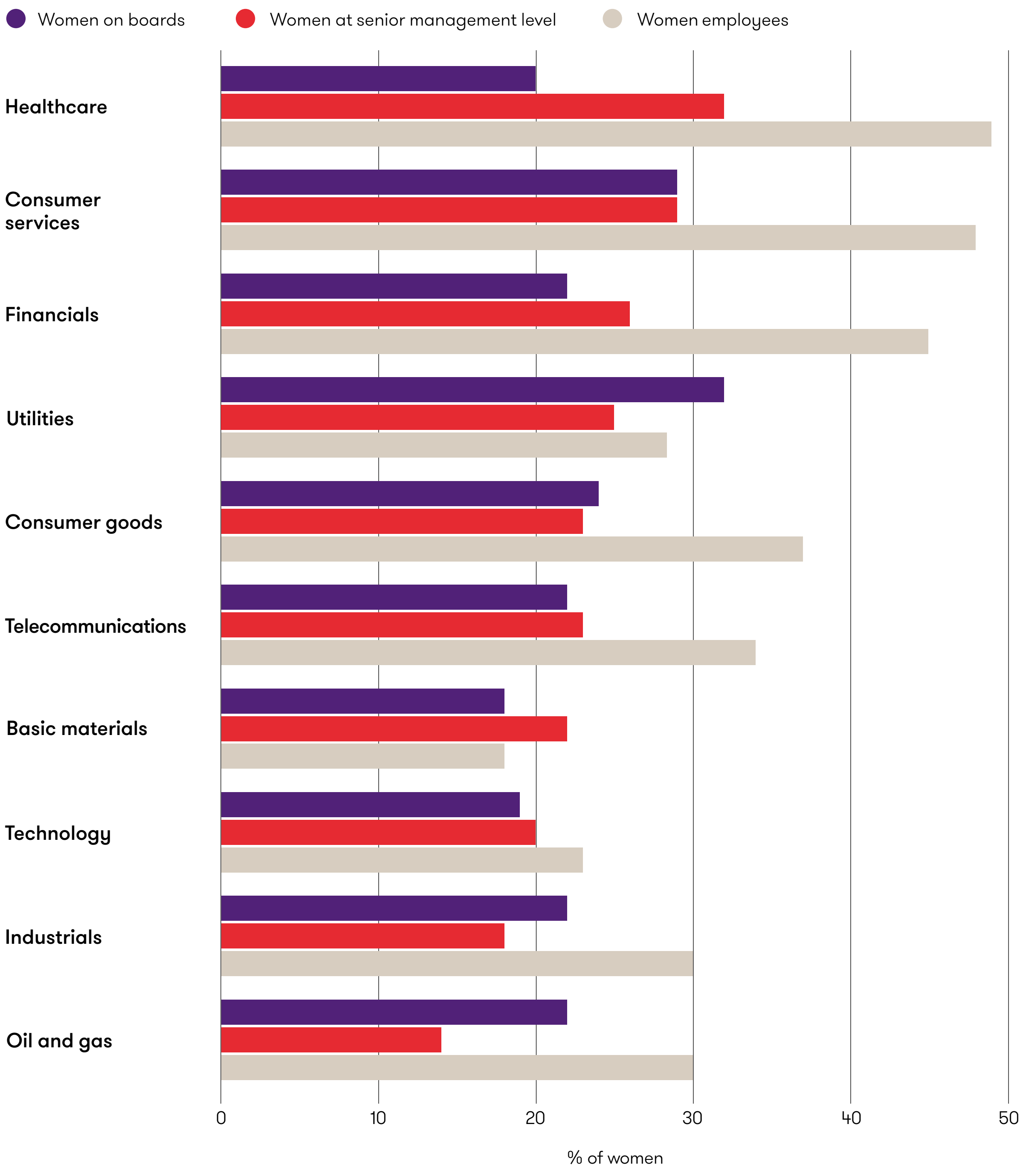
This apparent lack of focus on gender reporting this year is in contradiction to the increasing regulatory requirements being introduced by the gender pay gap legislation. Looking at the FTSE 350 overall, companies have on average 25% women and 75% men at senior management level, and 38% women and 62% men in their overall workforce (see more on page 39).

There are some industry differences. Perhaps unsurprisingly, Healthcare, Consumer Services and Financials fare the best for gender diversity, with a higher proportion of women at senior manager and employee level. Technology, Industrials and Oil & Gas have the lowest proportion of women in their workforce, falling far below the average.

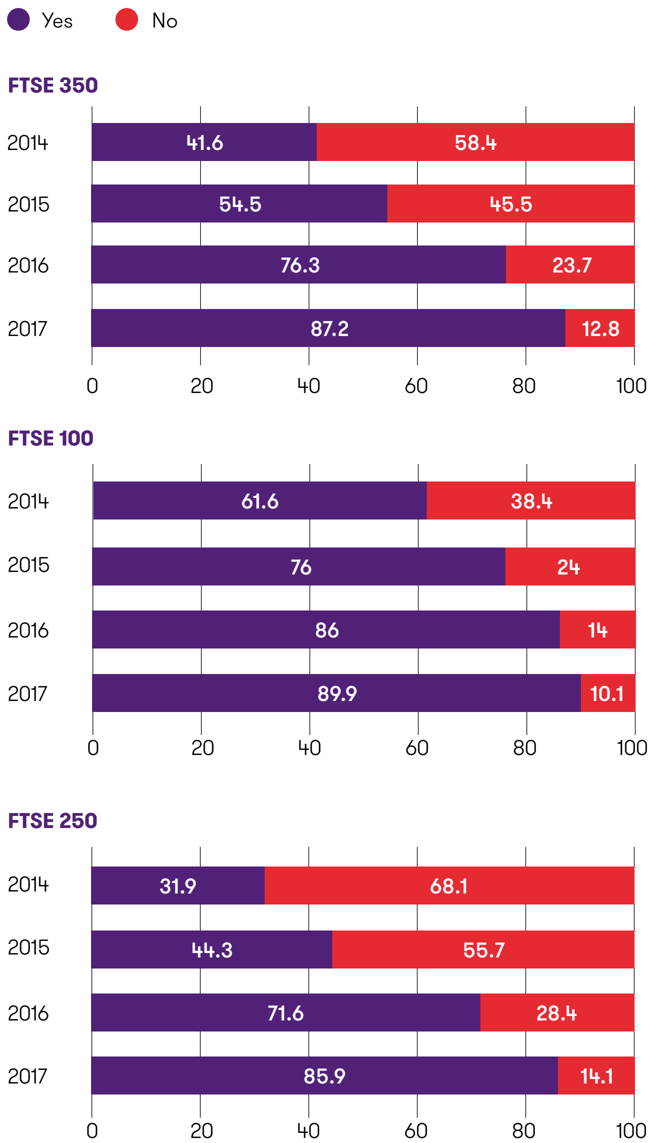
[25] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/482059/BIS-15-585-women-on-boards-davies-review-5-year-summary-october-2015.pdf?

[26] Improving Gender Balance in FTSE Leadership/Hampton-Alexander Review, Department for Business, Energy & Industrial Strategy, November 2016.

Gender split of employees, senior management and board (%)



Do they discuss other aspects of boardroom diversity? (%)



To what extent do they discuss other aspects of boardroom diversity? (%)

FTSE 350	None	Basic	General	Good	Detailed
2016	23.7	40.3	26.6	8.1	1.3
2017	12.8	59.3	24.6	3.3	0.0

What other kinds of diversity are mentioned? (%)

16.5	7.5	24.1
Nationality	Culture	Ethnicity
10.2	65	12
Race	Skills and experience	Age
7.1	22.6	21.4
Disability	Other	Not clear

The increasing focus on broader aspects of diversity (perhaps to the detriment of gender), such as ethnicity, race, nationality, cultural background, age, sexuality and religion – as well as breadth of skills and experience – increased again to 87% (2016: 76%; 2015: 56%). Perhaps a reflection of a practical rather than regulatory-driven need for wider diversity on boards in an increasingly connected, global marketplace. While we see an increase in the number of companies discussing wider diversity, there has been a drop in the quality of reporting. This is of concern if boards are to meet the target of 'Beyond One by '21' set by the Parker Review[27] in 2016, or embrace board diversity more widely.

This year we collected data on the kinds of diversity discussed in diversity policies. (The Code specifies only that boards should state what their policies are on diversity including gender, although the Guidance on Board Effectiveness[28] sheds more light on this area.) We found that by far the most common kind of diversity discussed is that of skills and experience, referred to by 65% of companies.

Investor viewpoint

Gender will remain high on our agenda both as a staple topic of our engagements and in collaboration with other investors under the guises of the Hampton-Alexander Review and the 30% Club Investor Steering Committee.

Given the regrettably slow progress in achieving the aim of women holding one-third of FTSE 350 board positions by 2020, investors not only strongly support, but also increasingly expect, companies to step up their efforts in this arena.

[27] A Report into the Ethnic Diversity of UK Boards, The Parker Review Committee (http://www.ey.com/Publication/vwLUAssets/A_Report_into_the_Ethnic_Diversity_of_UK_Boards/%24FILE/Beyond%20One%20by%2021%20PDF%20Report.pdf)

[28] Guidance on Board Effectiveness, FRC, March 2011.

Audit committee

FAST FACTS

- 80% of companies provide good or detailed risk management disclosures – the highest-ever
- But 35% keep internal controls disclosures scant, giving few useful insights
- Just 54% provide good/detailed disclosures on safeguarding auditor objectivity and independence, despite the EU's new audit regulations and directive
- 28 of the FTSE 350 remain non-compliant with the pending legal obligation to tender audit contracts every decade
- The average FTSE 100 audit fee is £6.7 million, up 7% from last year (£6.3m)
- The average non-audit fees are £1.2 million, down from £1.6 million
- 23% of the FTSE 350 had non-audit fees of more than 70% of their audit fees – the cap set by the EU

"The audit committee's workload continues to grow, with the introduction of secondary legislation to implement the EU audit regulations and directive."

New regulation boosts committee workload

"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 audit committee's workload continues to grow, with the introduction of secondary legislation to implement the EU audit regulations and directive. FTSE 350 companies are now required to put their audits out for tender at least every 10 years and to change auditor, at a minimum, every 20. There are also limits on the level of non-audit fees, which can be paid to the auditor, and a new category of prohibited services. This, together with the cooling off period, means companies need to revisit their existing pool of advisors if they are not to have their future choice of auditor heavily restricted. The regulation was effective for financial years beginning on or after 17 June 2016. Most companies in our research were not yet covered by this legislation, and there were few early adopters.

The average audit committee report is 4.8 pages long, up from 4.4, reflecting the increasing information requirements of the audit committee: with details now needed on auditor selection, principal risk considerations, and steps taken to ensure the annual statement is fair, balanced and understandable.

The individual accountability of the audit committee chair, as evidenced through the quality of personal introductions to the report, has improved slightly against last year. While 80% of chairs provide a personal introduction to the audit committee report (2016: 69%), only 36% (2016: 31%) provide good to detailed introductions.

Risk management and internal control

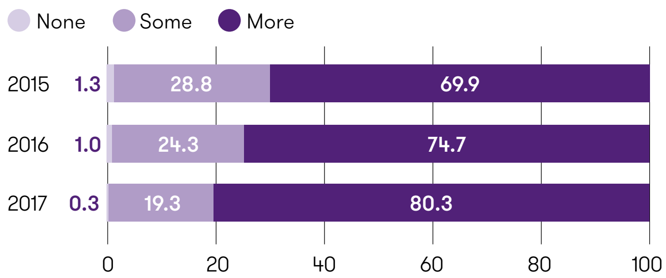
"The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance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

(UK Corporate Governance Code, C.2.3)

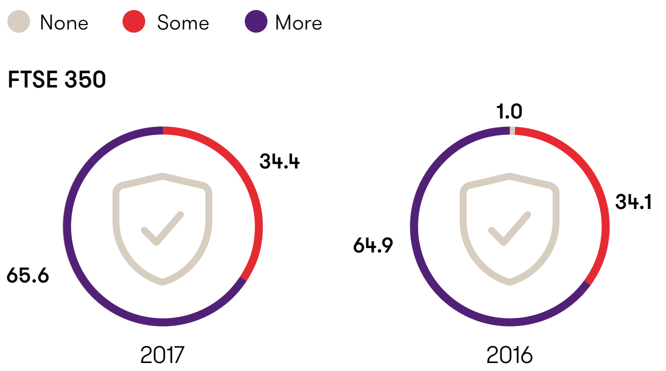
The risk management area continues to improve, with the proportion of companies providing good or detailed disclosures increasing to 80%, the highest-ever level. The FRC's explicit guidance on how risk management should be explained in annual reports came in in 2014, in the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting: it is encouraging to see how much this guide appears to have improved reporting quality. This contrasts with the relatively slow progress in other areas of reporting, such as the review of internal controls or the viability statement, where quality remains low.

While risk management reporting has improved strongly in recent years, coverage of internal controls remains weak. Thirty-four per cent of companies keep such disclosures to a bare minimum, giving few useful insights into internal control policies and systems, organisational structure and reporting lines. Following a number of well-publicised frauds and accounting failures in the past year arising, at least in part, from inadequate internal controls, investors may wish to start asking questions of management and audit committees where the information is less than comprehensive.

How much information is there surrounding the company's risk management process? (%)



How much information is there surrounding the company's internal control systems? (%)



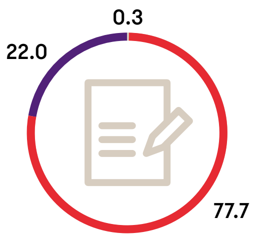
The board should summarise the process it has applied in reviewing the effectiveness of the system of risk management and internal control. The board should explain what actions have been or are being taken to remedy any significant failings or weaknesses.

(Guidance on Risk Management, Internal Control and Related Financial and Business Reporting[29])

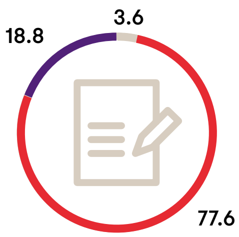
How much information is provided on the process the board have applied in reviewing the effectiveness of the internal control system? (%)

None Some More

FTSE 350



2017



2016

The review and monitoring of the effectiveness of internal controls has garnered much less attention than the recent addition to reporting requirements of the longer-term viability statement. Despite this, the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting states that boards need to explicitly state how they have monitored and reviewed the effectiveness of their internal control system throughout the year. This has been slow to materialise; while most companies provide information on their internal controls, as was required before the change, fewer detail how they have monitored and reviewed their effectiveness.

The quality of disclosures on the review of effectiveness of internal controls therefore remains low, with 78% providing basic or general explanations. Only 22% give good or detailed descriptions that deliver real reassurance to the investor.

Auditor independence

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

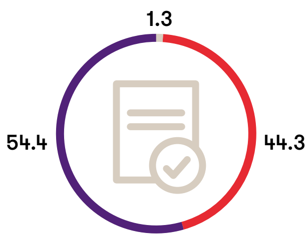
(UK Corporate Governance Code, C.3.8)

The quality of audit committee disclosures around their means of safeguarding auditor objectivity and independence dropped slightly this year, with 54% providing good or detailed disclosures, down from 61% in 2016. This drop is surprising, given the recent introduction of the EU audit directive and regulations[30], which are driven by the need for auditors to be – and to be seen to be – independent.

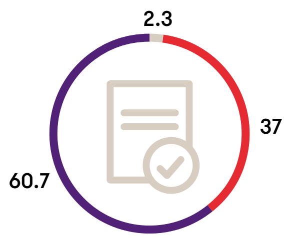
If the auditor provides non-audit services, is there a statement as to how the auditor's objectivity and independence is safeguarded? (%)

None Some More

FTSE 350



2017



2016

[29] https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf

[30] Directive/2014/95/EU, EU, October 2014 (http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN).

Audit tender

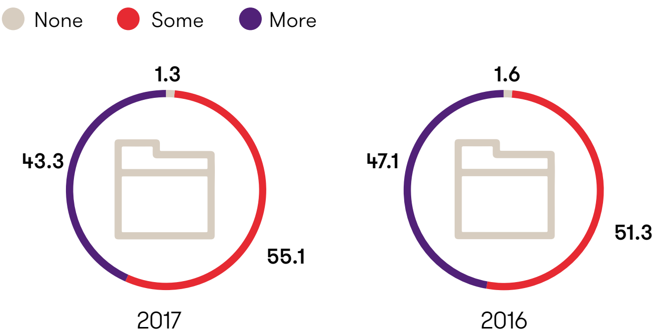
"The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors."

(UK Corporate Governance Code, C.3.7)

In 2017, 54% of companies include a statement committing themselves to an external audit contract tender at least every 10 years (2016: 58%). Of those that do not, the majority had tendered their external audit in the past 10 years or plan to do so in the coming decade. Twenty-eight FTSE 350 companies are currently non-compliant with the 10-yearly tender requirement, which became effective for organisations with financial periods beginning on or after 17 June 2016.

There is little change in the detail provided on how audit committees reach their recommendation on the appointment, re-appointment or removal of external auditors. Just over half (55%) of FTSE 350 companies provide basic or general disclosures – either stating there was a tender, but giving scant further information, or outlining very generic information. Just under half (43%) provide good or detailed disclosures. The reporting tends to be slightly more detailed when companies have tendered in the past year. Given the EU directive's focus on audit tenders, this reporting area should be prioritised in the coming year, with organisations ensuring that the audit committee report includes specific information about their auditor appointment process. When looking ahead, companies should outline their plans to keep would-be tenderers free from professional conflicts of interest, possibly even disclosing their existing relationships with these firms.

How much information is provided on how the audit committee reached its recommendation on the appointment, reappointment or removal of the external auditors? (%)



Non-audit fees

"When the statutory auditor or the audit firm provides to the audited entity, its parent undertaking or its controlled undertakings, for a period of three or more consecutive financial years, non-audit services... the total fees for such services shall be limited to no more than 70 % of the average of the fees paid in the last three consecutive financial years for the statutory audit(s) of the audited entity."

(Regulation (EU) 537/2014 of the European Parliament and of the Council of 16 April 2014, Art. 4(2))

In 2017, the average audit fee for the UK's largest companies, the FTSE 100, is £6.7 million (2016: £6.26 million), with non-audit fees being £1.2 million (2016: £1.7 million). The largest single audit fee was £67.3 million, with the greatest non-audit fee being £43.8 million (both HSBC).

The average amount spent on audit fees across the whole FTSE 350 in 2017 rose by 3% to £2.74 million (2016: £2.66 million), while the average amount of non-audit work awarded to auditors across the FTSE 350 increased by 41.4% to £1.16 million (2016: £0.82 million).

Nearly a quarter (23%) of the FTSE 350 had non-audit fees of more than 70% of their audit fee – the cap set in the EU audit reform. This includes 13 companies with non-audit fees of more than 200% of their audit fee and six with non-audit fees of more than 300% their audit fee.

Average non-audit fees as % of audit fees

	2010	2014	2015	2016	2017
FTSE 100	54	37	30.5	45.6[31]	40.1
FTSE 101-200	80	49	61.6	52	49.5
FTSE 201-350	88	91	83.3	80	60.1

Average non-audit fee spend across the FTSE 100 was 40% (2016: 31%) that of audit fees. The highest ratio of non-audit fees to audit fees still lies in the smallest companies: average non-audit fees were 60% of audit fees in the FTSE 201–350, where the greatest number of IPOs, acquisitions and merger-related activities occur and the denominator is much smaller. This is still a significant reduction on 2016, when this category of company averaged non-audit fees were 80% of audit fees, and brings the average under the cap set by the regulator.

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

Audit Non-Audit

	2014 Audit	2014 Non-Audit	2015 Audit	2015 Non-Audit	2016 Audit	2016 Non-Audit	2017 Audit	2017 Non-Audit
FTSE 100	6.24	1.7	5.88	1.52	6.26	1.74	6.74	2.29
FTSE 101-200	1.11	0.52	1.24	0.59	1.31	0.49	2.2	1.0
FTSE 101-200	0.43	0.31	0.62	0.35	0.59	0.29	0.54	0.25

[31] This figure includes high percentages from three companies that had average non-audit fees of 490%, 687% and 425% the level of their audit fees, which distort the average. Without these three companies, the average would be 30.5%.

Remuneration committee

FAST FACTS

- Remuneration chairs focus on their communication, with 97% personally introducing their report (2012: 48%) and 87% providing good and detailed introductions
- 93% of companies provide high-quality remuneration policy disclosures
- Only 13% state that remuneration committee chairs met with shareholders
- 37% make no use of non-financial metrics for performance-related remuneration
- 91% now have a clawback provision for bonuses and long-term incentive plans – but none have yet been invoked
- 96% of company annual reports refer to the link between executive remuneration and company strategy

Executive pay continues to provoke interest

Three years after the introduction of new disclosure and voting requirements on directors' pay,[32] the remuneration of UK directors still tops the Government's and investors' list of priorities. The issue has prompted a great deal of debate over the past 12 months, including the Government's green paper consultation[33] which addresses investors' concerns about the lack of transparency between executive pay and performance and is widely seen as being a significant contributor to the decline in the public's trust in business. This concern is reflected in the 24% increase in the number of resolutions with a significant minority vote against the recommendation of the board throughout 2016.[34]

The 2017 AGM season to date suggests improved shareholder support for FTSE 100 remuneration resolutions, perhaps helped by a reported 17%[35] drop in total CEO pay. However, many issues still need to be addressed – especially as FTSE 250 investors are protesting more than before over individual packages and company policies at the 2017 AGMs. The Government intends to address those concerns by requiring more transparency from quoted companies around their remuneration policies, introduction of a public register of listed companies encountering shareholder opposition to pay awards of 20% or more and annual reporting of the CEO to average UK workforce pay ratio.[36]

[32] The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, UK Department for Business, Innovation and Skills (www.legislation.gov.uk/uksi/2013/1981/pdfs/uksi_20131981_en.pdf).

[33] Corporate Governance Reform green paper, Department for Business, Energy & Industrial Strategy, November 2016 (www.gov.uk/government/consultations/corporate-governance-reform).

[34] Developments in Corporate Governance and Stewardship 2016, FRC (https://frc.org.uk/Our-Work/Publications/Corporate-Governance/Developments-in-Corporate-Governance-and-Stewa-(2).pdf).

[35] Executive pay: Review of FTSE 100 executive pay packages (https://www.cipd.co.uk/Images/7571-ceo-pay-in-the-ftse100-report-web_tcm18-26441.pdf)

[36] Corporate Governance Reform: The Government response to the green paper consultation (www.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-reform-government-response.pdf).

Quality of reporting and engagement

"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)

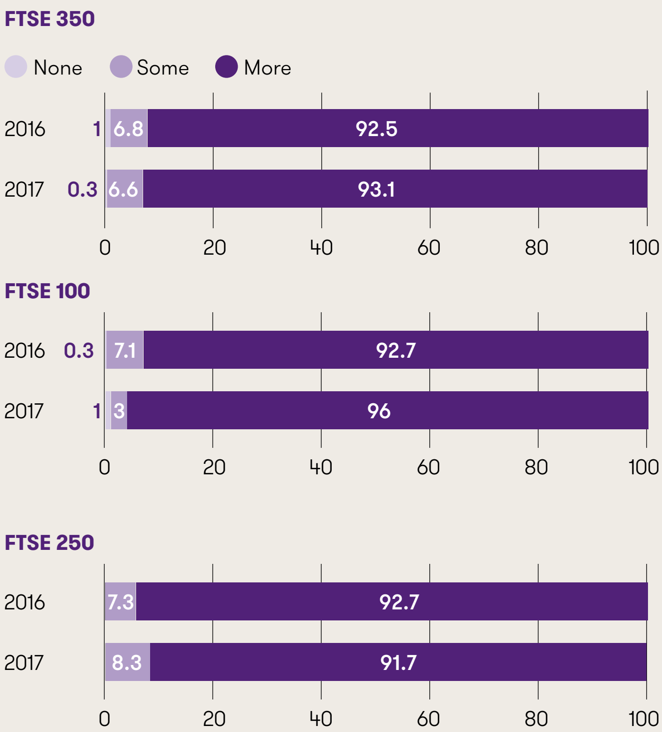
Remuneration committee chairs are engaging with investors through the remuneration report like never before. Almost all (97%) provide a personal introduction to the report, compared with 48% in 2012. Of those, 82% – slightly fewer than last year – give good or detailed insights; including clear overviews of company policy, with highlights of any changes and detailed accounts of matters considered during meetings. The most informative also include personal views on the issues faced by the committee and justifications of the remuneration package.

On average, remuneration committees meet five times a year.

Ninety-three per cent of companies provide high-quality remuneration policy disclosures, of which 59% give good explanations in line with Code guidance and legislative requirements and 34% provide very detailed explanations. In general, companies from utilities and basic materials industries have the clearest and most comprehensive remuneration policy disclosures, and travel and leisure sector businesses the poorest.

The remuneration report may be the most consistently well-explained section in the annual report – but it does take an average of 20.4 pages to achieve this (2016: 18.2). With proposals for further voting powers for investors under consideration, high-quality disclosure should not be a substitute for close dialogue between remuneration committees and shareholders. Such dialogue is vital in ensuring concerns are raised and addressed – without recourse to voting against remuneration policies – and that policies and packages align with company strategy. However, only 13% of companies state that their remuneration committee chairs met with shareholders, while 38% say that their NEDs (including remuneration committee chairs) were available for meetings yet do not report any taking place.

How clearly are companies describing their remuneration policies? (%)



Remuneration consultants

"Where remuneration consultants are appointed, they 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, D.2.1)

In 2017, 248 companies disclose whom they consulted about their remuneration policy. Twenty-four remuneration consultants are named, with more than 92% of advice coming from just six of these firms. Of these six, two audit firms acted as consultants to 42% and one other consultancy advised a quarter of the FTSE 350 – no doubt giving rise to issues of conflict and limiting audit choice.

Annual bonuses

"Remuneration incentives should be compatible with risk policies and systems. Upper limits should be set and disclosed. The remuneration committee should consider whether the directors should be eligible for annual bonuses and/or benefits under long-term incentive schemes."

(UK Corporate Governance Code, Schedule A)

The average earnings of executive directors dropped significantly this year.[37] However, the opportunities for significant rewards still exist: 95% of the FTSE 350 state the maximum bonus available to executive directors, with some CEOs potentially able to receive 500% of their salary. Bonus caps are unpopular with the UK regulatory bodies who believe that variable remuneration should constitute a substantial portion of overall pay[38] (as seen in the UK's application of the bonus capping provisions under the EU Capital Requirements Director (CRD) IV) and therefore such high levels of bonus are unlikely to be capped.

The 2017 median bonus average is 150%, unchanged since last year; median maximum bonus opportunities for the FTSE 100 CEO are at 180%, compared to 150% in the FTSE 250. By industry, telecommunications and oil and gas company CEOs have highest maximum bonus opportunities of 200% of salary, compared to 130% in utilities companies.

[37] Executive pay: Review of FTSE 100 executive pay packages (https://www.cipd.co.uk/Images/7571-ceo-pay-in-the-ftse100-report-web_tcm18-26441.pdf)

[38] PRA and FCA statement on compliance with the EBA guidelines on Sound Remuneration Policies, 2016 (http://www.bankofengland.co.uk/publications/Pages/news/2016/037.aspx). See also, High-level overview of Bank of England Response to the European Commission Call for Evidence on the EU Regulatory Framework for Financial Services, January 2016, p.6 (http://www.bankofengland.co.uk/financialstability/Documents/regframework/highleveloverview010216.pdf).

Shareholding guidelines and long-term incentives

"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)

The trend of increased long-term alignment – via more bonus deferral, additional holding periods for vested awards and higher shareholding requirements – continues this year. The most common shareholding requirement disclosed for CEOs reaches 200% of base salary, as reported by 43% of the FTSE 350. Fourteen companies report requirements of 500%, while four others disclose levels of between 500% and 800%.

Performance share plans remain the most common long-term incentive plan. Ninety-five per cent of FTSE 350 companies (2016: 96%) report having a long-term incentive plan, and 88% state a performance period for shares, typically of three years.

As problems arising from earlier business decisions may only become evident after a performance period has ended, further holding periods of awards after vesting are now commonly expected by investors. Sixty per cent of the FTSE 350 disclose their additional holding period, typically two years.

It is interesting to note that through increasing investor pressure, the combination of vesting and holding period is now on average five years and the Government is considering whether it should be extended further[39] and yet the typical viability statement looks forward only three years. Perhaps this longer-term commitment will start to be reflected in future viability statements.

Performance period of share awards: FTSE 350 performance share plans

Number of years	2	3	4	5
Number of companies	3	256	3	7

Retention (additional holding) period of awards after vesting: FTSE 350 companies

Number of years	0.5	1	2	3	4	5
2016	3	6	78	56	5	13
2017	3	12	146	14	3	4

[39] Corporate Governance Reform: The Government response to the green paper consultation, p.3 (www.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-reform-government-response.pdf).

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)

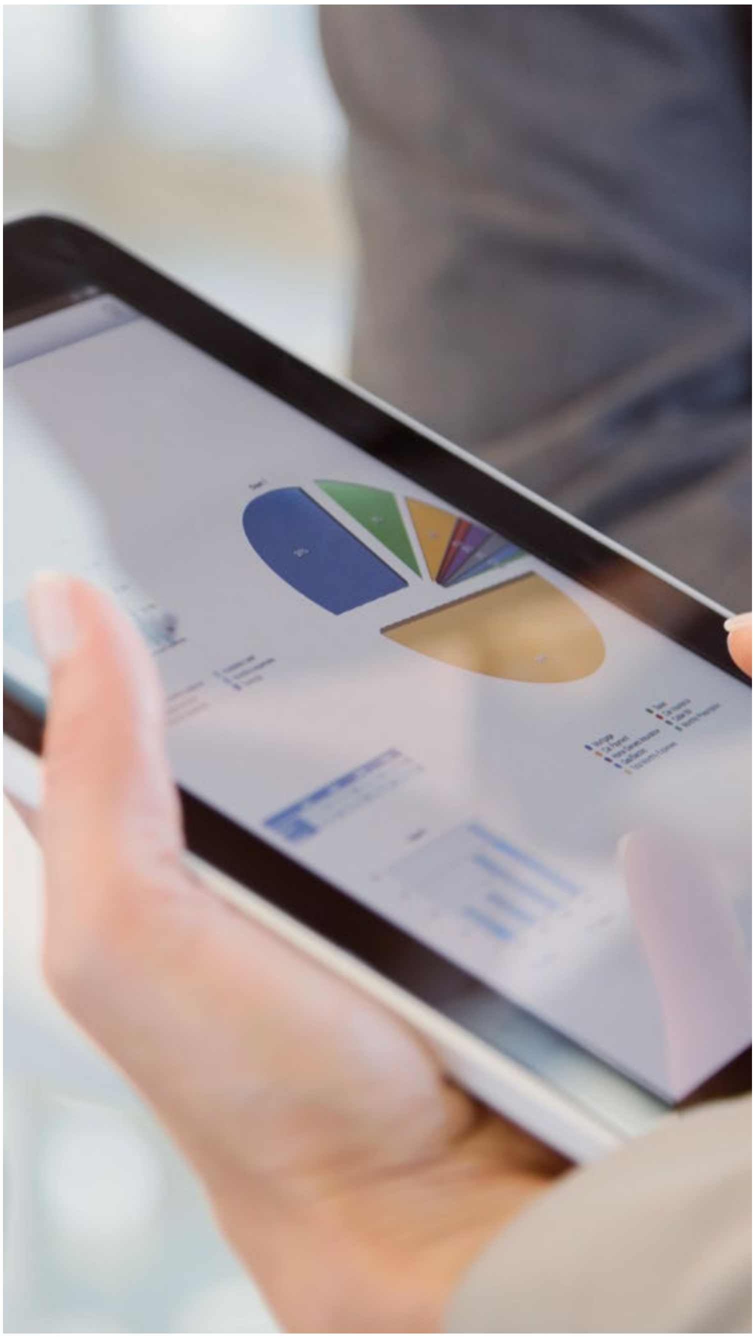
Investors often expect both prospective and retrospective disclosure of the targets related to long-term incentive measures, in line with the regulations.

The number of companies disclosing only financial metrics for executive performance-based remuneration in their policies increased slightly in 2017, to 37% (2016: 35%). Most use a broader range of metrics including strategic, personal and non-financial measures, such as customer service and employee engagement.

Total shareholder return (TSR) and earnings per share (EPS) remain the FTSE 350's most common measures. Of those companies using TSR, most do so on a comparative basis against a peer group. Others measure outperformance against an index or absolute TSR.

What metrics are used in executive performance-based remuneration?

Measures[40]	Financial	Strategic	Personal	Other non-financial
Number of companies	283	149	64	44



[40] The totals are greater than 100% given the frequent use of multiple performance measures.

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."

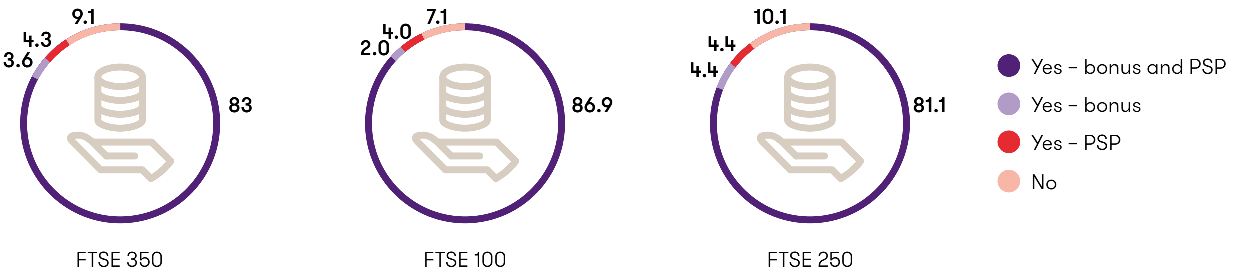
(UK Corporate Governance Code, D.1.1)

The 2014 Code updates introduced new recommendations around companies' ability to withhold or clawback variable pay from directors. The number of companies reporting a clawback provision for bonuses and long-term incentive plans increased again this year, to 91%. Around 87% of organisations have implemented a clawback provision on annual bonuses, with slightly more than 87% having done so on long-term plans.

Most of the companies without clawback provisions are from financial or basic materials industries. Many state that they will review their clawback arrangements next year, or at their next binding vote on policy. Some industrial metals and mining sector companies explain that such provisions would not be enforceable under the national legislation of their country of incorporation or operations, such as Russia.

This year, as in last year's review, no company invoked a clawback provision.

Is there a clawback provision? (%)



"Most of the companies without clawback provisions are from financial or basic materials industries."

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)

The increasing use of non-traditional metrics in performance share plans may indicate that companies wish to improve the link to business strategy, to acknowledge growing shareholder desire for directors' rewards to reflect their performance in delivering long-term sustainable value.

Ninety-six per cent (2016: 95%) of companies discuss the connection between executive remuneration and company strategy in their annual report – normally in the remuneration report, as might be expected. Little insight is given, however, as to what non-financial measures are considered important. Further, only 20% (2016: 11%) of the FTSE 350 use their strategic report to discuss the strong link between their strategy and wider range of KPIs and executive remuneration. As our findings show, companies are providing greater detail about their business model, strategy, performance and likely future developments in their strategic reports. The absence of transparency as to specific metrics to be applied, as opposed to a statement regarding the principle, is therefore surprising. Investors, politicians and the public are increasingly scrutinising executive pay. Reinforcing the link between the execution of strategy, the creation of long term sustainable value and rewards in the strategic report, can only help to ensure executives' and shareholders' interests align.

Investor viewpoint

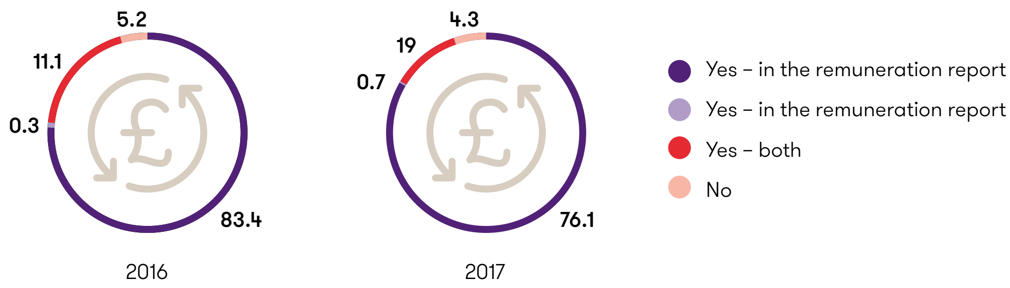
The Strategic Report is the showcase where companies can tell their story, explain their strategy, business model, KPIs, their impact on the environment and people and demonstrate their alignment with shareholders. We welcome companies using their stated KPIs and targets as their performance conditions under their share plans. This has the advantage of closely linking pay with what investors expect companies to achieve.

Material ESG (environmental, social and governance) performance measures should also be included, particularly for companies in high-risk sectors. As with all performance measures these should be material to the business: clear, transparent and measurable, with specified metrics and targets.

ESG considerations may be introduced via malus mechanisms, for example, if an individual has damaged the company's reputation through unethical behaviour, or if the company has poor health and safety records or customer complaints).

ESG considerations may also be incorporated as a form of underpin whereby certain ESG standards need to have been met before pay out, even if all the financial targets have been met.

Does the annual report discuss the link between executive remuneration and the company's strategy? (%)



Recent and forthcoming developments

	Comments	Timing	Mandatory reporting in the Annual Report?
Corporate governance reforms			
	In 2016 the Government and the Department for Business, Energy and Industrial Strategy (BEIS) launched an inquiry on corporate governance. This included a select committee inquiry and a green paper. The response to these proposed several changes. The Government intend to:	The response was published in August 2017 with secondary legislation changes expected to be introduced in 2018 The FRC Code revisions will be announced in November 2017 with a consultation ending in February 2018. The revised Code is expected to be announced in June 2018	Yes, when they are brought in All companies with a Premium listing of equity shares will be required to report on their compliance with a new Code in the annual report Pay ratio reporting may be required annually for quoted companies Section 172 reporting may be mandatory, in the annual report or on the company website Private company governance reporting may be mandatory in the Director's report and on the website
Executive pay	Invite the FRC to revise the Code to: • specify the steps companies should take when they encounter significant shareholder opposition • give remuneration committee broader responsibility for overseeing pay throughout the organisation • extend recommended minimum vesting and post-vesting holding period for executive share awards from three to five years. Introduce secondary legislation to require quoted companies to: • report annually the pay ratio between CEO and average employee, and narrative to explain the ratio • provide clearer explanation in remuneration policies of a range of potential outcomes from complex, share-based incentive schemes. Invite the Investment Association (IA) to maintain a public register of listed companies encountering shareholder opposition to pay awards of 20% or more, and what these companies say they are doing to address shareholder concerns		
Employee, customer and wider stakeholder voice	Invite the FRC to consult on the development of a new Code: • principle establishing the importance of strengthening the voice of employees and other non-shareholder interests • provision requiring plcs to adopt one of three employee engagement mechanisms: a designated non-executive director, a formal employee advisory council or a director from the workforce. Introduce secondary legislation to require all companies of significant size to explain how their directors comply with section 172 Ask ICSA and the Investment Association to complete their joint guidance on practical ways companies can engage with their employees and other stakeholders		

	Comments	Timing	Mandatory reporting in the Annual Report?
Corporate governance reforms			
Corporate governance in large privately-held businesses	Invite the FRC to work with the IoD, the CBI, the IFB, the BVCA and others to develop a voluntary set of corporate governance principles for large private companies Introduce secondary legislation to require companies of a significant size to disclose their corporate governance arrangements in their Directors' Report	The response was published in August 2017 with secondary legislation changes expected to be introduced in 2018 The FRC Code revisions will be announced in November 2017 with a consultation ending in February 2018. The revised Code is expected to be announced in June 2018	Yes, when they are brought in All companies with a Premium listing of equity shares will be required to report on their compliance with a new Code in the annual report Pay ratio reporting may be required annually for quoted companies Section 172 reporting may be mandatory, in the annual report or on the company website Private company governance reporting may be mandatory in the Director's report and on the website
Governance of companies			
The UK Corporate Governance Code	In February 2017 the FRC announced plans for a fundamental review of the UK Corporate Governance Code. This will take account of their work done on corporate culture and succession planning, and the issues raised in the Government's Green Paper and the BEIS Select Committee inquiry. This will build on the Code's globally recognised strengths while considering balance between principles and provisions and the growing demands on the corporate governance framework	The FRC will commence a consultation on its proposals later in 2017, based on the outcome of the review and the Government's response to its Green Paper. The new Code will be expected in July 2018	Yes, when the new Code is announced
Legislative changes			
Audit policy	The European Council 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 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	The EU Audit Directive and Regulation became law on 17 June 2016 and applies to financial years starting on or after that date	Yes

	Comments	Timing	Mandatory reporting in the Annual Report?
Legislative changes			
EU Directive on Non-Financial Reporting	On 22 October 2014 the EU Directive on non-financial reporting was adopted, requiring companies with 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. The majority of these requirements are already reflected in the strategic report requirements in the Companies Act. The Directive leaves significant flexibility for companies to disclose information in the way that they consider most useful, or in a separate report	Applies to companies with financial years commencing on or after 1 January 2017	Yes
Diversity			
Board diversity	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 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. Nomination committees will be expected to acknowledge this target and discuss in their annual reporting	In 2016 the increased target was brought in, aiming for 33% women on boards by 2020 for all FTSE 350 companies The report recommends that FTSE 100 boards should have at least one director of colour by 2021, and FTSE 250 by 2024	Yes. Reporting on board diversity should include any measurable objectives that a company has set for implementing its diversity policy
Gender Pay Gap reporting	Employers with more than 250 employees will be required to publish the difference between the average pay of their male and female employees. This will include: • annual snap shot of gender pay differentials based on mean and median differentials (the 'annual snapshot') • 12 month look-back of bonus and long-term incentive plan (LTIP) awards based on mean and median differentials as well as the percentage of males and females who have been paid a bonus over that period (the '12 month bonus look-back') • employee pay quartiles gender composition differentials ('quartile differentials'). 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 and will be reviewed by the Secretary of State	Companies will be required to report their pay gap data from 5 April 2017 and by 4 April 2018	No, although some companies are starting to include them as part of employee matters in the Strategic Report

	Comments	Timing	Mandatory reporting in the Annual Report?
Other narrative reporting			
Modern Slavery Act	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 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 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	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 The statement must be produced within six months of year end	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
Payment practices	Large companies and LLPs (regardless of whether they are private, public or quoted) are required to report on their payment practices, policies and performance on a half yearly basis. A company is large if it meets two of the following three criteria for consecutive years: • Turnover > £36m • Net assets > £18m • Number of employees > 250 The report should published within 30 days of the end of the reporting period via a web-based tool provided by the Government	Companies are required to report on their payment practices and policies for the financial years beginning on or after 6 April 2017 The first report will be due 30 days after the end of the first six months of a business' financial year	No
The Guidance on the Strategic Report	The FRC published a consultation draft of its Guidance on the Strategic Report. The Guidance was first issued in 2014, following the introduction of the requirement for companies to produce a strategic report. It is being amended now to take account of the new regulations for non-financial reporting that are effective for financial periods beginning on or after 1 January 2017. These proposals also reflect the FRC's desire to improve the effectiveness of section 172 of the Companies Act 2006	Comments are requested by 24 October 2017 The updated Guidance will be expected in 2018	The Guidance on the Strategic Report serves as a best practice statement and, as such, has persuasive rather than mandatory force

	Comments	Timing	Mandatory reporting in the Annual Report?
Executive remuneration			
GC100 and Investor Group directors' Remuneration Reporting Guidance	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: • 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	No, but much is covered by the remuneration reporting
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, in 2016 they categorised signatories to the code into tiers based on the quality of their Code statements – with Tier 1 one being the highest quality and Tier 3 the lowest. Tier 3 asset managers were given a period of time to improve their reporting or be removed from the list of Code signatories. The FRC engaged with Tier 3 signatories and about 20 improved their statements to Tier 1 or Tier 2 standard, whilst the other half chose to remove themselves from the list of signatories. The Tier 3 category has now been removed A detailed consultation on specific changes to the Stewardship Code will follow in 2018	The lists of those in each tier were published in November 2016 The tier 3 category was removed in August 2017 The Stewardship Code will be reviewed in 2018	No

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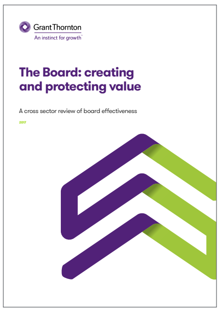
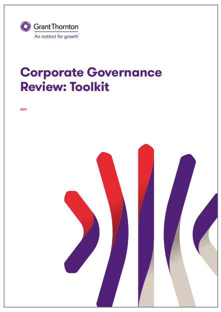
Governance matters

Corporate Governance Review 2017



The Board: creating & protecting value

Beyond compliance: building blocks of corporate culture



Corporate Governance Review: Toolkit 2017

For further information, visit: **grant-thornton.co.uk/governancematters**

Advising on governance

1 Corporate reputation

When is it relevant – Perceived value gap between company, investors and stakeholders

Value add to client – Independent investor and stakeholder relations advisory services to company management

Types of solutions enabled with management

- Tailored investor and stakeholder relations training
- Capital markets perception audit – investors focus, analysts and press if required
- Refine investment case and investor toolkit materials
- Investor and stakeholder reporting and communications
- Shareholder and debt holder register analysis (targeting, access and roadshow management worldwide)

2 Governance diagnostics

When is it relevant – Organisations wish to understand whether existing governance arrangements reflect good practice

Value add to client – Detailed and insightful comparison to a database of peers and sectors

Types of solutions enabled with management

- Benchmark reporting to market good practices
- Identification of areas to enable more effective oversight and messaging
- Development of implementation plans and change programmes
- Peer and sector comparison

3 Governance renewal

When is it relevant – Occurrence of a significant change event has occurred (growth, takeover, fraud) leading to a governance framework is no longer fit for purpose

Value add to client – Facilitation, design and implementation of corporate frameworks to support value creation

Types of solutions enabled with management

- Alignment, design and integration of governance framework with strategy
- Development and strengthening of governance frameworks, policies and procedures
- Group risk appetite identification and embedding
- Internal control reviews and redesign
- Internal audit effectiveness reviews
- Restructuring and implementation of performance and incentivisation measures

4 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 front end reporting
- Alignment and integration of internal KPI reporting with strategy
- Creation of CSR/ESG reporting methodology
- Non-financial reporting assurance

5 Leadership and culture

When is it relevant – Alignment of culture and strategy to realise corporate purpose

Value add to client – Value can be protected and enabled when values and behaviours are embedded into all, systems and processes

Types of solutions enabled with management

- Cultural audit and monitoring
- High potential assessment and development programmes
- Executive and board level coaching
- Alignment and communication of reward mechanisms with purpose and strategy

6 Board evaluation

When is it relevant – Assessment of existing board or committee practices

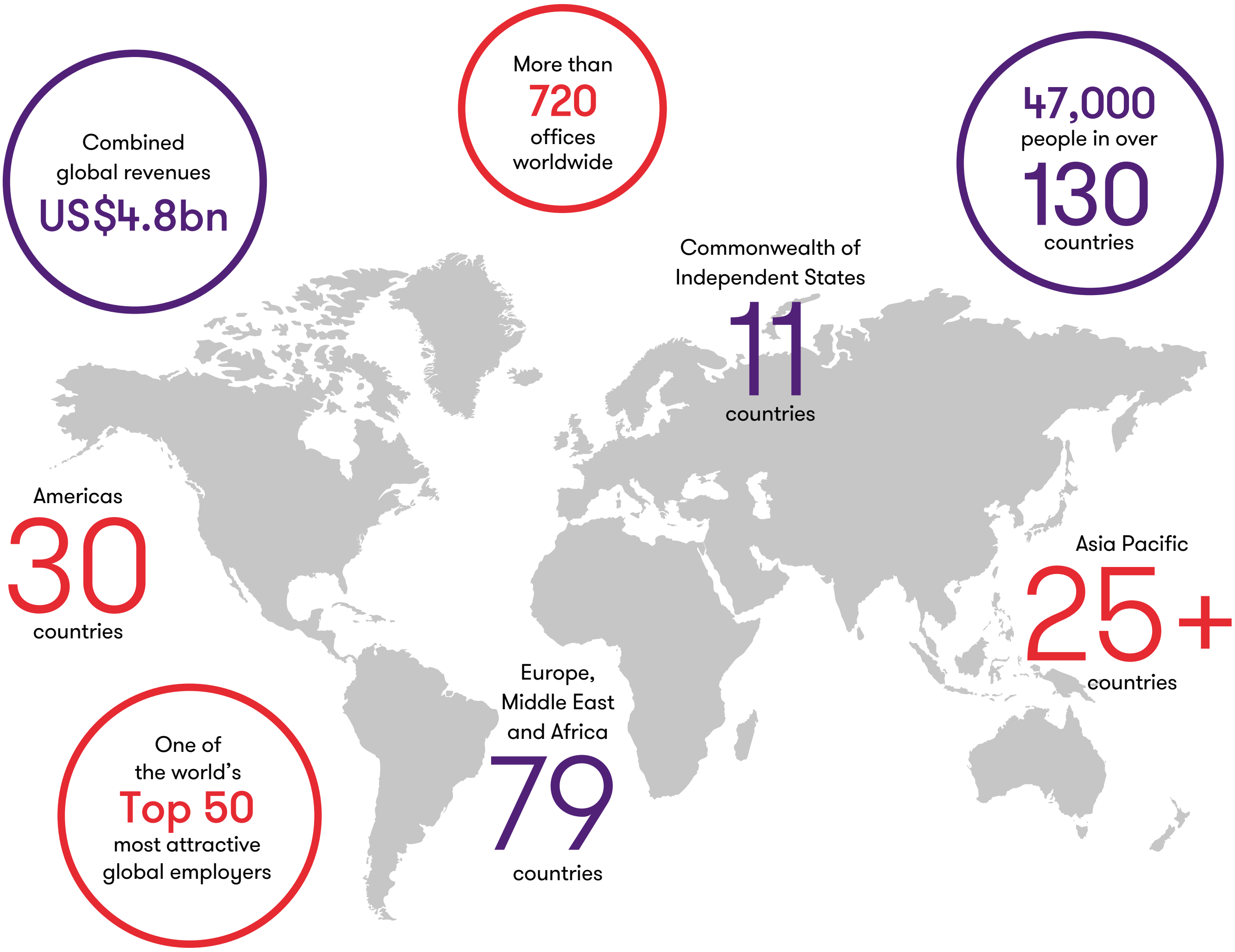
Value add to client – External assessment of board structure, capability and function

Types of solutions enabled with management

- Board effectiveness review
- Committee effectiveness reviews
- Committee structure and terms of reference design
- MI quality and effectiveness assessments
- Succession planning through alignment of existing skill set with long term needs

About Grant Thornton

Global reach



Revenues by region

CIS	Americas	Europe	Middle East	Asia Pacific	Africa
US$31m	US$2bn+	US$1.6bn+	US$40m	US$692m	US$98m

Afghanistan Albania Algeria Antigua St Kitts and Nevis Argentina Armenia Australia Austria Azerbaijan Bahamas Bahrain Bangladesh Belarus Belgium Belize Bolivia Bosnia and Herzegovina Botswana Brazil British Virgin Islands Bulgaria Cambodia Canada Cayman Islands Chile China Colombia Congo Costa Rica Côte d'Ivoire Croatia Cyprus Czech Republic Denmark Dominican Republic Ecuador Egypt El Salvador Estonia Ethiopia Finland France Gabon Georgia Germany Gibraltar Greece Guatemala Guinea Haiti Honduras Hong Kong Hungary Iceland India Indonesia Iraq Ireland Isle of Man Israel Italy Jamaica Japan Jordan Kazakhstan Kenya Korea Kosovo Kuwait Kyrgyzstan Latvia Lebanon Libya Liechtenstein Lithuania Luxembourg Macedonia Malaysia Malta Mauritius Mexico Moldova Monaco Morocco Mozambique Myanmar Namibia Netherlands New Zealand Nicaragua Nigeria Norway Oman Pakistan Panama Paraguay Peru Philippines Poland Portugal Puerto Rico Qatar Romania Russia Rwanda St Lucia Saudi Arabia Senegal Serbia Singapore Slovak Republic Slovenia South Africa Spain Sweden Switzerland Taiwan Tajikistan Tanzania Thailand Togo Trinidad and Tobago Tunisia Turkey Uganda Ukraine United Arab Emirates United Kingdom United States Uruguay Uzbekistan Venezuela Vietnam Yemen Zambia Zimbabwe

Notes

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