Grant Thornton

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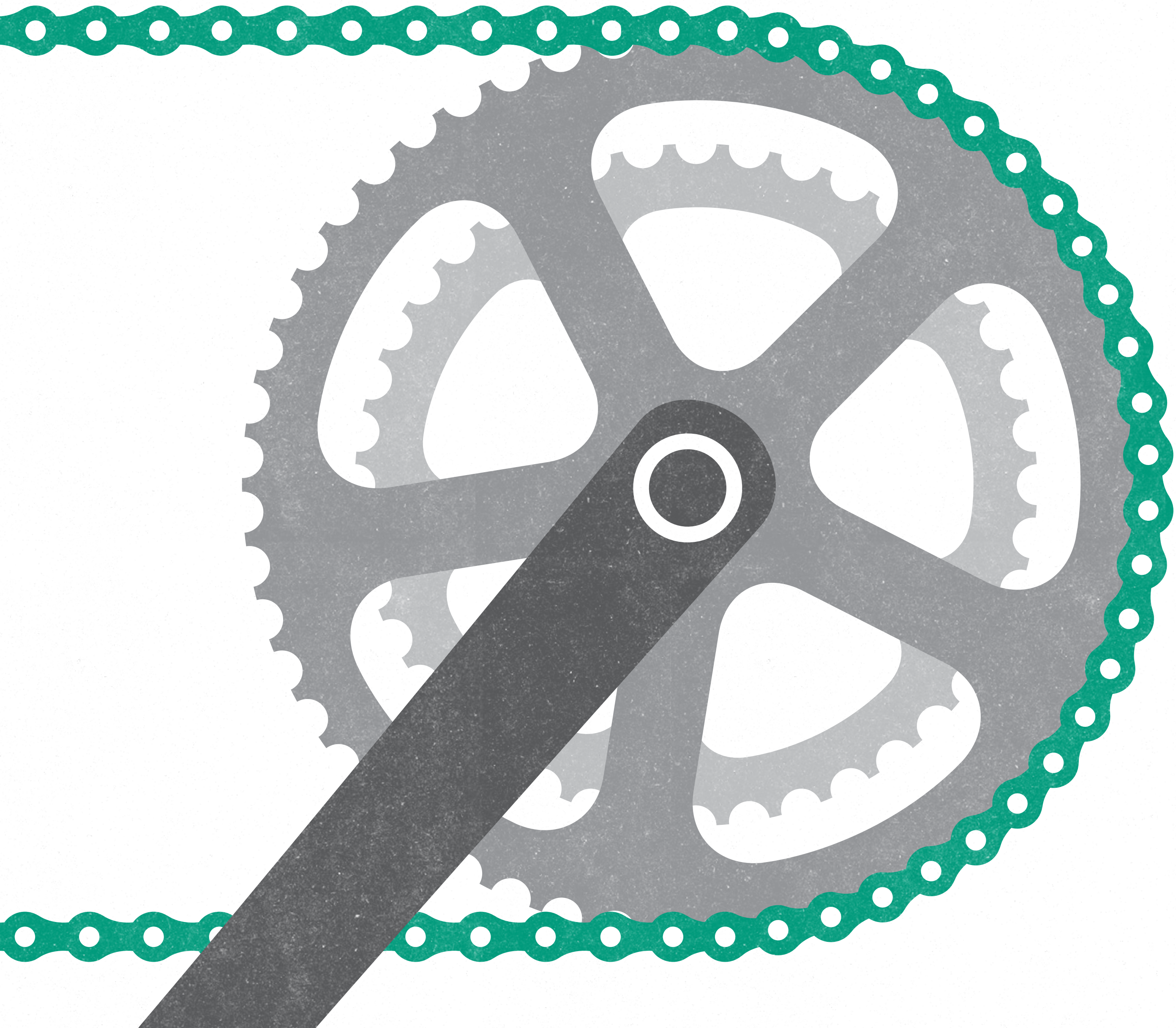
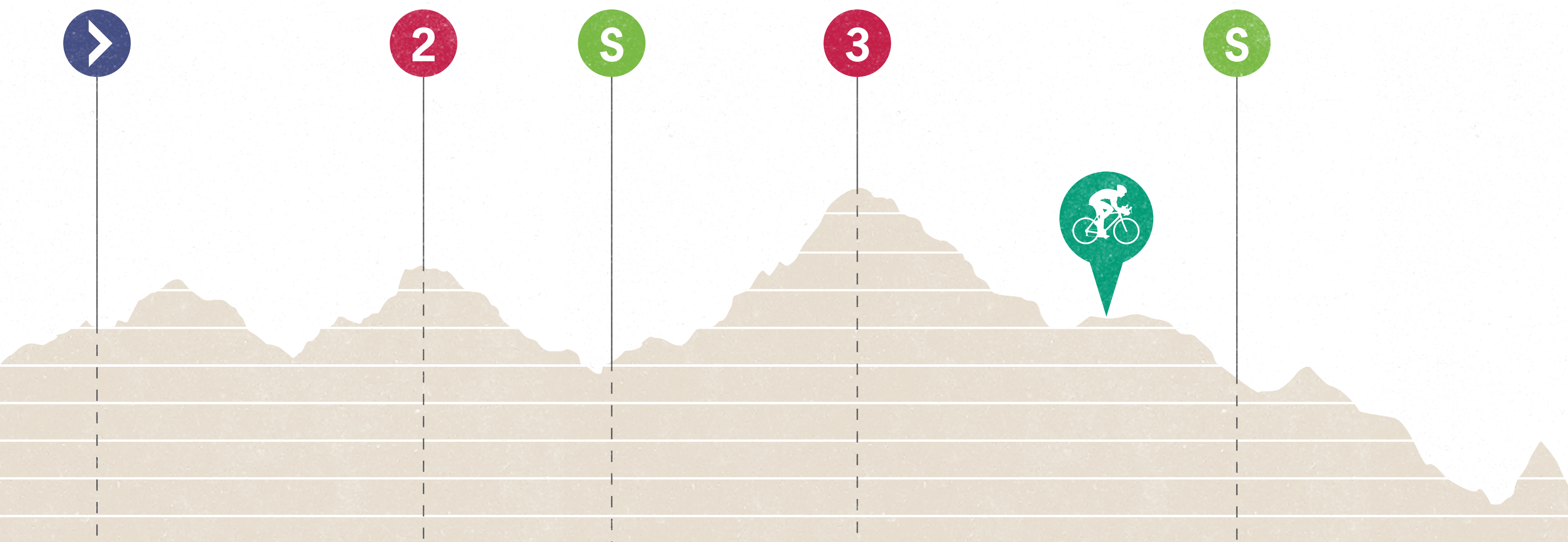
CORPORATE GOVERNANCE REVIEW 2013

Governance steps up a gear



2013 highlights

- 57% of FTSE 350 companies now comply with the UK Corporate Governance Code, up from circa 51% over the past three years.
- Non-audit fees paid to auditors fell by almost a quarter.
- Only 27% of companies give real insight into how they review the effectiveness of their systems of internal control.
- Early trends for chairmen to emphasise the importance of values and culture as the cornerstone of governance have stalled.
- Personal accountability is this year's clear trend with 60% of chairmen providing personal introductions to the corporate governance statement. The proportion of committee chairmen personally introducing their reports has also risen significantly.
- The average annual report is now 143 pages long, with the front end continuing to grow by about three pages per year.
- Only 16% of companies provide a description of their business model and future plans that effectively links strategy to key risks.
- Despite the huge impact of technology on all businesses, just six FTSE 350 companies have a chief information officer on the board.



Contents

Methodology

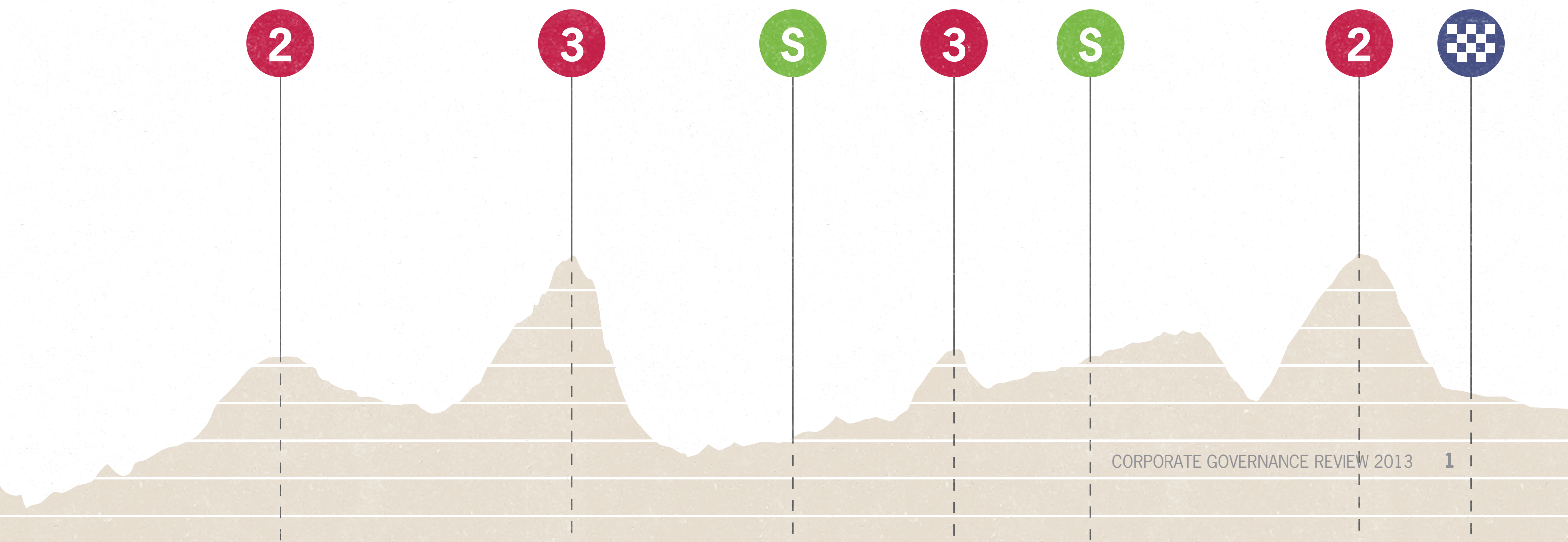
This review covers the annual reports of 298 of the UK's FTSE 350 companies with years ending between June 2012 and April 2013. Investment trusts are excluded as they are permitted to follow the AIC Code of Corporate Governance.

The review assesses compliance with:

- the disclosure requirements of the UK Corporate Governance Code
- the requirements for a business review as set out in s417 of the Companies Act 2006.

Key findings are discussed in the body of this report with full details in the appendix.

Simon Lowe would like to thank Rushabh Mehta, David Lok, Aqib Malik, Sarah Willis, Natasha Teeling, Ben Langford and Alex Worters for their help in preparing this report.



The regulator's perspective

To keep up the momentum of good governance, UK businesses need to move beyond compliance

Chris Hodge, Executive Director of Strategy, Financial Reporting Council

This year's rise in the level of companies complying with the UK Corporate Governance Code is clearly a good thing. However, to keep up the momentum of good governance, UK businesses need to move beyond compliance.

In this regard, two observations in the 2013 Grant Thornton review strike a particular chord:

- The low profile of nominations committees, in contrast to audit and remuneration committees, and their less proactive reporting
- The poor quality of FTSE 250 explanations, compared with the FTSE 100

In the context of nomination committees, we feel many companies could improve non-executive and executive director succession planning. Board evaluation reviews frequently raise this issue and our findings suggest companies often only start planning when vacancies come up, rather than thinking about long-term initiatives, such as nurturing pools of internal talent to fill executive positions. More strategic succession planning might also offset the continuing lack of female executive directors.

We think poor succession planning is also a factor in why explanations around board composition are often less than useful, particularly as to why companies opt to explain. There is often insufficient explanation as to how situations where companies combine CEO/chairman roles, or have less than half of the board made up of independent directors, arise in the first place.

When it comes to the inferior quality of FTSE 250 reporting, it is not the level of compliance that is below par, this is relatively consistent across the wider FTSE. It is rather that FTSE 250 companies seem less able to tell their story or give a clear explanation of what they are doing in practice. Writing clear and useful explanations requires little resource and should not be a function of a company's size: indeed, there are plenty of good examples among the FTSE 250 that show it can be done.

Looking ahead, in 2014, the FRC intends to do further work to help companies improve both these areas.

Foreword

After more than two decades of evolving governance guidance in the UK, many of us may be wondering if there is anything left to improve. Our 2013 research shows the answer must be an emphatic yes. The economic, commercial and regulatory environments continue to change and governance practice and guidance must keep pace.

Welcome to the Grant Thornton FTSE 350 Corporate Governance Review, now in its twelfth year.

Simon Lowe, Chairman,
The Grant Thornton Governance Institute

Last year's review marked the 20th anniversary of the publication of the Cadbury Report with a look at the development of UK corporate governance over those 20 years. We examined the influence of corporate scandals, governance failures and disengagement on the part of institutional shareholders. Our conclusion was that evolution had plateaued. It seemed the corporates' collective response was to hold their breath and do nothing more until pressured to do so. "Margin retention is a more urgent priority than compliance" was a common defence.

Institutional shareholders were starting to make noises but were still viewed, by regulators and others, as inadequately exercising their role as owners by failing to actively engage with management. It was argued that effective, open market capitalism would not operate efficiently until all parties fully played their part. The July 2012 Kay Report took a similar stance. Ironically for a free market, at least part of the solution was seen to be in further regulation and/or guidance with a capital 'G'.

Much has happened in the past 12 months. Regulators in the UK and wider Europe have been busy proposing, negotiating and introducing new regulation and guidance. Most recently, on 1 October 2013, the Department for Business, Innovation and Skills (BIS) regulations came into force, including requirements for more detailed disclosure on top executives' remuneration. Measures include a legally binding vote on executive pay, as well as changes to simplify and strengthen narrative reporting. BIS emphasised that boards should be encouraged to see this as the natural consolidation of previous developments, rather than a radical departure.

Investors flex their muscles, at last

Also in 2013, institutional investors finally flexed their muscles, most notably on remuneration, and in the main liked the experience. Indeed, there are signs they are starting to assert pressure in other areas, for example some audit committees are now having their authority to set auditors' remuneration challenged because of excessively high non-audit fees. It seems that the focus of investor engagement is widening.

"The economic, commercial and regulatory environments continue to change, and governance practice and guidance must keep pace."

Perhaps not surprisingly with all the guidance coming into effect in the past two years, as outlined in the 'Recent development summary' on page 38, there remains significant room for improvement. The quality of reporting, particularly with regard to transparency, still concerns regulators, not least when it comes to the interpretation and application of the cornerstone of governance – the 'explain' in 'comply or explain'. Our findings this year show they are right to be concerned. Yet, this is not the only challenge: the majority of companies are also failing to effectively articulate their business model and link strategy to risks and controls, as required.

In past reviews we have observed that new guidance invariably takes between four and five years to bed in. Perhaps now is the time to let what has been put in place embed itself fully, trusting that institutional investors will continue to seek more extensive and effective engagement and that boards and non-executive directors will rise to the challenge and guide their companies through this evolutionary phase.

Compliance steps up

This year, confounding assumptions that it had plateaued, compliance with the UK Corporate Governance Code (the Code) rose to 57%, having stalled at around 51% for three years. The greatest improvement is in the accountability of the board and its remuneration, nomination and audit committees. Perhaps we shouldn't be surprised given the heightened scrutiny of accounting judgements, auditor independence and executive remuneration over the past 12 months, not to mention the increasing drive for a more considered approach to board diversity and effectiveness. Once again, companies are least likely to comply with provisions relating to the balance of non-executives on the board and its committees, and the combining of the roles of chief executive and chairman.

This year also saw a sharp drop in levels of non-audit fees paid to auditors. Recent reviews have heightened awareness of the need to justify the level of such fees and the potential impact on auditor independence. Audit committees appear increasingly to have taken heed and challenged management over use of auditors for advisory work, with non-audit fees paid to auditors falling from 68% of audit fees, in 2012, to 51.7%. The trend is particularly marked among FTSE 100 companies, where non-audit fees on average now represent 33.7% (2012: 59.2%) of the external audit fee.

Poor explanations for non-compliance

While it is encouraging to see that full compliance has improved to 57%, the focus now shifts to the quality of explanations from the 128 companies who do not comply fully.

We found that the quality of explanation for non-compliance varied significantly, with the worst companies providing no insight into the reason for non-compliance and the alternative arrangements in place to protect shareholders' interests. There appears to be a small rump of companies who continue to pay only lip service to corporate governance, with 38 failing to update their compliance statement from the previous year.

That said, in the debate about the quality of explanations, one should be wary of focusing only on those who do not comply. At the heart of the 'comply or explain' principle is transparency and the need for high-quality explanations that inform the reader. These are key to promoting an effective agent-principal relationship between the board and shareholders, and ultimately the efficiency of our capital markets.

Following the FRC's recent report on quality of explanations, there has been some discussions about whether formal guidance should be included in future revisions of the Code. In doing so it could perhaps take a leaf out of the HMRC book and introduce a 'quality flag' system; a green flag receiving a light-touch review every three years, a red flag an annual review, and an amber flag somewhere in between. Such a system might promote good practice by drawing attention to effective examples, without having to provide the detailed guidance that has a tendency to be copied verbatim.

Turnbull revision highlights risk and control

We found a mixed picture in the reporting of risk management and control. While the majority of companies (FTSE 350: 64.8%) do provide helpful information about their internal control processes, there has been no progress from the previous year. When it comes to providing greater details around their risk processes, although improving, the majority of FTSE 250 companies (59%) tend towards the opaque, which is more than double the FTSE 100 at 29%.

For the first time in several years, the FRC is to overhaul the Turnbull Guidance. We welcome this: for too long companies have hidden behind the current guidance, stating only that they have reviewed control effectiveness while giving no real insight into their risk management and control practices.

Building effective shareholder engagement

We found little progress in corporate relationships with investors. The extent to which companies consider the views of major shareholders remains static. Just under three quarters of companies gave a good description of their approach to communicating information to major shareholders. However, few were able to articulate the feedback provided by shareholders and how this had influenced the company's activities.

The Investment Management Association (IMA) review of 'Adherence to the FRC's stewardship code' found that chairmen have noted an increased desire for engagement from shareholders in the last 12 months, particularly around business strategy and remuneration issues. Businesses must capitalise on the current desire of institutional shareholders to engage more actively, by improving both the quality of communications and the channels they employ. The onus is then on shareholders to respond and challenge the information and explanations provided. If either party fails to play its part, we run the risk of slipping back into the bland business practices and 'boilerplating' of the noughties.

"Businesses must capitalise on the current desire of institutional shareholders to engage more actively, by improving both the quality of communications and the channels they employ."

Greater personal accountability

The willingness of boards and committees to embrace personal accountability has increased in the last year, although the link between good governance and strong values often remains unclear.

Last year 58% of chairmen made reference to governance in their primary statement, and we noted an emergent trend towards chairmen highlighting the role of culture, values and ethical principles as the cornerstone of good governance, as discussed in the Code. This trend appears to have stalled in the last 12 months.

This year, the focus appears to have switched to the corporate governance statement; the number of chairmen personally introducing the corporate governance statement increased by just over a quarter to 60%. Notably, this trend of personal accountability is spreading to the committees. Remuneration committee chairmen lead the way: in 2012, nearly half made a personal statement; this year the figure topped 70%. Audit committees followed suit, increasing to 44% from 23%, and this year the nomination committee did likewise, with the figure nearly doubling from 17% to 31%. Willingness by committee chairmen to discuss how governance is discharged effectively is a clear demonstration of strong values in a company's leadership culture.

"This year, the focus appears to have switched to the corporate governance statement, the number of chairmen personally introducing the corporate governance statement increased by just over a quarter to 60%."

Longer, not better

One thing, like death and taxes, remains certain: the number of pages in the accounts' front end continues to grow – by an average of three pages per year over the past four years. At around 600 words per page this is a total increase of 7,200 words. Yet it is questionable whether this onslaught has been accompanied by a measurable improvement in the usefulness and quality of the narrative.

The need for transparent communication with shareholders remains a high priority. Over the past year this has been emphasised by the enactment of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 and accompanying FRC guidance; the implementation of the 2012 UK Corporate Governance Code; and the continued progress of the International Integrated Reporting Council (IIRC) in developing an integrated reporting framework. These share a common focus on the drive for quality, rather than quantity, of information.

In the face of so many changes, and with growing clamour for accountability, companies must now find time to reflect on what they are aiming to communicate and why, rather than slavishly copying and then adding to last year's document.

Narrative reporting must be stripped back and discussion refocused. Governance reporting must address the real principles of the Code and offer stakeholders more pertinent, concise insight into governance practices.

Integrated reporting remains a distant ideal

In stripping back the narrative, companies must be sure to instil greater transparency and accountability – qualities at the heart of the IIRC's work. The IIRC Consultation draft framework states: "An integrated report is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long-term".

Our research indicates there is a long way to go before this goal is accomplished. As mentioned above, companies are still struggling to articulate their business model and to link it to their strategy, risks, controls and KPIs. We found that less than 50% provide clear, succinct reporting in these areas. More worrying still, only 16% effectively describe their business model.

In these areas companies tend to provide descriptions that change little year-on-year, repeatedly failing to explain the rationale behind their board's approach. With the IMA confirming increased desire from their members for engagement on matters of strategy, companies must find ways to avoid generic repetition and instead offer genuine insight to shareholders.

Considering diversity – in every sense

To integrate governance successfully into an organisation, boards need the right balance of experience, expertise and outlook, with professional background and gender just two of the necessary considerations.

Gender has been under a particular spotlight since the publication of the Davies Report in February 2011. Our review indicates that the number of women on boards has grown overall, but this is driven mainly by an increase in female non-executive directors (NEDs) among the Mid 250. As we have observed previously, the pool of NED candidates is limited. For a real step change to occur, the number of women progressing from senior management to executive board roles must be increased. Recent Grant Thornton International research[1] highlights the underperformance of the UK compared to other global economies in supporting the development of women in senior management positions.

While gender remains the popular focus of the diversity debate, the issue of skills and expertise is rising up the agenda. The combined skills of board members should constitute a 'toolkit' to enable the company to succeed within a rapidly changing business environment.

"To integrate governance successfully into an organisation, boards need the right balance of experience, expertise and outlook."

Technology is one of the greatest challenges – and opportunities – to emerge in recent years. Companies must consider how to protect themselves against cyber-attack, stay ahead of competitors, and make best use of 'big data'. And yet very few companies have technology in all its guises, eg social media, real time analytics and cloud technology, represented in the boardroom. Recent research conducted by Grant Thornton in the US and TechAmerica considered the challenges of managing the risks associated with rapidly changing technology whilst also realising opportunities[2]. A review of directorships reveals that only six FTSE 350 companies have a chief information officer (CIO) on their board. Boards with chairmen, NEDs and CEOs aged, on average, 63, 59 and 52 respectively, may be ill-equipped to grapple with such emerging issues.

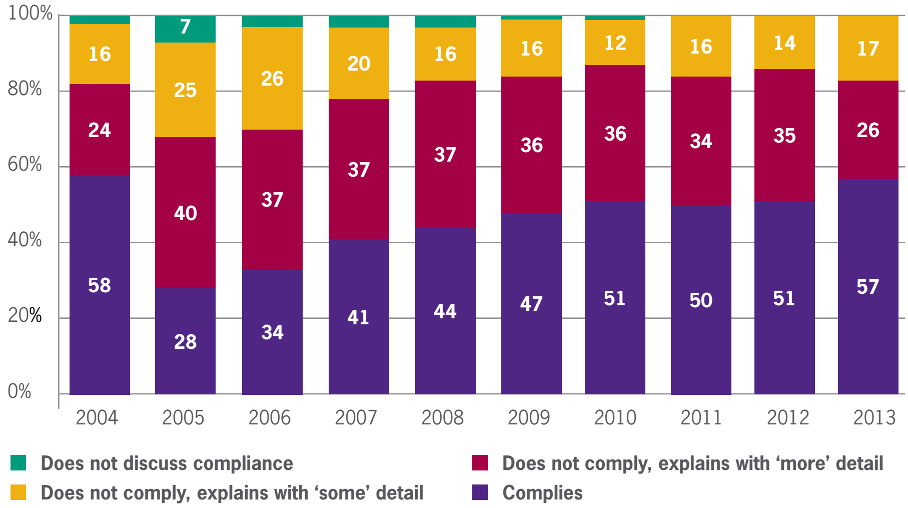
As the Cadbury Report reaches 21, a critical question: is given the clear activity of companies in response to recent regulatory change, should this focus and pressure be maintained or, with governance practice moving in a positive direction, should 'regulatory change' pause for breath and allow momentum to do its job?

[1]http://www.internationalbusinessreport.com/files/ibr2013_wib_report_final.pdf
[2]http://www.grantthornton.com/issues/library/survey-reports/advisory/2013/BAS-BC-CIO-Survey.aspx

Compliance with the UK Corporate Governance Code

For the first time in four years, there has been an increase in the level of compliance with the Code, with 57% of companies claiming full compliance compared to around 51% for the previous three years.

FTSE 350 companies choosing to 'comply or explain'



This figure reflects a step change towards compliance with the Code. Of those that do not now comply in full, a greater concentration (85%, 2012: 79%) failed to comply with no more than two Code provisions.

There are several possible reasons for the sudden increase in compliance after a period of relative stasis. These include: increased shareholder scrutiny as the Stewardship Code beds down; the introduction of the 2012 Code and Strategic Review Regulations; and the pending introduction of additional legislation on executive remuneration following the Kay Review. This wave of new guidance and regulation has perhaps kept governance at the top of companies' agendas, causing them to pause and reflect on their practices.

Number of Code provisions with which companies state non-compliance

Number of provisions	Number of companies 2013	Number of companies 2012
Not specified	4	0
1	77	85
2	32	29
3	6	11
4	3	7
5	3	7
>5	3	5
TOTAL	**128**	**144**

Quality of explanation

The Code states that: "An alternative to following a provision may be justified … if good governance can be achieved by other means. A condition of doing so is that the reasons for it should be explained clearly and carefully to shareholders". The increase in compliance noted above seems to have had the effect of highlighting a small rump of companies who show little inclination to either comply or explain.

Of the 128 companies that do not fully comply with the Code, 78 (61%) provide informative explanations while 50 give only a basic justification (2012: 42). In four cases the compliance statement admits the company has not been fully compliant during the year, but does not identify the specific Code provisions that have not been followed. Of the 90 companies that did not comply in consecutive years, 38 fail to provide an updated disclosure year-on-year. With Financial Reporting Council (FRC) and European Commission's attention now focusing on the explanations, these companies should consider themselves on notice.

Compliance with provisions

MOST COMMON AREAS OF NON-COMPLIANCE – % OF FTSE 350 (2012)

"Three elements were proposed for a meaningful explanation. It should set the context and historical background, should give a convincing rationale for the action it was taking, and describe mitigating action to address any additional risk and to maintain conformity with the relevant principle. Also, the explanation should indicate whether the deviation from the Code's provisions was limited in time and when the company intended to return to conformity with the Code's provisions."

(What constitutes an explanation under comply or explain?, FRC)

We looked at the quality of explanations in more detail by reviewing a sample of compliance statements against the criteria set out in the FRC guidance document: 'What constitutes an explanation under comply or explain?'.

We considered compliance statements for the three Code provisions with the highest level of non-compliance (B.1.2, D.2.1 and A.2.1), a sample of 61 companies, using the following criteria:

- Background to the Code principle as it has been applied to the company
- Rationale for non-compliance
- Explanation of mitigating actions to protect shareholders' interests
- Timescale of non-compliance

We found that the quality of rationale given for non-compliance varies and is rarely convincing. This is in part because few companies were able to articulate why their approach is more appropriate than that outlined in the Code.

Fewer than half of companies give detail on why they believe their current arrangements support good governance, with the remainder simply saying that, in the board's view, current arrangements are adequate. Only 22% of explanations discuss the impact of non-compliance on shareholders or refer to action taken to ensure an appropriate governance framework is maintained.

82% of companies failed to take heed of the Code's requirement to identify whether or not non-compliance is time limited, meaning that fewer than one in five give a transparent explanation of whether arrangements are temporary or will be in place for the foreseeable future. Of those companies that do specify that non-compliance is a temporary measure, only a fifth indicate when it will come to an end.

Incorrect board composition remains the highest area of non-compliance, with 12.8% of companies lacking sufficient independent directors (2012: 18.6%). There has, however, been a marked improvement in the number of companies meeting committee membership criteria: most notably, only 2.3% of audit committees fail to meet these criteria, compared to 10.8% last year. There is also a noticeable reduction in the number of companies failing to meet remuneration committee requirements – down to 6.7%, from 11.1% in 2012. Meanwhile nominations committee non-compliance fell to 3.4%, from 6.4% last year.

"Incorrect board composition remains the highest area of non-compliance, with 12.8% of companies lacking sufficient independent directors (2012: 18.6%)."

FAST FACTS

We analysed the explanations given by those failing to meet the three most frequent Code provisions that are not complied with.

- 82% of companies do not meet the Code's requirement to stipulate whether non-compliance is time limited
- 58% of companies give no rationale for non-compliance, or just a sweeping comment, not specific to the Code provision
- 78% failed to outline the mitigation in place to ensure that the relevant Code principle was still observed

Personal accountability

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

(UK Corporate Governance Code, Preface, paragraph 7)

"The chairman should promote a culture of openness and debate."

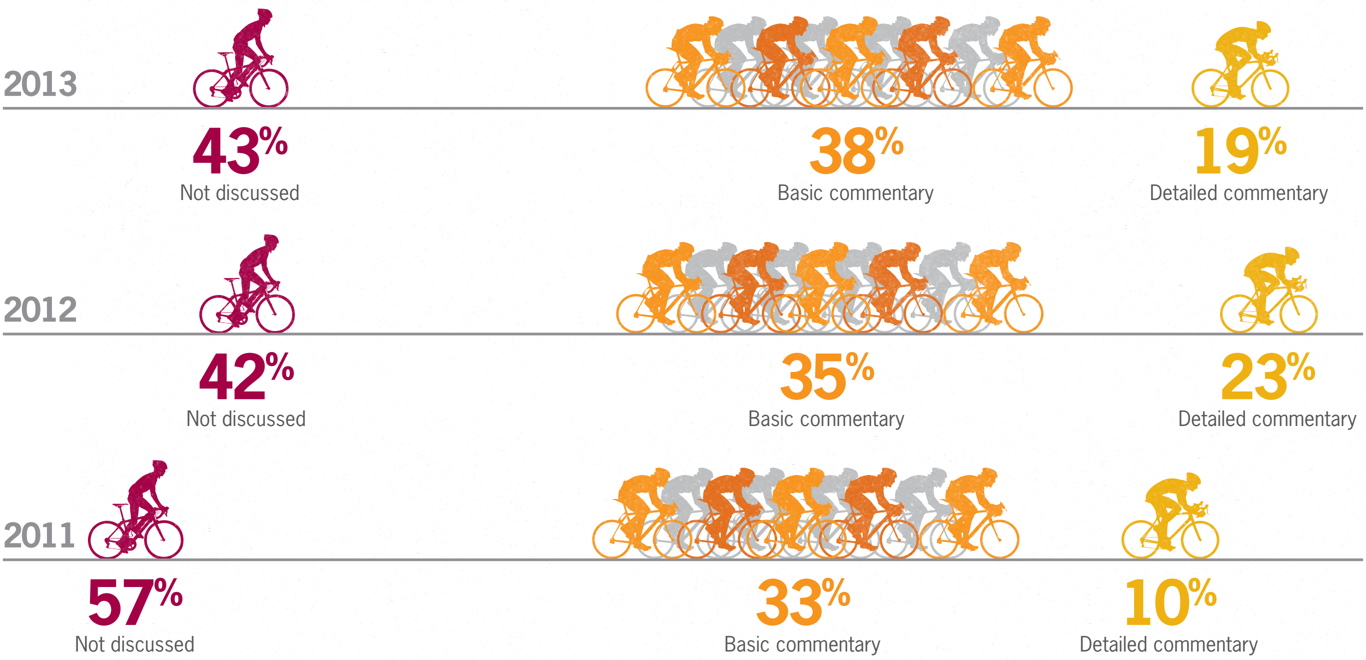
(UK Corporate Governance Code, Supporting Principle A1)

The Code recommends that chairmen discuss governance in their primary statement. Last year, we noted a small number of chairmen who had gone beyond traditional discussions of board structure and membership and used the primary statement to discuss the culture and values espoused by the board. At the time, we hoped that this was the start of a trend. However, it appears that when reporting on governance this year, the attention of chairmen has been transferred to the corporate governance statement. The number of chairmen making any comment on governance in their primary statement, the chairman's annual statement, fell slightly from 58% in 2012 to 56.7%.

What we have noted is an increase in the number of chairmen making personal introductions to the corporate governance section of the annual report. Just over 60% of FTSE 350 chairmen now give a personal introduction (2012: 47.3%). The level of detail provided in such introductions has also increased, with 38.9% giving informative commentary on the key features of governance – a significant increase from the 23% that did so in 2012.

Clearly greater transparency and personal accountability about the workings of the board will be well received by shareholders, and of course the FRC. However, we would encourage companies not to lose sight of the early stage trend we noted last year where chairmen used their primary statements to promote the importance of culture and values as a cornerstone of good governance.

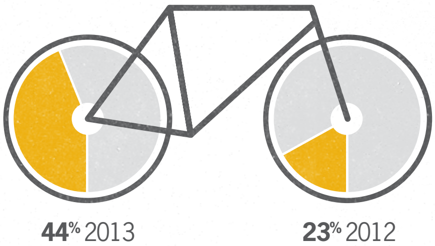
TO WHAT EXTENT ARE THE FEATURES OF GOVERNANCE DISCUSSED IN THE CHAIRMAN'S PRIMARY STATEMENT?



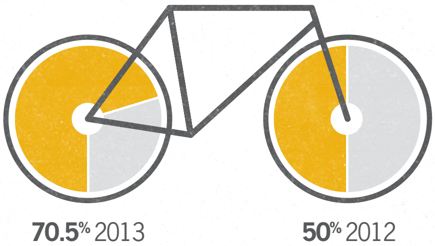
We found a strong upward trend – across all board committees – in the number of committee chairmen providing personal introductions to their reports. Such introductions demonstrate greater transparency and accountability and bring the committee reports to life. Good examples include descriptions of activities during the year, priorities for the coming 12 months, and commentary on the committee's balance of skills and experience.

DO COMMITTEE CHAIRS INTRODUCE THEIR REPORTS? (YES %)

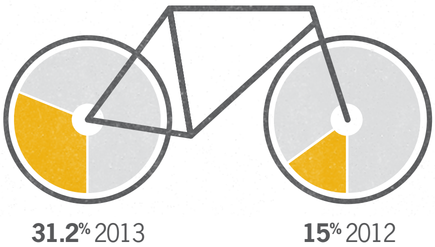
Audit committee



Remuneration committee



Nomination committee



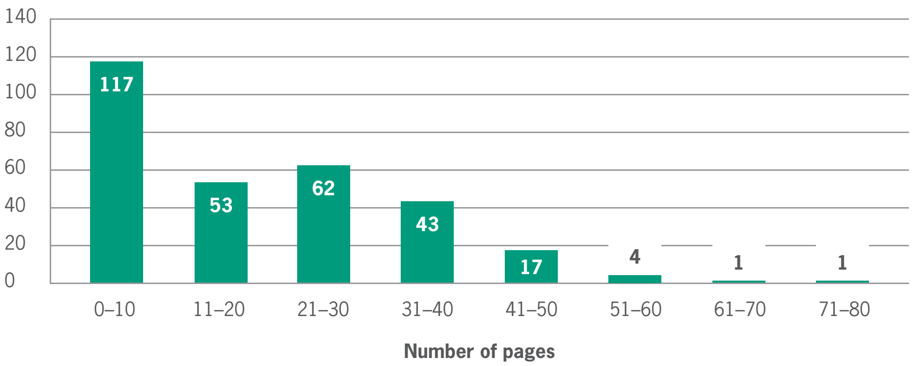
"Clearly greater transparency and personal accountability about the workings of the board in the corporate governance statement is a trend to be encouraged. However, we would encourage chairmen to consider how they can use their primary statements to set out what must be considered to be the cornerstone of governance: the values led culture promoted by the board."

- The number of companies discussing key features of governance in the governance statement increased by more than 12%
- The quality of this discussion increased, with 38.9% (2012: 30.4%) giving useful information, not just a basic description
- However, the number of chairmen referring to governance within their primary statement dropped by 1%
- The average number of pages for a FTSE 100 corporate governance statement is 24
- The average number of pages for a FTSE 250 corporate governance statement is 16

Corporate governance statements

There is significant variation in the length of the corporate governance statement. In part this reflects a lack of consensus on where to disclose such information. For instance, matters such as risk management, internal controls frameworks and diversity are included in the corporate governance statement by some companies and in the directors' report by others. Likewise, the remuneration disclosure is either included in the remuneration committee section of the corporate governance statement or as a stand-alone section.

Number of pages of the corporate governance statement, including sub-committee reports (FTSE 350)



The average length of the corporate governance statement (including sub-committee reports) is 19.1 pages. FTSE 100 reports tend to be longer, with an average of 24.4 pages compared to 16.5 pages in the Mid 250. The longest report – that of a FTSE 100 company – contained 72 pages. Only four FTSE 350 companies had no corporate governance statement at all in their annual reports.

"The wave of new guidance on regulation has kept governance at the top of companies' agendas, causing them to pause and reflect on their practices."

In our view, the most effective corporate governance statements:

- describe the role and structure of the board
- give an overview of the work of the board and its committees during the year
- highlight key areas of discussion and decision by the board during the year
- indicate issues that had an impact on strategy or strategic risk
- describe the assurance received by management on the operation of the company
- demonstrate how the board works to further the interests of shareholders
- show individuals' accountability for key aspects.

Leadership

The role of the board

"The board should set the company's values and standards and ensure that its obligations to the shareholders and others are understood and met."

(UK Corporate Governance Code, supporting principle A.1)

"An effective board develops and promotes its collective vision of the company's purpose, its culture, its values and the behaviours it wishes to promote in conducting its business."

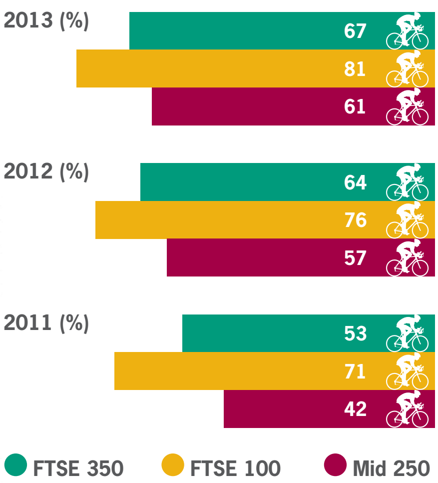
(FRC Guidance on Board Effectiveness, 1.2)

The quality of reporting on the role and activity of the board continues to improve this year, with just over two thirds (67.3%) of companies providing good quality disclosures in the annual report (2012: 63.5%), in line with the FRC's 'Guidance on Board Effectiveness'.

The leading examples include:

- a clear link between the board's governance practices and the company's culture and values
- discussion of strategic priorities
- details of board and committee meetings, including remit and focus
- an outline of powers and authorities retained by the board, and those delegated to management
- explanation of the company's reporting lines and monitoring structures, and how they are embedded within the company
- informative discussion of board composition
- explanation of how a high performance culture had been created
- description of how the board makes itself accountable to investors.

HOW MUCH DETAIL IS PROVIDED ON HOW THE BOARD OPERATES AND DISCHARGES ITS DUTIES (DETAILED EXPLANATION PROVIDED)?

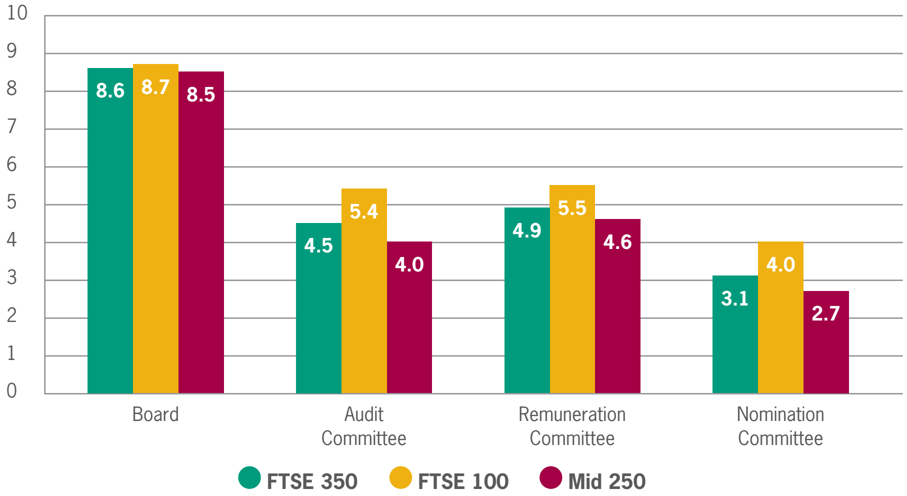


Meeting frequency

The Code does not advise on the frequency of board meetings, stating only that "the board should meet sufficiently regularly to discharge its duties effectively". This year, the average number of board meetings was 8.6 (2012: 8.5), with a range of between two and 20.

There is an increase in the average number of remuneration and nomination committee meetings, which rise to 4.9 and 3.1 (2012: 4.6 and 2.8) respectively. This rise is mainly attributable to FTSE 100 companies, perhaps not surprisingly, considering the climate of intense public debate on the remuneration of senior executives. Our research also identifies an improvement in the number of boards meeting independence requirements (see 'Board effectiveness' section), which is likely to have resulted in a heavier workload for the nomination committee.

Average number of board and committee meetings



The chairman

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

(UK Corporate Governance Code, main principle A.3)

"The chairman should promote a culture of openness and debate."

(UK Corporate Governance Code, supporting principle A.3)

Independence of chairmen

During the year, 50 companies appointed a new chairman. Of these, 37 disclose they were independent on appointment (a Code requirement), while 11 report they were not – rendering them non-compliant. The remaining four fail to state whether the chairman was independent, again in breach of the Code.

Division of responsibilities

"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. No one individual should have unfettered powers of decision."

(UK Corporate Governance Code, main principle A.2)

During 2013, 12 UK companies had a joint chairman and chief executive, compared to ten in 2012. At a further 18 (2012: 21) companies, the roles of the chairman and chief executive were separate, but the chairman held executive powers and was actively involved in running the business.

The main reasons cited for the executive or combined role of the chairman were:

- leadership during periods of strategic change
- an interim arrangement while a new CEO is being sought
- the chairman is a founder of the business
- the chairman represents a majority shareholder.

With the exception of chairmen assuming the chief executive role on an interim basis due to unforeseeable circumstances, most companies with a combined chief executive and chairman or an executive chairman intend to continue with the arrangement indefinitely.

In such instances, the Code requires that companies clearly identify how effective governance is promoted by the arrangement. However, this is one of many examples where we found significant variation in the extent and quality of explanations. While some companies provide a good level of detail about the reasons for the arrangement and how overall board independence is safeguarded, others do little more than state that the chairman had an executive or combined role. Given the significant power that can be wielded in these circumstances, it is remiss for companies not to explain how shareholders' interests are protected.

"Twelve UK companies had a joint chairman and chief executive, compared to ten in 2012."

Effectiveness

Board composition

"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 duties and responsibilities effectively."

(UK Corporate Governance Code, main principle B.1)

The composition of the average FTSE 350 board remains largely static, comprising one chairman, three executive directors and 5.6 non-executive directors.

There is a rise in the number of companies with appropriate independent non-executive membership on the board, with 14.1% failing to achieve or maintain a majority independent board, compared to 18.6% in 2012. This equates to 42 companies failing to meet independence requirements: 30 for the whole year and 12 for part of the year, compared to 55 companies in 2012.

The FTSE 100 lead the way with regard to sufficient NED membership: 94 companies maintained adequate balance of membership for the entire year, compared to 88 in 2012. Compliance rates in the Mid 250 are significantly lower, with 19% of companies failing to maintain appropriate balance of board membership. Non-compliance is more prevalent among smaller Mid 250 firms.

Board composition

FTSE rank	Number of companies in group	Insufficient NED membership (%)	Average number of Independent NEDs on board
1–100	98	4.1	6.7
101–200	90	17.8	4.8
201–350	110	20.0	4.1
TOTAL	**298**	**14.1**	**5.2**

Independence

Across the FTSE 350, 124 NEDs representing 75 companies were not considered independent (as compared with 149 NEDs at 83 companies in 2012). Of these, 44 represent significant shareholders, and 33 are either recent employees or board members of more than nine years' standing.

In addition, 39 companies had directors who were considered to be independent despite not complying with the independence criteria set out in provision B.1.1 of the Code. Of these, the majority (30) had served on the board for more than nine years.

Proportion of NEDs not considered to be independent

	FTSE 350	FTSE 100	Mid 250
Number of NEDS	1,667	965	702
Number not considered independent	124	46	78
%	7.4	6.6	8.1
Companies	75	22	53

FAST FACTS

- 14% of FTSE 250 boards have too few independent NEDs, 4% lower than 2012
- All companies have at least two NEDs on their boards, but one firm has no independent NEDs
- Two companies have no executive directors on their board
- The average FTSE 100 company has seven NEDs, while the average Mid 250 company has five
- Both the Mid 250 and the FTSE 100 have an average of three executive directors. The most common executive roles are those of CEO, chief financial officer and chief operations officer

Board appointments

"There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board."

(UK Corporate Governance Code, main principle B.1)

The quality of nomination committee reporting improved this year, although the committee still lags behind its audit and remuneration peers.

Nearly a third of nomination committee chairmen now provide a personal statement to introduce their report, almost double the 17% in 2012. However, the figure still trails far behind the audit committee chairmen and is less than half that of the remuneration committee chairmen. The quality of disclosures also improved, albeit not at the same pace, and for the first time more than half of nomination committee reports (51%, 2012: 46%) provide an informative description of their work.

The nomination committee has the lowest profile of the board committees but plays a key role in maintaining board composition and effectiveness. Many committee chairmen limit themselves to commenting on new board appointments in their introduction to the section. However, the most helpful examples also highlight diversity issues, succession planning, board composition and effectiveness. This trend is most prevalent in the FTSE 100, where 70.4% of companies provide a helpful description of the work of the nomination committee compared to 41.5% of their Mid 250 peers (2012: 62% and 37% respectively).

"Female representation in the boardroom has risen in the last year, with 13.9% of FTSE 350 board positions now held by women."

Diversity

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

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

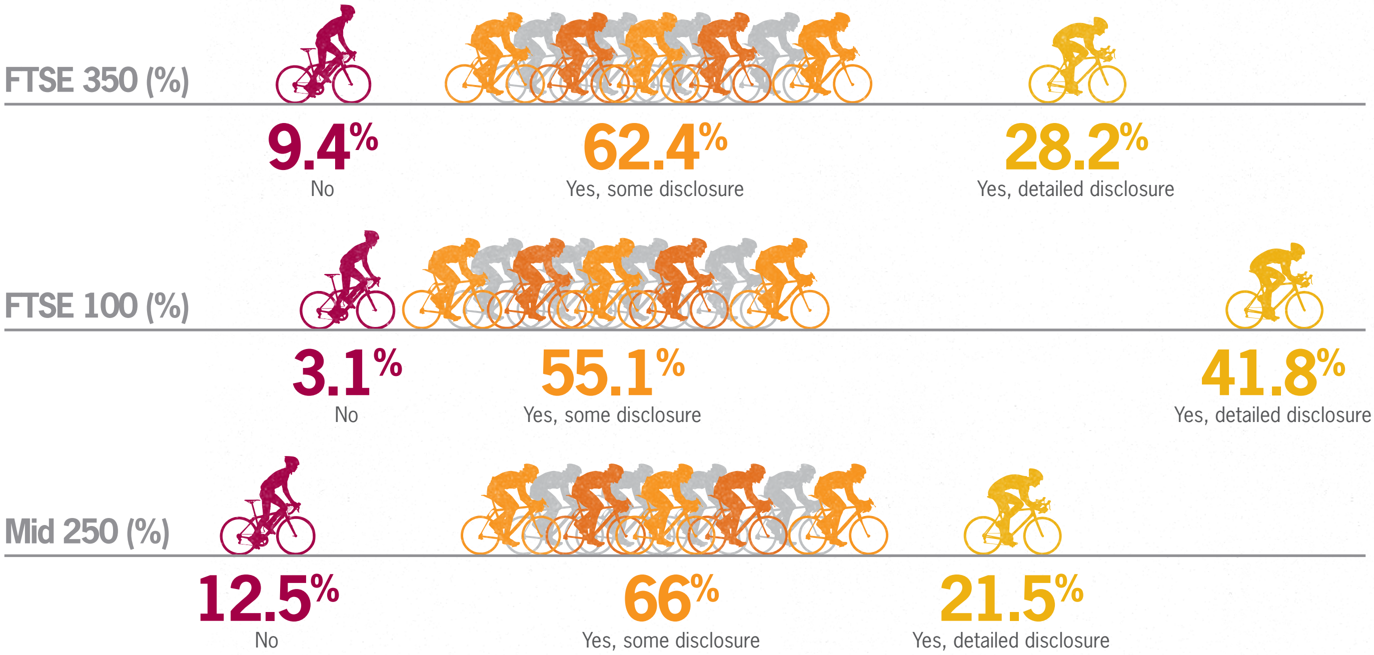
Gender diversity on boards continues to be a high-profile issue, with the approach of 2015, being the Davies Report's target date for 25% female membership. Research published by Cranfield School of Management in November 2013[3] shows that 19% of FTSE 100 board members and 15% of Mid 250 board members are now women. However, after a surge at the beginning of 2013, the rate of appointment of female directors has fallen, with women comprising only 27% of new FTSE 100 appointments and 30% of Mid 250 appointments in the last six months.

The majority of female directors are still NEDs, with our research showing that only 5.2% of executive directors (2012: 5.1%) are women. At the time of our research, only five companies in the FTSE 350 had a female chairman.

Given the introduction of the Strategic Review Regulations, the approach of the 2015 Davies Report deadline and tireless campaigning by the 30% Club, it is unsurprising that the number of companies discussing female board representation has gone up. Ninety per cent now refer to gender in the boardroom, compared to 78% in 2012. However, there is still some way to go to achieve the quality of disclosure envisaged by Lord Davies: 71.8% of companies still do not explain their strategy for improving gender balance. The majority merely state that gender is one of a number of factors considered when making board appointments.

[3]http://www.som.cranfield.ac.uk/som/dinamic-content/research/documents/WomenonBoards2012Code.pdf

DO COMPANIES DISCUSS GENDER DIVERSITY?



A broader definition of diversity

"[The nomination committee] section should include a description of the board's policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives."
(UK Corporate Governance Code, supporting principle B.2.4)

Without the backing of legislation, other areas of diversity receive less attention. Although the need to achieve a balance of skills and expertise is widely recognised and referred to by 86% of companies, less than 10% refer to age or ethnicity when discussing board diversity, and only 13% comment on the relevance of nationality or give insights into the type of experience considered desirable.

Few companies refer to the impact of the changing business environment on skills needs. In particular, while the need for financial and industry experience is well understood, boards rarely acknowledge the need for information and technology expertise. Automation of processes, the increasing complexity of information systems, reliance on cloud computing and increased use of social media have radically changed the business landscape. Boards need to be able to exploit the opportunities such changes create and to manage the associated risks. These challenges have been highlighted in a recent survey undertaken by Grant Thornton US and TechAmerica 'CIOs: Dealing with everything new is getting old'[4].

While the quality of disclosure regarding board diversity is generally limited, some companies have put considerable thought into explaining the rationale for their board composition and appointments.

Leading examples of diversity disclosure include:

- description of how the nationalities of board members reflect the company's international operations and customer base
- details of the technical and professional expertise required to support diversification into a new area of operations
- discussion of how the age, gender and ethnic balance of the board and senior management allows the company to understand its target market and attract more diverse staff into creative roles.

[4]http://www.grantthornton.com/issues/library/survey-reports/advisory/2013/BAS-BC-CIO-Survey.aspx

Age and experience

Due to the variations in biographical information in annual reports, as a proxy for experience we have used information on the age and length of tenure of board members filed at Companies House.

The average age of the executives, NEDs and chairmen has increased across the Mid 250 by approximately one year, suggesting low turnover of members. Average age has also gone up in the FTSE 100 by just under a year for executives and NEDs and by just under a year and a half for chairmen. Using age as a proxy for experience, it appears that the FTSE 100 has, on average, more experienced board members.

The tenure of a FTSE 100 director is shorter than that of a FTSE 250 counterpart, with chairmen serving on average 6.6 years and 9.1 years respectively. NEDs for Mid 250 companies serve marginally longer than their FTSE 100 peers. Almost a third (29.7%) of chairmen serve on the board of more than one FTSE 350 company.

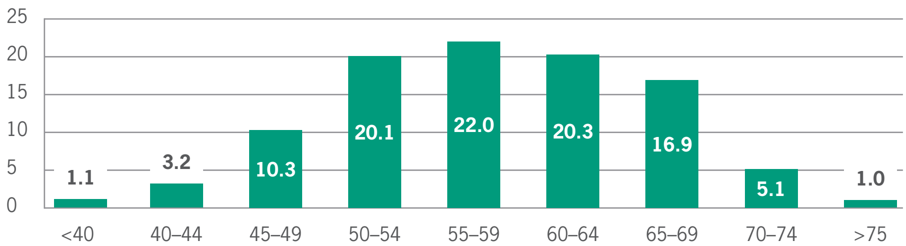
Average age of board members

	2013			2012		
	FTSE 350	FTSE 100	Mid 250	FTSE 350	FTSE 100	Mid 250
Executive	52.6	53.8	52.0	51.5	52.7	50.9
NED	59.7	59.9	59.6	58.7	59.0	58.6
Chair	63.9	64.9	63.4	62.9	63.5	62.5

Average tenure of board members

	2013			2012		
	FTSE 350	FTSE 100	Mid 250	FTSE 350	FTSE 100	Mid 250
Executive	7.0	6.5	7.3	6.8	6.7	6.8
NED	4.8	4.6	4.9	4.5	4.6	4.5
Chair	8.1	6.6	9.1	6.9	5.6	7.6

Average age of FTSE 350 directors (%)



"There has been strong and continued improvement in the information given by boards about the way they evaluate board effectiveness, with 63% now providing a detailed description."

- FTSE 100 executives have just over 1.5 years more experience than those in the Mid 250, based on age, suggesting that the Mid 250 may act as a training ground for FTSE 100 board members
- Average tenure of a chairman in FTSE 100 is 6.6 years and within the Mid 250 is 9.1 years
- 80% of directors (including chairmen, NEDs and executives) are aged between 50–70
- 10.6% of NEDs have been in post for nine or more years
- The oldest NED is 82. Nineteen others are over 75
- Within the FTSE 350, the average age of a chairman is 64 years old, of a NED is 60 years old and of an executive director is 53 years old

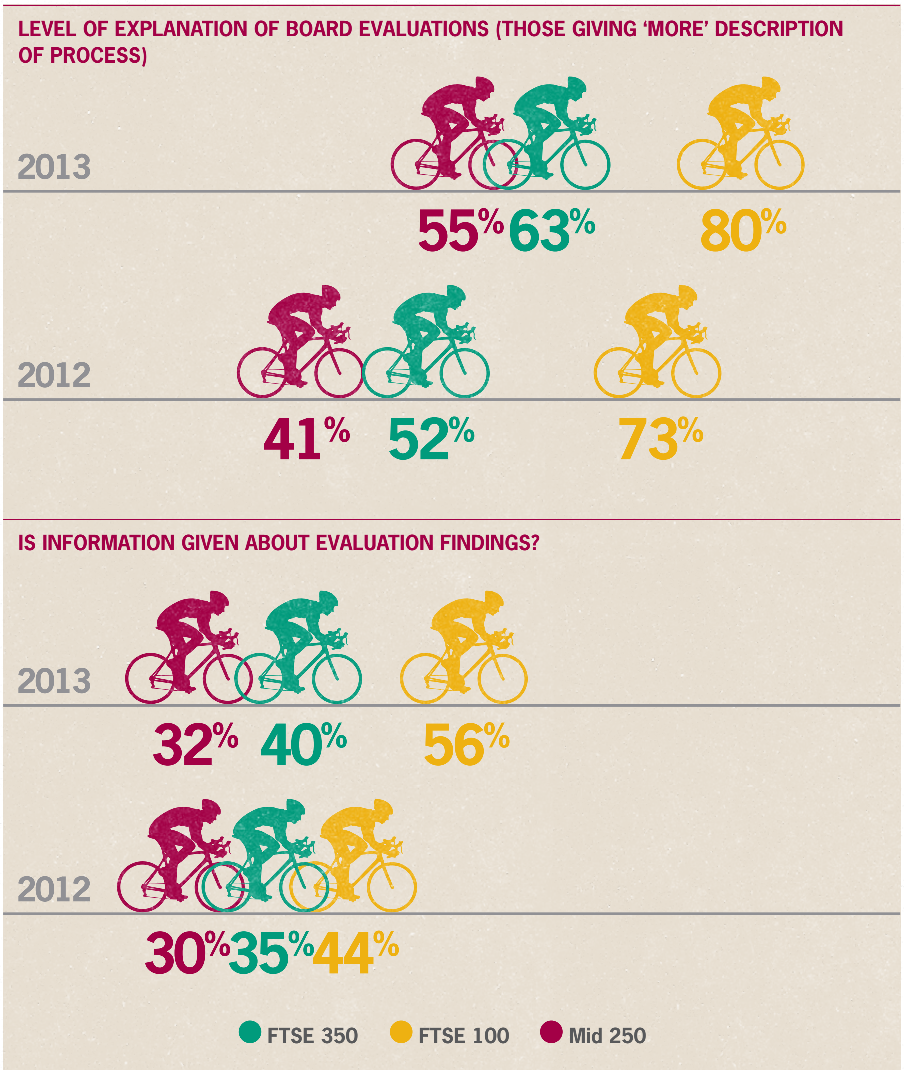
Board evaluation

"The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors."

(UK Corporate Governance Code, main principle B.6)

There has been strong and continued improvement in the information given by boards about the process by which they evaluate board effectiveness, with 63% of companies now providing a detailed description (2012: 51%). This trend is fuelled mainly by a rise in the quality of disclosure made by the Mid 250, with 55% of companies providing a 'good' explanation compared to 41% in 2012. However, this figure still lags behind the 80% with the same rating in the FTSE 100.

However, while progress is being made, at least among the FTSE 100, the challenge remains in respect of providing insight as to the outcomes of the reviews, with all companies remaining reticent to do so. Only two in five companies (2012: 35%) provide information about the outcomes of board evaluations. The proportion of FTSE 100 companies doing so is much higher, at 56% compared to 32% of Mid 250 companies. The very best provide a summary of findings, an outline of actions to be taken to address them, and the timescale for doing so, but the majority merely state that findings have been raised.



"24% of companies have not had and have no stated plan to undertake an externally facilitated review of their board."

Externally facilitated board evaluations

"Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years."

(UK Corporate Governance Code, B.6.2)

34% of companies state they had an externally facilitated board review during the year. At first glance this suggests the FTSE 350 is falling into line with the 2010 Code requirement for an externally facilitated board evaluation at least triennially. A closer analysis shows that 24% of companies are taking the guidance literally, in that their discussion of board effectiveness makes no reference to having had an externally facilitated review in the last few years, nor any future plans. It is possible that in a number of cases these companies have had or intend to undertake such a review, but have failed to mention it. Whether or not they have, this lack of explanation is not in the spirit of the Code.

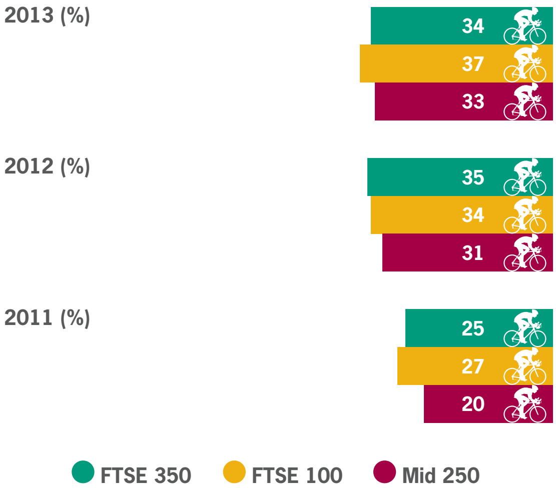
The 2012 Code requires companies to disclose the name of the external body facilitating the review. Of the 102 companies using external facilitators this year, 80% (2012: 70%) named the external reviewer. It is apparent that the provider market for such services is still embryonic; 43 different providers are mentioned. One company undertook 13 evaluations and of the remainder, 13 companies undertook two or more reviews and 29 carried out one review.

"Less than 10% refer to specific experience or ethnicity when discussing board diversity, and only 13% comment on the relevance of nationality or give insights into the type of experience considered desirable."

Was the board evaluated on its performance by an external body?

Has there been an externally facilitated evaluation?	Number of companies
Yes – this year	102
Yes – in the previous two years	70
Yes – plan for next year	55
Not stated	71

WAS THE BOARD EVALUATION EXTERNALLY FACILITATED?



Accountability

Audit committees

"The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor."

(UK Corporate Governance Code, main principle C.3)

"The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors."

(UK Corporate Governance Code, main principle C.3.1)

There is an increase in the number of audit committees meeting membership requirements, with 94% now fully constituted with independent NEDs (2012: 90%). Likewise, 98% have at least one member with recent and relevant financial experience compared to 94% in 2012.

Amendments to the Code, the passage of the Strategic Review Regulations and the publication of the Competition Commission's findings on audit market concentration all emphasise the roles and responsibilities of the audit committee. It seems companies have responded by improving the expertise and independence of audit committees and are more likely to highlight the credentials of named individuals.

There is a 19 percentage point increase, to 44%, in the number of audit committee chairmen providing a personal commentary on the work of their committee during the year (2012: 25%). However, this still accounts for less than half of all audit committee reports compared to nearly three quarters of remuneration committee reports. The quality of commentary is also weaker, with chairmen more likely to limit themselves to outlining the committee's terms of reference and commenting on the external audit process, rather than giving useful insight to the content and focus of their discussions during the year.

Despite the current focus of the government and regulators on external audit, audit committees should not focus on this topic to the exclusion of all others. The introduction to the audit committee report is the ideal place to discuss the committee's composition, its responsibilities (including risk management and internal control) and key matters considered during the year.

We anticipate that both the number of audit committee chairmen by-lined introductions and the quality of commentary will continue to grow next year from 25% this year (2012: 9%), as the revisions to the 2012 Code on audit committee reporting are digested and implemented.

FAST FACTS

- The average number of audit committee meetings is 4.5 (FTSE 100: 5.4, FTSE 250: 4.0)
- 94% of companies meet audit committee membership requirements, compared to 89.5% last year
- 97.7% (2012: 94.3%) identify a named member of the audit committee with recent and relevant financial experience
- There is a significant increase, from 9.5% to 24.8%, in the number of audit committees commenting on financial statements, including key judgements made
- 44% provide a personalised report from the committee chairman

2012 Code audit committee reporting revisions

The revisions require the audit committee to report on:

- significant judgements and estimates in relation to the financial statements
- the basis on which it determines that the annual report is fair, balanced and understandable
- how it assesses the effectiveness of the internal audit process.

Risk management and internal control

"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."

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

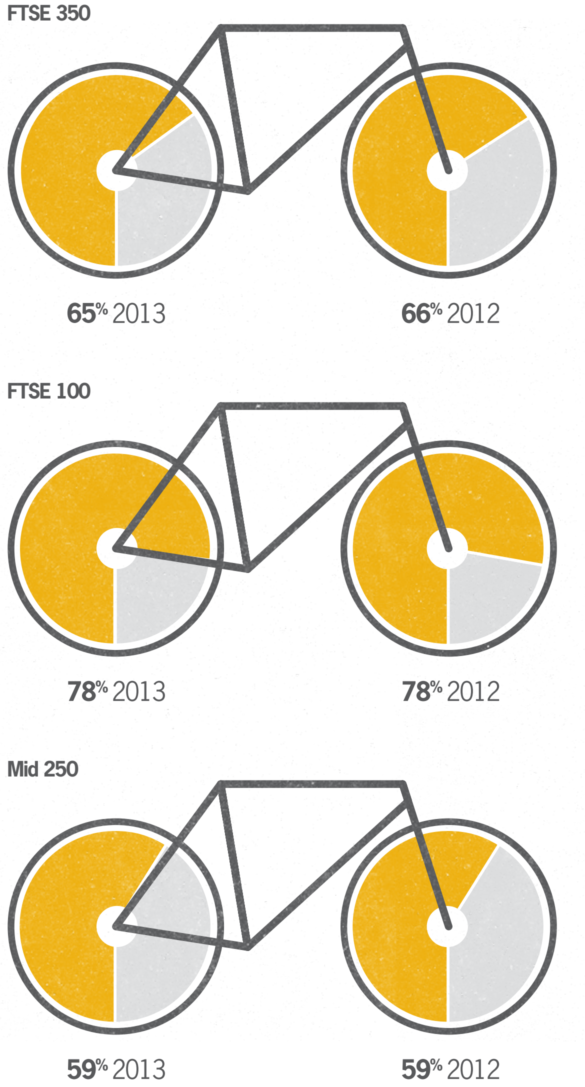
Assessing internal control effectiveness

Most companies now provide an informative disclosure of the principal risks they face (see 'Narrative reporting' section). However, many businesses still struggle to articulate the rationale behind their own internal control and risk management frameworks.

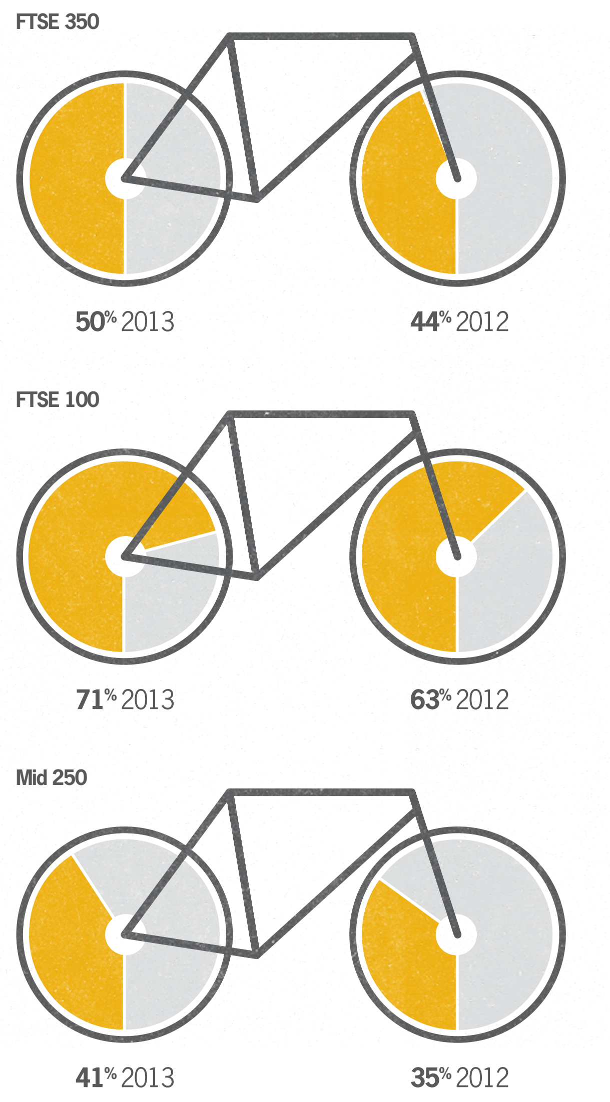
The quality of disclosure about internal control arrangements remains static, with two thirds (65%) providing a 'good' explanation (2012: 66%). However, only 27% of companies provide a 'good' explanation of the process undertaken by the board to review the effectiveness of the internal control system (2012: 26%). Similarly, despite 87% of companies providing detail on their risk management framework (2012: 85%), only half (2012: 44%) give useful information about how the company manages and mitigate risks.

Some of this lack of movement between years may be accounted for by companies entering and leaving the FTSE 350: 26 companies in our sample of 298 were not in the FTSE 350 in 2012. However, we also identified cases of companies rolling forward risk management and internal control disclosures from previous years without updating them.

RISK MANAGEMENT AND INTERNAL CONTROL PROCESS DISCLOSURES RATED AS GOOD



RISK MANAGEMENT DISCLOSURES RATED AS 'GOOD'



Disclosure of control weaknesses

The Code requires companies to disclose material or significant weaknesses. Four companies disclose significant control weaknesses (2012: 3) with 113 stating they have none (2012: 80). Of the remaining 181 companies, 102 do not refer to controls weaknesses (2012: 129) with the other 79 making an opaque statement to the effect that any such weaknesses would be remedied.

While it is understandable that companies are reluctant to disclose information that may place them at a competitive disadvantage, they should ensure the annual report gives sufficient information to reassure shareholders that their internal controls framework is effective, with measures in place to identify and address failings.

Risk committees

From 2012 all financial services companies were required to have separate risk and audit committees. Only 37.7% of companies outside this sector have discrete risk committees, a slight drop on the previous year. The reduction appears to be due to the change in the constitution of the FTSE 350 between the years. There is also a small increase in the number of risk committees with board representation, up to 87.9% from 86.6%.

While it is encouraging that some companies have created dedicated risk forums in the last few years, in order to ensure effective governance they need to be clear on which responsibilities are retained by the board and which are delegated to committees and management. While day-to-day responsibility for risk management can be delegated, ownership of strategic risk remains with the board.

Risk committees

Industry (size)	Separate risk committee %		With board representation %	
	2013	2012	2013	2012
Financials services	100.0	100.0	100.0	100.0
Other	37.7	39.6	87.9	86.6

Internal audit

An increasing number of FTSE 350 companies now believe internal audit has a valuable role in supporting risk management. Only 27 do not have an internal audit function (2012: 33), citing small size, lack of complexity and proximity of senior management to operations as the reasons. One third of companies without a function are real estate investment and holding companies, which are asset rich but have a small operational footprint.

Of the companies with an internal audit function, 24% disclose either an outsourced or co-sourced internal audit arrangement, showing no change from 2012. The remaining 76% either have an in-house function or fail to provide sufficient information to determine whether it is internal, co-sourced or outsourced.

With the increasing attention being given to internal audit, it is surprising that few companies give any information about the scale, expertise or focus of this third line of defence.

Does the company have an internal audit function?

FTSE rank	2013 (%)	2012 (%)
1–100	100	100
101–200	88	86
201–350	85	81
TOTAL	**91**	**89**

"An increasing number of FTSE 350 companies now perceive internal audit has a valuable role in supporting risk management."

Assurance

External audit

In October 2013, the Competition Commission published the final findings of its review of the UK statutory audit services market. The report found barriers to competition in statutory audit services to large listed companies.
The commission's remedies include:

- FTSE 350 audit engagements to be put out to tender at least every 10 years, five years is seen as desirable
- a ban on provisions in loan agreements which restrict choice of auditor
- the sufficiency of disclosures on external auditors in the annual report to be voted on by shareholders
- only audit committees to initiate tenders and recommend appointments for external audit work, negotiate fees, and authorise non-audit services.

The Competition Commission proposes that no company will be able to delay this external audit tender past ten years. This differs from the 2012 Code which still allows the use of 'comply and explain' beyond ten years. Audit committees have also to provide additional information about how the performance of the external auditor is evaluated, how the decision is made to appoint or re-appoint them, and the auditor's tenure/when the audit was last tendered.

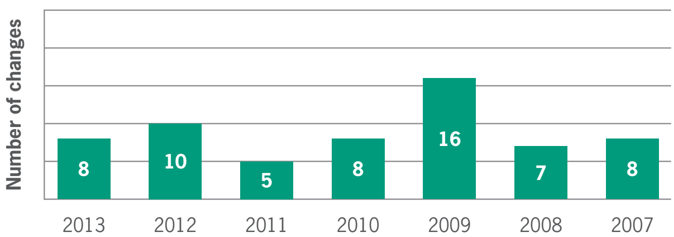
The European Commission entered into trialogue discussions with its co-legislators, the European Parliament and Council of Ministers, on its audit policy proposals in October 2013. Current indications are that mandatory audit firm rotation and possibly greater restrictions on the provision of non-audit services by a public company's auditor could be introduced in some form. The outcome should be known in early 2014.

Audit tendering

The introduction of the 10-year tendering provision came into effect for reporting periods commencing from 1 October 2012 and was well trailed in advance. Despite this, only 14.1% of FTSE 350 companies state a commitment to meet this requirement. However, several companies proactively set a policy of retendering every five years.

In the period under review, 13 companies announced that they had put the external audit appointment out for tender, resulting in eight firms appointing new auditors: four in the FTSE 100 and four in the Mid 250. This is broadly in line with the previous year, in which 10 companies appointed new auditors. Extrapolating across our sample, it appears that average UK auditor tenure is in the region of 33 years.

Auditor changes

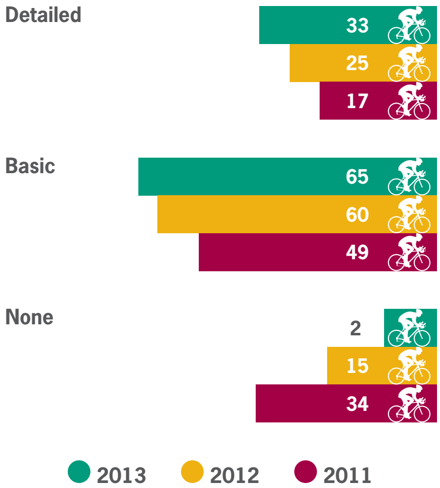


"Investors are left with little information about how long auditors have been engaged, what other services they provide and whether the relationship is managed in a way that promotes independence."

Almost all companies (98%) describe how the decision was reached to recommend the appointment, reappointment or removal of auditors (2012: 85%). However, the explanations remain opaque with just a third of companies providing sufficient detail to enable the reader to understand their reasoning (2012: 25%). 48% of FTSE 100 companies provided sufficient detail, compared to 26% of companies in the Mid 250.

Advice on disclosures relating to external auditor effectiveness and length of tenure have been included in FRC guidance on audit committees for a number of years. Taken together with considerable public debate led by both the Competition Commission and the European Commission, it is surprising to see so many companies continuing to provide such sparse information. Investors are left with little insight about how long auditors have been engaged, what other services they provide and whether the relationship is managed in a way that promotes independence. With the introduction of new guidance, next year's report should show something quite different.

QUALITY OF DISCLOSURE ON APPOINTING, REAPPOINTING AND REMOVING AUDITORS (%)



"Many businesses still struggle to articulate the rationale behind their own internal control and risk management frameworks."

FAST FACTS

- 90% of FTSE 350 firms do not state when they next plan to put audit services out to tender
- 57% do not state when they last went to tender for audit services
- 86% do not state that they intend to tender for audit services at least every 10 years, in line with the Code
- Only 33% of audit committees provide detailed, useful commentary on how they reach their recommendation to the board with regard to the appointment, reappointment or removal of their auditors

Auditor fees

This year, overall, there is a 3% rise in the average cost of audit fees, from £2.58 million in 2012 to £2.66 million. This hides significant variations: the average FTSE 100 audit fee is more than £6 million, with the top 30 average being £13.7m, while the lowest FTSE 350 audit fee is £50,000. FTSE 350 companies regularly appoint their external auditors to provide non-audit services. Typical examples include taxation services and transaction advice, for example, in relation to share offerings, initial offerings, acquisitions and disposals.

In recent years there has been a steady reduction in non-audit fees as a percentage of audit fees. This trend appears to have accelerated since our 2012 review and is particularly noticeable in the FTSE 100, where the average non-audit fee fell from 59% of the audit fee in 2012 to 34% in 2013. One possible explanation is that, due to the increased focus on audit independence by the Competition Commission and the European Commission, audit committees are becoming more sensitive about awarding additional services to their auditors. However there are notable exceptions, with one company having non-audit fees of 450%.

It is also possible that the reduction reflects a general downturn in advisory work as a result of the recession. In which case this may be expected to reverse as the crisis is left behind and discretionary spend starts to pick up.

The Competition Commission remedies and the new European law on accounting firms and audit will soon take effect, so now is maybe the time for other regulators to pause.

Average non-audit fees as a percentage of audit fees

FTSE rank	Number of companies in review	Average non-audit fees as a percentage of audit fees (%)*	
		2013	2012
1–100	98	33.7	59.2
101–200	90	53.0	63.0
201–350	110	66.7	81.7
TOTAL	**298**	**51.7**	**68.0**

*These figures represent the average non-audit fees paid by each FTSE 350 company as a percentage of their audit fees; as such they are not weighted by value of fees.

Average size of audit and non-audit fees

FTSE rank	2013		2012	
	Average audit fee (£m)	Average non-audit fee (£m)	Average audit fee (£m)	Average non-audit fee (£m)
1–100	6.45	1.72	6.09	2.26
101–200	1.06	0.49	1.13	0.65
201–350	0.65	0.34	0.5	0.28
TOTAL	**2.68**	**0.84**	**2.58**	**1.06**

Note: Audit fees include fees paid for audit related services

In assessing FTSE 100 audit fees, it is notable that the top 30 firms have an average fee of £13.7 million, while for the next 70 companies the figure is £3.4 million.

- FTSE 30 average fee was £13.7m
- Non-audit fees are approximately 51.7% (2012: 68.0%) of audit fees
- The consumer goods and oil and gas industries have the highest proportion of non-audit fees as a percentage of audit fees, at 68.8% and 68.5% respectively, while the utilities sector has the lowest, at 37.6%
- Highest non-audit fee in 2013 was £9.9m and the highest as a percentage of the audit fees was 450%

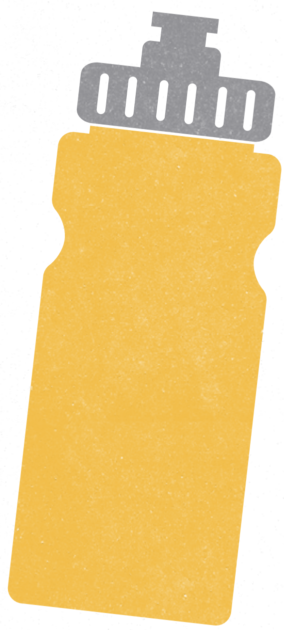
Remuneration

"Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance."

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

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

(UK Corporate Governance Code, schedule A)



Executive remuneration has continued to be a high-profile issue over the past year, with intense media scrutiny of major organisations, including the BBC, large charities, and high street banks. It is unsurprising, therefore, that remuneration is the area on which committee chairmen are most likely to provide personal commentary, with 70.5% now introducing their committee's annual report, a significant rise from 48% in 2012. This increase is spread across the full range of the FTSE, with Mid 250 companies increasing to 66% from 36.5%.

Executive pay

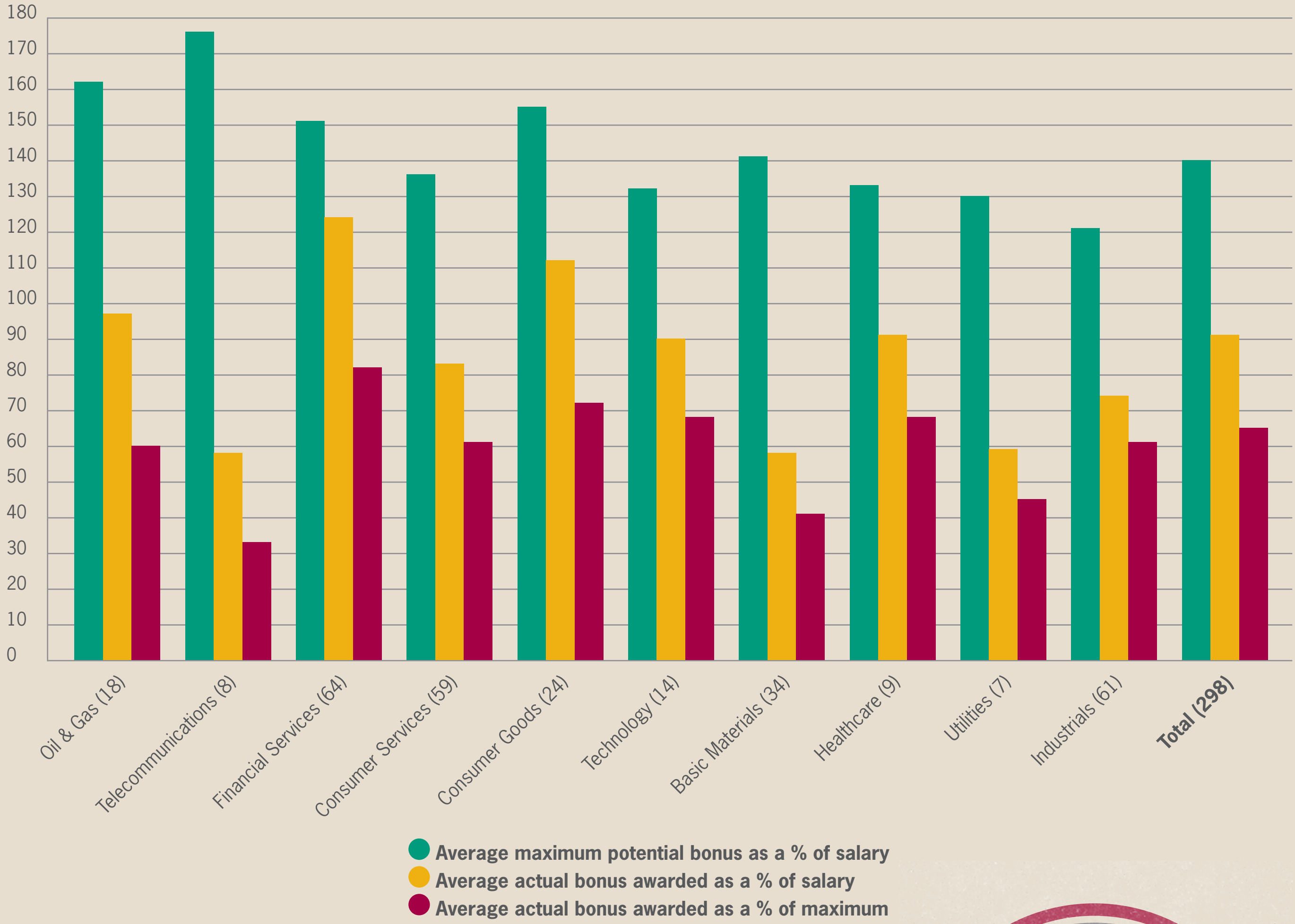
Our review identified that the average executive remuneration package includes a mix of elements, with LTIPs, bonus, pension and other benefits typically almost trebling the base salary of directors. This is particularly marked in the FTSE 100, where remuneration disclosures identify that for a typical FTSE 100 executive, the value of LTIPS and bonus alone is almost 200% of basic pay.

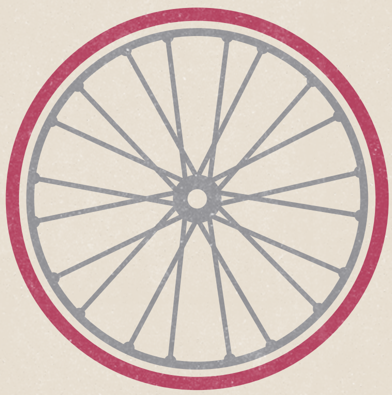
Components of executive pay

	Basic salary	Actual bonus % salary	Pension as % salary	Options as % salary	Other as % salary	Total as % salary
FTSE 350	427,540	91	16	65	11	284
FTSE 100	578,602	98	18	92	15	324
Mid 250	348,635	85	14	41	8	249

The biggest distinction in remuneration components used in FTSE 100 and FTSE 250 is options. Within the FTSE 100 they represent 92.7% of salary compared to only 41.7% of salary in the Mid 250.

BONUS DETAILS BY INDUSTRY





"It is unsurprising that remuneration is the area on which committee chairmen are most likely to provide personal commentary, with 70.5% now introducing their committee's annual report; a significant rise."

Bonus limits

"Upper limits should be set and disclosed."

(UK Corporate Governance Code, schedule A)

In accordance with the Code, upper limits for executive director annual bonuses are set by 93% of FTSE 350 companies (2012: 92%). Of the 20 companies that do not set an upper limit, 13 are in financial services. The average maximum bonus increased to 151% of basic salary, from 141% in 2012. Eighty seven companies offer maximum bonuses above 150% of salary (2012: 94).

On average, companies award actual bonuses at 91% of salary (2012: 91%), representing 60% of the maximum bonus available (2012: 62%). Thus, while the potential bonus payable has risen slightly, the actual bonus paid remains static in percentage terms. This may genuinely reflect tough trading conditions, but it does also create scope for companies to mask the fact that bonuses paid have increased – by setting higher maximum bonus levels the bonus paid expressed as a percentage of maximum bonus remains the same, or even falls.

The new requirements for the single figure, which took effect from 1 October 2013, aim to simplify this complex area but early disclosures have yet to support that objective.

The financial services industry awarded the highest level of bonus as a percentage of salary (124%, representing 67% of the maximum bonus available for those companies that impose an upper limit).

Long-term incentive plans (LTIPs) remain common, with 95% of companies offering them to directors.

Level of potential maximum bonus

Percentage of salary	Number of companies
Between 25–50%	9
Between 51–100%	94
Between 101–150%	88
Between 151–200%	58
Over 200%	29
No limit	20
TOTAL	**298**

Procedure

"There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration."

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

The average number of remuneration committee meetings rose to 4.9 this year (2012: 4.6). Perhaps a reflection of the high profile of executive remuneration following last year's 'shareholder spring' and the media focus upon it.

Despite the increased scrutiny, 38 companies fail to meet the remuneration committee membership criteria set out in the Code (2012: 32). Of these, 14 include an executive chairman on the committee and a further 24 do not have sufficient independent NEDs.

FAST FACTS

- Total earnings as a percentage of salary: FTSE 100 325% Mid 250 250%
- The financial services industry has the highest total earnings of 371% of salary, while the utilities industry has the lowest at 213%
- 56% of companies pay executive bonuses in a mixture of cash and shares, 27.5% in cash only, 3.0% in shares only and 13.4% of companies did not state the form in which bonuses are paid
- 27.5% pay bonuses in cash only, and 3% in shares only
- 13.4% do not state how bonuses are paid, a significant drop from last year's 35%
- 70.4% (2012: 50%) of chairmen of remuneration committees make personal statements

Shareholder relations

"There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place."
(UK Corporate Governance Code, main principle E.1)

"The chairman should discuss governance and strategy with major shareholders."
(UK Corporate Governance Code, E.1.1)

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

In its report on adherence to the Stewardship Code in 2012[5], the Investment Management Association (IMA) presents a mixed view of current engagement between shareholders and boards. As in 2011, remuneration and strategy are the issues most frequently discussed between investors and board members. Company chairmen note they have more regular contact with shareholders than in the past and are more likely to discuss strategy with them. However, investors believe there is scope to improve mechanisms for collaborative engagement with other shareholders, for example through joint meetings with other investors (although concert party actions remain an inhibitor).

Just over 73% of companies give an informative description of the steps taken to communicate with major shareholders (2012: 73%). Most go beyond basic shareholder relations activities, such as the AGM, annual report and investor bulletins, with many citing additional events such as face-to-face meetings between NEDs and major shareholders, regional and visits to overseas investors by the board, and Q&A sessions with the CEO.

[5]http://www.investmentuk.org/research/stewardship-survey/

Two features characterise the highest quality reporting in this area:

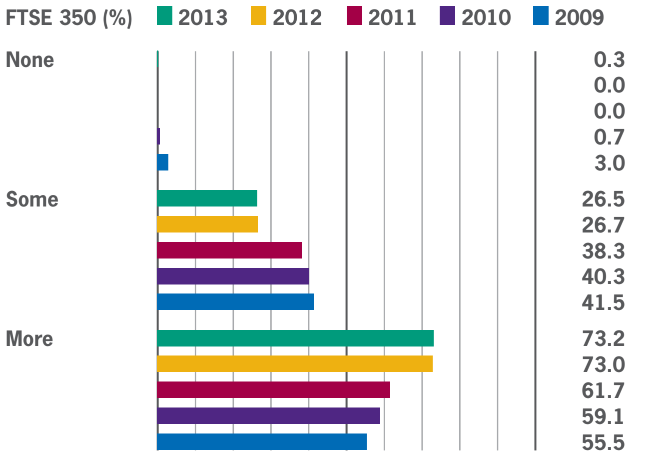
1 **All categories of investor are considered.** The best companies recognise that the communication needs of corporate, individual and debt investors differ. They detail the actions taken to communicate with each major category of investors

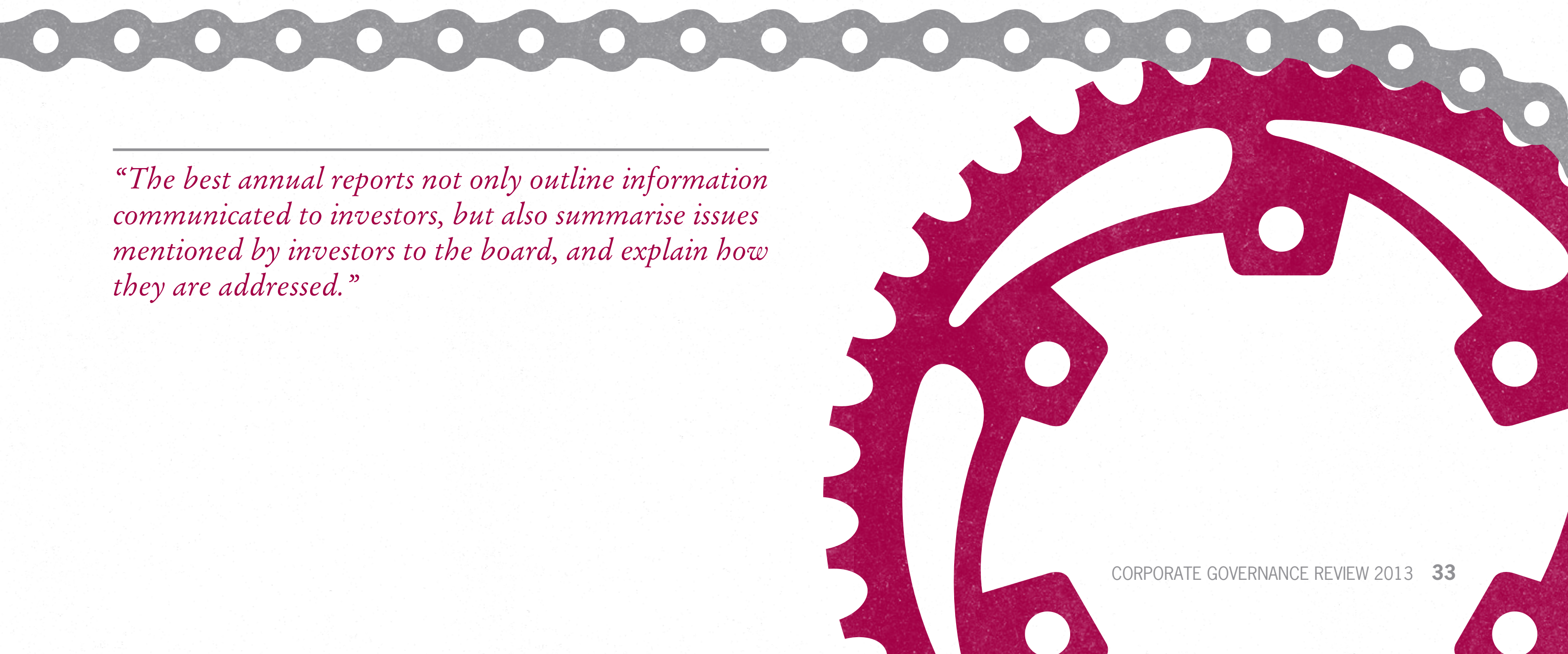
2) **The views of shareholders are responded to.** The best annual reports not only outline information communicated to investors, but also summarise issues mentioned by investors to the board, and explain how they are addressed

The 2012 Code requires companies to comment on the steps taken to understand the views of capital debt holders. However, only 3% of companies refer to communication with major debt holders as part of their disclosure on investor relations. Companies with significant loan facilities should be reflecting on their engagement with this category of stakeholder as they plan for the 2013 annual reporting period.

This year, our review shows that 25.8% of FTSE 350 chairmen describe discussing governance and strategy with major shareholders in the year, an improvement of over 8% (2012: 17%). This is likely to have been influenced by the higher profile of corporate stewardship, for both companies and investors, following the introduction of the FRC's Stewardship Code in 2010. Given that the IMA report highlights strategy as one of the main areas in which shareholders seek engagement from companies this is a positive development.

TO WHAT DEGREE DOES THE BOARD DEMONSTRATE THE STEPS IT TAKES TO UNDERSTAND THE VIEWS OF MAJOR SHAREHOLDERS?





"The best annual reports not only outline information communicated to investors, but also summarise issues mentioned by investors to the board, and explain how they are addressed."

Narrative reporting

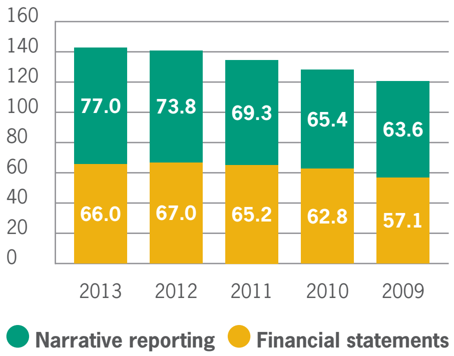
Business and financial reporting

"The board should present a balanced and understandable assessment of the company's position and prospects."
(UK Corporate Governance Code, main principle C.1)

"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."
(UK Corporate Governance Code, C.1.2)

The average length of the annual report has increased again this year, to 143 pages (2012: 141). The front end continued to grow at an average of over three pages per year, as it has for the last four years, with the front end representing typically more than half the total length (77 pages, 2012: 74). Calls for greater transparency appear to be being translated as calls for 'more' rather than 'better' information. As this section continues to grow so does the risk that investors and other accounts' users will not find the information they require.

Average length of annual report (FTSE 350)



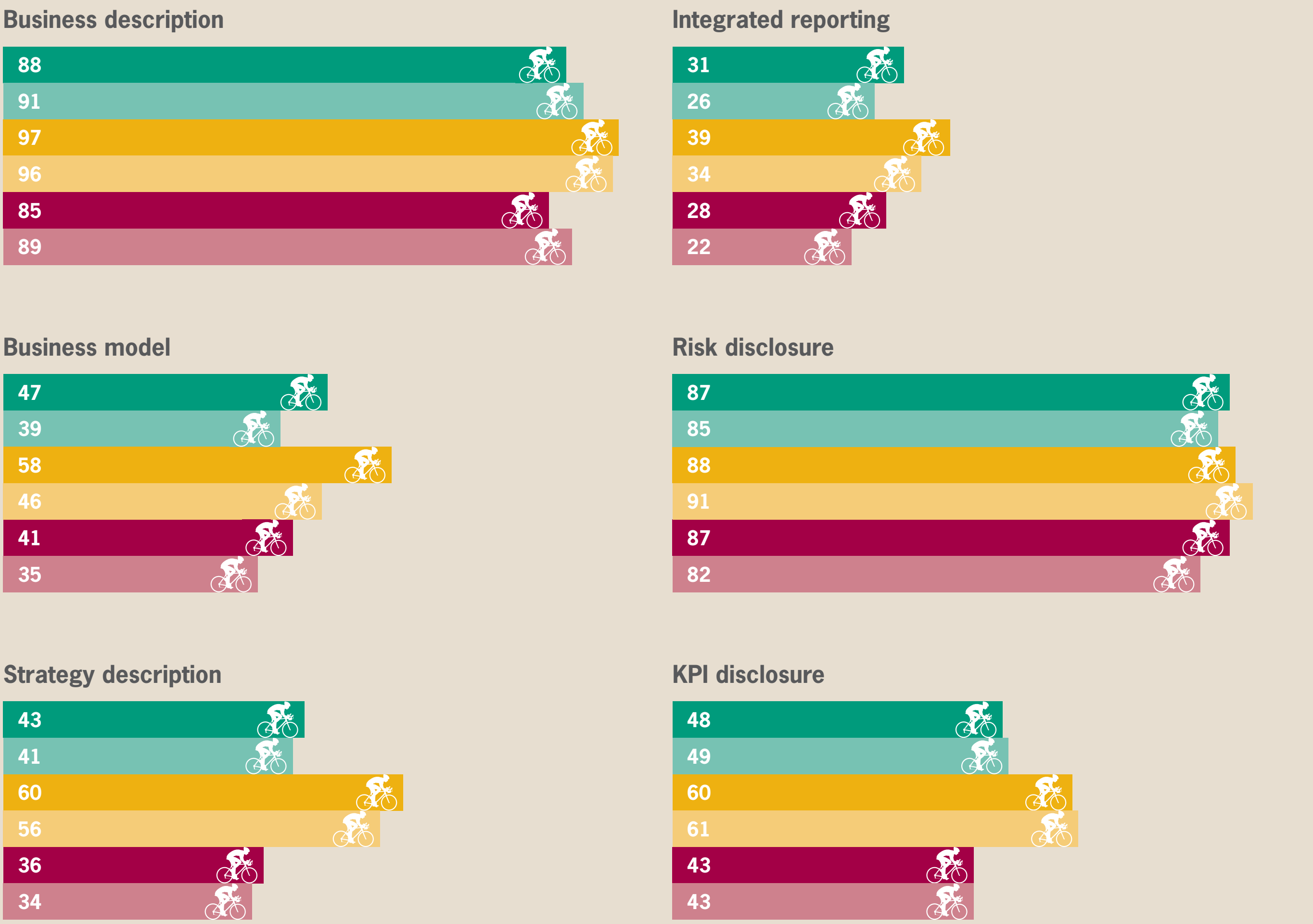
Our review confirms the findings of the FRC, in its 2012 Development of Corporate Governance report that, while some areas such as reporting on companies' principal risks and uncertainties standards continue to improve, explanation in other sections remains poor.

Company commentary on business models improved during the year: however, less than half (47%) explain them in a clear and useful way (2012: 39%). Similarly, the number of companies describing their future plans in an informative manner remains at 43%. There is a noticeable division here between the FTSE 100 and the Mid 250: just 35.5% of Mid 250 companies provide good disclosures about future strategy compared to 60% of the FTSE 100.

Although more companies demonstrate the link between strategy, key performance indicators (KPIs) and principal risks, less than a third (31.5%) give an adequate explanation of the 'business environment' in which they operate (2012: 26.4%). Again, the FTSE 100 leads the way, but even here only 38.8% of companies provide 'good' disclosures. The new strategic reporting requirements aim to address some of these areas but may only prove to be an interim solution until the International Integrated Reporting Council (IIRC) publishes its Integrated Reporting Framework in December 2013. This field of reporting clearly has some way to go. There are a few examples of real progress but the majority of companies struggle to provide succinct, relevant reporting on performance and strategy.

- The average length of a FTSE 350 report is 143 pages (2012: 141)
- The average front end of the report is 77.3 pages for the FTSE 350, 101 for the FTSE 100 and 65.5 for the Mid 250
- The two longest annual reports – both above 500 pages – are produced by financial services companies
- Only three FTSE 100 companies keep their annual reports under 100 pages

EXTENT OF FINANCIAL AND BUSINESS REPORTING DISCLOSURES ASSESSED AS 'GOOD' (%)



FTSE 350
2013
2012

FTSE 100
2013
2012

Mid 250
2013
2012

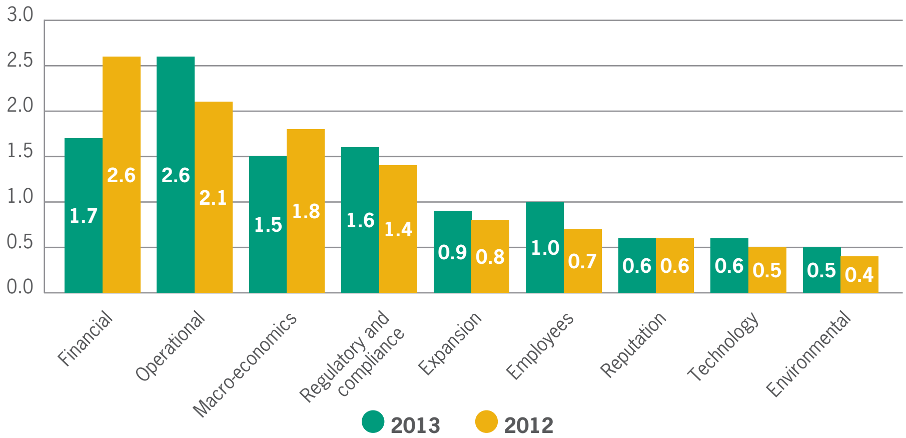
"There are a few examples of real progress but the majority of companies struggle to provide succinct, relevant reporting on performance and strategy."

Principal risks

"The business review must contain … a description of the principal risks and uncertainties facing the company."

(Companies Act 2006, Section 417; 3b)

Average number of principal risks identified by the FTSE 350



The way in which risks are presented is generally good, with 87% of companies now providing an effective description of their principal risks and risk mitigation measures. However, there is evidence that companies are not regularly updating the risk disclosures in their annual report – 36% of this year's risk disclosures are identical to those made in 2012. With risk management now widely established, we urge boards to continue to explore how they might present their risk disclosures in a fresh and more sophisticated manner.

In assessing company risk disclosures, we considered only 9.1% to be excellent. The majority of companies disclose between five and 15 principal risks. Of the outliers, one company identifies only two, and five report more than 30, including one company that reports 38 principal risks. Listing such a large number of risks signals a need for further review or revision of the way risk is quantified.

Increased risk exposure is seen in operational, regulatory and employee areas of businesses, while financial and macro-economic risks continue to occupy the focus of businesses. This may reflect a growing confidence in the economy and companies' increasing ability to borrow and recruit, coupled with the continued need to drive operational efficiency while having to deal with increasing regulatory burdens as the lessons of the recession come into law.

Excellent disclosures stood out for:

- giving an explanation of how the board reviewed corporate risks during the year and the key features of this review
- identifying where and why the risk score had moved since the previous year
- providing a clear link to corporate strategy
- making cross-references to the relevant section of the operating review
- presenting information in a clear and concise manner, often with tables, diagrams or flow charts.

"The improvement in KPI disclosures in previous years appears to have stalled, with less than half of companies providing effective supporting material for their basic statements."

KPI reporting

The average company reports just over eight KPIs. However, there continues to be a heavy focus on financial KPIs, with financial indicators being disclosed over non-financial indicators at a ratio of approximately two to one.

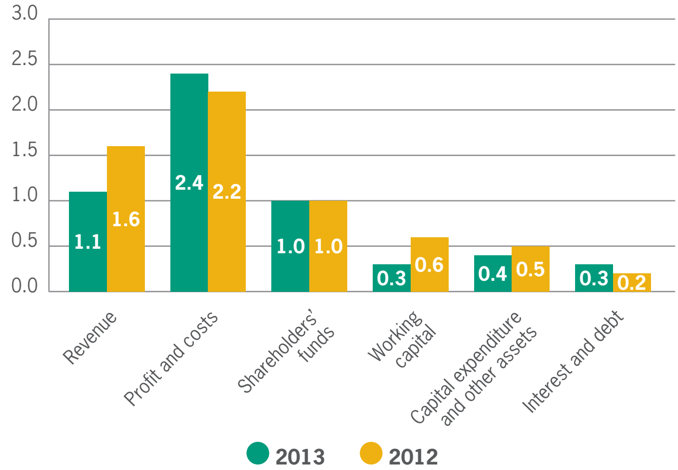
The number of financial KPIs in each category remains broadly consistent, with slightly less emphasis on revenue and working capital, and slightly more on profit and costs. This year, non-financial KPIs focus on operational activity more than in 2012. Given the topicality of sustainability issues, there is a surprising reduction in the average number of environmental KPIs disclosed, from 0.7 per company in 2012 to 0.4.

The improvement in KPI disclosures in previous years appears to have stalled, with less than half of companies (48.3%, 2012: 48.6%) providing effective supporting material for their basic statements. In many cases, KPIs are disclosed but no narrative is given to interpret them or link them to strategy or operations. Companies are also more likely to report on financial KPIs such as ROCE and EBITDA. Effective examples of operational indicators, such as footfall for retail businesses, occupancy rates for hotels and employee satisfaction levels for service companies, are less common.

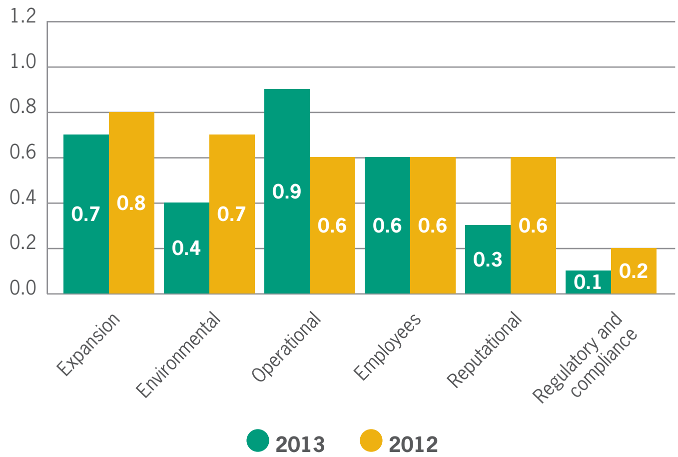
The introduction of the Strategic Review Regulations and the accompanying FRC guidance will no doubt shine a spotlight on such reporting and stimulate further improvement in the number, type and, hopefully, quality of KPI disclosures.

"Increased risk exposure is seen in operational, regulatory and employee areas of business."

Average number of financial KPIs disclosed (FTSE 350)



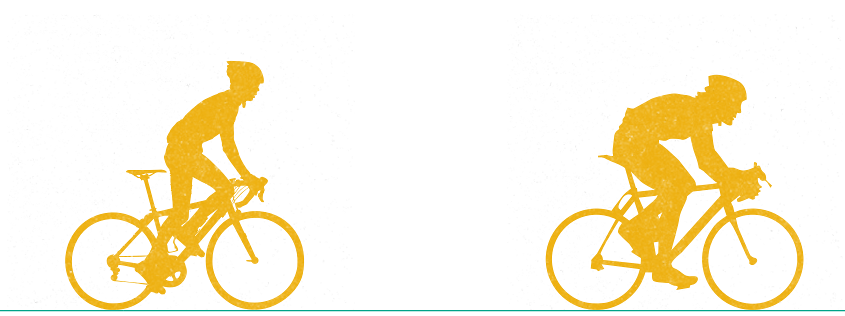
Average number of non-financial KPIs disclosed (FTSE 350)



Recent developments

	Comments	Timing
Governance of companies		
The UK Corporate Governance Code (September 2012)	• The 2012 Code revisions require: – companies to disclose their policy on boardroom diversity and report progress annually – the board to consider its diversity, among other factors, when assessing its effectiveness – the board to confirm that it considers the annual report and accounts, taken as a whole, to be fair and balanced – audit committees to disclose more information about their activities – FTSE 350 companies to put the external audit contract out to tender at least every 10 years (FRC comments on transitional arrangements published on FRC website) • The FRC paper "What Constitutes an Explanation under 'Comply or Explain'?" provides guidance on the features of a meaningful explanation. This has been included in the 2012 Code revisions • The FRC has announced that 2014 Code revisions will include updated provisions in relation to disclosures on risk management, internal control. See below	• Currently effective • The next annual monitoring report on the Code is scheduled to be published by the FRC in December 2013
Risk Management, Internal Control and the Going Concern Basis of Accounting	In November 2013 the FRC published for consultation, changes to the UK Corporate Governance Code, guidance for boards of listed companies and standards for auditors covering risk management and reporting. The proposals build on the FRC's work on 'Boards and risk' and aim to raise the bar for risk management by boards and communication about the risks faced by companies in which they invest and how they are managed or mitigated. They set out how the FRC will implement the recommendations of the 2012 Sharman Inquiry. The FRC has made a key change in these proposals by bringing together its previous guidance on risk management and internal control with the assessment of the going concern basis of accounting; so encouraging the integrated assessment and reporting recommended by Lord Sharman.	• Revised guidance to be published in the first half of 2014 • To take effect simultaneously with proposed changes to the Code to apply to reporting periods beginning on or after 1 October 2014
QCA Corporate Governance Code for Smaller Quoted Companies (May 2013)	• The Code, published in May 2013, adapted the UK Corporate Governance Code specifically for AIM and smaller quoted companies	• Currently effective
Corporate Governance Guidance and Principles for Unlisted Companies in the UK (November 2010)	• Issued by the Institute of Directors as a practical tool for shareholders, directors and stakeholders of unlisted companies • Adapted from pan-European guidance published by the European Confederation of Directors' Associations (ecoDa) in March 2010	• Currently effective

FRC Guidance on Audit Committees (September 2012)	• Guidance revised to support the 2012 changes to UK Corporate Governance Code and to give effect to the FRC's Effective Company Stewardship proposals • Audit committee to report to the board on: – the significant issues considered in relation to the financial statements and how these issues are addressed – the basis for its advice that the annual report is fair, balanced and understandable and provides the information necessary for users to assess the company's performance, business model and strategy – its assessment of the effectiveness of the external audit process and its recommendation on the appointment or reappointment of the external auditor, including steps taken in deciding whether to recommend the audit be put out to tender • FRC co-authored a report 'Walk the Line' summarising discussions with the audit committee chairs of leading companies in the UK, Australia, and other markets. The report provides insights into the role of the audit committee and its relationship with the board, management and external auditor	• Currently effective • The FRC Financial Reporting Lab published a report on reporting of Audit Committees in October 2013
FRC Guidance on Board Effectiveness (March 2011)	• Relates primarily to Sections A and B of the Code on the leadership and effectiveness of the board • Intended to stimulate board thinking on how it can carry out its role most effectively • Emphasises the role of the chairman in leading the board	• Currently effective
Governance of Investors		
Stewardship Code for Institutional Investors (September 2012)	• The 2012 Stewardship Code revisions include: – clarifying what is meant by stewardship, and the respective responsibilities of asset owners and asset managers – asking investors to disclose their policy on stock lending, and whether they recall lent stock for voting purposes • In November 2012, the Institute of Chartered Accountants in England and Wales published a revised edition of the Stewardship Supplement to its guidance on assurance reporting (AAF 01/06) to enable assurance to be carried out against the revised Code	• Currently effective
Kay Review of equity markets and long-term decision making (July 2012)	• Report commissioned by BIS to review activity in UK equity markets and its impact on the long-term performance and governance of UK-quoted companies • Concludes that short-termism is a problem in UK equity markets, with the principal causes being the decline of trust and misalignment of incentives throughout the equity investment chain • Report sets out a series of 10 principles and 17 recommendations which were broadly endorsed by the government in its November 2012 response	• An update is to be published by summer 2014 setting out progress
Financial Conduct Authority (FCA) Consultation: Enhancing the effectiveness of the Listing Regime	A consultation on the tightening of London listing rules to protect the interests of minority shareholders was published on 5 November 2013, in part in response to the issues exposed by the Eurasian Natural Resources Corp and Bumi scandals. • Majority shareholders of premium listed companies must maintain an 'arms length' distance from the company and not interfere in day-to-day decisions • Where majority shareholders, with more than or equal to 30% share, breach these rules, other investors will then be allowed to vote on all transactions • A double vote for independent directors will be introduced, passing a vote of all shareholders and a separate vote of minority shareholders only ahead of election	• Consultation closes on 5 February 2014



European Commission		
European Commission EU corporate governance action plan	• Considers the 'comply or explain' principle and introduces concept of monitoring bodies • Initial consultation in July 2011 posed 25 questions, ranging from board governance practice to institutional engagement • Action plan issued in December 2012 reaffirming the 'comply or explain' principle. • 'Non-legislative' initiative expected to improve the quality of corporate governance statements, in particular the quality of explanations	• Action plan issued in December 2012
European Commission proposed law on audit policy	• Considers market concentration of auditors, audit quality and governance and audit mandate and communication • Trialogue with the European Commission's co-legislators on its audit policy proposals commenced in October 2013	• The outcome of discussions with the European Parliament and Council of Ministers should be known in early 2014
Gender diversity		
The Davies Report on women on boards (February 2011)	• Recommends that FTSE 350 chairmen announce the percentage of women they aim to have on boards in 2013 and 2015 • FTSE 100 boards should aim for a minimum of 25% female representation by 2015 • Paper published by BIS in April 2013 reporting on action to date and progress on recommendations made in the initial report. The paper also gives targets for FTSE 100 and FTSE 250 companies. The report notes that overall progress has been good. Women now account for 17.3% of FTSE 100 and 13.2% of FTSE 250 board directors (as at 1 March 2013), up from 12.5% and 7.8% respectively in February 2011	• Regular status reports published
Executive remuneration		
Directors' Pay: Revised Remuneration Reporting Regulations	These regulations are intended to replace existing legislation and specify that the directors' remuneration report should contain two distinct parts: • a policy report setting out all elements of a company's remuneration policy and key factors taken into account in setting the policy. This part of the report need only be produced when there is a shareholder vote on the policy • an annual report on how the policy was implemented in the past financial year, setting out actual payments to directors and details on the link between company performance and pay.	• An update is to be published by summer 2014 setting out progress

Narrative reporting

A new structure for narrative reporting in the UK	• The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 will replace existing legislation on narrative reporting and require companies to produce a strategic report • This will be similar to the business review, with quoted companies being required to report on their strategy, business model, and number of men and women on their board, in executive committees and in the organisation as a whole. Disclosures on human rights and greenhouse gas emissions also required • The regulations remove several reporting requirements to simplify reporting • The FRC issued Exposure Draft: Guidance on the Strategic Report on 15 August 2013; the closing date for comments was 15 November 2013	• New regulations to apply for financial years ending on or after 30 September 2013 • FRC intends to finalise proposed guidance early in 2014 • DEFRA published Environmental Reporting guidelines, including guidance on the greenhouse gas emissions reporting requirements introduced by the regulations, in June 2013
FRC Financial Reporting Lab	The Financial Reporting Lab provides an environment where investors and companies come together to develop pragmatic solutions to today's reporting needs. Reports have been published on the following: • A single figure for remuneration • Net debt reconciliations • Operating and investing cash flows • Debt terms and maturity tables • Presentation of market risk disclosures • Reporting of pay and performance	• Report on Audit Committees published in October 2013
International Integrated Reporting Council (IIRC)	• The Consultation Draft of the International Integrated Reporting Framework was released on 16 April 2013: over a 90-day period 359 submissions were received • During 2013 the IIRC released topic-specific background papers on business model, capitals, connectivity, materiality and value creation • The IIRC Pilot Programme, the innovation hub for this market-led initiative which has representation from 26 countries, includes: – over 100 Business Network participants from a range of industries – over 35 investor organisations in its Investor Network • The journey towards Integrated Reporting is presented in resources, including the Pilot Programme Yearbook and the IIRC's emerging examples database • There was specific reference to Integrated Reporting and the work of the IIRC by regulators including in the FRC Exposure Draft on the Strategic Report and the proposed changes to the 4th and 7th EC Directives on Annual and Consolidated Accounts • The IIRC has Memorandum's of Understanding with organisations including the International Accounting Standards Board (IASB) and the International Federation of Accountants (IFAC)	• Following a three-month consultation period, the International Integrated Reporting Framework will be published in December 2013

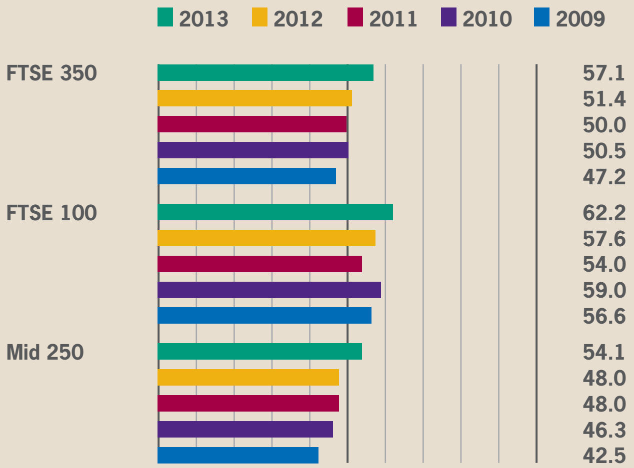
Appendix

Compliance with the code

QUESTION 1. DO THEY CLAIM FULL COMPLIANCE WITH THE CORPORATE GOVERNANCE CODE?

Guidance: “The following additional items must be included in its annual financial report: a statement as to whether the listed company has: (a) complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code; or (b) not complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code”. (Listing Rule 9.8.6 (6))

Figure 1 (%)



COMPLIANCE BY INDUSTRY

Figure 2

Industry (size)	Claim full compliance or provide “more” explanation % 2013	2012	2011
Healthcare (9)	100	100	100
Telecommunications (8)	100	100	100
Technology (14)	100	92	80
Basic Materials (34)	68	88	96
Industrials (61)	87	88	86
Consumer Goods (24)	88	88	85
Utilities (7)	86	88	100
Financials (64)	83	86	78
Oil & Gas (18)	89	86	89
Consumer Services (59)	76	79	79
TOTAL (298)	**87**	**87**	**84**

QUESTION 2. OF THE 128 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 (%)

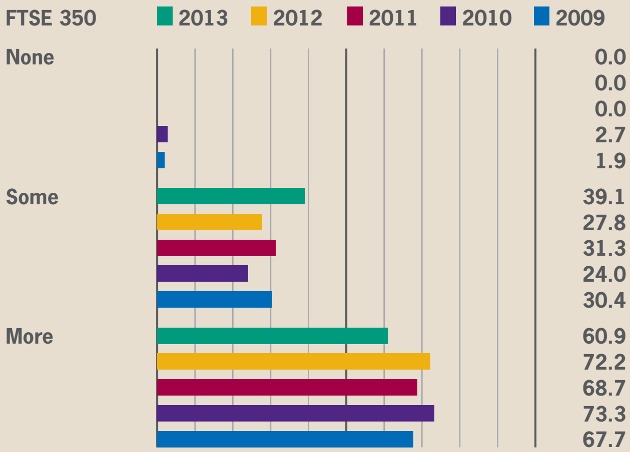


Figure 4 (%)

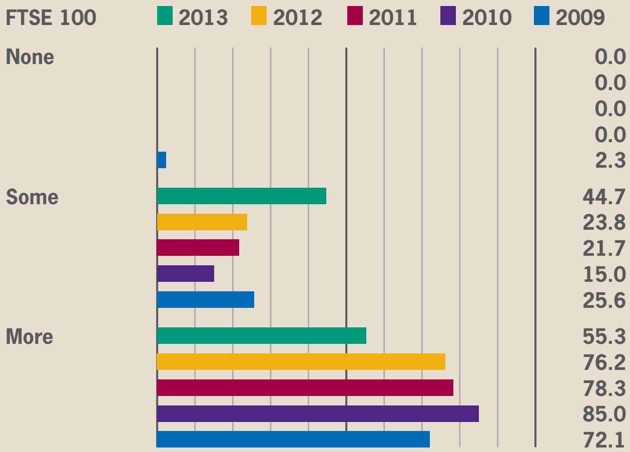
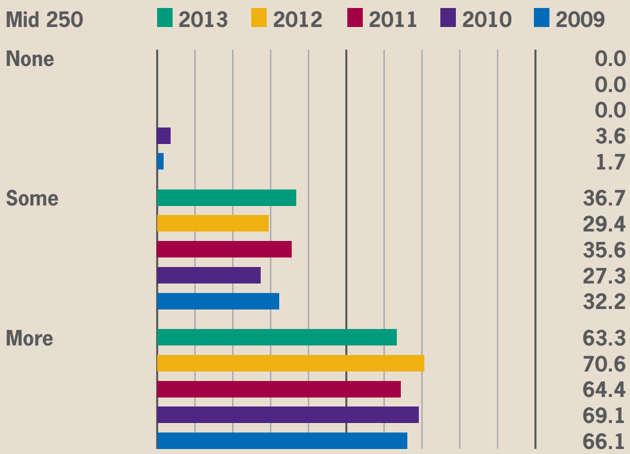


Figure 5 (%)

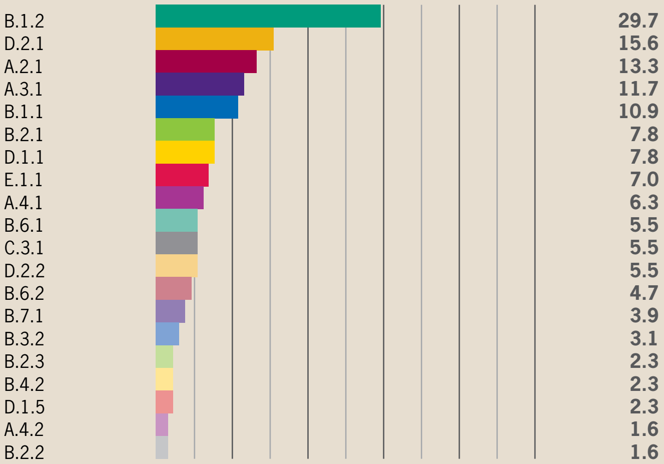


'More' disclosure is achieved where a company provides a detailed explanation to support each area of the Code with which they choose not to comply. This includes the reasons for their non-compliance and an explanation as to why they feel that this non-compliance is in the best interests of the company and the shareholders. There would normally be reference to a regular review of the rationale for non-compliance to assess whether it continues to be in the best interests of the company.

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.

QUESTION 3. OF THE 128 COMPANIES WHO DO NOT CLAIM FULL COMPLIANCE WITH THE CODE, WHICH PROVISIONS DO THEY MOST COMMONLY CHOOSE NOT TO COMPLY WITH?

Figure 6 (%)



Code provisions

CODE	% OF NON-COMPLIANT COMPANIES	CODE DETAIL
B.1.2	29.7%	At least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.
D.2.1	15.6%	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. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board. Where remuneration consultants are appointed, they should be identified in the annual report and a statement made as to whether they have any other connection with the company.
A.2.1	13.3%	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	11.7%	The chairman should on appointment meet the independence criteria set out in B.1.1.
B.1.1	10.9%	The board should identify in the annual report each non-executive director it considers to be independent. 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.
B.2.1	7.8%	There should be a nomination committee. A majority of members should be independent non-executive directors.
D.1.1	7.8%	In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code.
E.1.1	7.0%	The chairman should discuss governance and strategy with major shareholders. 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.4.1	6.3%	The board should appoint one of the independent non-executive directors to be the senior independent director.
B.6.1	5.5%	The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.
C.3.1	5.5%	The board should establish an audit committee of at least three independent non-executive directors. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.
D.2.2	5.5%	The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration for senior management.
B.6.2	4.7%	Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company.
B.7.1	3.9%	All directors of FTSE 350 companies should be subject to annual election by shareholders.
B.3.2	3.1%	The terms and conditions of appointment of non-executive directors should be made available for inspection. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them.
B.2.3	2.3%	Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director. Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.
B.4.2	2.3%	The chairman should regularly review and agree with each director their training and development needs.
D.1.5	2.3%	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.
A.4.2	1.6%	The chairman should hold meetings with the non-executive directors without the executives present. 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 and on such other occasions as are deemed appropriate.
B.2.2	1.6%	The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

Leadership

The role of the board

QUESTION 4. TO WHAT EXTENT ARE THE FEATURES OF GOVERNANCE DISCUSSED IN THE CHAIRMAN'S STATEMENT?

Guidance: "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".
(UK Corporate Governance Code, Preface, paragraph 6)

Figure 7 (%)

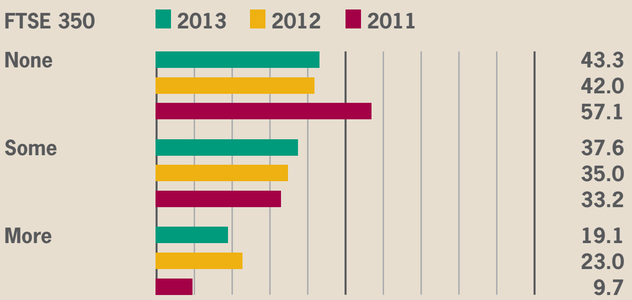


Figure 8 (%)

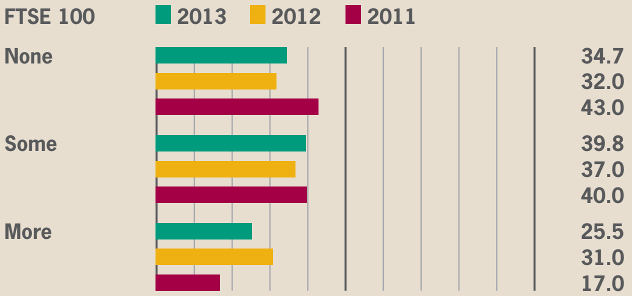
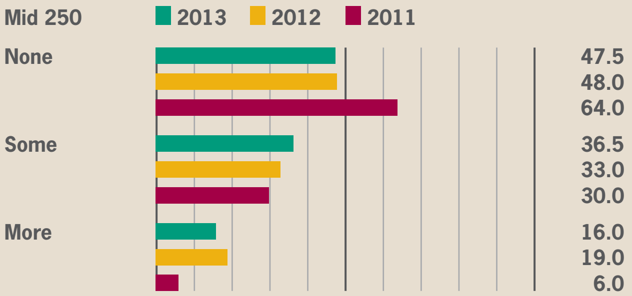


Figure 9 (%)



QUESTION 4A. TO WHAT EXTENT DOES THE CHAIRMAN DESCRIBE KEY FEATURES OF GOVERNANCE IN THE GOVERNANCE REPORT?

Figure 10 (%)

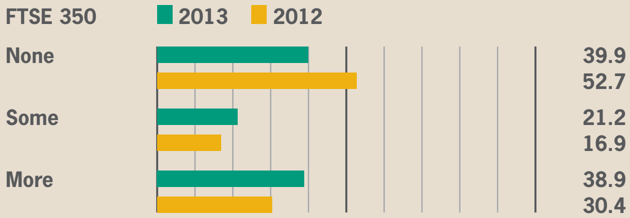


Figure 11 (%)

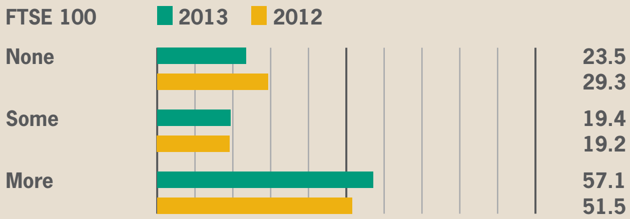
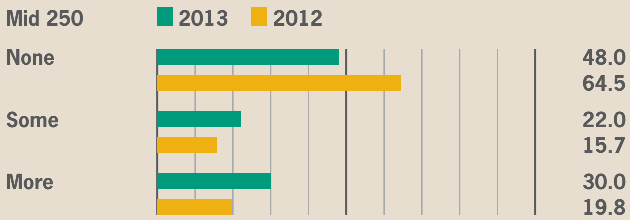


Figure 12 (%)



The most informative disclosures included detail of the following areas:

- The key governance issues facing the business
- Their key governance targets
- Board activities throughout the year
- The company's governance framework
- The corporate governance report
- The company's approach to regulation and guidelines
- Their approach to remuneration
- The key governance objectives and focus of the board for the next year
- Importance of governance to running a successful business
- Stated their personal responsibility for the smooth running of the board
- The results of board evaluation reviews and resultant actions, such as long-term succession planning or increased training
- The key features of governance as they see it
- The significance of good governance in achieving business success and linked what was written in the Chairman's Statement to the Corporate Governance section of the report

QUESTION 4B. IS THERE ANY PERSONAL COMMENTARY FROM THE CHAIRMAN OF THE AUDIT, NOMINATION AND REMUNERATION COMMITTEES?

Figure 13 (%) **Audit Committee**

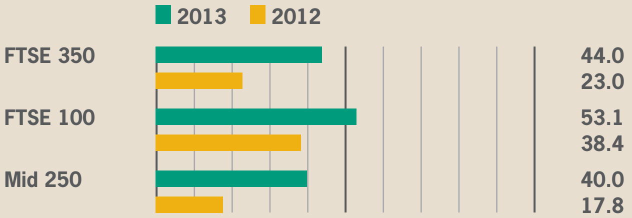


Figure 14 (%) **Remuneration Committee**

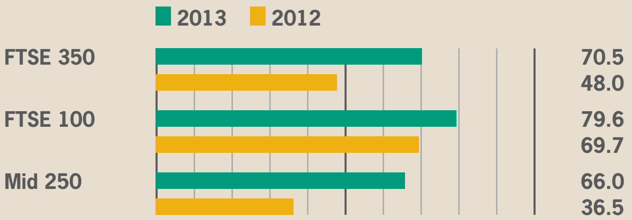
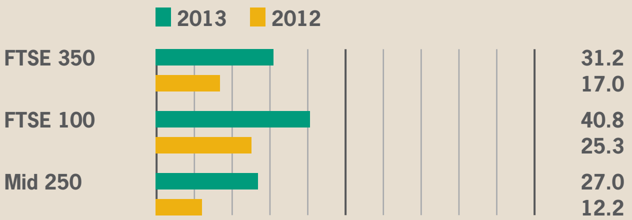


Figure 15 (%) **Nomination Committee**



QUESTION 5. TO WHAT EXTENT DOES THE ANNUAL REPORT DESCRIBE HOW THE BOARD OPERATES AND ITS DUTIES ARE DISCHARGED EFFECTIVELY?

Guidance: "The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions is to be taken by the board and which are to be delegated to management". (UK Corporate Governance Code, A.1.1)

Figure 16 (%)

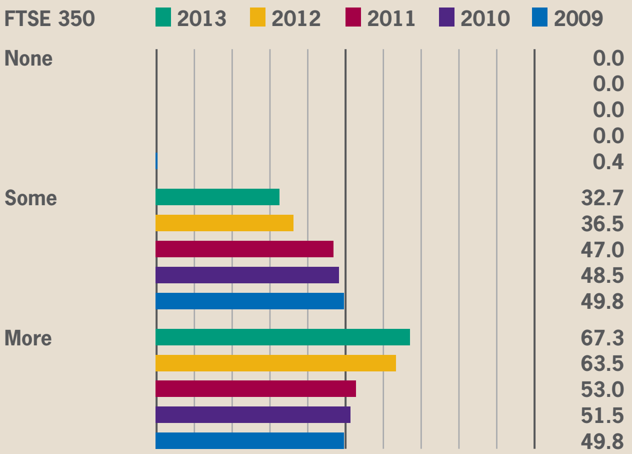


Figure 17 (%)

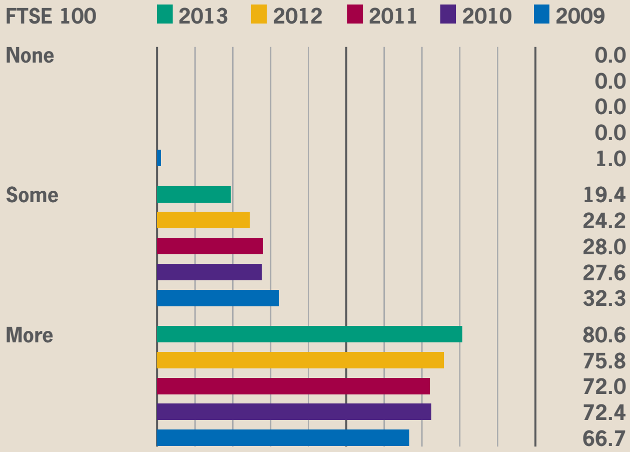
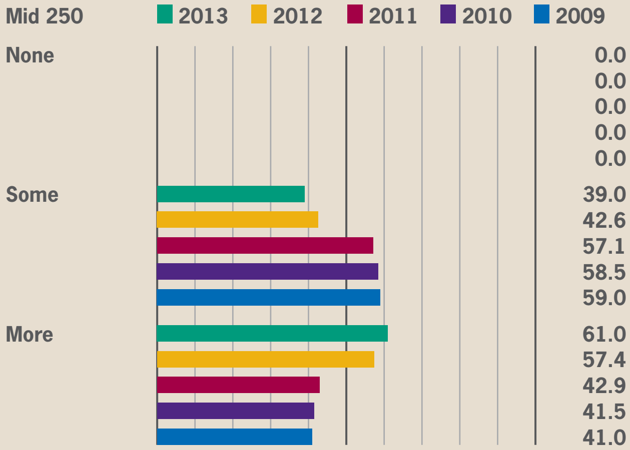


Figure 18 (%)



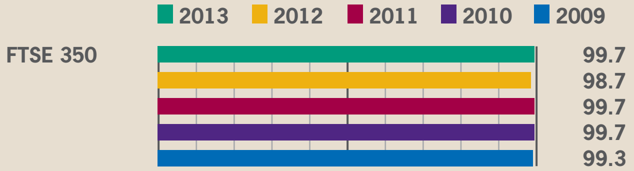
The best disclosures include details such as the following:

- 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
- Demonstration of ethical leadership
- Powers and authorities retained by the board and those delegated to management
- Clearly defined reporting lines and monitoring structures across different levels within the organisation
- Information flows to the board
- Consideration of governance arrangements
- Performance culture created
- Accountability (especially to investors)
- Roles of chairman, chief executive, executives and NEDs
- Areas of strategic importance
- Governance oversight practices

QUESTION 6. IS THE NUMBER OF MEETINGS OF THE BOARD AND OVERALL ATTENDANCE DISCLOSED?

Guidance: "The annual report … should also set out the number of meetings of the board and its committees and individual attendance by directors". (UK Corporate Governance Code, A.1.2)

Figure 19 (%)



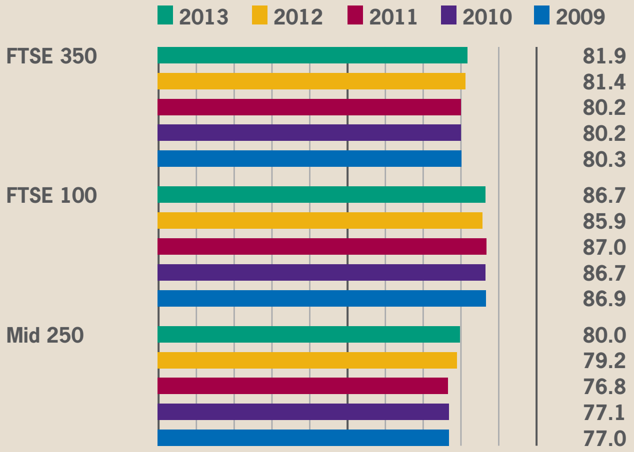
The Chairman

QUESTION 7. 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 and on such other occasions as are deemed appropriate". (UK Corporate Governance Code, A.4.2)

"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". (UK Corporate Governance Code, B.6.3)

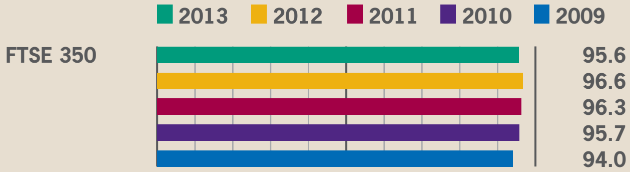
Figure 20 (%)



QUESTION 8. ARE THE ROLES OF THE CHAIRMAN AND CHIEF EXECUTIVE SEPARATE?

Guidance: "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". (UK Corporate Governance Code, A.2.1)

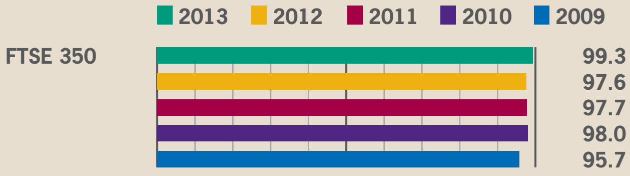
Figure 21 (%)



QUESTION 9. DOES THE REPORT IDENTIFY THE CHAIRMAN, CHIEF EXECUTIVE, SENIOR INDEPENDENT, 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 board committees. It should also set out the number of meetings of the board and those committees and individual attendance by directors". (UK Corporate Governance Code, A.1.2)

Figure 22 (%)



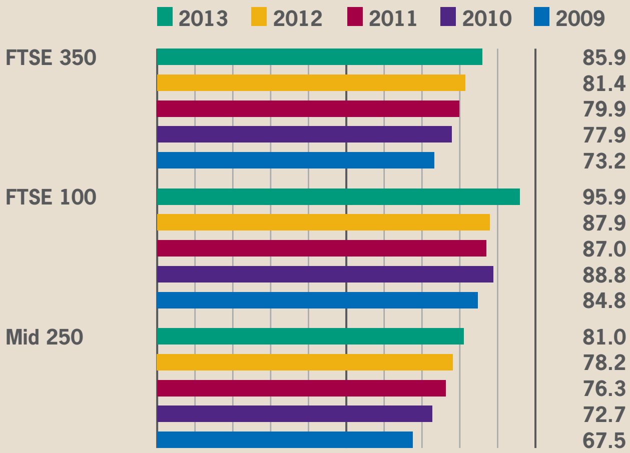
Effectiveness

Composition of the board

QUESTION 10. IS AT LEAST HALF OF THE BOARD, EXCLUDING THE CHAIRMAN, COMPRISED OF INDEPENDENT NON-EXECUTIVE DIRECTORS DETERMINED BY THE BOARD TO BE INDEPENDENT?

Guidance: "Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors". (UK Corporate Governance Code, B.1.2)

Figure 23 (%)

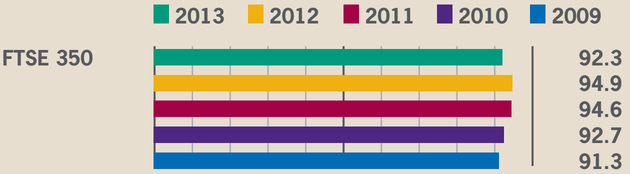


Appointments to the board

QUESTION 11. ARE THE NOMINATION COMMITTEE MEMBERSHIP REQUIREMENTS MET?

Guidance: “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. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board”. (UK Corporate Governance Code, B.2.1)

Figure 24 (%)



QUESTION 12. 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.

This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company”. (UK Corporate Governance Code, B.2.4)

Figure 25 (%)

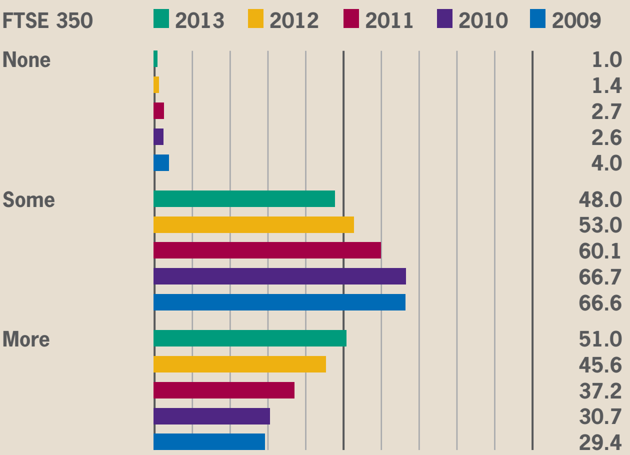


Figure 26 (%)

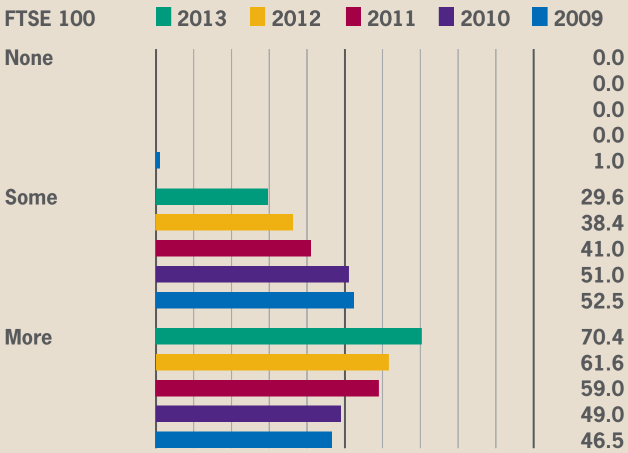
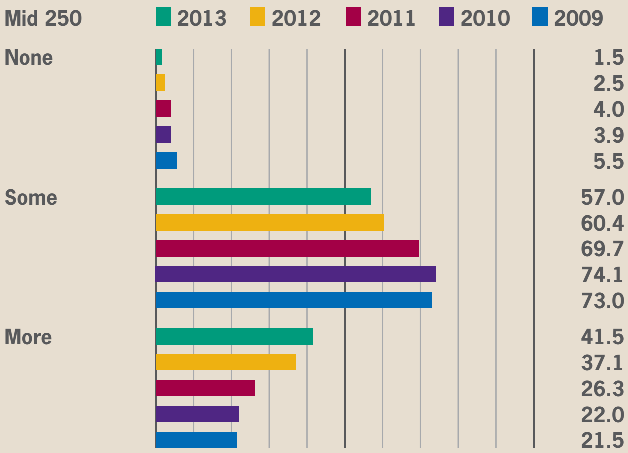


Figure 27 (%)



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 the effectiveness of the board
- Consideration of re-appointment of directors
- Consideration of diversity
- Activity in year

Evaluation

QUESTION 13. HOW MUCH EXPLANATION IS THERE OF THE COMPANY'S POLICY ON GENDER DIVERSITY IN THE BOARDROOM?

Guidance: "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.

The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board". (UK Corporate Governance Code, B.2)

Figure 28 (%)

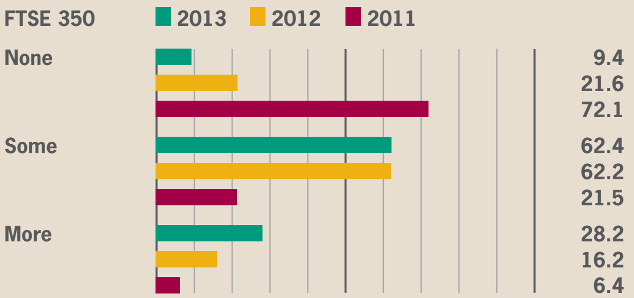


Figure 29 (%)

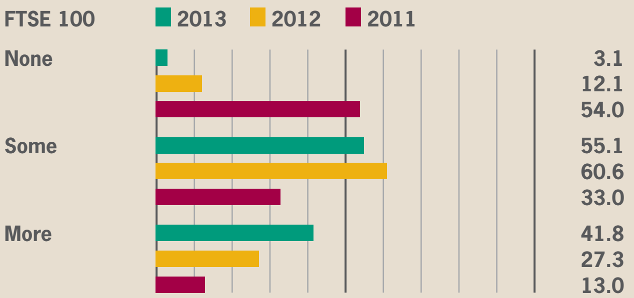
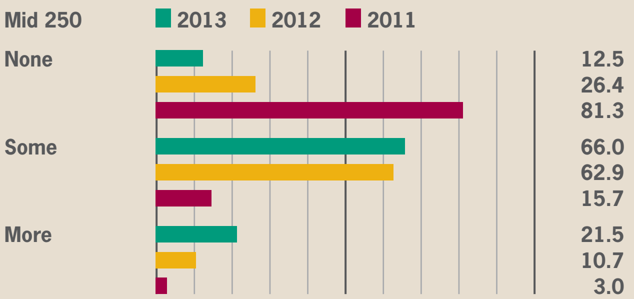


Figure 30 (%)



QUESTION 14. 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". (UK Corporate Governance Code, B.6.1)

Figure 31 (%)

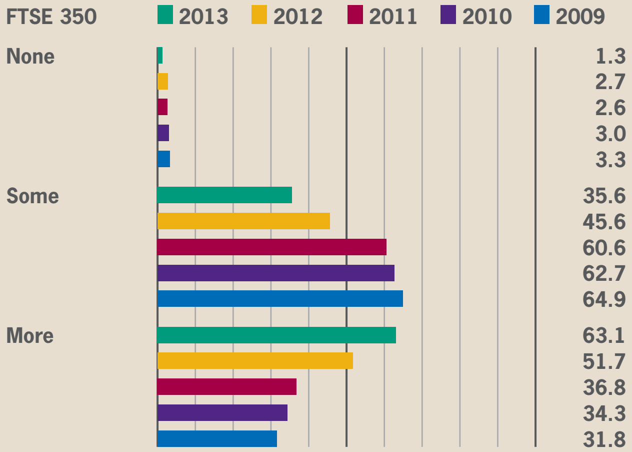


Figure 32 (%)

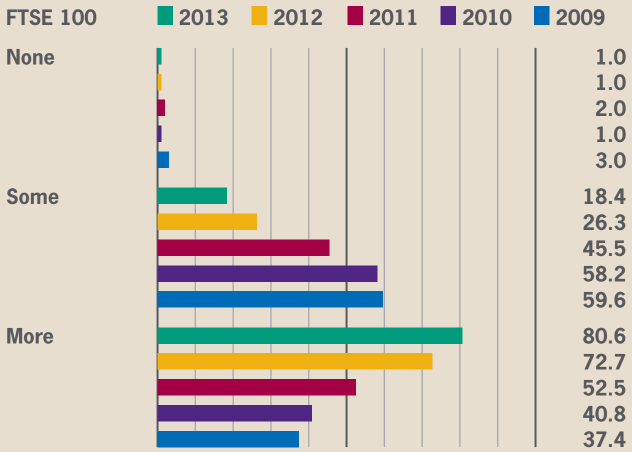
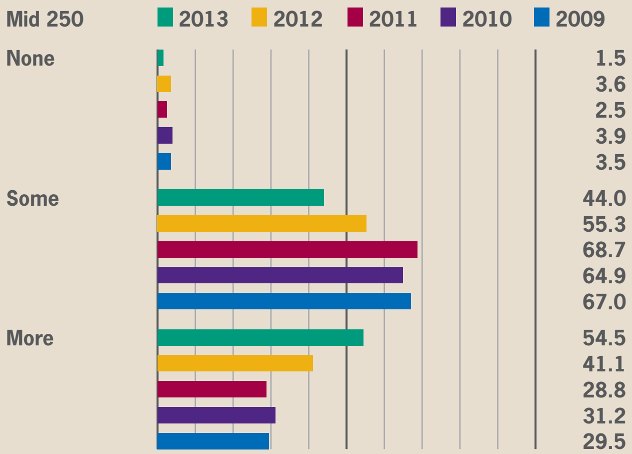


Figure 33 (%)



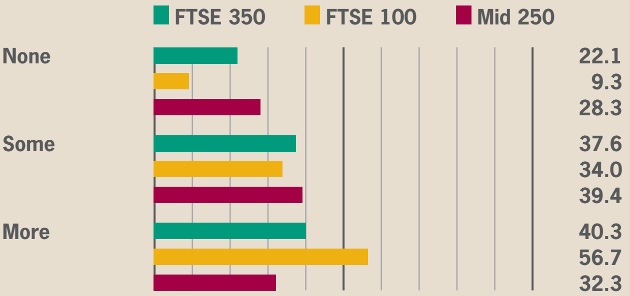
Strong disclosures may include the following details:

- A full description of the appraisal process
- Key categories considered, including board and committee structure, board dynamics, the conduct and frequency of board meetings and information provided to directors
- Evaluation criteria linked to strategy and performance
- Use of peer review between directors and management
- Inclusion of major shareholder feedback
- Achievement of KPIs
- Outcomes of the evaluation and action plans

QUESTION 14A. DO THEY DISCLOSE THE OUTCOME OF THE PERFORMANCE APPRAISAL FOR BOARD MEMBERS?

Guidance: "The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors". (UK Corporate Governance Code, Supporting Principles B.6)

Figure 34 (%)

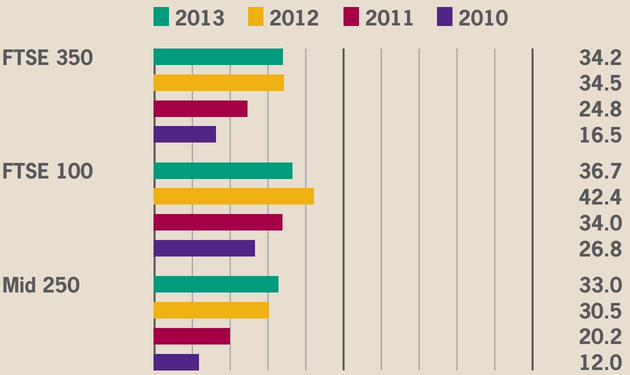


QUESTION 15. WAS THERE AN EXTERNALLY FACILITATED BOARD EVALUATION IN THE YEAR?

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

Note: Graph shows year on year comparative of how many companies had an externally facilitated board evaluation in the current year.

Figure 35 (%)

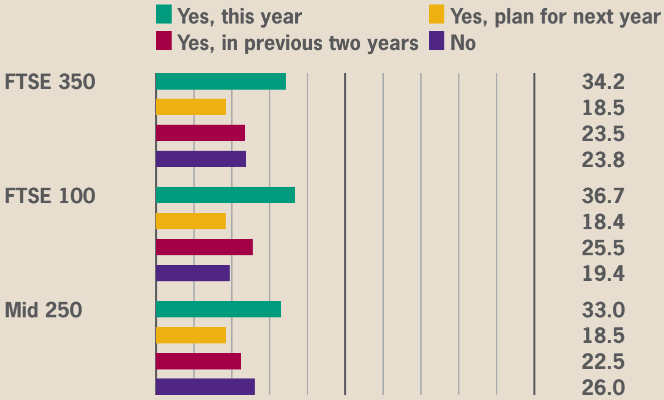


QUESTION 15A. WAS THERE AN EXTERNALLY FACILITATED BOARD EVALUATION IN THE YEAR?

Guidance: "Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company". (UK Corporate Governance Code, B.6.2)

Note: Graph shows comparative of how many companies had an externally facilitated board evaluation in the current year, plan for next year, past two years and not at all.

Figure 36 (%)

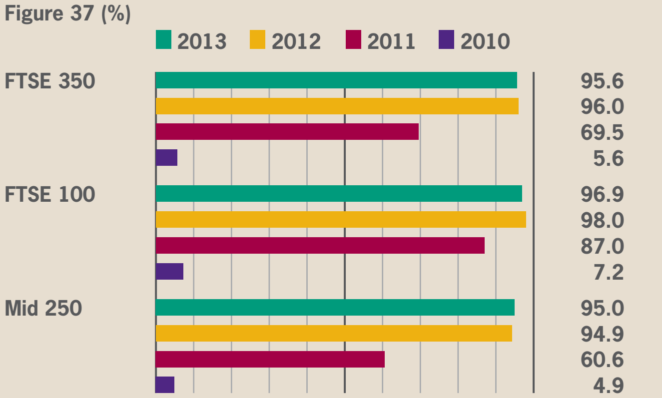


Re-election

QUESTION 16. ARE ALL DIRECTORS SUBJECT TO RE-ELECTION ON AN ANNUAL BASIS?

Guidance: "All directors of FTSE 350 companies should be subject to annual election by shareholders". (UK Corporate Governance Code, B.7.1)

Figure 37 (%)

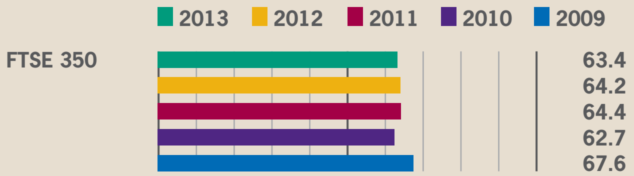


Commitment, development, information and support

QUESTION 17. IS IT DISCLOSED THAT THE TERMS AND CONDITIONS OF APPOINTMENT OF NON-EXECUTIVE DIRECTORS ARE AVAILABLE FOR INSPECTION?

Guidance: "The terms and conditions of appointment of non-executive directors should be made available for inspection. The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes". (UK Corporate Governance Code, B.3.2)

Figure 38 (%)



Committee membership and terms of reference

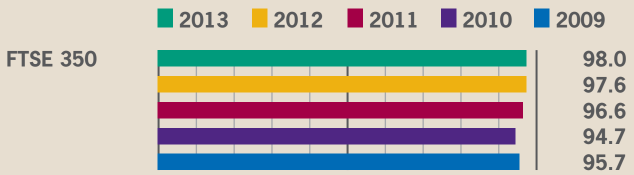
QUESTION 18. IS IT DISCLOSED THAT THE TERMS OF REFERENCE FOR THE AUDIT, REMUNERATION AND NOMINATION COMMITTEES ARE AVAILABLE FOR INSPECTION?

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". (UK Corporate Governance Code, C.3.3)

"The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board". (UK Corporate Governance Code, D.2.1)

"The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board". (UK Corporate Governance Code, B.2.1)

Figure 39 (%)



Accountability

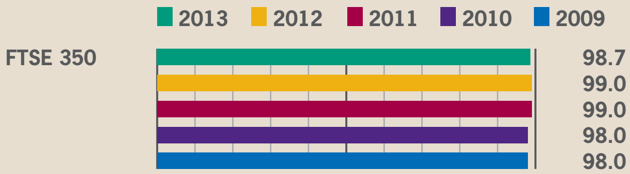
Risk management and internal controls

QUESTION 19. 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". (Internal Control: Guidance to Directors*, paragraph 34)

*formerly known as the Turnbull Guidance

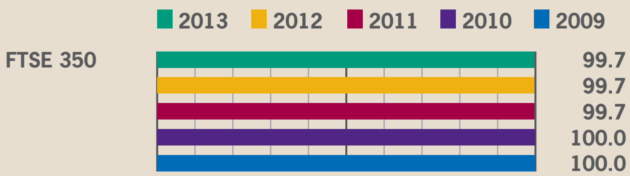
Figure 40 (%)



QUESTION 20. IS THERE A STATEMENT THAT A REVIEW OF THE EFFECTIVENESS OF THE GROUP'S INTERNAL CONTROLS HAS BEEN UNDERTAKEN IN THE YEAR?

Guidance: "The board should, at least annually, conduct a review of the effectiveness of the company's risk management and internal control systems and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls". (UK Corporate Governance Code, C.2.1)

Figure 41 (%)



QUESTION 21. HOW MUCH INFORMATION IS PROVIDED ON THE PROCESS THE BOARD/COMMITTEES HAVE APPLIED IN REVIEWING THE EFFECTIVENESS OF THE INTERNAL CONTROL SYSTEM?

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". (Internal Control: Guidance to Directors, paragraph 36)

Figure 42 (%)

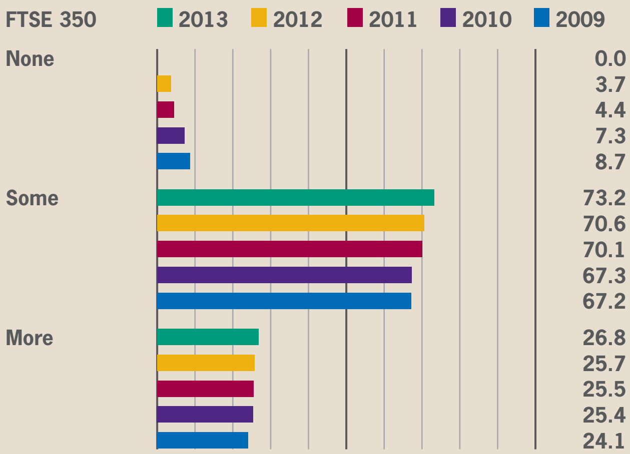


Figure 43 (%)

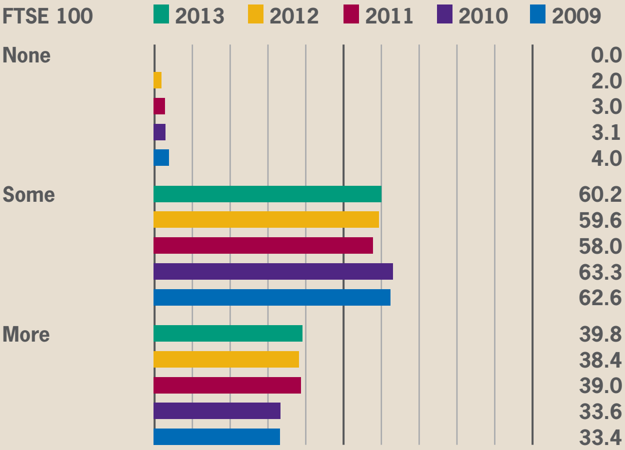
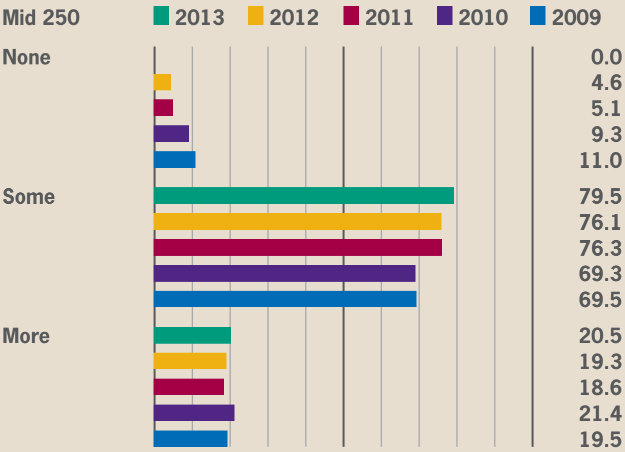


Figure 44 (%)



Most companies made reference to their application of the Internal Control: Guidance to Directors in this area, but the best companies went on to provide a description of how they applied this guidance to their own process. This could include:

- 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.

QUESTION 22. 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". (Internal Control: Guidance to Directors, paragraph 33)

Figure 45 (%)

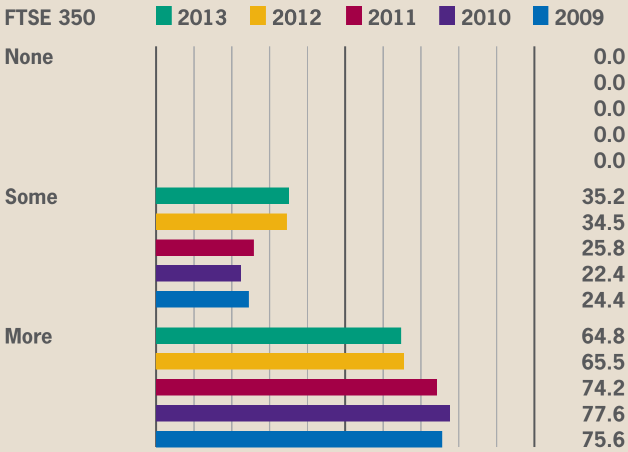


Figure 46 (%)

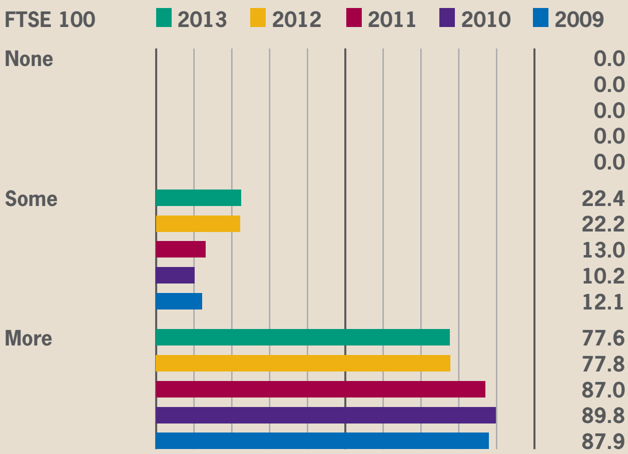
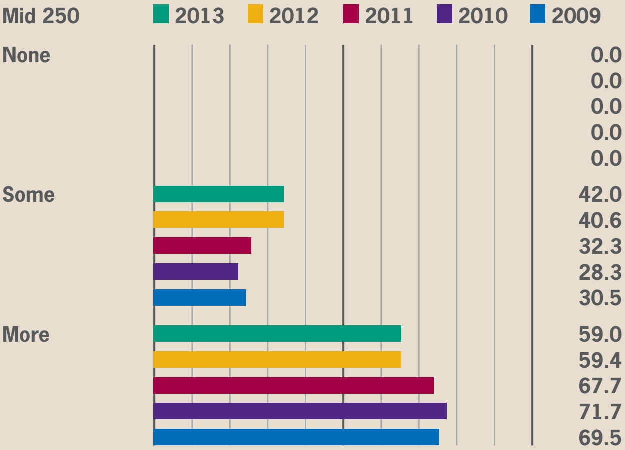


Figure 47 (%)



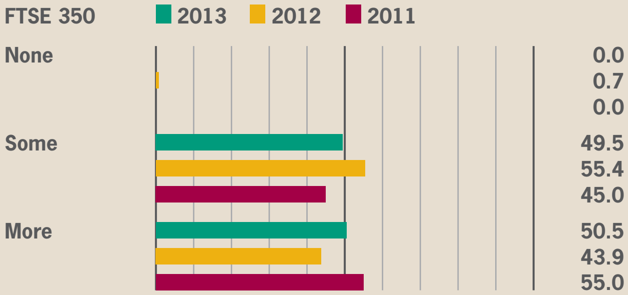
Best disclosures outlining the key elements of a company's internal control system discussed:

- Who is included in the process
- How often risks are assessed
- Who these risks are reported to
- Procedures to ensure compliance with external regulations
- Evidence of a risk group or committee to monitor the process
- Organisation structure and reporting lines
- Procedures to learn from control failures
- Corporate policies, procedures and training
- Links to key business objectives or values
- Examples of reviews of reviews of control activities and response resolution

QUESTION 23. HOW MUCH INFORMATION IS THERE SURROUNDING THE COMPANY'S RISK MANAGEMENT PROCESS IN PARTICULAR?

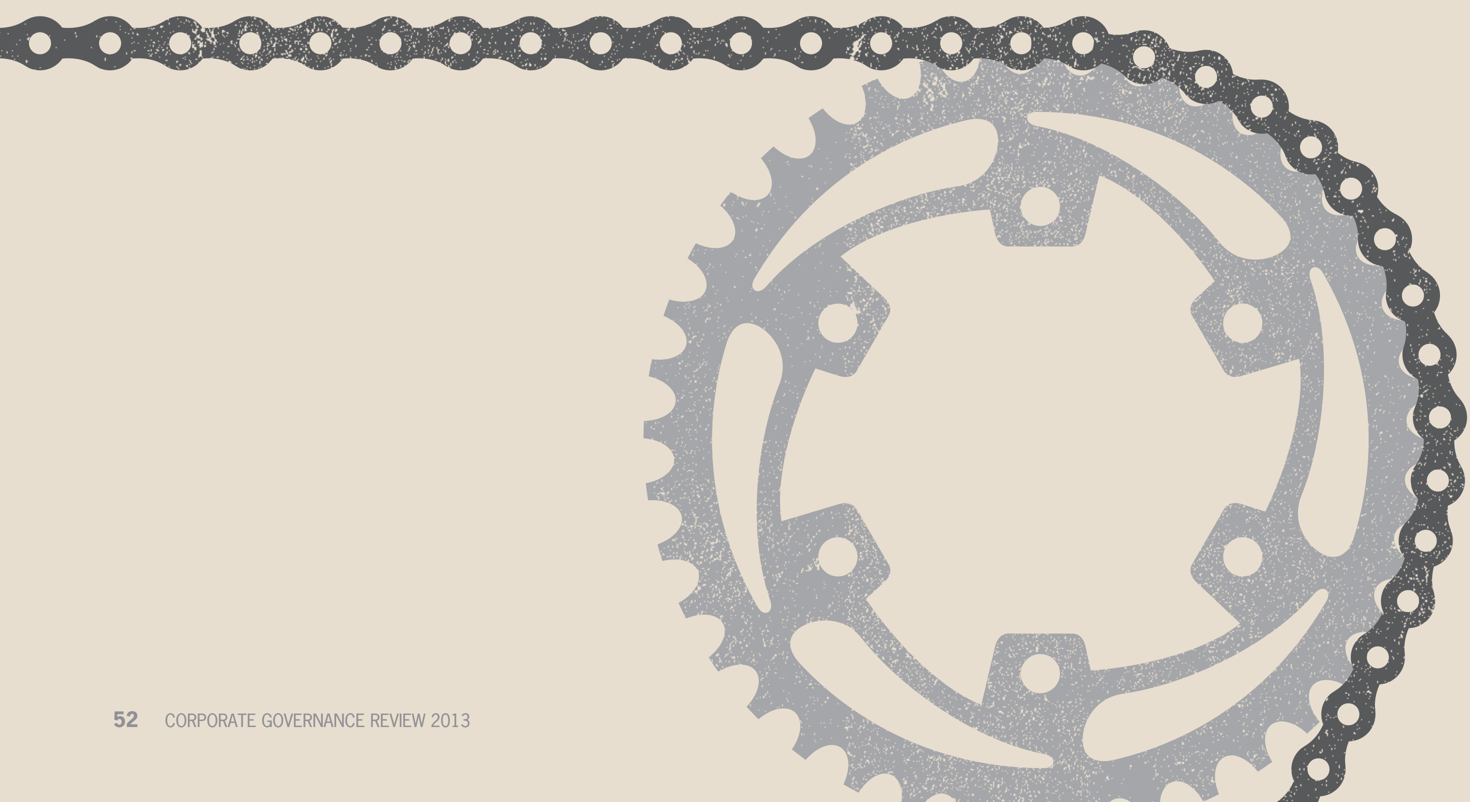
Guidance: "The board should, as a minimum, disclose that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, that it has been in place for the year under review and up to the date of approval of the annual report and accounts, that it is regularly reviewed by the board and accords with the guidance in this document." (Internal Control: Guidance to Directors, paragraph 34)

Figure 48 (%)



Best disclosures outlined the key elements of a company's risk management system including:

- links to corporate objectives
- involvement of senior management
- risk management methodology
- training and knowledge throughout the business
- prioritisation of risk
- risk reporting
- regular refresh and update of risks
- central and divisional risk registers
- risk responses (mitigation) and monitoring of progress
- a reference to principal risks.

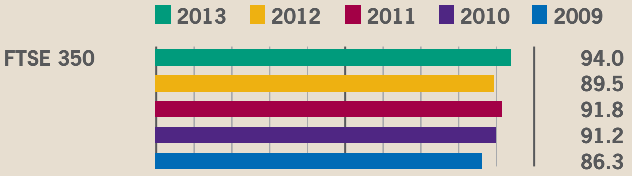


Audit committee

QUESTION 24. ARE THE AUDIT COMMITTEE MEMBERSHIP REQUIREMENTS MET?

Guidance: "The board should establish an audit committee of at least three, or in the case of smaller companies two, members, who should all be independent non-executive directors". (UK Corporate Governance Code, C.3.1)

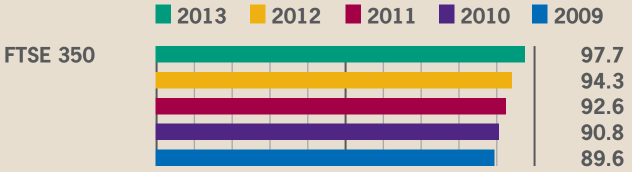
Figure 49 (%)



QUESTION 25. DOES THE AUDIT COMMITTEE IDENTIFY 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". (UK Corporate Governance Code, C.3.1)

Figure 50 (%)

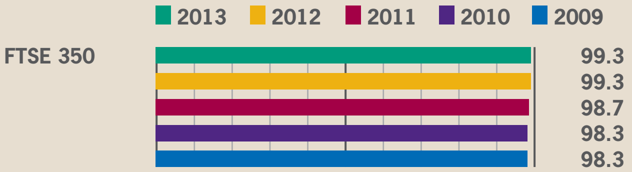


QUESTION 26. IS THERE A SEPARATE SECTION OF THE ANNUAL REPORT WHICH DESCRIBES THE WORK OF THE AUDIT COMMITTEE?

Guidance: "A separate section of the annual report should describe the work of the committee in discharging its responsibilities. The report should include:

- the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed;
- an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, and information on the length of tenure of the current audit firm and when a tender was last conducted; and
- if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence is safeguarded". (UK Corporate Governance Code, C.3.8)

Figure 51 (%)

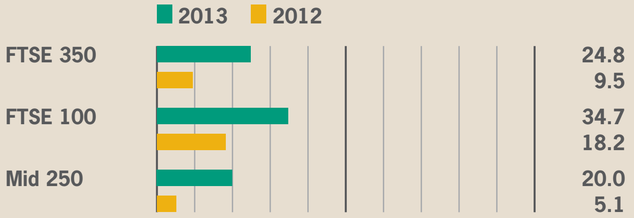


QUESTION 27. DOES THE AUDIT COMMITTEE REPORT ON THE ISSUES CONSIDERED IN RELATION TO THE FINANCIAL STATEMENTS, INCLUDING ANY KEY JUDGEMENTS THAT IT MADE?

Guidance "The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:

- to monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them". (UK Corporate Governance Code, C.3.2)

Figure 52 (%)



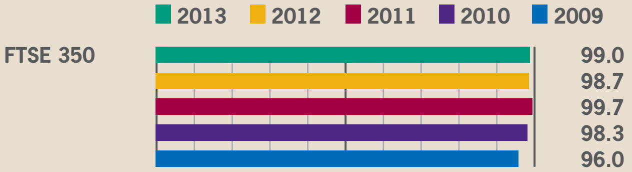
Assurance

External audit

QUESTION 28. IF THE AUDITOR PROVIDES NON-AUDIT SERVICES, IS THERE A DESCRIPTION AS TO HOW THE AUDITOR'S OBJECTIVITY AND INDEPENDENCE IS SAFEGUARDED?

Guidance: "The [annual] report should include, if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence is safeguarded". (UK Corporate Governance Code, C.3.8)

Figure 53 (%)



QUESTION 29. 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". (FRC Guidance on Audit Committees, 4.46)

Figure 54

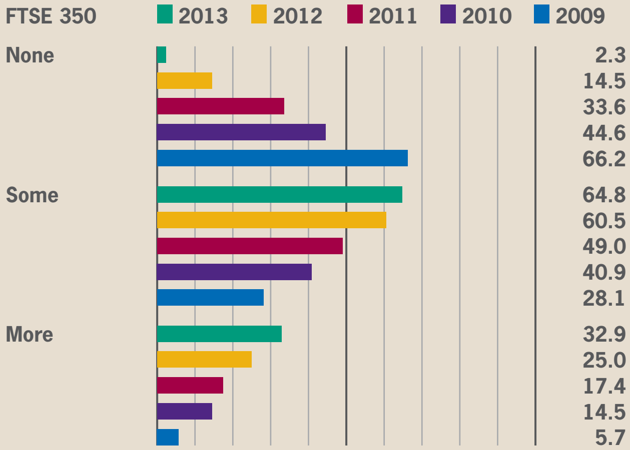
		Average non-audit fees as a percentage of audit fees %		
Industry	**Size**	**2013**	**2012**	**2011**
Technology	14	45.8	104.9	49.3
Utilities	7	37.6	86.3	74.0
Consumer Services	59	58.3	80.2	87.3
Consumer Goods	24	68.8	76.4	99.3
Telecommunications	8	43.7	70.8	61.0
Healthcare	9	43.3	70.1	97.9
Basic Materials	34	40.5	68.3	117.6
Oil & Gas	18	68.5	59.7	91.1
Financials	64	51.5	56.9	73.4
Industrials	61	44.6	56.2	57.6
Total	**298**	**51.6**	**68.0**	**79.5**

*Audit fees include fees paid for audit related services

QUESTION 30. HOW MUCH INFORMATION DOES THE AUDIT COMMITTEE REPORT PROVIDE ON HOW IT REACHED ITS RECOMMENDATION TO THE BOARD ON THE APPOINTMENT, REAPPOINTMENT OR REMOVAL OF THE EXTERNAL AUDITORS?

Guidance: "The [annual] report should include an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, and information on the length of tenure of the current audit firm and when a tender was last conducted". (UK Corporate Governance Code, C.3.8)

Figure 55 (%)



The most informative disclosures included information on:

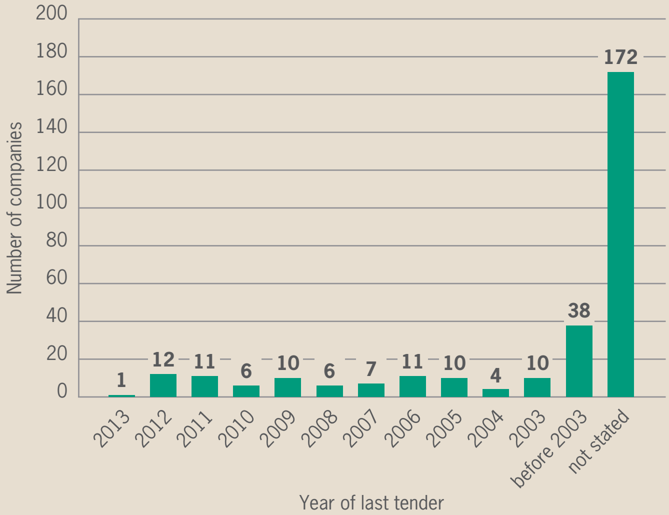
- dates of appointment and length of tenure
- tender frequency and processes
- an assessment of the auditor's qualifications, expertise and resources
- any contractual obligations that acted to restrict the audit committee's choice of external auditors
- when the audit was last subject to tender
- when the current group auditor was appointed.

QUESTION 31. IN WHAT YEAR WAS THE LAST AUDIT TENDER?

Guidance: "FTSE 350 companies should put the audit services contract out to tender at least once every ten years, to enable the audit committee to compare the quality and effectiveness of the services provided by the incumbent auditor with those of other audit firms". (FRC Guidance on Audit Committees, 4.23)

"The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. FTSE 350 companies should put the external audit contract out to tender at least every ten years". (UK Corporate Governance Code, C.3.7)

Figure 56



Internal audit

QUESTION 32. 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". (UK Corporate Governance Code, C.3.2)

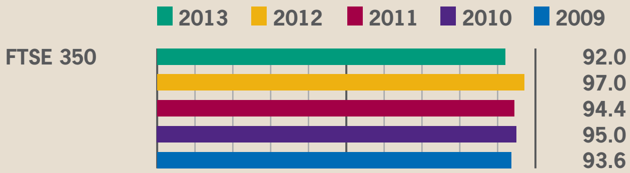
Figure 57

FTSE rank	Do they have an internal audit function or equivalent? 2013	2012
1–100	100%	100%
101–200	88%	86%
201–350	86%	81%
1–350	**91%**	**89%**

QUESTION 33. OF THE COMPANIES WHICH DO NOT HAVE AN 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". (UK Corporate Governance Code, C.3.6)

Figure 58 (%)



Remuneration Committee

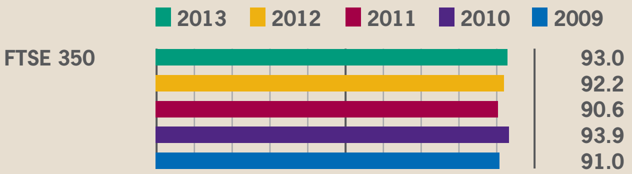
Levels and components of remuneration

QUESTION 34. DOES THE COMPANY SET AND DISCLOSE THE MAXIMUM CASH BONUS AVAILABLE TO EXECUTIVE DIRECTORS AS A PERCENTAGE OF BASE SALARY?

Guidance: "The performance-related elements of executive directors' remuneration should be stretching and designed to promote the long-term success of the company". (UK Corporate Governance Code, Supporting Principle D.1)

"Upper limits should be set and disclosed". (UK Corporate Governance Code, Schedule A)

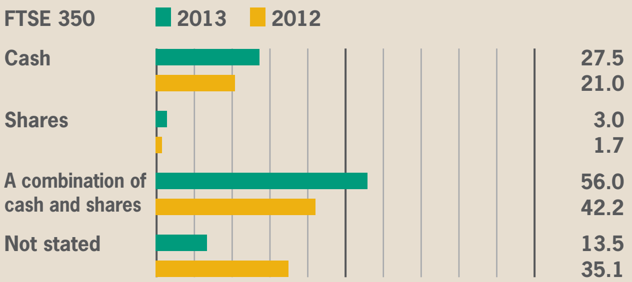
Figure 59 (%)



QUESTION 35. HOW ARE ANNUAL EXECUTIVE BONUSES PAID?

Guidance: "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 promote the long-term success of the company. Upper limits should be set and disclosed. There may be a case for part payment in shares to be held for a significant period". (UK Corporate Governance Code, Schedule A)

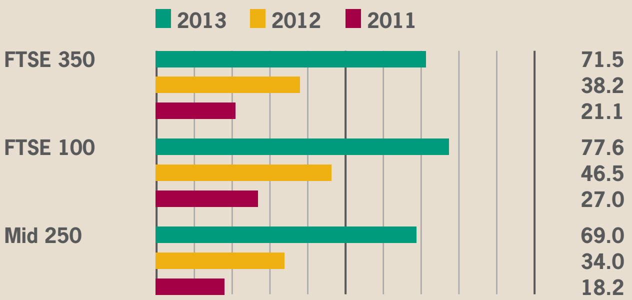
Figure 60 (%)



QUESTION 36. IS THERE ANY POTENTIAL CLAWBACK OF THE BONUS PAID?

Guidance: "Consideration should be given to the use of provisions that permit the company to reclaim variable components in exceptional circumstances of misstatement or misconduct". (UK Corporate Governance Code, Schedule A)

Figure 61 (%)

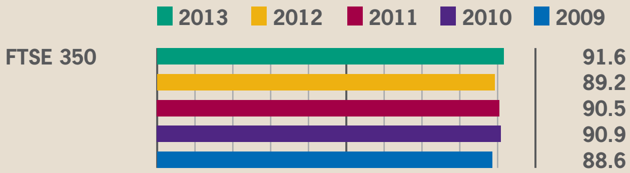


Procedure

QUESTION 37. ARE THE REMUNERATION COMMITTEE MEMBERSHIP REQUIREMENTS MET?

Guidance: "The board should establish a remuneration committee of at least three members or, in the case of smaller companies, two independent non-executive directors". (UK Corporate Governance Code, D.2.1)

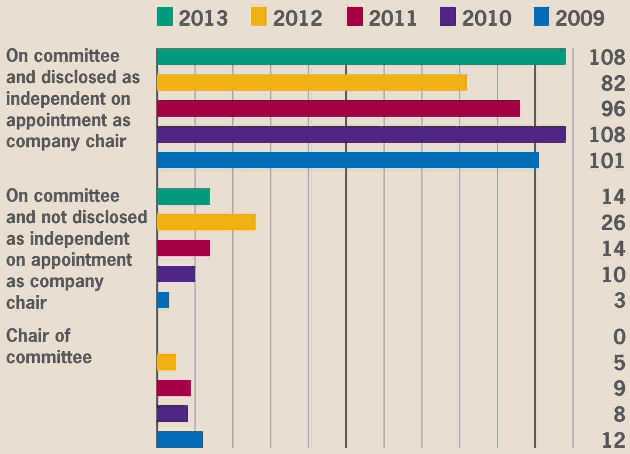
Figure 62 (%)



QUESTION 38. IF THE CHAIRMAN SITS ON THE REMUNERATION COMMITTEE, DOES HE/SHE CHAIR IT?

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". (UK Corporate Governance Code, D.2.1)

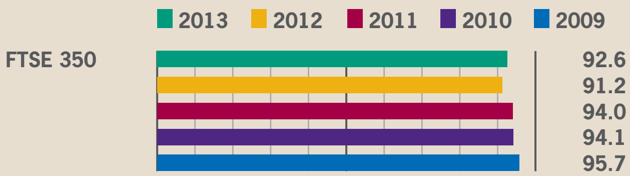
Figure 63



QUESTION 39. 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 within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive". (UK Corporate Governance Code, D.2.3)

Figure 64 (%)



Relations with shareholders

QUESTION 40. 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 the members of the board, and, in particular, the non-executive directors, develop an understanding of the views of major shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion". (UK Corporate Governance Code, E.1.2)

Figure 65 (%)

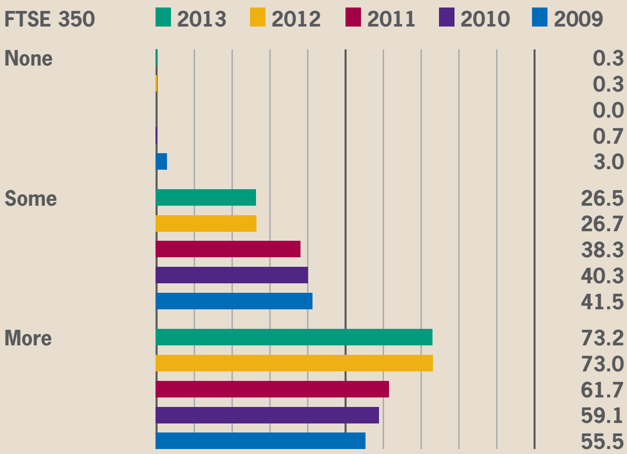


Figure 66 (%)

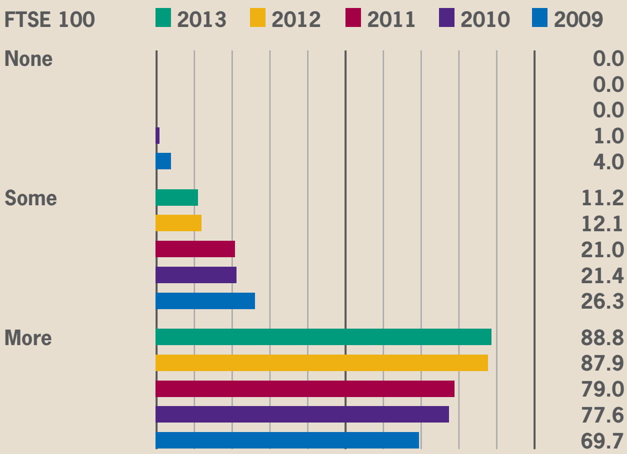
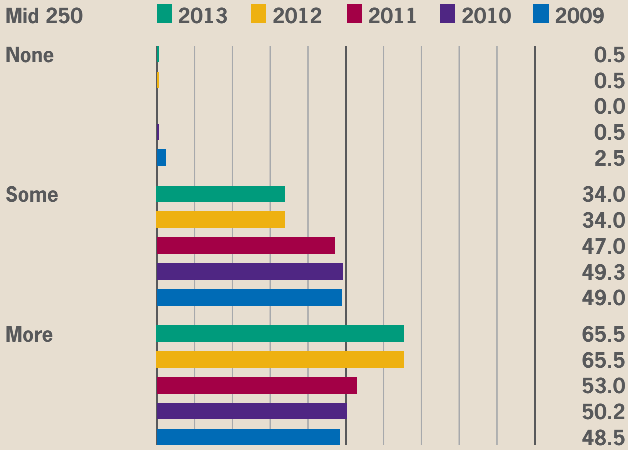
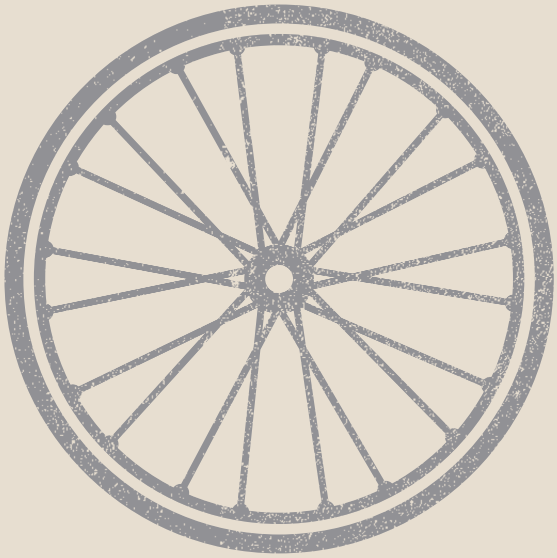


Figure 67 (%)



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

- regular dialogue with shareholders
- non-executive directors availability to meet with shareholders
- surveys of shareholder opinion
- use of the AGM to communicate with investors and to encourage their participation
- private investors as well as institutions.



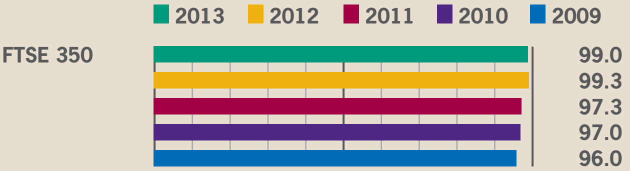
Narrative reporting

Financial and business reporting

QUESTION 41. HAS THE COMPANY PROVIDED A SEPARATE BUSINESS REVIEW IN THE DIRECTOR'S REPORT?

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

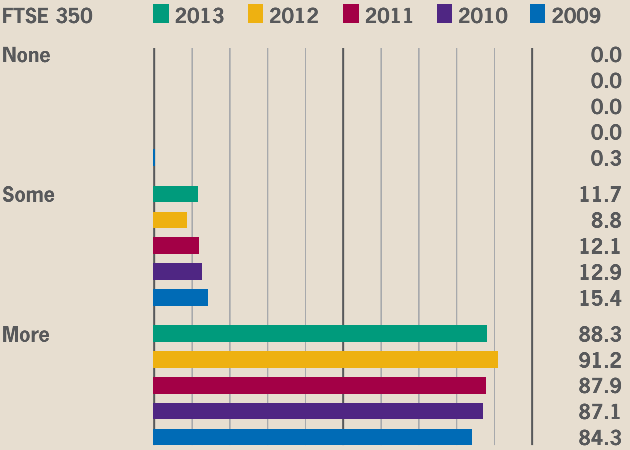
Figure 68 (%)



QUESTION 42. 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 a) the development and performance of the company's business during the financial year, and b) 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 69 (%)



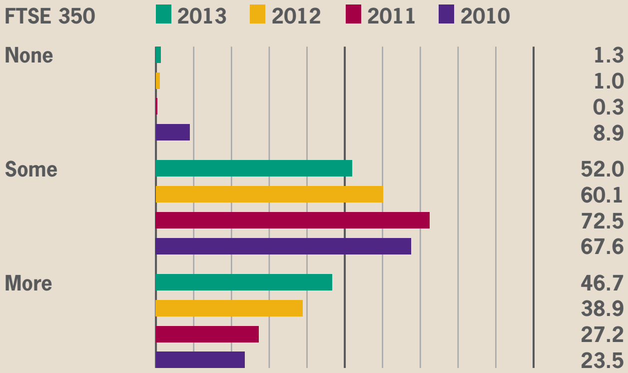
Companies providing 'more' detailed disclosures give a description of:

- 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.

QUESTION 43. TO WHAT EXTENT DO COMPANIES DESCRIBE THEIR BUSINESS MODEL?

Guidance: "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". (UK Corporate Governance Code, C.1.2)

Figure 70 (%)



Business model disclosures are evolving and there is not one best practice approach. Good disclosures we have seen:

- provided clarity around how they create and sustain value
- structured their narrative reporting around the business model
- explained not just what they do, but how they do it
- described their key strengths and differentiators from competitors such as financial strength, intellectual property, human capital and access to natural resources
- recognised the impact of external factors.

QUESTION 44. 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 71 (%)

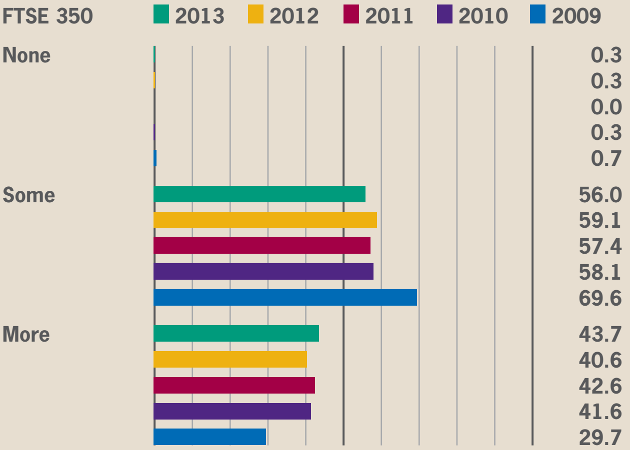


Figure 72 (%)

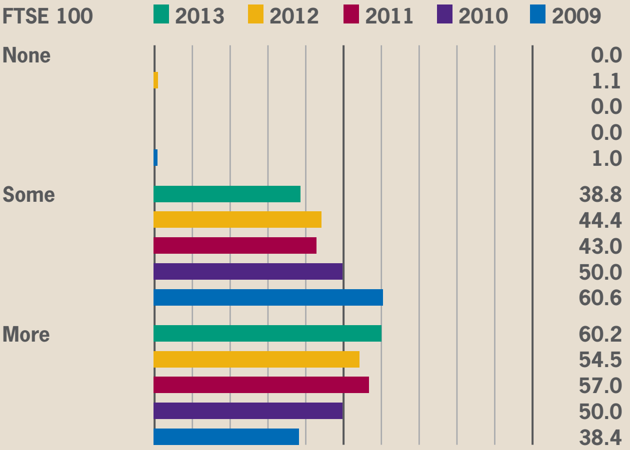
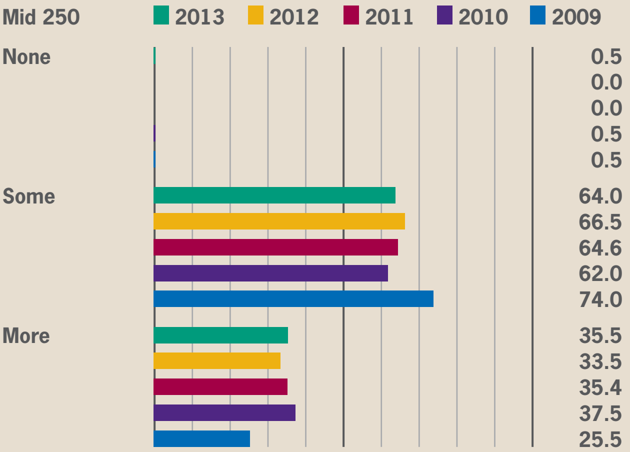


Figure 73 (%)



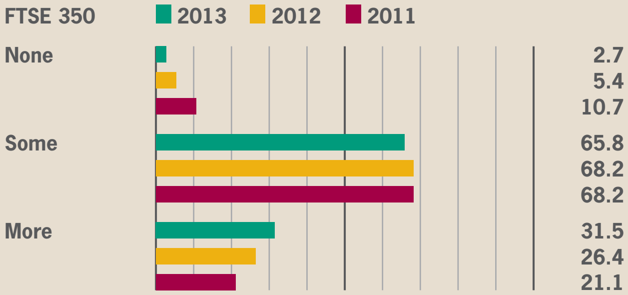
The best disclosures provided:

- 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.

QUESTION 45. TO WHAT EXTENT DOES THE COMPANY'S STRATEGY/ STRATEGIC OBJECTIVES LINK TO SPECIFIC RISKS, OPPORTUNITIES AND KPIS?

Guidance: "The FRC believes that, in future, narrative reports should focus primarily on strategic risks rather than operational risks and those risks that arise naturally and without action by the company; and disclose the risks inherent in their business model and their strategy for implementing that business model". (FRC Effective Company Stewardship: Next Steps, Summary of Action)

Figure 74 (%)

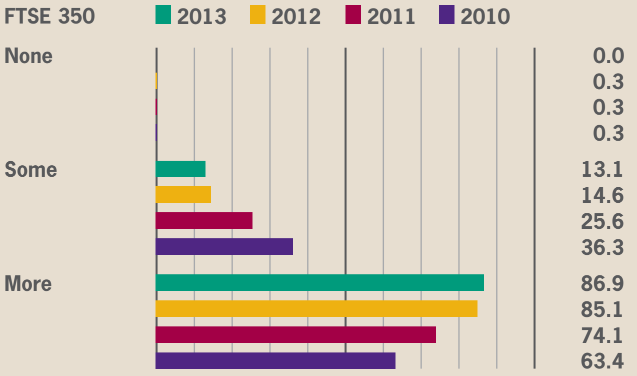


Principal risks

QUESTION 46. TO WHAT EXTENT DO COMPANIES DESCRIBE THEIR PRINCIPAL 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 75 (%)



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.

QUESTION 47. 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 76 (%)

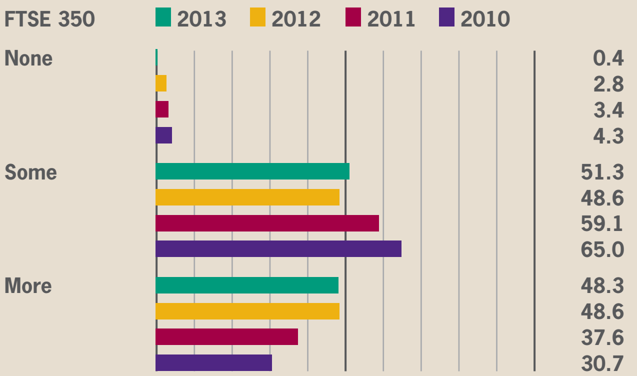


Figure 77 (%)

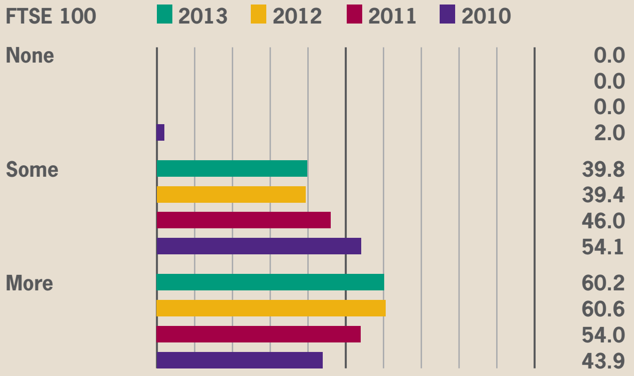
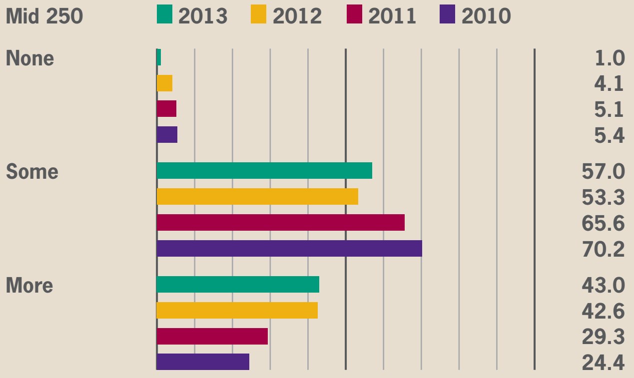


Figure 78 (%)



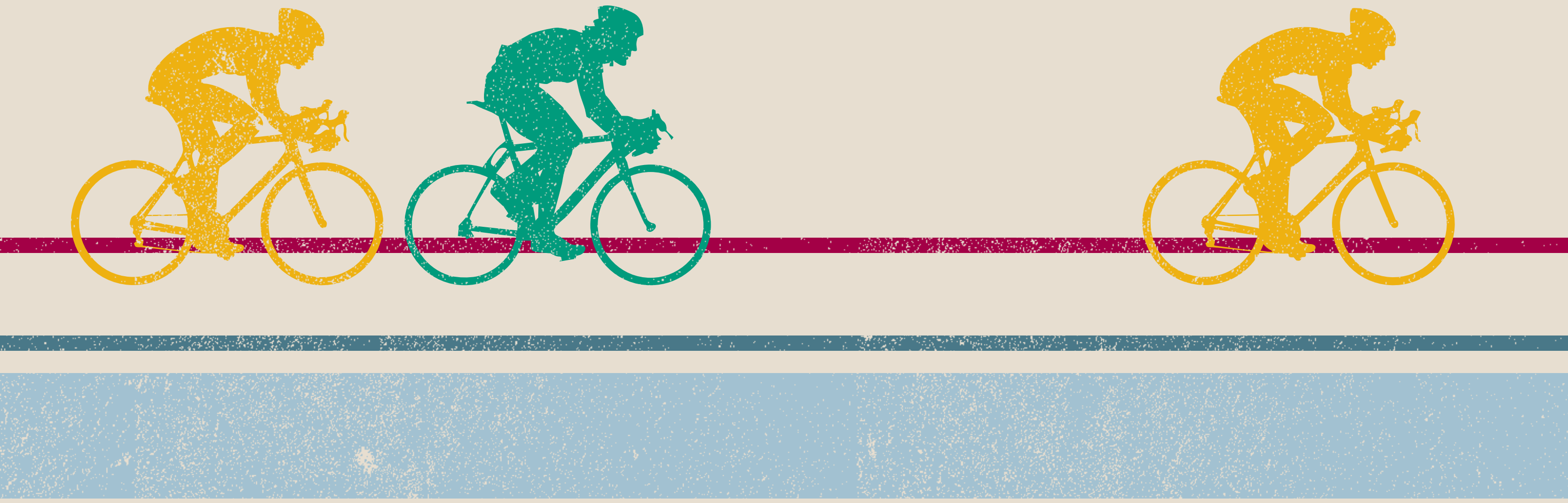
The best disclosures:

- 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 risks disclosed by category by industry

Figure 79

	FTSE 350 (298)	Basic Materials (34)	Consumer Goods (24)	Consumer Services (59)	Financials (64)	Healthcare (9)	Industrials (61)	Oil & Gas (18)	Technology (14)	Telecommunications (8)	Utilities (7)
Environmental	0.5	1.0	0.6	0.4	0.2	0.6	0.5	1.0	0.1	0.4	1.4
Expansion	0.9	1.2	0.5	1.1	0.7	2.1	0.9	1.2	1.2	0.6	0.9
Financial	1.7	1.9	1.3	1.7	2.6	1.3	1.2	1.6	1.2	0.5	2.7
Macro-economic	1.5	1.7	1.4	1.5	1.6	1.2	1.4	1.4	1.1	0.6	1.4
Technology	0.6	0.3	0.5	1.2	0.2	0.4	0.8	0.3	0.9	1.0	0.6
Regulatory and compliance	1.6	1.4	2.0	1.4	1.5	4.6	1.3	2.1	1.4	1.4	2.3
Reputation	0.6	0.4	0.6	0.8	0.6	0.9	0.4	0.9	0.2	0.4	1.1
Employees	1.0	1.5	1.0	1.3	0.7	1.0	0.9	1.1	0.6	0.3	1.0
Operational	2.6	2.9	3.3	2.4	2.4	3.2	2.4	3.5	2.1	2.5	2.7
Average total number of risks	**11.0**	**12.3**	**11.0**	**11.8**	**10.4**	**15.3**	**9.8**	**13.0**	**8.8**	**7.6**	**14.1**



Key performance indicators

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

Figure 80

	FTSE 350 (298)	Basic Materials (34)	Consumer Goods (24)	Consumer Services (59)	Financials (64)	Healthcare (9)	Industrials (61)	Oil & Gas (18)	Technology (14)	Telecommunications (8)	Utilities (7)
Revenue	1.1	0.8	1.4	1.2	0.8	1.8	1.3	0.6	1.9	1.0	0.4
Profits and costs	2.4	2.8	2.3	2.4	2.5	2.1	2.3	1.9	2.9	1.6	2.1
Shareholders funds	1.0	0.9	0.8	0.8	1.4	1.1	0.8	1.1	0.6	0.4	1.3
Working capital	0.3	0.3	0.2	0.1	0.3	0.2	0.4	0.7	0.2	0.1	0.1
Capital expenditure and other assets	0.4	0.4	0.4	0.1	0.6	0.4	0.3	0.7	0.4	0.1	0.4
Interest and debt	0.3	0.3	0.3	0.3	0.4	0.1	0.3	0.4	0.1	0.1	0.3
Average total number of financial KPIs	**5.4**	**5.4**	**5.4**	**5.0**	**6.0**	**5.8**	**5.4**	**5.4**	**6.1**	**3.4**	**4.7**

Figure 81

	FTSE 350 (298)	Basic Materials (34)	Consumer Goods (24)	Consumer Services (59)	Financials (64)	Healthcare (9)	Industrials (61)	Oil & Gas (18)	Technology (14)	Telecommunications (8)	Utilities (7)
Environmental	0.4	0.4	0.6	0.3	0.1	0.0	0.5	0.2	0.1	0.3	2.0
Operational	0.9	1.1	1.6	0.9	0.4	0.6	0.6	2.0	0.6	0.5	2.6
Expansion	0.7	0.5	0.9	0.7	0.7	1.1	0.4	0.4	0.8	1.3	0.3
Employees	0.6	0.6	0.7	0.4	0.3	0.6	1.0	1.1	0.2	0.5	0.9
Regulatory and compliance	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.1	0.0	0.0	0.6
Reputation	0.3	0.2	0.4	0.5	0.3	0.1	0.3	0.0	0.2	0.5	0.7
Average total number of non-financial KPIs	**2.9**	**2.8**	**4.2**	**2.8**	**1.9**	**2.6**	**2.9**	**3.8**	**1.9**	**3.0**	**7.0**
Total number of KPIs	**8.3**	**8.2**	**9.6**	**7.8**	**7.9**	**8.3**	**8.3**	**9.2**	**8.1**	**6.4**	**11.7**

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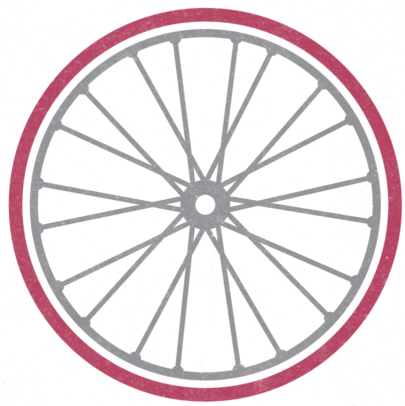
- $1.9 billion assurance
- Over 100 countries
- Over 35,000 staff
- Over 2,600 partners
- Global strategy, global brand, global values

Grant Thornton UK LLP
- c. 4,400 staff
- 25 offices
- Over 200 partners
- Fee income £471m
- Full service practice with extensive specialist advisory services



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Zimbabwe

How our clients work with us

Realise strategic ambitions	Win the talent battle	Optimise operations	Finance growth	Maximise and protect wealth	Master risk

Realise strategic ambitions

- Challenging and exploring your strategic options to build value
- Evaluating new markets and commercial opportunities
- Planning and implementing strategic transactions – including mergers, bolt-on acquisitions and disposals
- Delivering specialist due diligence services
- Providing valuations to support board decisions on organic growth, acquisition and JV opportunities
- Identifying the most suitable exit strategy to maximise value
- Supporting new market entry with on-the ground support from member firms in over 100 countries

Win the talent battle

- Ensuring that you have the right people in the right roles, being rewarded at the right level
- Developing tax-efficient reward packages that align performance with rewards for key employees, eg share-based reward plans
- Positioning your business as an employer of choice through creative, efficient and flexible pension and benefit solutions
- Developing international talent mobility programmes, which are cost effective and in line with corporate governance best practice

Optimise operations

- Benchmarking the efficiency of day to day operations
- Identifying opportunities for direct cost savings
- Outsourcing back-office functions
- Evaluating and improving your supply chain efficiency
- Optimising the efficiency of the finance function
- Improving working capital management through process improvement and innovative tax planning
- Major change Programme Management, eg mergers and carve outs
- IT system review, selection and implementation

Finance growth

- Advising on the best capital structures to support your strategy
- Providing assurance to assist with accessing capital for growth
- Assessing funding requirements against our knowledge of the market
- Testing the strategy and business plan
- Preparing financial models for submission to funders
- Introducing you to potential funders

Maximise and protect wealth

- Applying tax and financial planning expertise to often complex personal, family or business issues
- Planning effectively for succession, inheritance tax, estates and trusts
- Advising on international issues such as domicile and residence issues, overseas investments and tax-efficient offshore structures
- Delivering independent investment advice and asset allocation strategies
- Ensuring compliance with HMRC rules

Master risk

- Delivering insightful, value-added audits to reassure stakeholders and support your strategic goals
- Supporting boardroom decisions around tax strategy risk
- Minimising disruption and loss from business critical events and disputes
- Re-structuring and de-risking pension schemes
- Ensuring regulatory compliance and responding to regulatory investigations
- Mitigating fraud, bribery and corruptions risks
- Implementing control environments to manage the risks of operating and sourcing overseas

Contact us

The Grant Thornton Governance Institute

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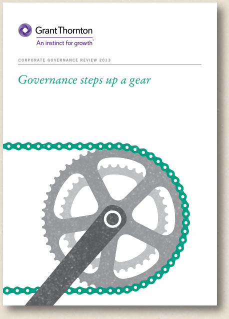
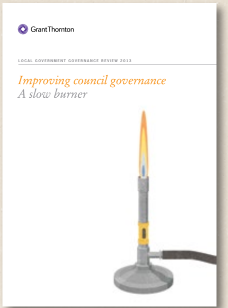
Governance matters



Corporate Governance Review 2013

NHS Governance Review 2013



Local Government Governance Review 2013

Charities Governance Review 2013

New in 2014

Housing Governance Review

New reports to be released Spring 2014

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

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