Grant Thornton

A changing landscape: are you ready?

Evolving with the Code

Corporate Governance Review December 2010

Contents

Disclosure requirements

Corporate governance disclosure requirements are set out in three places (as summarised by Schedule C of the Combined Code):

- FSA Listing Rule 9.8.6 (which includes the 'comply or explain' requirement);
- FSA Disclosure and Transparency Rules Sections 7.1 and 7.2 (which set out certain mandatory disclosures); and
- the Combined Code (in addition to providing an explanation where they choose not to comply with a provision, companies must disclose specified information in order to comply with certain provisions).

The requirements for a Business Review are set out in s417 of the Companies Act 2006.

Simon Lowe would like to thank the following for their help in preparing this report: Omolara Dare, Matthew Earll, Govinder Heer, Callum Hind, Ben Langford, Maria Loftus, Sajni Radia and Claire Roebuck-Sacks.

Introduction

Welcome to our ninth annual review of governance practices in the UK's FTSE 350 companies. This year our review covers the annual reports of 303 of the UK's largest companies with years ending between May 2009 and April 2010.

We assess their compliance with the provisions of the Combined Code (the Code), we highlight trends in disclosure of compliance and assess the quality of explanations and underlying practices. In addition our review covers aspects of the Business Review including the use of key performance indicators (KPIs) and the extent and quality of principal risk reporting.

We have also continued our analysis by industry, using the FTSE Group and Dow Jones Index classification system called the 'Industry Classification Benchmark' (ICB). As in previous years, we exclude investment trusts due to the differences in their nature, structure, management and approach to corporate governance.

2010 has seen wholesale review and revision of the Code resulting in the issue of the 2010 UK Corporate Governance Code. Further reviews are currently underway in respect of what were formerly known as Higgs and Smith and a review of Turnbull, which was expected to begin in November and has now been deferred to 2011. In addition, the Stewardship Code directed at all institutional investors was issued in July replacing what was Section E of the Code.

Our review focuses on the annual report because, in our view, it is the primary window through which a company should showcase its attitude to governance. If a company fails to take this opportunity in such a public document, we consider it reasonable for the stakeholders to conclude that this is a reflection of the underlying culture within that organisation.

The governance landscape is changing. This year our review takes a final look at how governance has evolved under the existing Code before the 2010 revisions start to impact.

Simon Lowe
Chairman, The Grant Thornton Governance Institute

Foreword

The financial crisis, which came to a head in 2008, triggered a widespread reappraisal of the governance systems which many believed existed primarily to prevent such an event. In the UK, Sir David Walker undertook a review of the governance of banks and other financial institutions, and the Financial Reporting Council (FRC) brought forward the Code review scheduled for 2010 so that corporate governance for all listed companies could be addressed at the same time.

The Walker report was issued in November 2009 and the FRC issued the renamed UK Corporate Governance Code in June 2010, too late to have an impact on our findings, but both changing the landscape for governance practice in the UK. Greater emphasis was placed on embedding the practice of governance into the heart of a business. Risk management was moved to centre stage and the spotlight was put on the role of the chairman and the board in providing both leadership and rigorous challenge, and the role of the institutional investor.

Two principal conclusions were drawn by the FRC. First, that much more attention needed to be given to following the spirit of the Code. Second, that the impact of shareholders in monitoring the Code could and should be enhanced by better interaction between the boards of listed companies and their shareholders.

As a result, formal risk management became almost mandatory for financial service companies and more expected of other companies. In addition, the Higgs guidance was put out for a top to bottom rethink and is now addressing the effectiveness of the whole board. Section E was taken out of the old Code to be replaced by the Stewardship Code to provide guidance on good practice for institutional investors.

The ‘comply or explain’ principle was retained by the FRC after receiving strong support from both companies and shareholders. However, an ongoing European Commission consultation is questioning the success of this principle and is considering the role of increased regulation. It is hoped that the Stewardship Code will result in increased shareholder engagement to monitor and encourage companies’ compliance with the Code.

A subtle but significant shift in emphasis was included in the preface to the Code. Chairmen are being encouraged to report personally in their annual statement on the state of governance practice in their companies.

UK Corporate Governance Code, Preface

“Chairmen are encouraged to report personally in their annual statements how the principles relating to the role and effectiveness of the board (in Sections A and B of the new Code) have been applied. Not only will this give investors a clearer picture of the steps taken by boards to operate effectively but also, by providing fuller context, it may make investors more willing to accept explanations when a company chooses to explain rather than to comply with one or more provisions.”

The draft ‘Improving Board Effectiveness’ envisages an empowered role for the company secretary who “should consider whether board and other governance procedures are fit for purpose and advise the chair of any improvements and initiatives which could add value to the governance of the company”. As currently only 11% of chairmen comment on their company’s governance practice, company secretaries may wish to anticipate increasing requests for support in this area.

The number of companies claiming full compliance continued to strengthen to 51% although many of those were in fact not compliant in disclosure. However by looking at compliance with individual provisions, a much stronger picture emerges with companies typically complying with all but one or two of the Code’s provisions. Overall, this suggests 92% compliance with the Code.

But as the governance landscape changes in the aftermath of the financial storm, the 92%, rather than representing the summit of achievement, is taking on more the look of a base camp, with the hard work yet to be done. Just as top sportsmen and women train day in day out to turn practice into instinctive behaviour, so governance now faces the hard challenge of turning compliance into embedded behaviour so that every decision and every activity becomes instinctive, or in corporate terms, part of the culture.

With greater emphasis being given to how the board operates our review highlights significant differences in the quality of disclosures between the larger and smaller members of the FTSE 350.

The most commented on changes to the Code were the introduction of annual re-election of directors and the triennial externally facilitated board effectiveness review. Currently only 17 companies have annual elections and 50 have triennial effectiveness reviews. As Sir David Walker observed, a significant learning curve lies ahead, not only for the companies, but also for the consultants. For the process to be effective, not only do companies have to be more open minded and transparent but the facilitators undertaking the reviews need to up their game as well.

With greater emphasis on the role of the board and the need for greater diversity how will companies respond to the emotive issue of, for example, gender? Currently, only 9% of FTSE 350 directors are female with 139 companies (46%) having exclusively male boards.

Narrative reporting is attracting a growing level of attention. There is clearly a danger that the more you say the more people ask for, and yet anecdotal comment suggests that people cannot see the wood for the trees. Annual reports are getting longer and longer. The average length of a FTSE 350 annual report is now 128 pages (ranging between 48 and 500), with the front unaudited section averaging 65 pages.

Typically companies are reporting 11 risks, and 8 KPIs. But we found few examples of companies successfully linking risks and KPIs to strategy and then identifying those key controls which they rely on to keep strategy on track. The Department of Business Innovation & Skills (BIS) is currently seeking consultation on the issue of achieving more connected purposeful reporting. In the meantime it might prove an effective discipline if companies were to set themselves a target for reducing the front end of this year's annual report by say 10%.

This year we looked at the relationship between a company's ownership structure and its compliance with the Code. We found a strong correlation between the number of shares in public ownership and the likelihood that a company will seek fully to comply with all the Code provisions. The smaller the shareholding in public ownership the more likely it is that a company will choose the explain option. Is this a reflection of companies feeling less accountable to the outside shareholder or a result of closer personal engagement with fewer investors which perhaps allows them more flexibility?

So how can companies improve the quality of their disclosures? This could be achieved in a number of ways, for example:

- commenting on the impact of the 2010 Code revisions and actions taken or planned to enhance their governance practice
- the chairman's statement giving a real insight into the governance culture of the organisation
- ensuring that disclosures support the claim for full compliance
- providing further explanation of how the board operates, including key topics for discussion, the type of decisions taken by the board and their role in governance oversight
- the introduction of greater connectivity between the company strategy, risk management and KPIs used to measure performance
- providing greater insight into how companies oversee the effectiveness of risk management and internal control throughout the year
- providing more certainty over the statistics and performance measures through greater use of independent verification
- setting a target of reducing the front end of the annual report by 10% through sharper, more incisive reporting.

What will be the impact of all these recent revisions and reviews? How will companies' governance practices evolve? Past experience suggests that it takes 4–5 years for changes to work their way through into practice. Will next year's review see the start of the final push for the summit or will the cold wind of prescription force a different approach in this evolving governance landscape?

Executive summary

For the first time since 2004, more than half of FTSE 350 companies now claim full compliance with the Code. It has taken five years since the last significant revision to the Code, for a majority of companies to fully implement the changes.

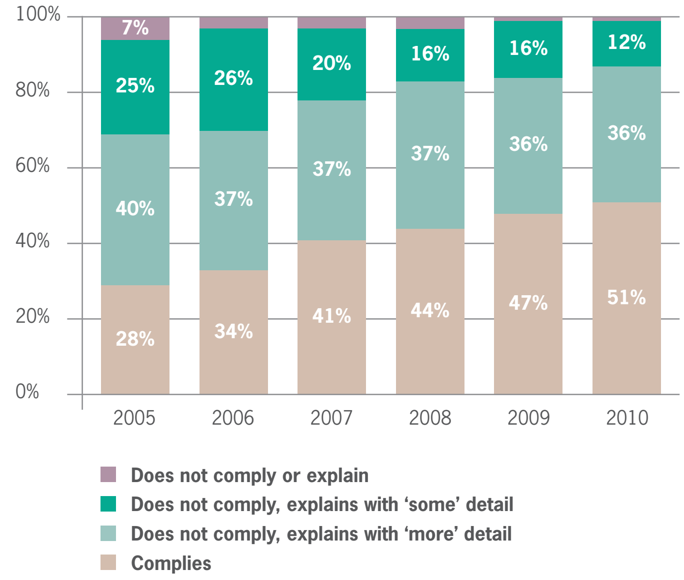
The revised UK Corporate Governance Code, issued in June 2010, will apply to reporting periods beginning on or after 29 June 2010. While it does not impact the current, 2010 reporting season, best practice would be for companies to comment on how and to what extent they will comply with the revised Code provisions. As in 2005, we expect claimed compliance to fall once it comes into force.

Of the 153 companies who claim full compliance, only 48 companies provide all the necessary detail, as set out in Schedule C of the Code, to support their claim for compliance. Perhaps this is due to an oversight in reporting rather than a failure in their corporate governance practices, but at the very least, it does suggest a need for a stronger verification process.

The Code recognises that non-compliance may be justified in particular circumstances if good governance can be achieved by other means and the company's rationale is provided. This year we see a continued move towards providing more informative disclosures with 87% (2009: 83%) of FTSE 350 companies either claiming full compliance or providing 'more' detail as to their reasons for non-compliance.

Not only are companies giving more detailed information to support their rationale for non-compliance, more companies are updating these explanations to reflect their changing environment. This year 34% (2009: 14%) of those who chose to explain made substantive changes to these explanations.

FTSE 350 companies choosing to 'comply or explain'



FTSE 350 companies comply with the vast majority (92%) of the Code's provisions. Of the 150 companies who do not claim full compliance, 112 (75%) are non-compliant with no more than two of the Code's provisions.

The board

The average FTSE 350 board has 5.2 non-executive directors (NEDs) compared to 3.1 executive directors. After a number of years of the balance shifting toward non-executive directors, this now appears to have levelled off. Board structure and composition continues to be the most common reason for non-compliance, with insufficient independent NEDs accounting for four of the five most common reasons for non-compliance.

The number of NEDs on the boards of the smallest 201–350 companies was 4 with 36% of these companies having insufficient independent NED membership to satisfy Code requirements. These companies clearly face a challenge to maintain an effective board balance.

This year we have analysed the time commitment required of non-executive directors in attending board and principal committee meetings. Making an assumption that an NED typically attends two out of three principal board committees, the average attendance is 17 meetings per year (FTSE 100: 18.6, Mid 250: 16.3). When analysed against the reported fees for NEDs in the same period this suggests an average fee per meeting of £4,250 for FTSE 100 and £2,800 for Mid 250, raising a further challenge for smaller companies when looking to attract experience to their board.

The 2010 Code, has put the spotlight on the performance of the board. By introducing the requirement for externally facilitated reviews the FRC is seeking to improve the quality of and transparency around board activities. There is clearly a steep experience curve ahead as only 17% of companies undertook such a review and the quality and depth of insight that was given in the annual reports varied considerably.

Insight was even more elusive when it came to describing the process and outcome of the chairman's performance evaluation. Here only 5% of companies provide more than the bare minimum of information.

There is a stark contrast between the 72% of FTSE 100 and 41% of Mid 250 companies who provide detailed explanations as to how their boards operate. The current review of 'Improving Board Effectiveness' will increase the attention on how a board operates and how decisions are taken. Mid 250 companies in particular, should revisit their practices in this important area.

The 2010 Code revisions require new board appointments to be made with due regard for the benefits of diversity on the board, including gender. This year we looked at the gender mix of FTSE 350 boards, identifying that only 9% of director positions are held by women and that 139 companies (46%) had exclusively male boards.

Given the absolute number of companies in the Mid 250 and the perception of them being the proving ground for a FTSE 100 appointment, it is notable that there were fewer female directors in the Mid 250 (115), than in the FTSE 100 (132). Far from the passing of time providing the solution to gender diversity, as some would suggest, this imbalance suggests that a problem may be building for the future.

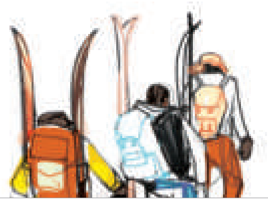
With the increased attention on the functioning, composition and effectiveness of the board, the next two years should see a transformation in our insight and understanding of the workings of the boards of UK plc.

Internal audit

There has been a growing trend for companies to fully outsource or materially co-source their internal audit function (2010: 64, 2009: 41). Perhaps surprisingly 40 of the UK's largest public companies choose to operate without this third line of defence.

External internal audit effectiveness reviews are some way off meeting the IIA best practice guidelines of being undertaken at least every five years. Furthermore a small but well publicised exercise of transferring internal audit functions to the external auditors has stirred up independence concerns at the FRC.

Executive summary



External audit

In 2008 the FRC started to address the issue of auditor choice, requiring greater transparency around appointment, reappointment and removal. Fifty five per cent of companies now provide at least some information in this respect. However, only 44 companies (15%) went further and provided detailed explanations to give shareholders real insight into the decision process.

Last year, just two FTSE 100 and six Mid 250 companies changed their auditors. Taken together with the actual number of changes which have occurred over the last four years, this suggests an average tenure of an external auditor to be more than 31 years.

If it is to achieve its objective of encouraging transparency and choice in this market the FRC may need to resort to more robust regulatory intervention.

The percentage of non-audit fees to audit fees has risen to 75% (FTSE 100: 54%, Mid 250: 84%) against average audit fees of £2.6m (FTSE 100: £6.3m, Mid 250: £0.8m). The recession has had its effect with audit fees decreasing by 9%. The smallest companies in the FTSE 350 (201–350), perhaps counter intuitively, have experienced an increase in both audit and non-audit fees suggesting an increasing reliance on their auditors in challenging times.

Internal control

The FRC has deferred its planned review of the Turnbull guidance on risk management and internal control to 2011. It is clear from our review that, while virtually all FTSE 350 companies are complying at a basic level, few are going further and providing the detailed information necessary to enable the reader to develop an informed opinion on the adequacy and effectiveness of their system of internal control.

While all FTSE 350 companies reviewed the effectiveness of their internal controls in the year, only 25% provided a detailed description of how they had approached this review. Very few gave any insight to the frequency of the review giving it a feel of annual compliance rather than regular oversight.

The quality of disclosures concerning companies' internal control processes has continued to improve but 22% are still failing to provide meaningful descriptions of the key elements of their risk management and internal control processes.

Risk and the management thereof is an integral part of internal control. It remains common practice for the two to be treated as separate in a company's reporting, with risk being addressed in the business review and internal control in the governance section. The very best companies demonstrated their appreciation of this relationship, through more integrated reporting.

Shareholder relations

The quality of disclosures with regards to shareholder engagement have continued to improve. The percentage of companies providing detailed explanations of their shareholder relations has almost doubled to 59% over the last five years. There remains a notable disparity between the FTSE 100 (78%) and Mid 250 (50%). This perhaps reflects the difficulty that smaller companies often refer to when seeking to engage with institutions.

The recent introduction of the Stewardship Code has emphasised the role of institutional investors in promoting governance. The largest investors have recently reported on their application of the Stewardship Code and a link to these statements has been published on the FRC website. Non-executive directors may find it helpful to visit their institutional investors' websites to understand better their approach to engagement and to compare it to their own experience from the other side of the fence.

Business review

There have been a number of recent developments in the area of narrative reporting. The most significant is the current government consultation on 'The Future of Narrative Reporting', which it is anticipated will lead to the introduction of the 'son of OFR'.

New provisions in the 2010 Code also impact on narrative reporting and will require companies to disclose more detailed information on their 'business model'. Our review of early adoption identified that 23% of FTSE 350 companies currently meet these more stringent requirements.

FTSE 350 companies are often reluctant to provide detailed information on the strategy and future direction of their business with only 50% of FTSE 100 and 38% of Mid 250 companies providing relatively detailed disclosures. As this information is often publicly available outside of the annual report, on company websites and in results presentations, this reticence is a little puzzling.

Risk

The quality of principal risk disclosures was strong, with 63% of FTSE 350 companies (FTSE 100: 75%, Mid 250: 58%) providing detailed descriptions of their risks, explanations as to their impact on the company and the mitigating actions being taken. However, there remains more than a third of companies who provide only generic risk descriptions and/or fail to explain how they are managing these risks. Typically companies highlight 11.2 (2009: 10.7) risks, with operational risks assuming a greater profile this year.

Key performance indicators

The quality of KPI disclosures is patchy, with only 31% of FTSE 350 companies (FTSE 100: 44%, Mid 250: 24%) providing detailed explanations of their KPIs and 13 companies who make no reference to KPIs at all.

Verification of non-financial KPI information continues to be largely absent amongst FTSE 350 members with only 21 using external, independent bodies to provide assurance over any of their non-financial KPIs.

Substantially improved KPI disclosures are needed to provide shareholders with any lasting value.

Corporate governance

Over half (2010: 51%, 2009: 47%) of the FTSE 350 now claim full compliance with the Code. However a more detailed review shows that only 16% (48) of these provide all of the required disclosures to fully support their claim.

The 'comply or explain' principle[1]

The Code is not a rigid set of rules. While it is expected that companies will comply wholly or substantially with its provisions, it is recognised that non-compliance may be justified in particular circumstances if good governance can be achieved by other means.

If a company chooses not to comply with one or more provisions of the Code, it must give shareholders a careful and clear explanation which shareholders should evaluate on its merits. In providing an explanation, the company should aim to illustrate how its actual practices are consistent with the principle to which the particular provision relates and contribute to good governance.

[1]Extracts from preamble to the Code

Where companies fail to provide sufficient information to support their claim of compliance, the disclosures most commonly omitted related to the following provisions:

- the terms and conditions of appointment of non-executive directors to be available for inspection (A.4.4)
- the review of internal controls to cover all material controls including financial, operational and compliance controls, and risk management systems (C.2.1)
- the audit committee to monitor and review the effectiveness of internal audit activities (C.3.2).

It is possible that these represent a failure in reporting rather than in the practice, but at best it suggests that companies need to pay more attention to their internal verification processes.

Companies can demonstrate good governance even when they choose not to comply fully with the Code, through the quality of their explanations.

Of the 150 companies choosing to explain rather than fully comply, we identified a continued increase in the number of companies providing informative, detailed disclosures 73% (2009: 68%). On closer analysis, this improvement is largely due to the FTSE 100 where 85% of these companies provide good quality disclosures. The Mid 250 had some catching up to do with 30 companies seemingly making a virtue of a minimalist approach and a few remaining absolutely silent.

Boilerplating is a frequent criticism of the 'comply or explain' form of governance reporting, with companies offering the same explanation year on year despite them operating in a constantly changing environment. This year we have seen significant improvements in this area. But will it continue?

Last year, while 68% of the companies choosing to explain rather than fully comply gave helpful explanations, only 14% had made any significant change to their previous year's explanation. This year 73% gave informative explanations with 34% making significant changes to their previous year's explanation.

The statistic of 49% of companies choosing to explain rather than comply does not show the full picture. For the vast majority of those companies, their non-compliance only relates to one or at most two provisions of the Code. Indeed, including those who claim full compliance, the FTSE 350 claim compliance with 96% of the Code provisions and disclose information to support compliance with 92% of the provisions.

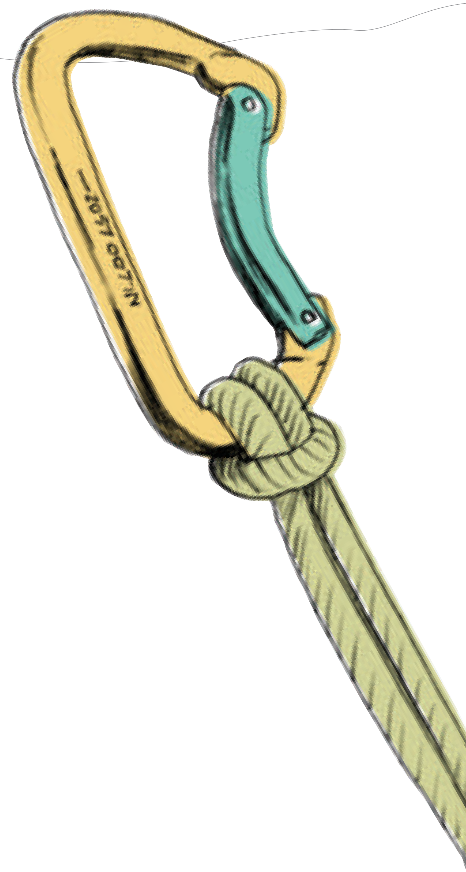
Number of Code provisions stated in non-compliance statements	Number of companies
1	68
2	44
3	23
4	3
5	3
>5	6
No disclosure	3
TOTAL	**150**

Seven of the top ten reasons for non-compliance are covered by provisions in Section A of the Code, and relate in one way or another to Directors. One conclusion is that the pool of available NEDs is too small, with not enough to go around. This appears to manifest itself in a number of areas where companies have had to resort to explanation rather than compliance. The most common explanation relates to board composition where at least half the board was not comprised of independent NEDs (49%, 73 companies). Of these, 29 were satisfied with their board balance and had no plans to recruit additional independent NEDs.

The apparent shortage of independent NEDs also contributed to the other common reasons for non-compliance, with 29% unable to fill the audit committee entirely with NEDs and 25% without at least three NEDs on the remuneration committee.

There are 25 companies who cite non-compliance with the Code provision regarding the independence of the chairman on appointment. However, the majority of these companies appointed the chairman in previous years. We have noted inconsistent interpretation of this Code provision despite a clear footnote in the Code requiring compliance or otherwise with this provision only to be reported in the year of appointment.

The revised 2010 Code encourages the chairman to provide a personal commentary in their annual statement on how the principles relating to the role and effectiveness of the board have been applied. Currently only 11% of chairmen take the opportunity to comment on this aspect of governance in their annual report.



Corporate governance

By industry

There has been an improvement in the degree of compliance and depth of explanation across the principal industry sectors represented in the FTSE 350.

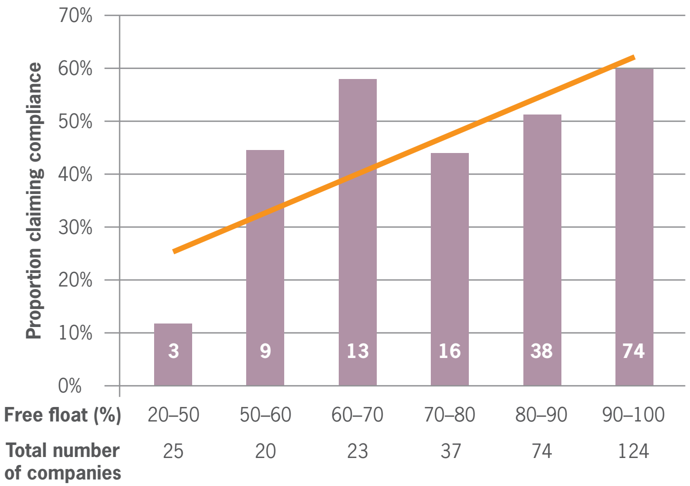
Surprisingly, given the amount of recent attention given to the sector, it is in the financials industry that the quality of 'compliance' appears to have slipped, with 23% of companies providing only the barest of explanations to support their non-compliance.

Industry (size)	Claim full compliance or provide 'more' explanation % (2010)	% (2009)
Healthcare (8)	100	100
Telecommunications (5)	100	100
Utilities (9)	100	89
Basic Materials (22)	96	81
Oil & gas (19)	95	79
Consumer services (65)	88	77
Technology (16)	88	73
Industrials (71)	87	89
Consumer goods (28)	82	83
Financials (60)	77	84
Overall average	**87**	**83**

By free float

For the first time we explored the relationship between the amount of shares in 'public' ownership and governance. We found a strong correlation between claimed compliance and the size of a company's free float (the proportion of shares that are readily available for trading). Of the 25 FTSE 350 companies with less than half of their shares publicly traded, only three companies (12%) chose to comply. This compares to 60% of companies (74 of 124) with a free float of more than 90%.

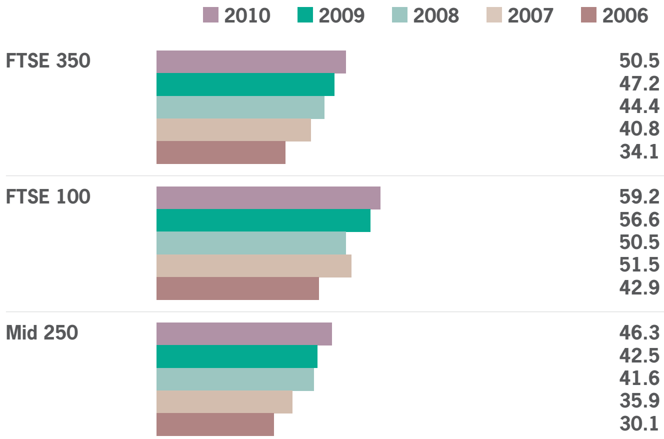
Perhaps this is both an indication of the power of external capital and a clarion call to institutional investors to actively pursue their responsibilities under the Stewardship Code, particularly where there are strong shareholder parties.



Q1. Do they claim full compliance with the Combined Code?

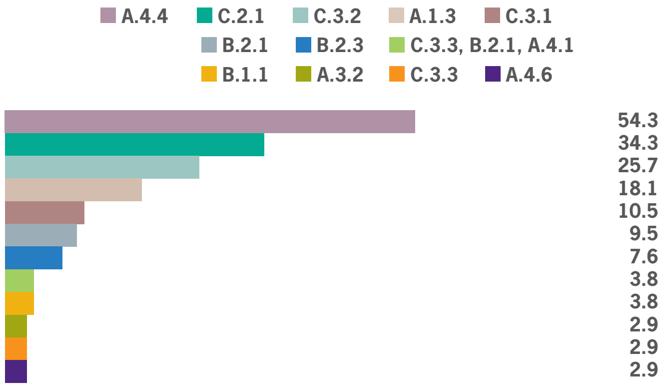
Guidance: "The following additional items must be included in its annual financial report: statement as to whether the listed company has complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code." (Listing Rule 9.8.6(6) (a))

Figure 1 (%)



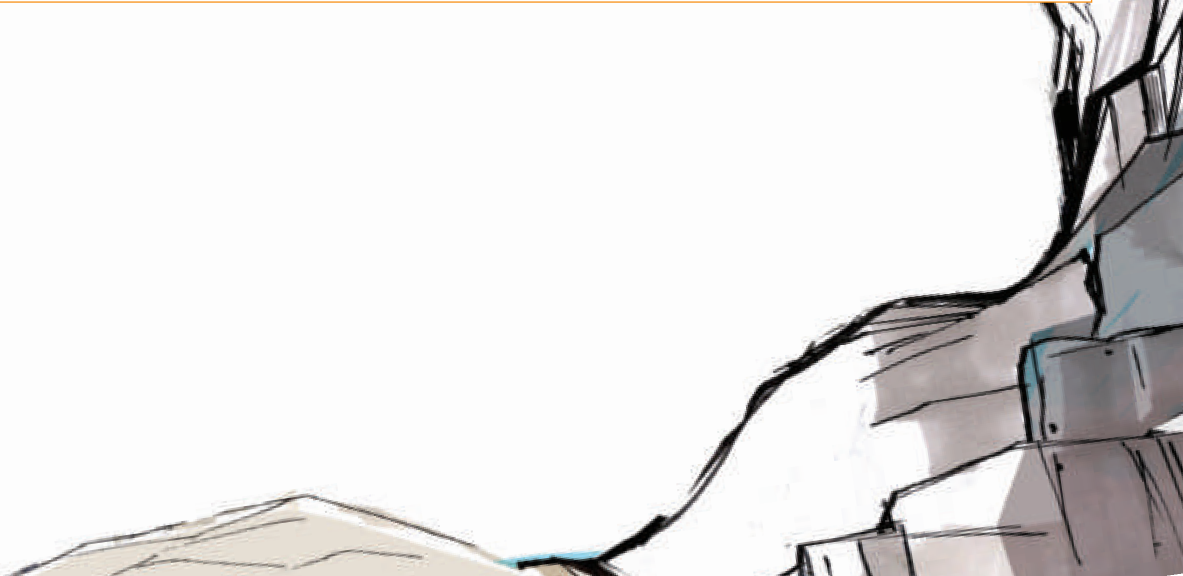
Q2. Of the 105 companies which do not disclose information to support their claim of full compliance with the Code, which provisions do they most commonly fail to disclose?

Figure 2 (%)



Code provisions

A.4.4	The terms and conditions of appointment of non-executive directors should be made available for inspection.
C.2.1	The review of the effectiveness of the group's system of internal controls should … cover all material controls, including financial, operational and compliance controls and risk management systems.
C.3.2	The main role and responsibilities of the audit committee should be set out in written terms of reference and should include … to monitor and review the effectiveness of the company's internal audit function.
A.1.3	Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance.
C.3.1	The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.
B.2.1	The board should establish a remuneration committee of at least three … independent non-executive directors.
B.2.3	The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors.
C.3.3, B.2.1, A.4.1	C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available[1].
	B.2.1 The remuneration committee should make available[1] its terms of reference, explaining its role and the authority delegated to it by the board.
	A.4.1 The nomination committee should make available[1] its terms of reference, explaining its role and the authority delegated to it by the board.
	[1]The requirement to make the information available would be met by including the information on a website that is maintained by or on behalf of the company.
B.1.1	The remuneration committee should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to enhance shareholder value. Upper limits should be set and disclosed.
A.3.2	At least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.
C.3.3	A separate section of the annual report should describe the work of the [audit] committee in discharging those responsibilities.
A.4.6	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.



Corporate governance

Q3. Of the 150 companies who do not claim full compliance with the Code, to what degree do they explain their reason for non-compliance?

Guidance: "A company that has not complied with the Code must include in its financial report a statement setting out the company's reasons for non-compliance." (Listing Rule 9.8.6(6) (b) (iii))

Figure 3 (%)

FTSE 350

	2010	2009	2008	2007	2006
None	2.7	1.9	5.3	4.5	4.3
Some	24.0	30.4	28.8	33.7	39.6
More	73.3	67.7	65.9	61.8	56.0

'More' disclosure is achieved where a company provides a detailed explanation to support each area of the Code with which they choose not to comply. This includes the reasons for their non-compliance and an explanation as to why they feel that this non-compliance is in the best interests of the company and the stakeholders. Those companies providing 'more' disclosure often laid out this information in a tabular format, providing an easy to digest set of explanations for shareholders, who may be unfamiliar with the Code's provisions.

Figure 3 (%)

FTSE 100

	2010	2009	2008	2007	2006
None	0.0	2.3	6.3	6.5	8.9
Some	15.0	25.6	27.1	34.8	42.9
More	85.0	72.1	66.7	58.7	48.2

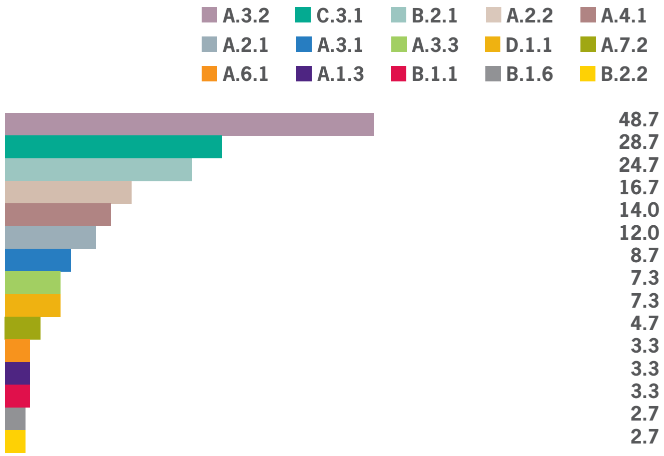
Figure 3 (%)

Mid 250

	2010	2009	2008	2007	2006
None	3.6	1.7	4.9	3.8	2.6
Some	27.3	32.2	29.5	33.3	38.4
More	69.1	66.1	65.6	62.9	58.9

Q4. Of the 150 companies who do not claim full compliance with the Code which provisions do they most commonly choose not to comply with?

Figure 4 (%)



Code provisions

A.3.2	At least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company [sub FTSE 350] should have at least two independent non-executive directors.
C.3.1	The board should establish an audit committee of at least three, or in the case of smaller companies [sub FTSE 350] two, independent non-executive directors. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.
B.2.1	The board should establish a remuneration committee of at least three, or in the case of smaller companies two, independent non-executive directors. In addition, the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman.
A.2.2	The chairman should on appointment meet the independence criteria set out in A.3.1. A chief executive should not go on to be chairman of the same company. If exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.
A.4.1	There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors.
A.2.1	The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.
A.3.1	The board should identify in the annual report each non-executive director it considers to be independent. The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination.
A.3.3	The board should appoint one of the independent non-executive directors to be the senior independent director.
D.1.1	The chairman should ensure that the views of shareholders are communicated to the board as a whole. Non-executive directors should be offered the opportunity to attend meetings with major shareholders and should expect to attend them if requested by major shareholders.
A.7.2	Non-executive directors should be appointed for specified terms subject to re-election and to Companies Act provisions relating to the removal of a director.
A.6.1	The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.
A.1.3	Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance.
B.1.1	The remuneration committee should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to enhance shareholder value. Upper limits should be set and disclosed.
B.1.6	Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.
B.2.2	The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments.

Non-executive directors

There has been little movement in board sizes in the FTSE 350. The average number of NEDs increased slightly to 5.2 (2009: 5.1) while the average number of executive roles dropped slightly to 3.1 (2009: 3.3). Across 303 FTSE 350 companies our review identified 1,565 NED positions (excluding the chairman).

Insufficient independent non-executive directors on the board was the most common reason disclosed by companies for non-compliance with the Code (73 companies, 49% of those which do not comply). Taking into account non-compliance with membership requirements for the audit, remuneration and nomination committees, insufficient numbers of independent NEDs accounted for four of the five most common reasons for non-compliance.

FTSE rank	Number of companies in group	Insufficient NED membership	NEDs on board (average)
1–100	98	10.2%	6.7
101–200	95	16.8%	4.9
201–350	110	35.5%	4.0
1–350	**303**	**21.5%**	**5.2**

The majority of these companies failing to comply were either due to retirements or unforeseen director movements in the year. The challenge is greatest for the smaller companies where the average number NEDs falls to 4.0 from 6.7. Here both succession planning and maintaining a full complement represent significant challenges. It appears that circumstances are dictating that the concession for smaller companies is being applied, Code or no Code.

Independence seems to cause some confusion. The Code lists a number of indicators which would point to an NED failing to be independent, but makes it clear that it is up to the board to determine whether a director is independent or not.

There were ten companies who stated they were not compliant with this Code provision, but based on their own assessment of independence actually met the requirement to have a majority of independent NEDs on the board.

The average NED has served on the board for 4.3 years, with 6% having served for more than nine years.

More than a third of companies still do not state that the terms and conditions of appointment for the NEDs are available for inspection. This remains the most common provision that companies claiming full compliance with the Code fail to disclose, and yet it is so easily remedied.

The Walker report's recommendation that external advisers should be made available to NEDs has been implemented. While only 6% of FTSE 350 companies stated that NEDs had cause to consult external advisers, 92% confirmed that they were available.

The 2010 Code and proposed revisions to the Higgs report both emphasise the role of a chairman as leader of the board. And yet only 5% of companies provide detailed information on the process and outcome of the evaluation of the chairman's performance. This disclosure appears to be particularly susceptible to boilerplating. We would expect to see enhanced disclosures in coming years as focus on the chairman's role increases.

A.3 The chairman

Main Principle

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

Supporting Principle

The chairman is responsible for setting the board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues. The chairman should also promote a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular and ensuring constructive relations between executive and non-executive directors. The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders.

Q5. Is at least half of the board (excluding the chairman) comprised of independent non-executive directors?

Guidance: "Except for smaller companies at least half of the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent." (Combined Code, A.3.2)

Figure 5 (%)

	2010	2009	2008	2007	2006
FTSE 350	77.9	73.2	79.4	73.5	69.7
FTSE 100	88.8	84.8	90.7	89.7	79.6
Mid 250	72.7	67.5	74.2	66.0	65.3

Q6. How well do companies describe the consideration of independence?

Guidance: "The board should identify in the annual report each non-executive director it considers to be independent." (Combined Code, A.3.1)

Figure 6 (%)

FTSE 350	2010	2009	2008	2007	2006
None	1.7	1.3	2.9	6.2	6.4
Some	61.4	60.9	59.8	55.2	58.0
More	37.0	37.8	37.3	38.6	35.7

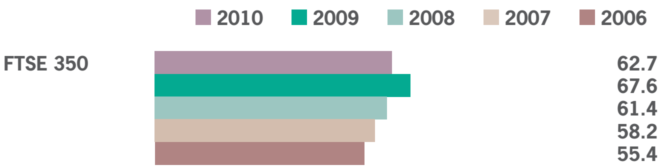
Best disclosure examples detailed the basis on which directors are considered to be independent, utilising the criteria listed in the Code including areas such as shareholdings, tenure on the board, previous positions held in the company, any material relationship with the company in the last three years, any remuneration received (apart from director's fees), any participation in a company's share or pension schemes, and any close family ties with the company, its major customers or suppliers.

Non-executive directors

Q7. Is it disclosed that the terms and conditions of appointment of non-executive directors are available for inspection?

"The terms and conditions of appointment of non-executive directors should be made available for inspection." (Combined Code, A.4.4)

Figure 7 (%)



A.4 Non-executive directors

Main Principle

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

Supporting Principle

Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors, and in succession planning.

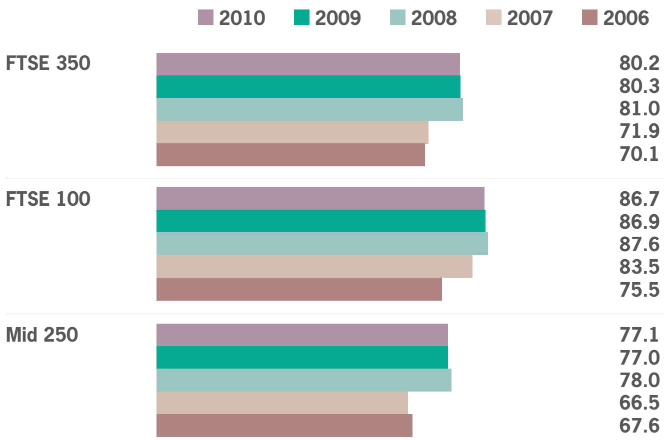
Code Provisions

A.4.1 The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary.

Q8. Led by the senior independent director, do the non-executive directors meet without the chairman at least annually to appraise the chairman's performance?

Guidance: "Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance." (Combined Code, A.1.3)

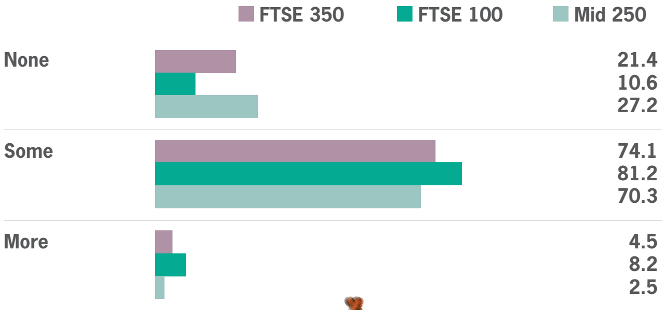
Figure 8 (%)



Q9. Of those companies which do appraise the chairman's performance, how much detail is provided on the process?

Guidance: "The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors." (Combined Code, A.6.1)

Figure 9 (%)



Best disclosure examples include:

- a full description of the appraisal process, including the use of independent experts
- the key categories considered to assess the skills and contribution of the chairman
- linkage with the full board and committee evaluation process
- use of peer review and feedback from directors and senior management
- outcomes from the evaluation and any resultant actions.

Boards and committees

Board processes

While always at the heart of governance, the activities of the board increasingly are coming under scrutiny. The current review of the Higgs report, which is addressing improving board effectiveness, encompasses all the key roles on the board not just that of the non-executive director. It has turned the spotlight on how a board operates, how decisions are taken and broadened the debate around diversity emphasising background, experience and psychological traits as well as gender.

This year all companies provided at least some information on their board processes. However this remains an area in which many companies have yet to go beyond the minimum of disclosures required to comply with the Code. In particular, improvements are required among the Mid 250 companies where only 42% provide more detailed disclosures, compared to 72% in the FTSE 100.

The Code specifies that "the board should meet sufficiently regularly to discharge its duties effectively". The average number of meetings in the companies surveyed was 8.9, a figure that was broadly consistent across both the Mid 250 and the FTSE 100. The highest number of board meetings held by a company in the year was 25, with 26 companies holding 13 or more meetings. These were typically unscheduled meetings to deal with specific issues.

The 2010 revisions to the Code have placed greater emphasis on the need for boards to review their performance with external assessment now expected every three years. Furthermore guidance is encouraging far greater transparency as to the output and board's response to these reviews. With two thirds of companies (2010: 66%, 2009: 68%) providing little insight, it is apparent that to match these heightened expectations a step change will be required in this area.

There is considerable scope for more informed disclosures as to the outcomes of board effectiveness evaluations. While 73% of companies provide at least some information, the majority of disclosures were in the form of a simple boilerplated statement that the board was found to be functioning effectively. Such statements do little to inform shareholders of the effectiveness of the board's performance or demonstrate that the evaluation was a rigorous and useful process.

The challenge laid down by the FRC to undertake triennial externally facilitated reviews is considerable as only 17% (2009: 15%) undertook such reviews last year. But going through the motions is not enough. If the added insight into board effectiveness is to be of any lasting value to the board and investors alike, the quality of the facilitators as well as the format and quality of the review process needs to be considered – something that Sir David Walker observed in his report in November 2009.

Thirteen companies (2009: 18) disclosed that they have combined the role of chairman and chief executive. In two cases (2009: 7) this was a temporary measure until a new chief executive or chairman could be appointed with another four companies intending to separate the roles in the following year or soon after. The remaining seven companies (2009: 11) considered the benefits of the executive chairman's experience and skills outweighed the obligation to separate the duties in question, despite the controversy that this practice often causes among shareholders.

A controversial addition to the 2010 Code was a new provision that all directors of FTSE 350 companies be subject to annual re-election. This constitutes a significant change from the current guidance which recommends re-elections once every three years. Currently only 17 FTSE 350 companies re-elect their directors on an annual basis. Given the challenge that the smaller companies in our review already face in respect of complying with the requisite numbers of independent non-executive directors, this may become an increasing source of concern for chairmen as they seek to balance the board.

B.1 The Composition of the Board

Main Principle
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.

B.6.2 Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. A statement should be made available of whether an external facilitator has any other connection with the company.

B.7.1 All directors of FTSE 350 companies should be subject to annual election by shareholders. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.

Boards and committees

Q10. Is there a statement of how the board operates and how its duties are discharged effectively?

Guidance: "The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management." (Combined Code, A.1.1)

Figure 10 (%)
FTSE 350

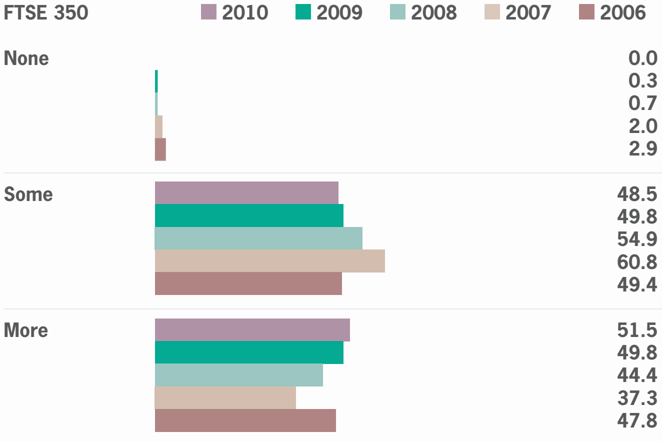


Figure 10 (%)
FTSE 100

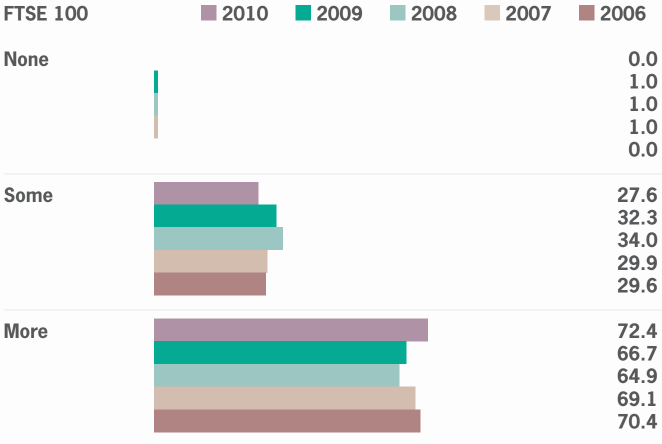
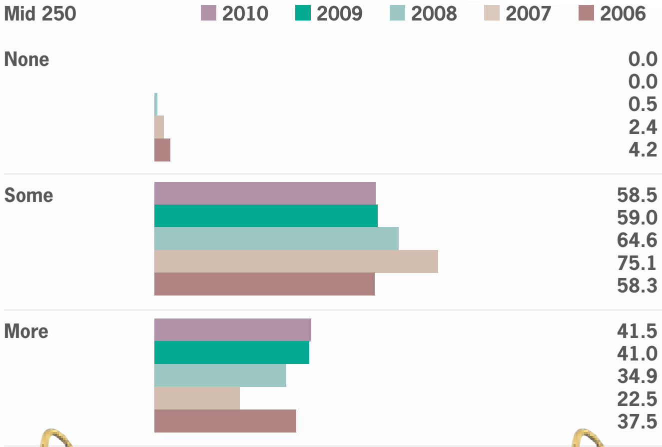


Figure 10 (%)
Mid 250



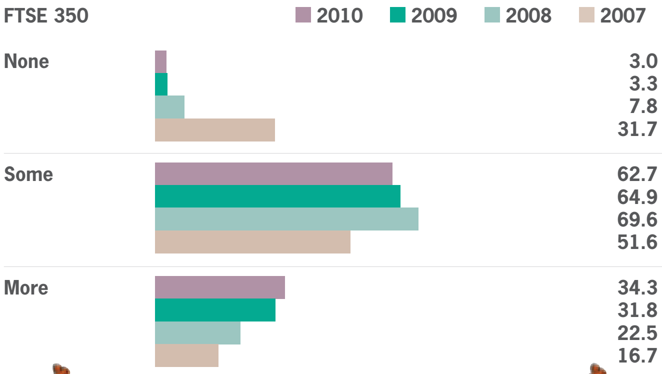
The most informative disclosures included detail of the following areas:

- the board's governance practices and linkage to ethical practices
- an established framework for management practice
- details of meetings of the board and committees, including focus and remit
- powers and authorities retained by the board and those delegated to management
- areas of strategic importance
- governance oversight practices.

Q11. How much explanation is there of how the board, committees and individual directors are annually formally evaluated for their performance?

Guidance: "The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted." (Combined Code, A.6.1)

Figure 11 (%)



Strong disclosures included the following:

- a full description of the appraisal process, including the use of independent experts
- the key categories considered, including board and committee structures, board dynamics, the conduct and frequency of board meetings, the consideration of strategic issues by the board and the information provided to directors
- evaluation criteria linked to overall strategy (as well as operational and financial performance)
- use of peer review between directors and senior management
- inclusion of major shareholder feedback as a measure of performance
- achievement of KPIs and specific reference to objectives set for the coming year
- outcomes from the evaluation and any resultant actions.

Figure 11 (%)

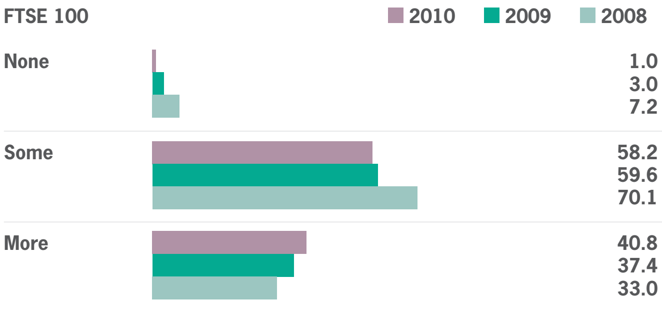
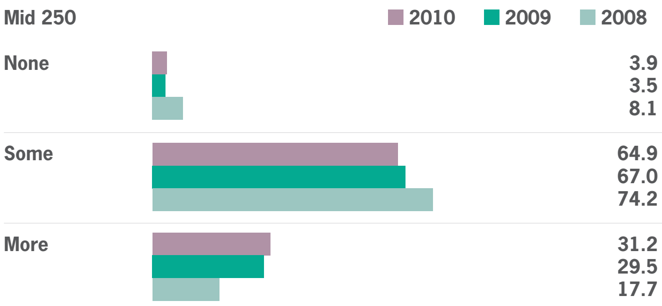


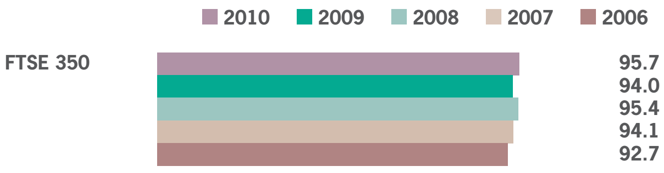
Figure 11 (%)



Q12. Are the roles of the chairman and chief executive separate?

Guidance: "There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business." (Combined Code, A.2.1)

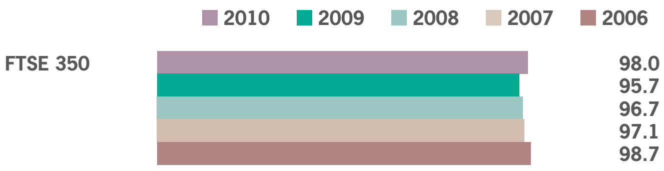
Figure 12 (%)



Q13. Does the report identify the chairman, the deputy chairman (where there is one), chief executive, senior independent director, members and chairs of the nomination, audit and remuneration committees?

Guidance: "The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination audit and remuneration committees." (Combined Code, A.1.2)

Figure 13 (%)



Board committees

Sixty two companies failed to meet the membership requirements for at least one of their board committees. The Code provision on composition of the nominations committee is more easily complied with, since it only requires a majority of members to be non-executive directors rather than a specific number. For other committees requiring a minimum of three independent NEDs, the challenge is greater.

The average number of NEDs for the 201–350 companies is 4 which compares to 6.7 for the FTSE 100. With the average number of meetings (full board and principal committees) being 20, the challenge for the smaller FTSE 350 companies to remain quorate and continue to provide the robust challenge, borne of a diversity of skills, experience, intellect and gender, is considerable.

Only 5% of companies fail to disclose that the committees' terms of reference were available for inspection. A noticeable contrast to the 37% of companies failing to make the equivalent disclosure regarding the availability of the terms of conditions of appointment of non-executive directors – a common area of non-compliance.

This year we have for the first time analysed the time commitment of non-executive directors as reported in the annual report. Making the broad assumption that an NED sits on an average of two out of three principal committees, this amounts to attendance at an average of 17.1 formal board and committee meetings. In addition to which AGMs, familiarisation visits, investor engagement and strategy days need to be taken into account.

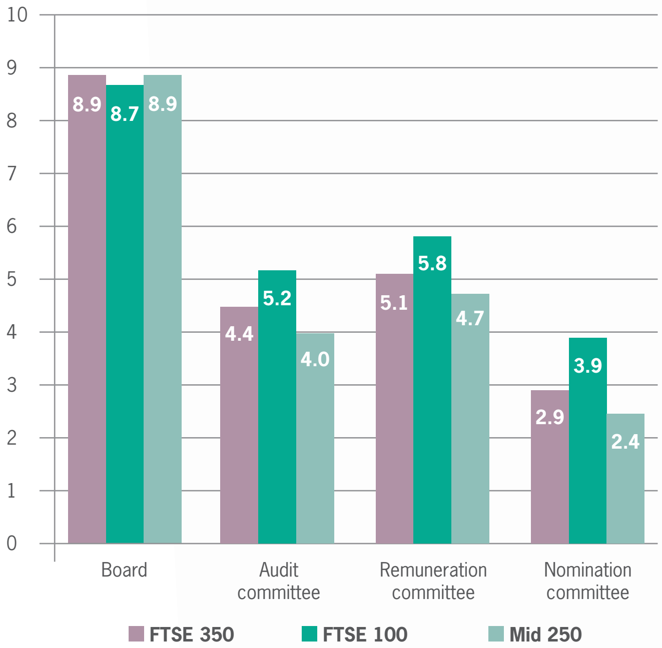
NED commitments	FTSE 350	FTSE 100	Mid 250
Average number of meetings for NEDs[1]	17.1	18.6	16.3
Average fees[2]	£60,000	£79,000	£46,000
Average fee per meeting	£3,500	£4,250	£2,800

[1]Assuming membership of 2 out of 3 principal board committees

[2]Source: Hemscott

NEDs in the FTSE 100 receive an average of £4,250 per meeting compared to £2,800 in the Mid 250. This adds further to the challenge for the chairman of the smaller companies in maintaining an effective board.

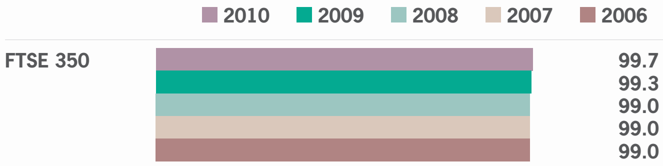
Average number of board and committee meetings



Q14. Is the number of meetings of the board and committees and overall attendance disclosed?

Guidance: "[The board] should also set out the number of meetings of the board and those committees and individual attendance by directors." (Combined Code, A.1.2)

Figure 14 (%)



Boards and committees

Q15. Is it disclosed that the terms of reference for the audit, remuneration and nomination committees are available for inspection?

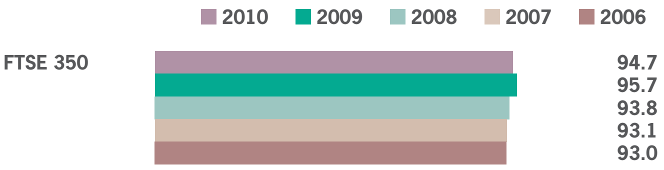
Guidance: "The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available[1]." (Combined Code, C.3.3)

"The remuneration committee should make available[1] its terms of reference, explaining its role and the authority delegated to it by the board." (Combined Code, B.2.1)

"The nomination committee should make available[1] its terms of reference, explaining its role and the authority delegated to it by the board." (Combined Code, A.4.1)

[1]The requirement to make the information available could be met by including the information on a website that is maintained by, or on behalf of, the company.

Figure 15 (%)



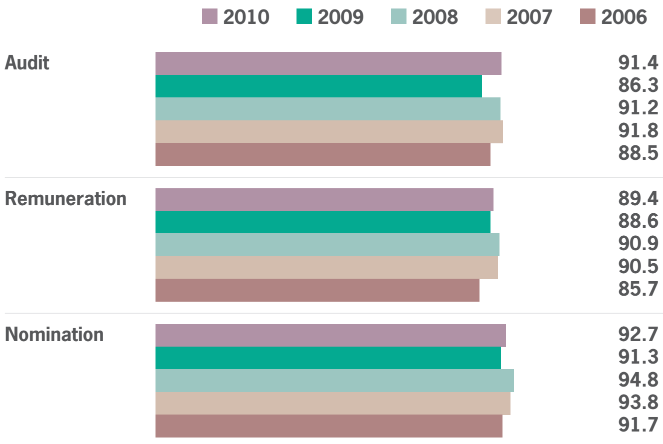
Q16. Are the committee membership requirements met?

Guidance: "The board should establish an audit committee of at least three … members, who should all be independent non-executive directors." (Combined Code, C.3.1)

"The board should establish a remuneration committee of at least three … independent non-executive director members." (Combined Code, B.2.1)

"A majority of members of the nomination committee should be non-executive directors. The chairman or an independent non-executive director should chair the committee." (Combined Code, A.4.1)

Figure 16 (%)



Audit committee

The average number of audit committee meetings held annually was 4.4 (FTSE 100: 5.2, Mid 250: 4.0), with 79% of companies holding between three and five meetings per year.

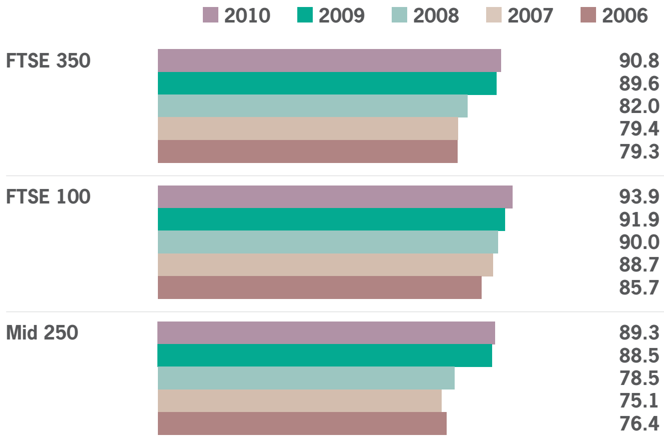
The Guidance on Audit Committees, formerly known as The Smith Guidance, was last updated in 2008. Draft guidance, addressing the provision of non-audit services by the company's auditor, was issued for consultation in 2010. No other changes are envisaged.

Twenty eight companies (2009: 31) still do not identify that member of the committee who has recent and relevant financial experience. While one of these companies states that the board as a whole has the required experience and another company's non-compliance was due to a mid-year appointment, the remaining 26 companies do not provide any reason for their non-compliance in this area. Considering the importance of having recent and relevant financial experience represented on the committee, such reticence is concerning.

Q17. Does the audit committee state it has at least one member with recent and relevant financial experience?

Guidance: "The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience." (Combined Code, C.3.1)

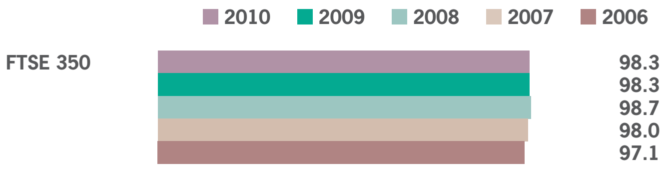
Figure 17 (%)



Q18. Is there a separate section of the annual report which describes the work of the committee?

Guidance: "A separate section of the annual report should describe the work of the committee in discharging those responsibilities." (Combined Code, C.3.3)

Figure 18 (%)



Internal audit

There has been a growing trend toward outsourcing with 64 companies (2009: 41) adopting a fully outsourced or materially co-sourced internal audit solution.

While the majority of companies choose the in-house option there remain 40 of the UK's largest public companies who still operate without a third line of defence at all.

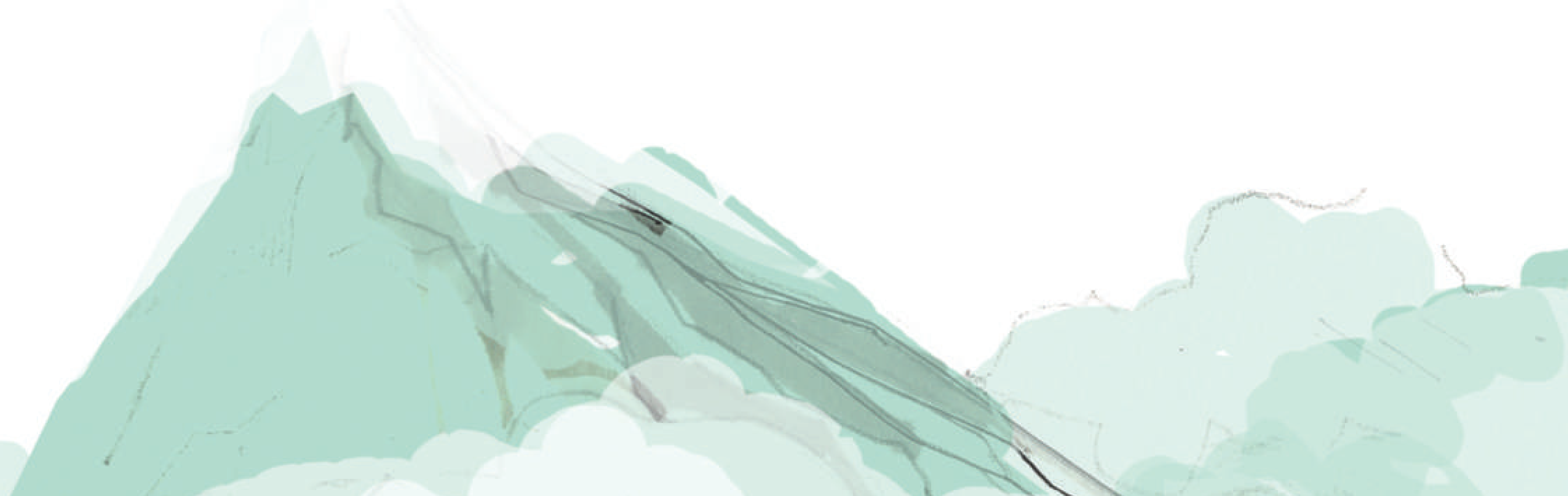
The practice of subjecting internal audit functions to at least a five yearly independent external review (in accordance with IIA guidance) still appears to be patchy. Thirty three per cent of companies make reference to having considered the effectiveness of internal audit but only 6% confirm that they have undertaken such a review.

During the year, a contentious development saw two companies turn to their external auditor for the provision of internal audit services. This prompted the FRC to issue draft guidance for audit committees reflecting concerns as to the impact of such appointments on internal controls, independence and investor perceptions.

Q19. Does the company have an internal audit function or equivalent?

Guidance: "The audit committee should monitor and review the effectiveness of the internal audit activities." (Combined Code, C.3.5)

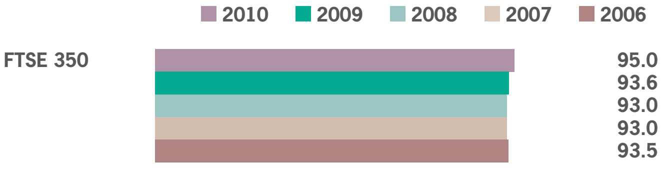
FTSE rank	Do they have an internal audit function or equivalent?
1–100	99%
101–200	86%
201–350	76%
1–350	**87%**



Q20. Of the companies which do not have internal audit function, is the absence of the function explained and is there disclosure that a review of the need for one has been carried out during the year and a recommendation been made to the board?

Guidance: "Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report …" (Combined Code, C.3.5)

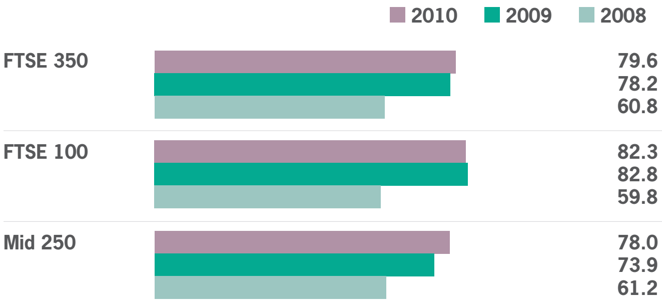
Figure 20 (%)



Q21. Does the audit committee monitor and review the effectiveness of internal audit activities?

Guidance: "The main role and responsibilities of the audit committee should … include … to monitor and review the effectiveness of the company's internal audit function." (Combined Code, C.3.2)

Figure 21 (%)



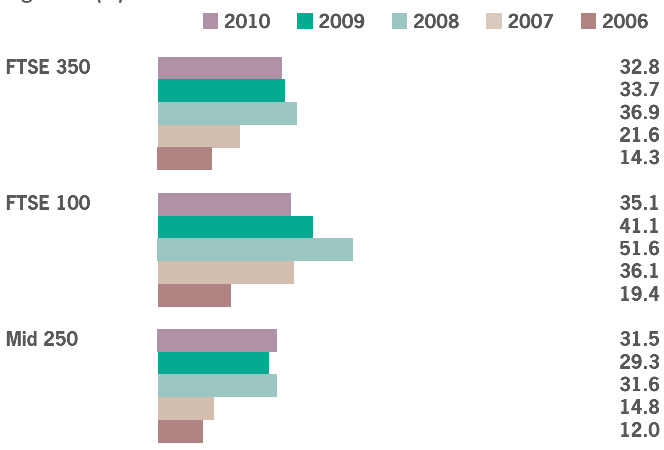
Q22. Does the company make reference to an internal audit effectiveness review being performed?

Guidance: "The audit committee should ensure that the function has the necessary resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with appropriate professional standards for internal auditors." (FRC Guidance on Audit Committees, 4.1.3)

"Internal assessments should include: Ongoing reviews of the performance of … internal audit … ; and periodic reviews performed through self-assessment or by other persons …" (International Standards for the Professional Practice of Internal Auditing – 1311)

"External assessments should be conducted at least once every five years. The potential need for more frequent external assessments … should be discussed … with the board. Such discussions should also consider the size, complexity and industry of the organisation." (International Standards for the Professional Practice of Internal Auditing – 1312)

Figure 22 (%)



External audit

Only eight companies changed external auditors in the last year. Taken together with the actual number of changes which have occurred over the previous three years (2009: 16, 2008: 7, 2007: 8) this suggests that on average a FTSE 350 company changes auditor just once every 31 years.

The 2008 review of the Guidance on Audit Committees introduced greater requirements for disclosure in respect of auditor choice. This year sees a continued improvement in such disclosures with 55% (2009: 34%) of companies now providing at least some information to support reappointment, appointment and/or removal of their auditors. However only 44 companies gave 'more' information, such as tendering frequency, tenure of the incumbent, and any contractual obligations that restrict the committee's choice, to give the shareholders real insight into the decision process.

This low turnover, coupled with such a significant majority of companies giving only limited insight, suggests that the FRC's objective of encouraging transparency and choice in this important capital market may not be achieved without more robust regulatory intervention.

Average non-audit fees as a percentage of audit fees (%)[1]

FTSE rank	No. of companies in our review	Current year %	Prior year %
1–100	98	54.3	54.7
101–200	95	80.1	77.6
201–350	110	88.1	77.4
1–350	**303**	**74.7**	**70.1**

[1]This represents the average non-audit fees paid by each individual FTSE 350 company as a percentage of their audit fees – as such they are not weighted by value of fees.

The average audit fee paid by FTSE 350 companies (for statutory audits and other services pursuant to legislation) has decreased by 8.1% this year with the average non-audit fee decreasing by 7%, possibly a reflection of cost-cutting measures undertaken by companies in response to the economic downturn.

Average audit and non-audit fees

FTSE rank	Current year		Prior year	
	Average audit fee (£m)	Average non-audit fee (£m)	Average audit fee (£m)	Average non-audit fee (£m)
1–100	6.34	2.48	6.87	2.71
101–200	1.14	0.66	1.27	0.63
201–350	0.51	0.39	0.49	0.36
1–350	**2.60**	**1.15**	**2.83**	**1.22**

There was a slight increase in non-audit fees paid by the Mid 250 which, coupled with the decrease in audit fees, led average non-audit fees as a percentage of audit fees to increase slightly (2010: 75%, 2009: 70%). Perhaps counter-intuitively, the smaller companies (201–350) appear to be placing greater reliance on their external auditor to provide consulting services.

The FRC is providing further guidance to audit committees on the use of auditors for non-audit work. Audit committees will need to review their policies for engagement of auditors for non-audit services in light of the revised guidance.

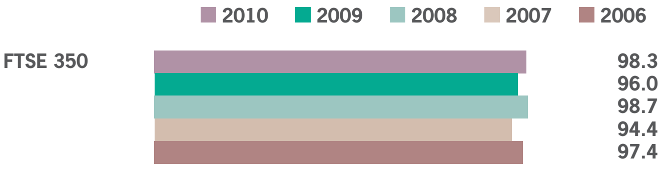
Average non-audit fees as a percentage of audit fees (%)

Industry (size)	Current year %	Prior year %
Utilities (9)	140.2	64.6
Oil & gas (19)	123.7	103.1
Telecommunications (5)	110.7	56.8
Consumer goods (28)	84.0	95.0
Financials (60)	83.6	61.7
Consumer services (65)	75.0	77.8
Technology (16)	70.3	59.2
Healthcare (8)	66.7	65.4
Industrials (71)	53.3	54.9
Basic materials (22)	34.9	71.6
OVERALL AVERAGE	**74.7**	**70.1**

Q23. If the auditor provides non-audit services, is there a statement as to how the auditor's objectivity and independence is safeguarded?

Guidance: "The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded." (Combined Code, C.3.7)

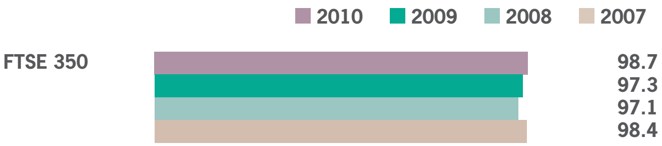
Figure 23 (%)



Q24. Does the company provide a breakdown of audit and non-audit fees?

Guidance: "[The annual report] should: … set out … the fees paid to the auditor for audit services, audit related services and other non-audit services; and if the auditor provides non-audit services, other than audit related services, explain for each significant engagement, or category of engagements, what the services are." (consultation revisions to FRC Guidance on Audit Committees, 4.38)

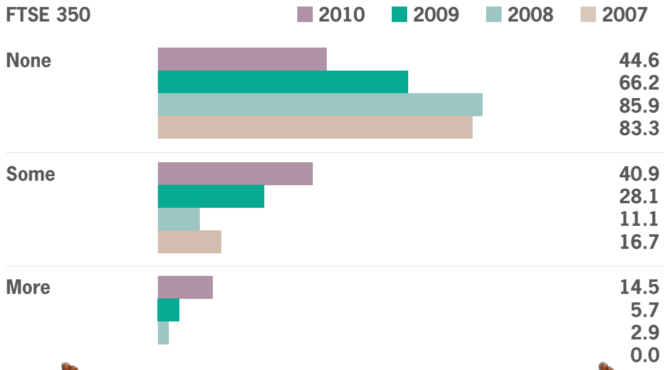
Figure 24 (%)



Q25. To what degree does the audit committee report on how it reached its recommendation to the board on the appointment, reappointment or removal of the external auditors?

Guidance: "The audit committee section of the annual report should explain to shareholders how it reached its recommendation to the board on the appointment, reappointment or removal of the external auditors. This explanation should normally include supporting information on tendering frequency, the tenure of the incumbent auditor and any contractual obligations that acted to restrict the committee's choice of external auditors." (FRC Guidance on Audit Committees, 4.22.)

Figure 25 (%)



'More' disclosure is achieved by including information on:

- dates of appointment and length of tenure
- tender frequency and processes
- restrictions and/or contractual obligations on the choice of auditor
- a review of the auditor's effectiveness
- an assessment of the auditor's qualifications, expertise and resources.

Remuneration committee

After initial growth, the number of board chairmen sitting on the remuneration committee has stabilised at around 40%. Eighteen of these (2009: 15) do not comply with the provisions either as a result of their not being considered independent on appointment as chairman or taking the chair role on the committee.

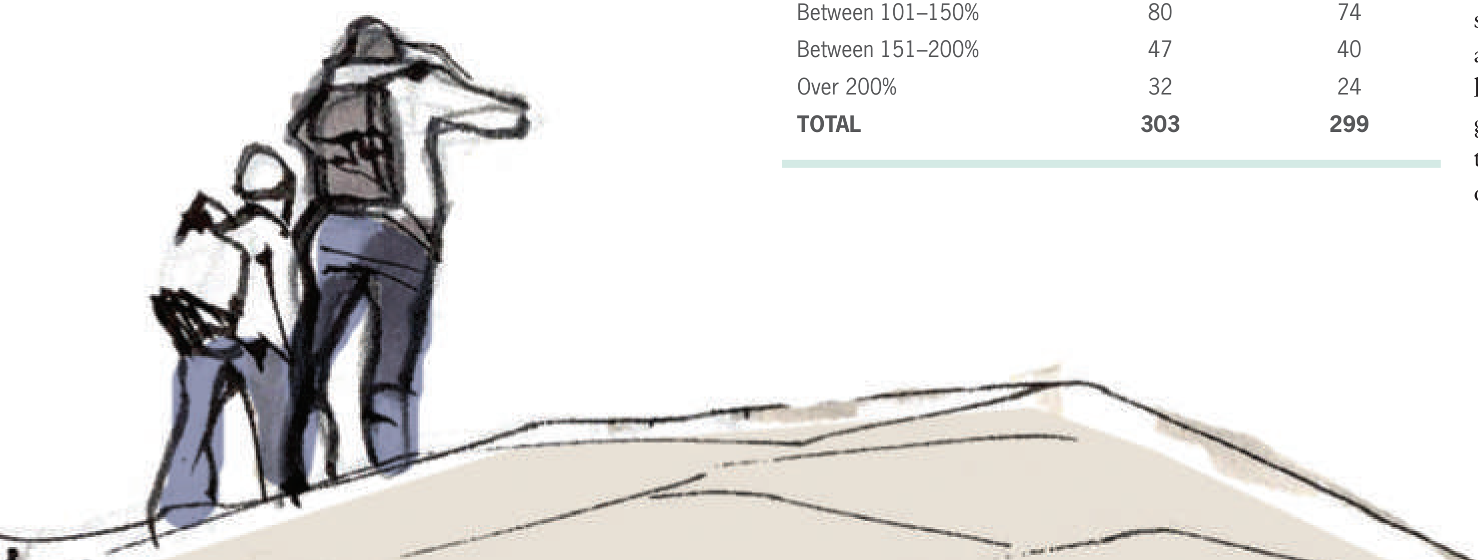
This Code provision was designed to ensure that the chairman is independent of executive management and does not exercise undue influence over the committee.

Ninety four per cent of FTSE 350 companies now disclose upper limits for annual bonuses of executive directors. The average maximum bonus remained virtually static at 138% (2009: 140%) of basic salary. There were 79 companies (2009: 64) offering bonuses in excess of 150% of basic salary. Of the FTSE 350's constituent industries, the financials industry again had the highest with maximum potential bonuses averaging at 212%. Actual bonuses fell considerably short of their potential with awards averaging 66% of the maximum.

% of salary	2010	2009
Not stated	20	29
Between 0–50%	8	7
Between 51–100%	116	125
Between 101–150%	80	74
Between 151–200%	47	40
Over 200%	32	24
TOTAL	**303**	**299**

Industry (size)	Average maximum potential bonus as a % of salary	Average actual bonus awarded as a % of salary	Average actual bonus as a % of maximum potential
Financials (60)	212	114	54
Consumer goods (28)	174	109	63
Oil & gas (19)	158	89	56
Healthcare (8)	150	113	75
Basic materials (22)	148	74	50
Telecommunications (5)	145	100	69
Technology (16)	130	94	72
Consumer services (65)	125	90	72
Utilities (9)	119	87	73
Industrials (71)	117	65	56
OVERALL AVERAGE	**138**	**91**	**66**

Companies awarded bonuses averaging 91% of basic salary. The financials industry awarded the largest bonuses at an average of 114% of basic salary. Not surprisingly however, among financial services the banks showed the greatest restraint with three out of five paying no bonus to the executive directors and the average representing 30% of salary.



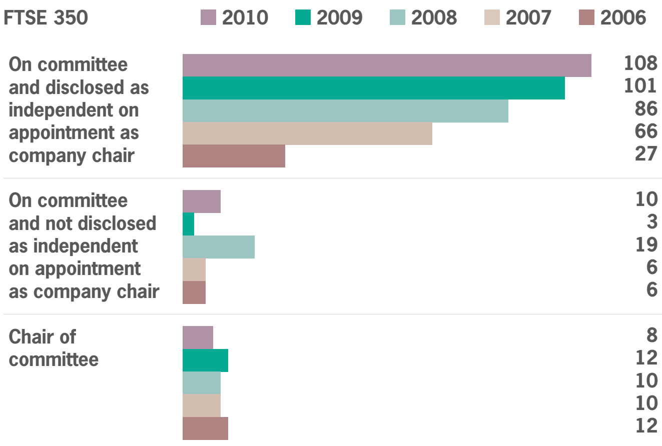
Remuneration committees met on average 5.1 times in the year, more than either the audit or nominations committee, reflecting the increased profile and sensitivity around executive remuneration, the growing complexity of executive pay and long term incentive schemes and the extensive disclosures now required in the annual report.

Further disclosures on executive remuneration are being considered by BIS in their consultation on the future of narrative reporting.

Q26. Does the chairman sit on the remuneration committee?

Guidance: "The company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman." (Combined Code, B.2.1)

Figure 26
FTSE 350

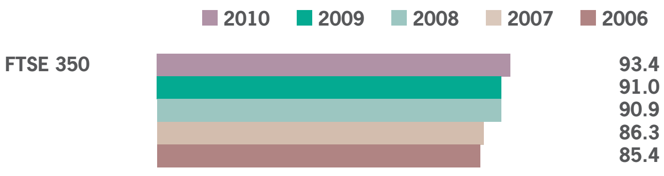


Q27. Does the company state the potential maximum remuneration available for executive directors?

Guidance: "The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors …" (Combined Code, B.1.1)

"… and upper limits should be set and disclosed." (Combined Code, Schedule A)

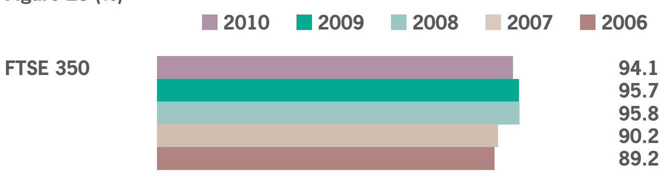
Figure 27 (%)



Q28. Is it stated that the board (or shareholders where required) set the remuneration for the non-executive directors?

Guidance: "The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors." (Combined Code, B.2.3)

Figure 28 (%)



D.1 The Level and Components of Remuneration

Supporting Principle

The performance-related elements of executive directors' remuneration should be stretching and designed to promote the long-term success of the company.

D.1.3 Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options or other performance-related elements.

Schedule A The design of performance-related remuneration for executive directors

Payouts or grants under all incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria reflecting the company's objectives, including non-financial performance metrics where appropriate. Remuneration incentives should be compatible with risk policies and systems.

Consideration should be given to the use of provisions that permit the company to reclaim variable components in exceptional circumstances of misstatement or misconduct.

Nomination committee

Succession planning, performance evaluation, re-appointment (with its increased frequency), director rotation, diversity and even ethical and cultural considerations are areas where the best companies have increasingly been shedding light on what previously were considered 'closed doors' activities.

The challenge is now for those 69% of companies who restrict their comments to the basics to give that extra detail to truly inform the reader.

Nomination committees met on average 2.9 times a year (FTSE 100: 3.9, Mid 250: 2.4), often only convening to discuss board appointments. In 18 companies the nomination committee did not meet at all during the year and another 59 companies only held one meeting. There was a significant discrepancy in meetings between the FTSE 100 and Mid 250 either reflecting the larger size of boards in the FTSE 100, or an enhanced role.

Among the smaller companies, the absence of sufficient independent non-executive directors, often due to retirement or 'unforeseen reasons', was the most common reason for non-compliance with Code provisions. Perhaps suggesting that succession planning needs to assume a more prominent place on the committees' agenda.

Nomination committees will need to take note of the 2010 Code revisions which require companies to consider the benefits of diversity, including gender, in board appointments.

Across the FTSE 350 currently only 4% of executive director positions and 13% of non-executive director positions are filled by women, with 139 companies (46%) having exclusively male boards.

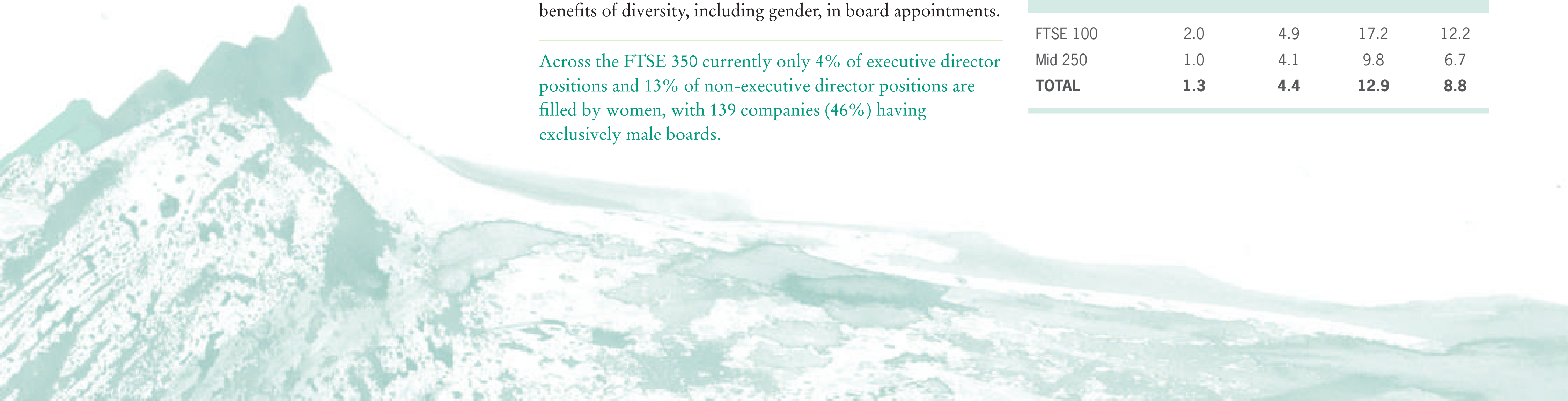
There was a significantly higher proportion of female directors in the FTSE 100 (12%) than the Mid 250 (7%). But in absolute terms this still only amounted to 247 female director positions, of which 132 were in the FTSE 100. Taking into account multiple directorships, there were 217 women sitting on the boards of FTSE 350 companies.

The government has recently launched a consultation on 'Women on Boards' led by Lord Davies. One of the reported options on the table is the introduction of a direct quota requiring up to 40% of board directors to be female.

Whatever proposal makes it through into practice, it will take time. Meanwhile, with fewer women directors in the proving ground that is the Mid 250 than the FTSE 100, this imbalance suggests that a problem may be building for the future.

Gender diversity (% director positions held by women)

FTSE rank	Chairman	Executive Director	NED	Total
FTSE 100	2.0	4.9	17.2	12.2
Mid 250	1.0	4.1	9.8	6.7
TOTAL	**1.3**	**4.4**	**12.9**	**8.8**



Q29. Is there a description of the work of the nomination committee, including the process it has used in relation to board appointments?

Guidance: "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." (Combined Code, A.4.6)

Figure 29 (%)

FTSE 350

	2010	2009	2008	2007	2006
None	2.6	4.0	9.8	15.0	26.4
Some	66.7	66.6	66.7	61.4	50.6
More	30.7	29.4	23.5	23.5	22.9

Those companies providing 'more' disclosure gave details on:

- succession planning
- search and interview processes and the use of external recruitment consultants
- the skills required for the board
- process for reviewing effectiveness of the board
- consideration of re-appointment of directors.

B.2 Appointments to the Board

Supporting Principles

The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.

Internal control

Only 25% of companies provide a detailed description of how they go about reviewing the effectiveness of internal controls, even though they all undertake such a review. With so many companies giving the briefest of explanations, or in 22 cases no explanation, it is difficult to gain any real insight as to how this important oversight role is effected throughout the year. The absence of disclosure seems merely to reinforce the apparent compliance nature of the exercise.

The Code requires this review to cover all material controls including financial, operational and compliance controls, and risk management systems. Sixty nine per cent of companies disclosed that their review covered all of these types of controls. Eighty one companies make no reference to their operational and compliance systems of control and 33 make no mention of their risk management system.

The effectiveness of risk management and internal control systems is attracting greater attention in part driven by the recent economic downturn. It is perhaps surprising that companies are still not taking the opportunity to give greater insight and therefore assurance to shareholders as to how their management safeguard the business.

The Turnbull Guidance on Internal Control requires companies to disclose any actions taken in response to significant failings identified. Only three companies disclosed specific control weaknesses and there was only limited disclosure on the existence or non-existence of reportable weaknesses.

Boilerplate disclosures are commonplace here and it is unclear whether control weaknesses were identified and are being resolved, or whether none existed. The introduction of a positive statement that there have been no material internal control failures identified in the year might encourage greater focus and clarity in this area.

The quality of disclosures on companies' internal control processes continues to strengthen, with 78% now providing meaningful descriptions as to the key elements of their system of internal control. The best companies recognise the role of risk management in identifying principal risks and understanding the controls or other activities which are key to the management of those risks.

The 2010 Code has introduced a new principle regarding the board's responsibility for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives.

The FRC planned to review the Turnbull Guidance on Internal Control in late 2010, for the first time in five years. However this review has been deferred until 2011 due to recent developments such as the BIS consultation 'A Long-Term Focus for Corporate Britain' and EU Green Papers on corporate governance. It is clear from the results of our survey that there remains further scope for improvement in this area.

Forty six per cent (2009: 39%) of FTSE 100 companies and 26% (2009: 24%) of Mid 250 companies have a separate risk committee. Of these 100 risk committees 75 included board directors among their membership. The regulated industries of utilities and financials are the strongest proponents of having separate risk committees with financials, excluding real estate, being 66%.

Industry (size)	Separate risk committee %	With board representation %
Utilities (9)	56	80
Financials (60)	52	74
Consumer goods (28)	36	100
Technology (16)	31	80
Basic materials (22)	27	100
Industrials (71)	27	68
Oil & gas (19)	26	80
Healthcare (8)	25	100
Consumer services (65)	25	56
Telecommunications (5)	20	0
OVERALL AVERAGE	**33**	**75**

C.2 Risk Management and Internal Control

Main Principle

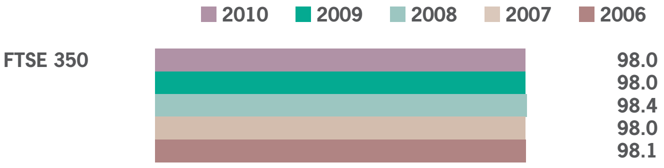
The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

Internal control

Q30. Is there a statement that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company?

Guidance: "The board should, as a minimum, disclose that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, [and] that it has been in place for the year under review." (Turnbull, paragraph 34)

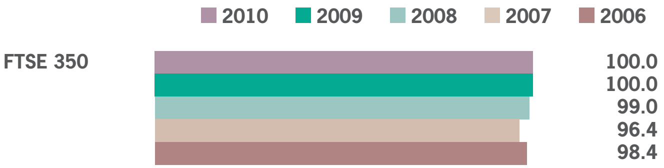
Figure 30 (%)



Q31. Is there a statement that a review of the effectiveness of the group's internal controls has been undertaken at least annually?

Guidance: "The board should at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so." (Combined Code, C.2.1)

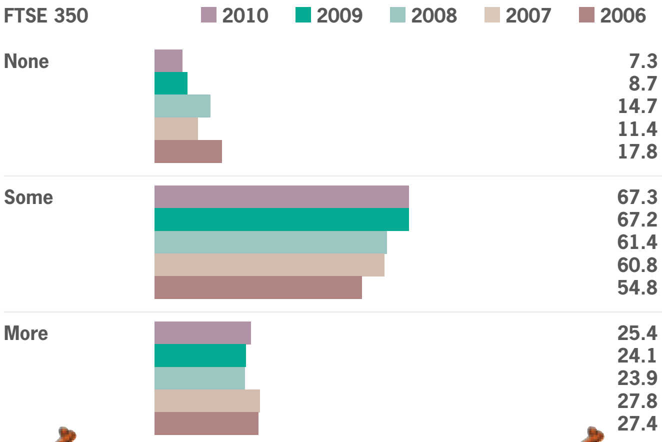
Figure 31 (%)



Q32. Is there a summary of the process the board/committees have applied in reviewing the effectiveness of the system of internal control?

Guidance: "In relation to Code provision C.2.1, the board should summarise the process it has applied in reviewing the effectiveness of the system of internal control." (Turnbull paragraph 36)

Figure 32 (%)



Most companies made reference to their application of the Turnbull guidance, 'more' was achieved by those companies that then went on to provide a detailed description of how they have applied this guidance to their own process. These included:

- the areas of the system that have been reviewed and the rationale for their selection
- the method used for analysis (eg through analysis of reports from management, self certification and/or internal audit)
- reviews of any internal guidance documents on internal control
- any specific areas which are given a more detailed review due to their importance to the sector/industry in which the company operates.

Q33. Is it clear that this review covers all material controls including financial, operational and compliance controls, and risk management systems?

Guidance: "The review [of the effectiveness of the group's system of internal control] should cover all material controls, including financial, operational and compliance controls and risk management systems." (Combined Code, C.2.1)

Figure 33 (%)

Q34. How much information is there surrounding the company's risk management and internal control process?

Guidance: "The annual report and accounts should include such meaningful, high level information … to assist shareholders' understanding of the main features of the company's risk management processes and system of internal control." (Turnbull paragraph 33)

Figure 34 (%)

FTSE 350

	2010	2009	2008	2007	2006
None	0.0	0.0	1.0	2.3	1.9
Some	22.4	24.4	25.5	25.5	28.0
More	77.6	75.6	73.5	72.2	70.1

Best disclosures outlined the key elements of a company's internal control system including:

- the key business objectives
- the organisation structure and reporting lines
- procedures to ensure compliance with external regulations
- alignment/embedding with corporate values and a code of ethics
- procedures to learn from control failures
- range of corporate policies, procedures and training
- examples of reviews of control activities and response resolution
- active engagement of senior management in process.

Figure 34 (%)

FTSE 100

	2010	2009	2008	2007	2006
None	0.0	0.0	1.0	1.0	1.0
Some	10.2	12.1	11.3	10.3	10.2
More	89.8	87.9	87.6	88.7	88.8

Figure 34 (%)

Mid 250

	2010	2009	2008	2007	2006
None	0.0	0.0	1.0	2.9	2.3
Some	28.3	30.5	32.1	32.5	36.1
More	71.7	69.5	67.0	64.6	61.6

Q35. Is there specific reference to the financial reporting process and associated controls?

Guidance: "The corporate governance statement must contain a description of the main features of the [company's] internal control and risk management systems in relation to the financial reporting process." (Disclosure and Transparency Rules 7.2.5 R)

Figure 35 (%)

	2010	2009	2008	2007
FTSE 350	90.8	83.3	77.1	47.4

Shareholder relations

The number of companies providing detailed disclosures on shareholder relations has steadily increased in recent years, a trend that has continued in this review. The greater the lengths to which a company goes to understand its shareholders' views, the greater the opportunity for shareholders to promote good governance through dialogue with the company. This year 59% (2009: 56%) of companies detailed how the board has demonstrated the steps taken to understand the views of major shareholders.

In issuing the Stewardship Code in July 2010, the FRC emphasised the importance of the role that shareholder engagement has to play in the establishment of effective governance practices. This Code's stated aim is to encourage institutional investors to promote good governance in investee companies through high quality dialogue.

The most informative disclosures describe initiatives including formal presentations of full year and interim results, briefing meetings between executive directors and institutional investors, non-executive directors attending meetings, regular presentations to the City, communication via the company website and responses to shareholder enquiries through an investor relations department.

There remains a significant disparity between the FTSE 100 and Mid 250 companies with only 50% of Mid 250 companies providing detailed information on shareholder relations, in comparison to 78% of FTSE 100 companies. Perhaps this reflects the difficulty that the smaller companies often refer to in getting airtime with the institutions.

The highest proportions of companies providing detailed disclosures in this area were in the basic materials and oil & gas industries (77% and 68% respectively). In the financials industry, only 53% of companies provided these detailed disclosures. This is a surprising finding as the Walker report's recommendations for shareholders to promote good governance specifically applied to the financials industry.

The Investment Management Association's (IMA) first formal report, on behalf of its members and overseen by the FRC, is due to be published in the first half of 2011. In parallel, individual institutions have been encouraged to publish more information on their websites about investee engagement, with the FRC maintaining a list of all these statements. It will be interesting to see if company and investor reporting tells a similar picture.

E.1 Dialogue with Shareholders

Supporting Principles

Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman should ensure that all directors are made aware of their major shareholders' issues and concerns.

Q36. To what degree does the board demonstrate the steps taken to understand the views of major shareholders?

Guidance: "The board should state in the annual report the steps they have taken to ensure that members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company ..." (Combined Code, D.1.2)

Figure 36 (%)
FTSE 350

	2010	2009	2008	2007	2006
None	0.7	3.0	2.6	7.8	2.2
Some	40.3	41.5	50.0	48.4	65.9
More	59.1	55.5	47.4	43.8	31.8

Figure 36 (%)
FTSE 100

	2010	2009	2008	2007	2006
None	1.0	4.0	2.1	3.1	3.1
Some	21.4	26.3	29.9	34.0	54.1
More	77.6	69.7	68.0	62.9	42.9

Figure 36 (%)
Mid 250

	2010	2009	2008	2007	2006
None	0.5	2.5	2.9	10.0	1.9
Some	49.3	49.0	59.3	55.0	71.3
More	50.2	48.5	37.8	34.9	26.8

Many companies had separate sections for shareholder relations, with the best companies making reference to:

- avenues for engagement with shareholders
- non-executive engagement with investors
- format of communication through the annual general meeting
- dedicated resources such as an investor relations department
- use of company website with dedicated investor section
- regularity of presentations to the City and financial institutions.

Business review

Eighty seven per cent of the FTSE 350 now provide detailed explanations of their business and external environment, with all companies providing at least some detail. However only 23% of FTSE 350 companies (FTSE 100: 35%, Mid 250: 18%) yet provide sufficient information to meet the more exacting Code requirement to explain their 'business model'.

The enhanced business review for quoted companies, introduced by the Companies Act 2006, requires disclosures on the company's development, performance and position at the year-end; the main trends and factors likely to affect its future development; and its principal risks and key performance indicators.

BIS has recently issued a consultation document on 'The Future of Narrative Reporting' with formal proposals expected by the end of the year. It is anticipated this will enhance disclosure requirements and lead to the introduction of the 'son of OFR'.

New provisions in the 2010 Code will require companies to disclose more detailed information on how they will generate and preserve value over the long term and the strategy for delivering the objectives of the company.

There appears to be some reticence to provide detailed information on the strategy and future direction of their business. Only 42% (FTSE 100: 50%, Mid 250: 38%) provide anything approaching detailed disclosures in this area. As this information is often publicly available outside of the annual report, on company websites and in analyst presentations, it is puzzling why companies are so reluctant to provide this key information within the business review.

When it comes to linking strategic objectives, risks and KPIs, only 21% of FTSE 350 companies (FTSE 100: 33%, Mid 250: 16%) clearly linked their objectives to KPIs, and 37 companies provided no link at all.

The way by which companies are able to articulate and report on the connection between their overall strategic objectives, risks and KPIs (both financial and non-financial) is a concept promoted by The Prince's Accounting for Sustainability Project. This together with the work of the recently inaugurated International Integrated Reporting Committee, may provide a blueprint for corporate reporting in the future.

There has been a growing trend for companies to present their detailed CSR report via their website, restricting disclosure within the annual report to their most significant social, environmental and ethical matters. This has led to a more focused disclosure in the annual reports. Compliance with the Companies Act remains strong with only nine companies failing to provide at least high level disclosures on the required areas of environmental matters, company employees and social and community issues.

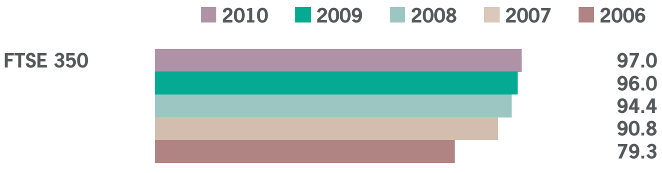
Virtually all companies have assessed the impact of their business on the environment, with 28% of companies considering the environment to be one of their principal business risks. However 56% of companies do not include an environmental KPI in their business review.

The area of narrative reporting was given greater attention in the FRRP's 2010 Annual Report and is likely to remain a key area of interest for the Panel. In particular, they are looking at opportunities for 'clear linkages between the narrative and accounts'.

Q37. Has the company provided a separate business review in the directors' report?

Guidance: "Unless the company is entitled to small companies exemption in relation to the directors' report, the report must contain a business review." (Companies Act 2006 s417; 1)

Figure 37 (%)



C.1 Financial and Business Reporting

C.1.2 The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company.

[1]It would be desirable if the explanation were located in the same part of the annual report as the Business Review required by Section 417 of the Companies Act 2006. Guidance as to the matters that should be considered in an explanation of a business model is provided in paragraphs 30 to 32 of the Accounting Standard Board's Reporting Statement: Operating And Financial Review.

Business review

Q38. To what extent do companies describe their business and the external environment in which they operate?

Guidance: "The review required is a balanced and comprehensive analysis of the development and performance of the company's business during the financial year, and the position of the company's business at the end of that year, consistent with the size and complexity of the business." (Companies Act 2006 s417; 4)

Figure 38 (%)

FTSE 350

	2010	2009	2008	2007
None	0.0	0.3	1.6	4.9
Some	12.9	15.4	16.3	43.1
More	87.1	84.3	82.0	52.0

Companies providing 'more' detailed disclosures give a description of:

- the structure of the business
- the company's main products and services
- main operating facilities and locations
- key customers and suppliers
- relevant sector or industry specific information including the regulatory and competitive environment.

Q39. To what extent do companies describe the likely future development of their business?

Guidance: "The business review must … include the main trends and factors likely to affect the future development, performance and position of the company's business" (Companies Act 2006 s417; 5a)

Figure 39 (%)

FTSE 350

	2010	2009	2008	2007
None	0.3	0.7	4.6	17.0
Some	58.1	69.6	68.3	62.7
More	41.6	29.8	27.1	20.3

The best disclosures provide:

- a clear description of the company's objectives
- an explanation of strategies designed to achieve these objectives
- areas of business which the company expects to develop in the near future
- general discussion of more long term plans
- relevant information on trends and factors, both company specific and market-wide.

Q40. Is there a statement that an assessment of the impact of the company's business on the environment has been undertaken?

Guidance: "In the case of a quoted company the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about (i) environmental matters, (ii) the company's employees, and (iii) social and community issues." (Companies Act 2006 s417; 5b)

Figure 40 (%)

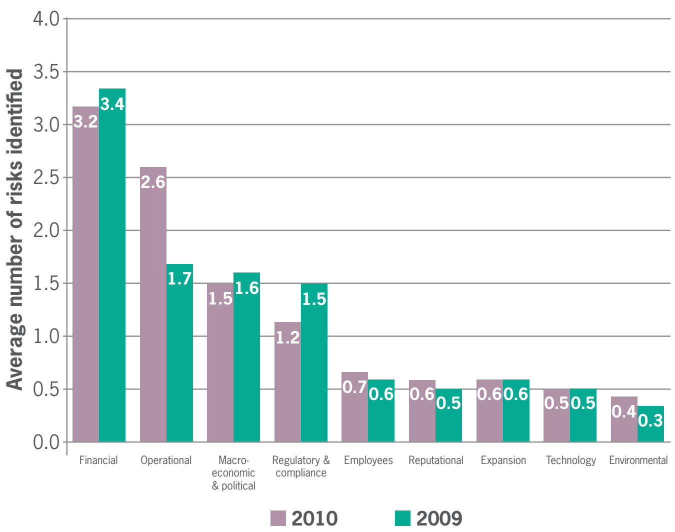
FTSE 350

	2010	2009	2008
None	98.0	95.0	59.8

Risks

The quality of disclosure of principal risks was strong, with 63% of FTSE 350 companies providing detailed descriptions of the risks, explaining their specific impact on the company and the mitigating actions being taken.

Average number of principal risks identified



There remains, however, a significant minority of companies, especially in the Mid 250, who provide only generic risk descriptions and/or fail to explain how they are managing these risks. It seems strange that some companies are willing to disclose the principal risks they face, but fail to explain how these risks are managed and controlled. One consequence might be that investors and other stakeholders conclude that the company's control environment is inherently weak, and so look to reduce their exposure.

The best disclosures were often shown in tabular format clearly stating a good description of the risk, an explanation of how it impacts the company and actions taken to mitigate the risk. A link to objectives and/or specific business segments was also provided in the very best examples. We found little correlation between the length of disclosure and the quality. We identified a number of reports with extensive disclosure but which failed to meet our best practice criteria.

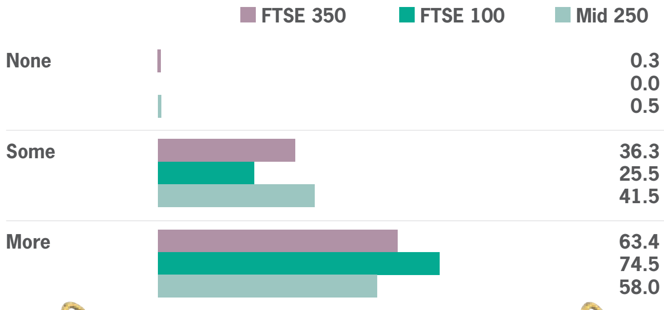
On average companies identified 11.2 (2009: 10.7) principal risks. But this masked a significant spread of reporting ranging from 4 to 33 risks. Those at the extremes might benefit from a reprioritisation of their impact in order to highlight their true risk profile.

While financial risks (eg credit, currency, liquidity, interest rates, etc) are the most prominent, operational risks are assuming greater profile, 2.6 (2009: 1.7). Perhaps surprising was a decline in regulatory and compliance risks to 1.2 (2009: 1.5) hinting at companies' greater focus on the basics of business during a period of intense recession.

Q41. To what extent do companies describe their principal business risks and uncertainties?

Guidance: "The business review must contain a description of the principal risks and uncertainties facing the company." (Companies Act 2006 s417; 3)

Figure 41 (%)



Companies giving more detailed descriptions provided:

- sufficient detail to understand the risk, and how it specifically relates to the business
- an indication of how company strategy is impacting the risk profile
- an analysis of the potential impact of the risk
- information on how each risk is being mitigated
- detail on how the risk is being monitored and measured, through, for example, the use of key risk indicators.

Business review

An analysis of the average number of risks disclosed by category by industry

Risk category	Industry (size)										
	Average	Healthcare (8)	Oil & gas (19)	Basic materials (22)	Utilities (9)	Consumer services (65)	Consumer goods (28)	Financials (60)	Industrials (71)	Technology (16)	Telecom-munications (5)
Financial	3.2	4.4	4.0	3.1	2.7	3.4	2.8	4.1	2.9	1.4	1.6
Operational	2.6	2.7	3.5	3.8	3.3	2.3	3.1	2.2	2.0	3.1	2.6
Macro-economic & political	1.5	1.3	1.7	1.6	1.8	1.7	1.6	1.4	1.4	1.6	1.4
Regulatory & compliance	1.2	3.6	1.2	1.3	2.6	1.3	1.4	0.9	0.9	0.9	1.0
Employees	0.7	0.6	0.8	0.6	0.1	0.7	0.7	0.6	0.7	0.8	0.2
Reputational	0.6	0.3	0.9	0.5	0.4	0.9	0.8	0.5	0.5	0.1	0.6
Expansion	0.6	1.7	0.9	0.9	0.4	0.4	0.5	0.3	0.7	0.7	0.4
Technology	0.5	0.3	0.1	0.2	0.3	0.8	0.4	0.2	0.6	0.9	1.0
Environmental	0.4	0.4	0.7	0.6	0.9	0.4	0.7	0.1	0.3	0.0	0.2
Average total number of risks	**11.2**	**15.3**	**13.9**	**12.6**	**12.6**	**11.9**	**11.8**	**10.4**	**10.0**	**9.4**	**9.0**

Key performance indicators

The quality of KPI disclosures is patchy, with only 31% of FTSE 350 companies (FTSE 100: 44%, Mid 250: 24%) providing detailed explanations of their KPIs. There are still 13 companies (2009: 27) who do not disclose any KPIs at all.

Average number of KPIs disclosed by industry

Industry (size)	Financial KPIs	Non-financial KPIs	Total
Utilities (9)	3.9	5.4	9.3
Consumer goods (28)	4.5	3.9	8.4
Telecommunications (5)	5.0	3.2	8.2
Consumer services (65)	4.5	3.6	8.0
Industrials (71)	5.0	3.0	8.0
Basic materials (22)	3.9	4.1	8.0
Technology (16)	4.8	2.1	6.9
Financials (60)	4.9	2.8	7.7
Healthcare (8)	3.9	3.1	7.0
Oil & gas (19)	4.0	2.7	6.7
OVERALL AVERAGE (303)	**4.6**	**3.3**	**7.9**

The best disclosures explained why KPIs were chosen and explicitly linked them into their objectives, often through a table or diagram. They also compared performance with prior years and set broad targets for future years.

Many companies appeared reluctant to disclose future targets for their KPIs in the annual report, although this information was often publicly available through other sources.

The choice of KPI remains varied and diverse, making it difficult for readers to benchmark the information against others in the same sector. There is more consistency within financial KPIs such as Earnings Per Share (EPS), Return on Capital Employed (ROCE) and Earnings Before Interest, Depreciation and Amortisation (EBITDA) being recognised metrics supported by common accounting practice and underpinned by external audit.

The government consultation on narrative reporting poses the question of whether more guidance would be helpful, in for example the use and selection of KPIs. The risk however is that such lists can all too easily lead to large numbers of indicators being presented, without any clarity as to which ones are key to a particular company's business.

The average number of KPIs reported this year was 7.9 (4.6 financial and 3.3 non-financial). Financial KPIs are well established but for non-financial, practice is continuing to emerge with 53 companies (2009: 103) yet to provide any non-financial KPIs.

Only 49 companies provide no comparative data on non-financial KPIs. However, just 21 companies (2009: 17) are using external independent bodies to provide assurance over any of their non-financial KPIs, with a further 16 using internal audit. This brings into question the relevance, reliability and comparability of the data, and therefore its ability to add value.

Greater comparability and value might be derived through establishing common measurement and greater use of sources of external assurance, as has been the case with KPIs around carbon reporting. However, judging by our review, extracting real value from the wider KPI reporting is some way off.

There has been a big increase in environmental KPIs, particularly around carbon reporting.

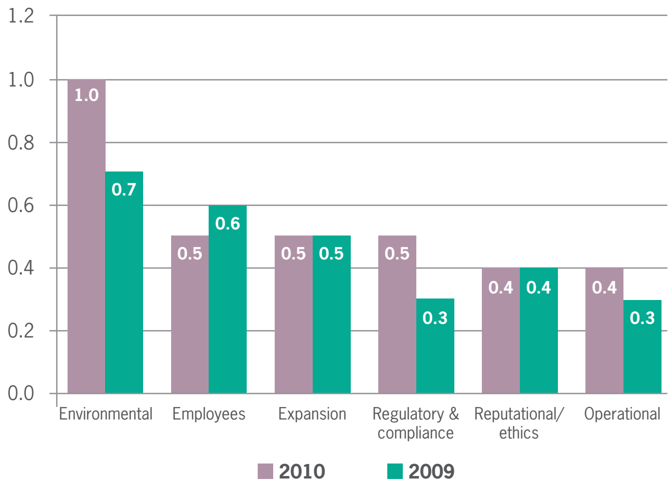
The non-financial KPIs continue to be spread across a broad range of categories with environmental and employee KPIs being the most prominent, possibly reflecting their specific mention in the Companies Act 2006.

In addition to KPIs in the business review, many companies report additional KPIs in their corporate responsibility section of the annual report covering social, environmental and employee matters. We have not included these additional performance indicators in our analysis here, instead concentrating on key strategy-linked KPIs.

Business review

Breakdown of financial KPIs by type
Average number in FTSE 350

Breakdown of non-financial KPIs by type
Average number in FTSE 350



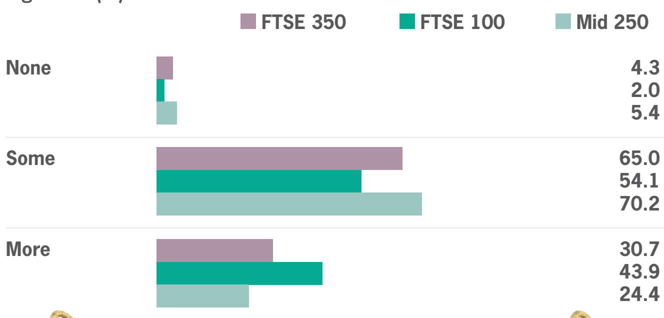
Q42. To what extent do companies describe specific key performance indicators (KPIs) which measure the performance of their business?

Guidance: "The [business] 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."

'Key performance indicators' means factors by reference to which the development, performance or position of the company's business can be measured effectively.

(Companies Act 2006 s417; 6)

Figure 42 (%)



The best disclosures:

- link KPIs to the company's objectives explaining why they have been selected and what they measure
- disclose quantifiable results that are compared to prior years
- explain how they are calculated and the source of data
- include future targets or expectations.

An analysis of the average number of KPIs disclosed by category by industry

Financial KPIs	Industry (size)										
	Average	Basic materials (22)	Consumer goods (28)	Consumer services (65)	Financials (60)	Healthcare (8)	Industrials (71)	Oil & gas (19)	Technology (16)	Telecom-munications (5)	Utilities (9)
Profits and costs	**1.8**	2.1	1.6	1.9	1.8	1.4	1.7	1.4	2.3	2.4	1.7
Revenue	**1.2**	0.4	1.4	1.5	1.1	1.3	1.4	0.6	1.5	1.2	0.2
Shareholders' funds	**0.6**	0.6	0.6	0.4	0.9	0.3	0.7	0.6	0.3	0.0	0.8
Working capital	**0.5**	0.4	0.6	0.3	0.4	0.6	0.8	0.9	0.6	0.6	0.4
Capital expenditure and other assets	**0.3**	0.2	0.1	0.2	0.5	0.1	0.1	0.6	0.1	0.8	0.3
Interest and debt	**0.2**	0.2	0.3	0.2	0.3	0.3	0.3	0.1	0.0	0.0	0.4
Average total number of financial KPIs	**4.6**	**3.9**	**4.5**	**4.5**	**4.9**	**3.9**	**5.0**	**4.0**	**4.8**	**5.0**	**3.9**

Non-financial KPIs	Industry (size)										
	Average	Basic materials (22)	Consumer goods (28)	Consumer services (65)	Financials (60)	Healthcare (8)	Industrials (71)	Oil & gas (19)	Technology (16)	Telecom-munications (5)	Utilities (9)
Environmental	**1.0**	1.0	1.6	1.1	0.8	0.8	1.1	0.3	0.4	1.6	2.1
Employees	**0.5**	1.0	0.6	0.4	0.1	0.5	0.5	1.0	0.1	0.0	0.8
Expansion	**0.5**	0.5	0.4	0.4	0.5	0.4	0.6	0.4	0.6	0.4	0.6
Regulatory & compliance	**0.5**	1.0	0.6	0.4	0.1	0.5	0.5	1.0	0.1	0.0	0.8
Reputational	**0.4**	0.2	0.5	0.6	0.7	0.3	0.2	0.1	0.2	0.8	1.2
Operational	**0.4**	1.1	0.3	0.3	0.2	0.1	0.2	0.6	0.1	0.2	0.8
Average total number of non-financial KPIs	**3.3**	**4.1**	**3.9**	**3.6**	**2.8**	**3.1**	**3.0**	**2.7**	**2.1**	**3.2**	**5.4**

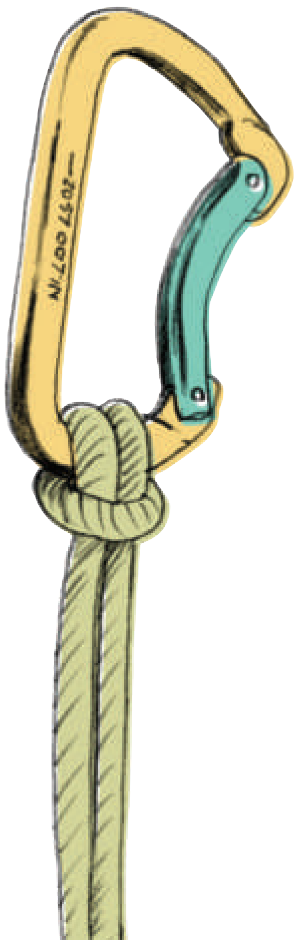
Recent developments

	Comments	Timing
FRC – Governance of Companies		
The UK Corporate Governance Code (June 2010)	• Last major revisions to Code in 2003, with limited amendments in 2006 and 2008. • Adopts Walker review recommendations where relevant to all listed companies. • Retention of 'comply or explain' concept.	• Applicable to reporting periods beginning on or after 29 June 2010.
Internal control (Turnbull guidance)	• Proposed review of Turnbull guidance on risk management and internal control (see page 34).	• Consultation deferred until 2011.
FRC guidance on Audit Committees (formerly Smith guidance)	• Limited changes proposed on consideration of non-audit services provided by a company's auditor (see page 28).	• Consultation closed in October 2010.
Higgs report (best practice guidance relating to non-executive directors)	• Draft guidance on 'Improving Board Effectiveness' to replace the Higgs report (see page 18). • Short, non-prescriptive guidance will have considerable influence over how boards operate in the future.	• Updated guidance expected by early 2011.
FRC – Governance of Investors		
Stewardship Code for Institutional Investors (July 2010)	• Walker report recommendation to enhance the quality of engagement between institutional investors and companies (see page 38). • Replaces Section E 'Institutional Shareholders' of the 2008 Combined Code.	• Voluntary disclosures in September 2010. • FSA to begin consultations in late 2010 on mandatory disclosure requirements.
Department for Business, Innovation and Skills consultation papers		
A Long Term Focus for Corporate Britain	• Review into corporate governance and economic short termism in UK equity markets.	• Consultation ends January 2011 with government proposals to be published in April 2011.
Women on Boards	• Review into obstacles that prevent women from reaching senior positions in business. • Considering option of a direct quota of 30–40% membership of board.	• Recommendations to be developed into a business strategy for publication in February 2011.

Key changes in the 2010 UK Corporate Governance Code

- Board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives (see page 35).
- More emphasis on the role of chairman (see pages 15 and 38).
- Enhanced role for the senior independent director (see page 16).
- Diversity, including gender, to be taken into account for new board appointments (see page 33).
- Externally facilitated evaluations of the board at least every three years (see page 19).
- Annual election of directors (see page 19).
- Enhanced disclosure of business model and strategy in the annual report (see page 41).
- Performance related remuneration (see page 31):
  - criteria for achievement of executive bonuses
  - consider use of 'claw-back' provisions for bonuses
  - no performance-related elements in non-executive directors' remuneration.

	Comments	Timing
European Union		
European Commission Green Paper on corporate governance in financial institutions	• Questions the future of the 'comply or explain' principle. • A broader review planned on corporate governance within listed companies.	• Initial consultation ended September 2010, with proposals expected in 2011.
Narrative reporting		
Business Review (s417 Companies Act 2006)	• Consultation on 'The Future of Narrative Reporting'. • Proposed reintroduction of the 'Operating & Financial Review' (see page 40).	• Government proposals to be issued by the end of the year.
The Prince's Accounting for Sustainability Project	• Development of the concept of the Connected Reporting Frameworks (see page 40).	• Connected Reporting Framework developed in 2007 with additional guidance in 2009.
International Integrated Reporting Committee (IIRC)	• A remit to create a globally accepted framework for accounting for sustainability.	• IIRC established in August 2010.
ASB Reporting Statement on Operating and Financial Review (Voluntary)	• ASB issued 'Rising to the Challenge', a review of narrative reporting by UK listed companies, in 2009.	• No planned update, pending government consultation on "The Future of Narrative Reporting".
IASB Exposure Draft on Management Commentary guidance	• "Provides a context within which to interpret the financial position, performance and cash flows of an entity … to understand management's objectives and its strategies."	• Expected to be issued in 2010.
Transparency Directive Consultation	• Limited impact on large listed companies. • Consults on reduced transparency obligations for small listed companies (including definition of small).	• Initial consultation ended August 2010.



Grant Thornton highlights

Grant Thornton International

- Fee income US $3.6bn
- More than 500 locations in over 100 countries
- Over 30,000 staff and 2,500 partners
- The fastest growing international accounting organisation for the past three years

Grant Thornton UK LLP

- Nearly 4,000 staff across 28 locations
- 215 partners
- Fee income of £380m
- Full service practice with extensive specialist advisory services
- Provide non audit services to 1 in 6 of the FTSE 100

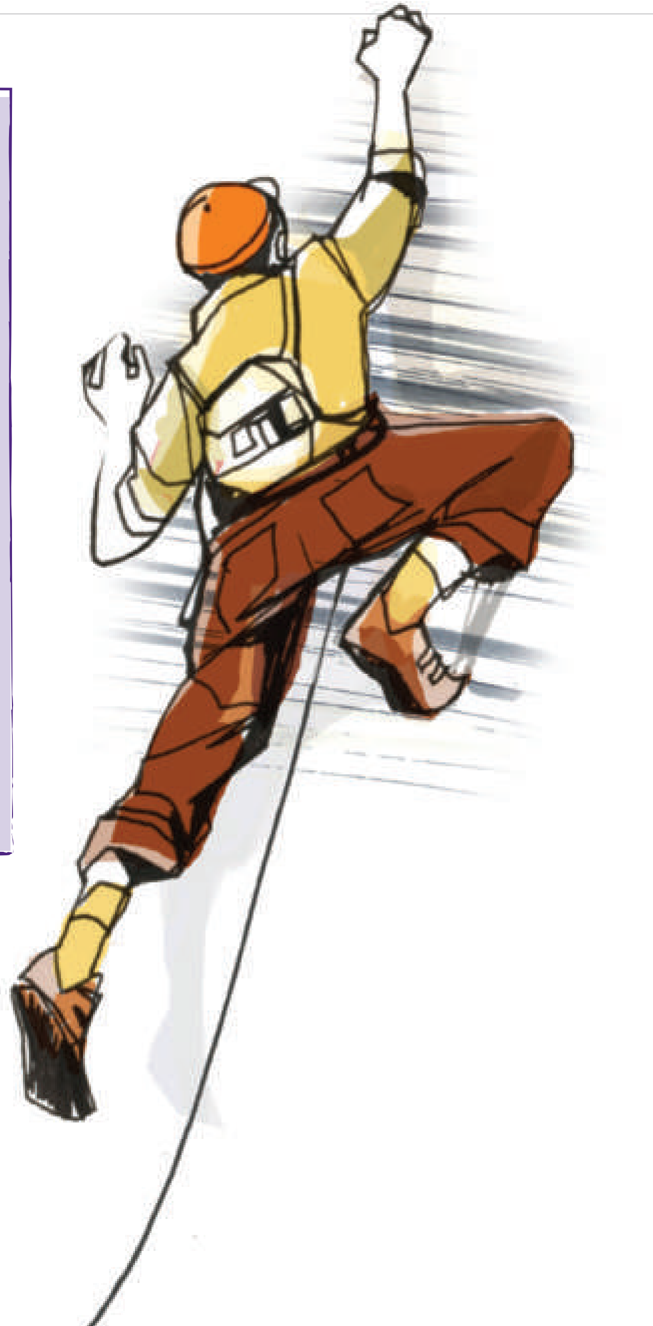
Business Risk Services

Globally

- Over 1,300 dedicated internal audit and business risk professionals worldwide in key financial centres
- Revenues US $280 million

In the UK

- Over 120 professionals with significant experience in the provision of governance, risk and compliance services
- Significant experience in providing services to complex global organisations
- Numerous FTSE 350 and equivalent clients
- Integrated financial services and technology risk teams



Business Risk Services

We have proven international capability and experience of adding value to clients' governance, risk, internal audit, technology and business process change programmes.

Assurance

- Outsourcing or co-sourcing of internal audit
- Internal audit effectiveness reviews
- Operational audit
- Revenue, contract and cost verification audits
- SAS 70 and AAF 01/06

Advisory

- Governance
- Enterprise risk management
- Process and control improvement
- Post-merger integration
- Fraud risk assessment
- Programme management
- Sarbanes-Oxley

IT Advisory & Assurance

- Outsourced IT audit
- IT audit co-sourcing
- Data mining
- Security
- Post implementation reviews
- IT strategy and assessment
- ERP evaluation and selection
- Project management
- Accounts payable automation
- On demand ERP solutions

Notes

Contact us

Head of Business Risk Services
Simon Lowe
T 020 7728 2451
E simon.j.lowe@uk.gt.com

London and South
Martin Gardner
T 020 7728 2847
E martin.n.gardner@uk.gt.com

Eddie Best
T 020 7728 2849
E eddie.best@uk.gt.com

Sandy Kumar
T 020 7728 3248
E sandy.kumar@uk.gt.com

Philip Keown
T 020 7728 2394
E philip.r.keown@uk.gt.com

Alan Lees
T 020 7865 2392
E alan.lees@uk.gt.com

Midlands
Lorna Barry
T 0121 232 5226
E lorna.barry@uk.gt.com

North
Ian Falconer
T 0161 953 6480
E ian.falconer@uk.gt.com

For other queries please contact your local Grant Thornton office:

Belfast
T 028 9031 5500

Birmingham
T 0121 212 4000

Bristol
T 0117 305 7600

Bury St Edmunds
T 01284 701271

Cambridge
T 01223 225600

Cardiff
T 029 2023 5591

Edinburgh
T 0131 229 9181

Gatwick
T 01293 554130

Glasgow
T 0141 223 0000

Ipswich
T 01473 221491

Kettering
T 01536 310000

Leeds
T 0113 245 5514

Leicester
T 0116 247 1234

Liverpool
T 0151 224 7200

London
T 020 7383 5100

Manchester
T 0161 953 6900

Milton Keynes
T 01908 660666

Newcastle
T 0191 261 2631

Northampton
T 01604 826650

Norwich
T 01603 620481

Oxford
T 01865 799899

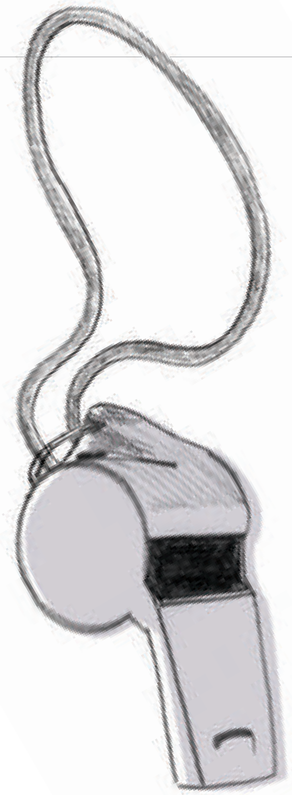
Reading
T 01189 839600

Sheffield
T 0114 255 3371

Slough
T 01753 781001

Southampton
T 023 8038 1100

Or alternatively, email us at
heretohelp@uk.gt.com



Grant Thornton

www.grant-thornton.co.uk

GT.587.10