Corporate governance review 2021

Key observations

90%
define their purpose, but only 7% actively measure

56%
provide only basic or general explanation of their review of internal controls effectiveness

61%
describe what shareholder engagement has occurred, up from less than 7% in 2019

only 17%
describe in detail how business model, strategy, and risks connect to drive value

89%
outline what they consider their emerging risks, while only 33% outline how these are mitigated

46%
provide no or very little explanation for succession planning below board level

97%
mention how they monitor culture, however only 15% say they have a dashboard to measure culture

only circa 40%
of companies have a KPI relating to environment and/or people

62%
give good or detailed accounts of company culture, up from 49%

Contents

Methodology

The annual report is a window into a company. It's a critical and measured insight into a board's leadership style and impact – outlining the culture and values of the company, and their commitment to transparency and accountability. It looks at the 'what' and 'how' of sustained value creation. The annual report is the single most reliable indicator of how a company aims to create value for stakeholders.

For two decades, our Corporate Governance Review has analysed, tracked, and captured best practice and emerging governance trends. We use data extracted from the front end of annual reports from FTSE 350 companies, who are required to apply the UK Corporate Governance Code 2018. This data is a distillation of governance best practice.

The review assesses compliance with:

- UK Corporate Governance Code 2018 (the Code) disclosure requirements, and
- S414c of the Companies Act 2006 narrative reporting requirements, as amended

This year's review covers 277 FTSE 350 companies (as of March 2021): 98 from the FTSE 100 and 179 from the FTSE 250, with years ending between April 2020 and May 2021.

Our analysis excludes investment trusts which follow the AIC Code of Corporate Governance. Further detail on our approach can be provided on request from Alex Worters.

Sarah Bell would like to thank: Alex Worters, Gabriella Demetriou, Gaurav Gund, Ines Bello, Karen Brice, Sai Rajini Nagaru Pillai, Simon Lowe and Zoe Cunningham from Grant Thornton UK LLP, and Dr Scarlett Brown and Pippa Lowe for their intellect, insight, and ingenuity in pulling these findings together.

Foreword

Sarah Bell
Partner, Governance and Board Advisory

Over the last 24 months, boards, organisations, and wider society have dealt with abrupt disruption, significant uncertainty and change – challenging corporate stability, identity, and working practices.

The inflection point for governance

The spotlight on the purpose of business in wider society and its responsibility has intensified. Practices and attitudes towards areas such as transparency, ways of working, social injustice, environmental impact, privacy, the use of big data has shifted consideration of stakeholder interests against the historical primacy of the shareholder.

The past two years have also required boards to spend a prolonged period of time focusing on the immediate term horizon and driven a proliferation of wider market issues for consideration and prioritisation.

Rising stakeholder engagement, public expectations, and new ways of working will have a lasting impact on how organisations function. But will these factors drive an inflection point for companies to consider reviewing their entire governance framework to drive a more future-fit approach?

This year the evidence of how increased connectivity and attention on wider societal issues have accelerated an expanded adoption of certain aspects of the UK Code is encouraging. Historically, key areas with weaker acceptance – purpose, culture measurement, wider stakeholder engagement, business resilience, and emerging risks – have all shown increasing signs of greater application. These areas largely existed as compliance exercises, seemingly separate from the business model and strategy. Now, they are core considerations.

There has been wider and more frequent engagement between board, senior management, workforce, and stakeholders which has brought many positives, but it has sometimes 'blurred' lines between oversight and operations, and directorship and assurance.

While online accessibility has improved connectivity, transmitting a message and judging its impact are very different practices.

Our review suggests many organisations still struggle to demonstrate impact, particularly in the strategic report. There remains misalignment between purpose, identified risks, metrics, and the associated reward structures which drive accountability. Reporting in many of these areas is still relatively siloed. Whilst environment, social and governance issues are increasingly being highlighted as areas of strategic importance, there are limited examples of remuneration being linked through to either environmental or social performance targets; only c14% link remuneration to bonuses, and 7.4% to long term incentive plans (LTIPs). It will be interesting to see whether organisations adopt a more integrated approach to compensation among other areas in the current reporting round.

The annual report, originally designed for retrospective shareholder communication, continues to grow: 200 pages on average this year, an increase of 43% in the last ten years, responding to the need to include more information. It's likely that the majority approach this formulaically, treating the additional information as an 'add on' as opposed to an 'integration of'.

Looking forward, board priorities, where governance practices are likely to remain at the top of the agenda and evolve, are the people agenda, business and margin resilience, control environments and data governance, long term strategic bandwidth, and integrating ESG considerations with strategy and risk– ensuring it's real, and integral to culture and purpose.

As you consider our findings, I leave you with several areas to reflect on:

The people agenda

Given the recalibration of the traditional employee/employer relationship, reduced barriers on social mobility, the importance of diversity and inclusion, and the need for new experiences and skills, human capital remains a key challenge for many organisations in terms of retention and attraction. As such do succession plans look deeply enough into the organisation; are they supported by reward structures which go beyond financial targets? Are the nominations committee and the board clear on their respective roles regarding the people agenda? Does the cultural framework provide sufficient insight into how effectively the strategy is being delivered? Finally, as the competition for talent and the 'great resignation' dominate conversations around recruitment and retention, does the board have the right people skills and believe the governance structures support the right systemic outcomes?

ESG, s172 and behaviours

With the public and investor shift to valuing broader ESG considerations, are organisations integrating ESG and s172 into strategy, and appropriately measuring and rewarding these future opportunities and risks? Do current governance frameworks properly integrate new and emerging areas as they transition from public areas of interest to business-critical considerations? Has the board properly considered the process and control environment, data governance and the assurance approach needed for new and emerging data sets?

Board composition, dynamics, and processes

Has the board recalibrated the NED and executive dynamic– reconfirming roles and revisiting ways of working (following a pandemic-driven period) to ensure sufficient opportunity is created for strategic-generative discussion, horizon-scanning, and supporting the Executive around expansive thinking. Is the leadership team equipped to deliver against its future strategy based on the current processes, composition, and dynamics?

Internal control environments

With the government considering some form of heightened acknowledgment by directors on the effectiveness of control environments; do Boards have sufficient understanding and oversight to judge and provide public assurance that financial and non –financial control environments are appropriate, effective, and robust?

Purpose – North Star, or marketing statement of intent?

Does the company's purpose resonate throughout the company and is it integrated into all key decisions? Does the board know how deeply embedded it really is, and how impact is measured?

It's still unclear if the pandemic will prove to be an inflection for corporate governance. The proliferation of new issues requiring board attention means many will need to ensure their governance frameworks leverage their time and resources efficiently and effectively. We hope that these trends and emerging practices are useful as organisations reflect on their own governance and reporting practices for the next year.

Purpose, value creation and protection

90%
now define purpose, but only 7% actively measure progress

89%
outline their emerging risks, but only 33% detail how they mitigate these risks

only 17%
describe in detail how the business model, strategy, and risks connect to drive value

only circa 40%
have a KPI relating to environment and/or people

Organisational purpose provides a framework for decision making and strategic focus – a 'north star'. The Code recommends companies embed purpose and gauge progress on it by integrating it with strategic priorities, KPIs, risk considerations, executive remuneration, and people performance measures.

One of our key findings is a broader acknowledgement of the value of purpose – 90% of companies now explain their purpose in their annual report, and 81% outline how the board assesses if the company's policies, practices, and behaviours are aligned with its purpose and values (a rise from 68% in 2020). This includes some real sector success stories – in 2019, only 22% (2021: 100 %) in technology, and 33% (2021: 71%) in oil and gas engaged with purpose. A similar percentage (89%) of companies also talk about their values.

There's still, however, a long way to go on accountability in terms of measurement. Many companies are likely to have indicators of purpose at the board level, but just 7% describe how they measure progress on embedding their corporate purpose in their annual report.

Objectives around purpose need to be supported by leadership buy-in and accountability. We find a higher percentage of chairs (57%) than chief executives (36%) discuss the importance of corporate purpose in their primary statements.

While we've seen significant progress in this area, a large number of companies still do not substantiate their messaging with and clear understanding of how impact will be measured and detailed explanations which can guide decision-making.

Questions to ask

- Is our purpose clearly defined and does it provide decision-making clarity?
- Are we committed to reviewing our purpose at regular intervals to ensure that it continues to drive the right culture, values, and strategic priorities?
- Is there a clear link from purpose to strategy to values to key performance indicators to remuneration?
- Have we developed tangible measures for our purpose?
- What is the impact of our purpose on stakeholders? Consider frameworks such as the UN's Sustainable Development Goals (SDGs)

Does the annual report explain the board's activities in relation to assessing if the company's policies, practices, and behaviours are aligned with the company's purpose and values? (%)

Best practice toolkit – reporting on purpose

Elements/content	Things to consider	Reporting tips
Defining and embedding	Engage with stakeholders and prioritise purpose at board level. Agree a clear and robust articulation of your purpose. A clear purpose gives people something to believe in and operates as an easily identifiable direction in terms of decision-making. Consider how your suggested purpose informs strategic changes and conflicting agendas. Company values should support the achievement of this purpose. Although the purpose is constant, it still may evolve under some circumstances during the life of business.	Open the annual report with your company's purpose. Clearly differentiate between your purpose, mission and vision. Articulate your purpose journey – provide transparency showing board engagement in shaping, overseeing and implementing purpose in tandem with other key stakeholders. Showcase alignment with company policies, practices and behaviours. Provide personal commentary on purpose in the statements from the chair and CEO. Provide case studies to showcase how purpose is lived within the company.
Measuring progress against stated purpose	Achievement of purpose cannot be measured directly – it is a more complex process which involves an assessment of impact across a number of capitals material to a broad stakeholder group. To an extent, KPIs which clearly measure progress against the strategy will provide some indication of success. Behaviours that the company encourages should be consistent with the company's purpose.	Provide case studies. Consider establishing a framework of financial and non-financial indicators to understand how the purpose is impacting internal and external outcomes/relationships against desired strategic goals as well as environmental and social outcomes. Demonstrate how executive remuneration enables delivery on the stated purpose.

Purpose, mission and vision – a guide

Purpose is your 'why'
Purpose is the reason you exist, and/or the impact a company intends to have over a sustained period of time. It sits at the core and drives decision-making clarity, inspires those that work with you and helps guide long-term strategy. A constant purpose is a bedrock to build on and the North Star to guide you.

Vision is where you aspire to be
Where you want to get to, in line with your purpose, by a specific point in time; the measurable goals you want to achieve. Your vision is how you want to behave and interact with stakeholders. It is your overall corporate attitude.

Mission is your 'how'
The mission is what actions you want to take to achieve your vision.

Strategic reporting

Companies remain broadly strong at articulating their business model, including the resources, relationships, and associated elements which help create value. Fifty percent of companies (50%) clearly show how their business model connects to and informs strategic priorities, while 38% make reference to it, but only through signposting.

Connectivity is a notoriously difficult area of strategic reporting. When it comes to strategy, we see similar themes: while 71% mention this connection, most (55%) use signposting and only 17% describe in narrative and visual terms how business model, strategy, and risks are integrated. The transparency of reporting about the future impact, opportunities and challenges remains weak, with 37% providing basic or generic reporting on discussing the future (2020: 29%). It may be that the uncertainty of the last two years has caused companies to refrain from discussing future plans and focus on past performance, which has always been an area of stronger reporting.

KPIs continue to be an area of strong transparency, with 83% of companies demonstrating a connectivity to strategic priorities (2020: 72%). Of these, 41% provide real insight into this connection, up from 31% last year. The other half (42%) demonstrate this through signposting or cross-referencing. The clearest disclosures explain why those performance indicators are relevant for measuring strategic priorities.

Companies cite an average of eleven KPIs: six financial and five non-financial; although some provide too many indicators for them to be considered as strategic metrics, with 14 (2020: 11) disclosing more than 20, two disclosing 30 and one company disclosing 57. The average number of KPIs relating to people has increased steadily over the last decade, although half of the FTSE 350 don't have a KPI connected to people. Similarly with environment, only 40% cite 'environmental impact' as a KPI. Nevertheless, this is an area of marked progress. In 2010 the average across the FTSE 350 was 0.1 and now, the average is 0.7.

The average number of principal risks reported remains constant at 12, with most disclosing between seven and 14, although ten companies report more than 20. These companies might benefit from reconsidering what constitutes a key strategic risk. The quality of explanation around linkage between risk and strategy is marginally smaller than last year. Seventy-one percent (71%) link risks to strategy (2020: 73%) but only 17% (2020: 18%) give explanations as to this linkage in addition to signposting.

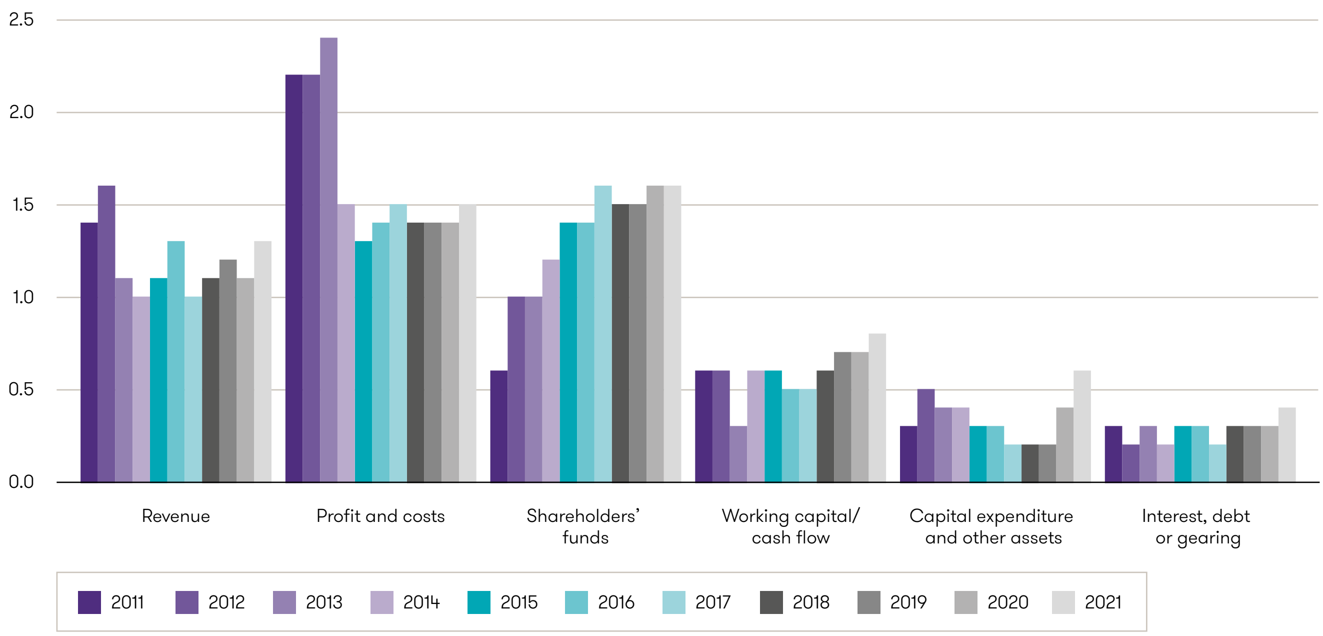
The quality of risk reporting remains high with over 90% of companies setting out clearly the definition, mitigations, and impact of principal risks, however fewer, 66%, state how the risk changes year on year, and only 27% describe the likelihood of the risk materialising.

The number of companies reporting environmental risks has risen slightly to 78 (2020;75, 2019; 58). This steady increase is also matched by reporting around ESG, although there's still a long way to go. It may be that environmental concerns are being regarded as market issues companies need to tackle, but fewer companies are acknowledging the opportunity and risk it may pose to their business models. See section on ESG considerations for more on this topic.

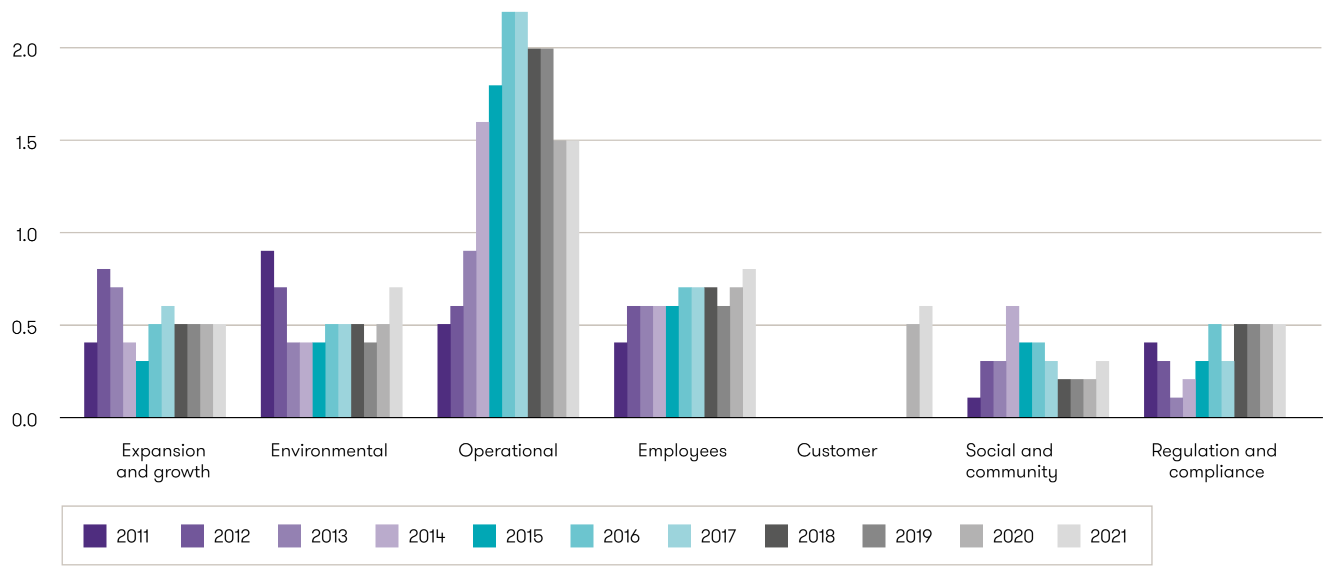
Reporting on emerging risks – a relatively new focus of the Code – has been adopted quickly, with 97% companies reporting their emerging risks (2020; 89%, 2019; 64%). It's clear that most companies focus more on the process of identifying risks, instead of the likely nature of those emerging risks. Only a third provide information about how they mitigate against these risks. While the most common principal risks relate to operations, regulation, and finance, emerging risks tend to relate to themes such as unexpected events (such as pandemics), climate change, the wider economy or geopolitics.

This year's findings support the business trends we've seen for the last decade around risk: more focus on technology disruption and cyber risk, growing concern around regulation and compliance, with the primary risks remaining operational. Most areas of risk have increased, but there are some declines: financial capital risks (down from 2.90 in 2011 to 1.8 in 20210) and macroeconomic risks (down from 1.6 in 2011 to 0.9 in 2021). Both of these perhaps represent the shift from the post-financial crisis climate to the current climate.

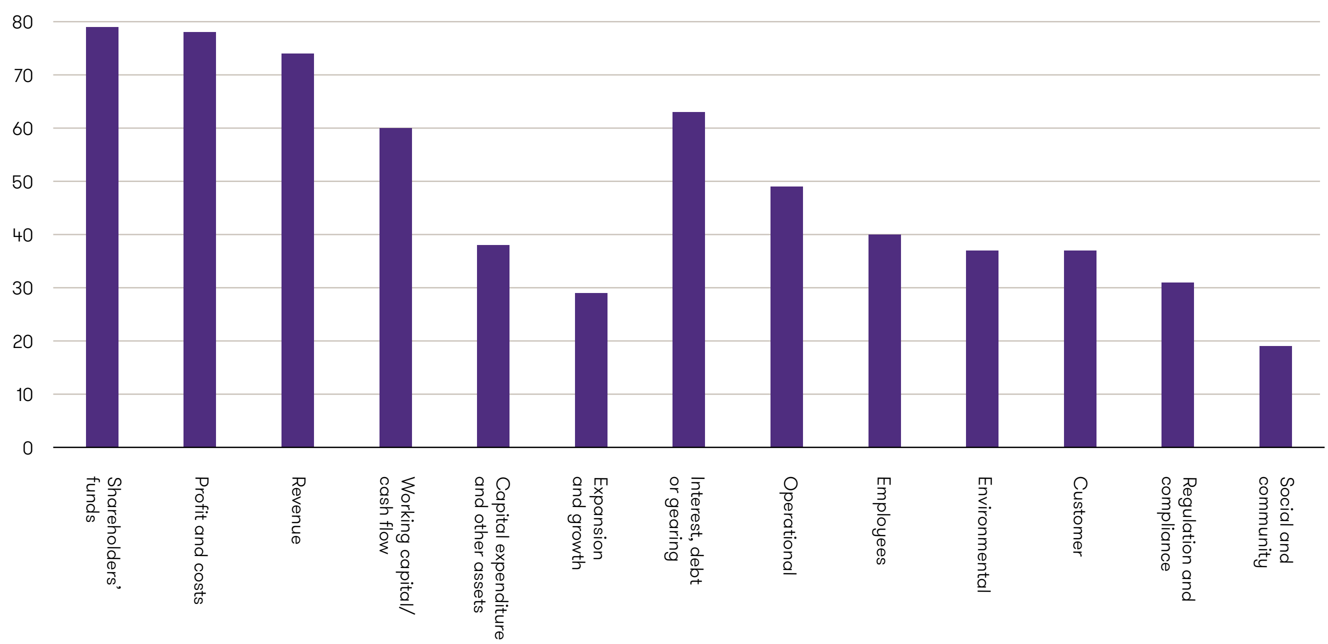
Average number of financial KPIs disclosed



Average number of non-financial KPIs disclosed



Types of KPI across the FTSE 350 (% of companies with at least one KPI)



Principal and emerging risks included at least once by the FTSE 350

	% at least one principal risk	% at least one emerging risk
Operational	96	19
Regulation/compliance	93	17
Financial	82	13
Employee/people issues	75	7
Wider economy/geopolitics/ economic uncertainty	72	29
Cyber/data	71	10
Strategy	70	8
Technology	42	14
Unexpected incidents/pandemics	40	37
Climate change	27	30
Social/community issues	24	8
Environment	14	10

There's a clear need to enhance scrutiny on emerging risks (figure above) in comparison to previous years.

Which of the following is included in principal risks disclosures? (%)

Definition	99.2
Mitigation	98.6
Impact	90.6
Link to strategy	71.4
Year-on-year changes	65.7
Risk indicator	37.5
Heat map	29.6
Risk appetite	29.2
Likelihood	27
Link to KPIs	6.9
Upside risks and opportunities	6.5

Culture

62%
give good or detailed accounts of company culture, up from 49%

98%
now mention how they monitor culture – but often use limited sources, such as employee surveys

58%
of CEOs now discuss culture and values in their opening statements

nearly
90%
of companies articulate their values

only
7%
don't explain which sources they use to assess culture, down from 50% last year

43
companies say they've developed a dashboard to measure culture

only
40
companies include a culture metric in remuneration measures

15%
of board evaluations identified embedding and monitoring culture as an area to develop

Over the last 10 years, the market's efforts to define and measure culture have progressed significantly – connecting through purpose, strategy, values, and risks. Culture has moved from being a fringe concept, 'too nebulous' to frame or measure, to a key enabler of business success. Figures indicate that boards are embracing the Code and taking a more active leadership role in framing, monitoring, and reviewing culture, to ensure that is enables an effective delivery of purpose and strategy.

Our 2019 research demonstrated that financially successful companies (the top quartile) typically had better-defined cultural practices (89%) compared to bottom-quartile performers (33%)[1]. The pandemic has challenged the resilience and agility of many companies and potentially driven the noticeable shift in approaches to culture. For the first time since 2002 more than half of companies (62%) are articulating their culture well: clear and understandable with the emphasis on how it underpins all business activities, instead of just paying lip service with a passing mention and a list of values.

Four out of every five companies now use their annual report to illustrate how culture enables, or is connected to, their strategy. This is up from 70% last year. Although there's still some way to go on accountability with only 14% (40 companies) including a culture metric in remuneration measures. Equally the quality of this explanation requires further attention: 40% explain the connection in their narrative, while 40% use signposting rather than explanation.

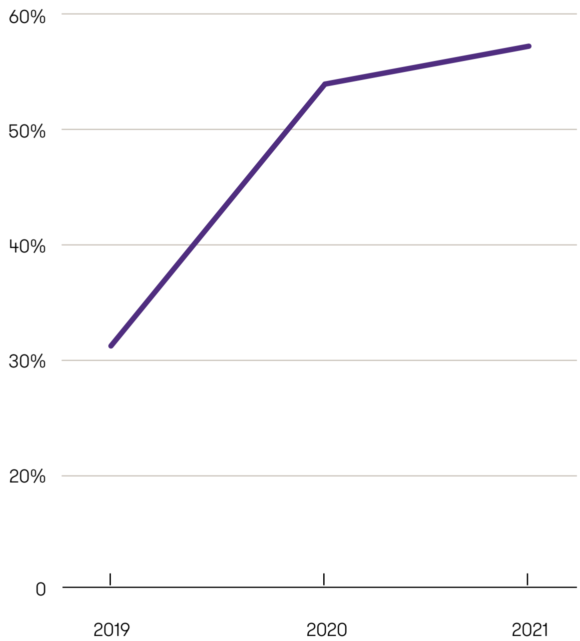
Setting the tone

Culture is integral to any company, and the role of leadership in setting the tone is vital. Again, there's been a noticeable shift in tone since 2015, when only 22% of chairs discussed the role of culture in their business. This has now risen to 88%. We're also seeing a trend towards more companies positioning culture front and centre in the introduction to their report, instead of the governance report. Although, historically culture tended to be the preserve of the chair's introduction, this year more than half of CEOs (58%) mention culture in their opening statements, up from a third in 2019 (2019: 32%; 2020: 55%). Given the vital role the CEO plays in setting tone from the top, we would expect to see this trend continue.

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

FTSE 350	No	Yes, in their primary statement	Yes, in their introduction to the corporate governance report	Yes, in both
2015	77.9	11.9	9.6	0.6
2019	28.1	16	30.9	25
2020	14.8	15.1	30.8	39.8
2021	12.3	21.7	26.4	39.7

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



1 Getting smart about governance', Grant Thornton, July 2019. www.grantthornton.co.uk/gettingsmartaboutgovernance

To what extent does the annual report address culture and values? (%)

FTSE 350	None	Basic	General	Good	Detailed
2015	26.3	28.2	26.3	16.3	2.9
2019	3.5	17.0	34.0	38.5	6.9
2020	2.5	11.5	37.0	43.4	5.7
2021	1.1	8.7	28.5	55.6	6.1

Monitoring culture

Companies should have a holistic and relevant way of measuring and monitoring culture, ideally using a basket of measures[2] aligned to specific strategic areas, and corporate purpose. Nearly all companies (98%) explain the methods they use to monitor culture, an impressive increase from just 43% in 2019. Similarly, 93% companies give detail on the sources of information they gather on culture. However, in both cases this is dominated by employee surveys, which continue to be the most common method of gathering data. Anecdotal evidence suggests that many companies were already conducting employee engagement surveys. Some have sought external advice to redraft them to specifically assess culture, but many have merely repurposed them as a sole measure of culture.

In line with guidance from the FRC, an employee survey isn't a sufficient measure on its own, but can be included as one of several indicators[3] on a dashboard. Monitoring culture should involve regular analysis and interpretation of evidence gathered from a range of sources[4] to indicate the degree of embeddedness and effectively alignment throughout the organisation. Only 15% of companies describe using a culture 'dashboard' of three or more measures, (70% of companies utilise three or more metrics but not in the form of a dashboard) which would be required if boards are looking for assurance effectiveness of company culture – either in delivering strategic objectives or in meeting wider purpose.

The immediate to mid-term market indicates that human capital constraints are here to stay in addition to the continued need to better integrate ESG considerations into the wider business model. It will be interesting to see if this further drives the need to address improvements in areas such as measurement and accountability.

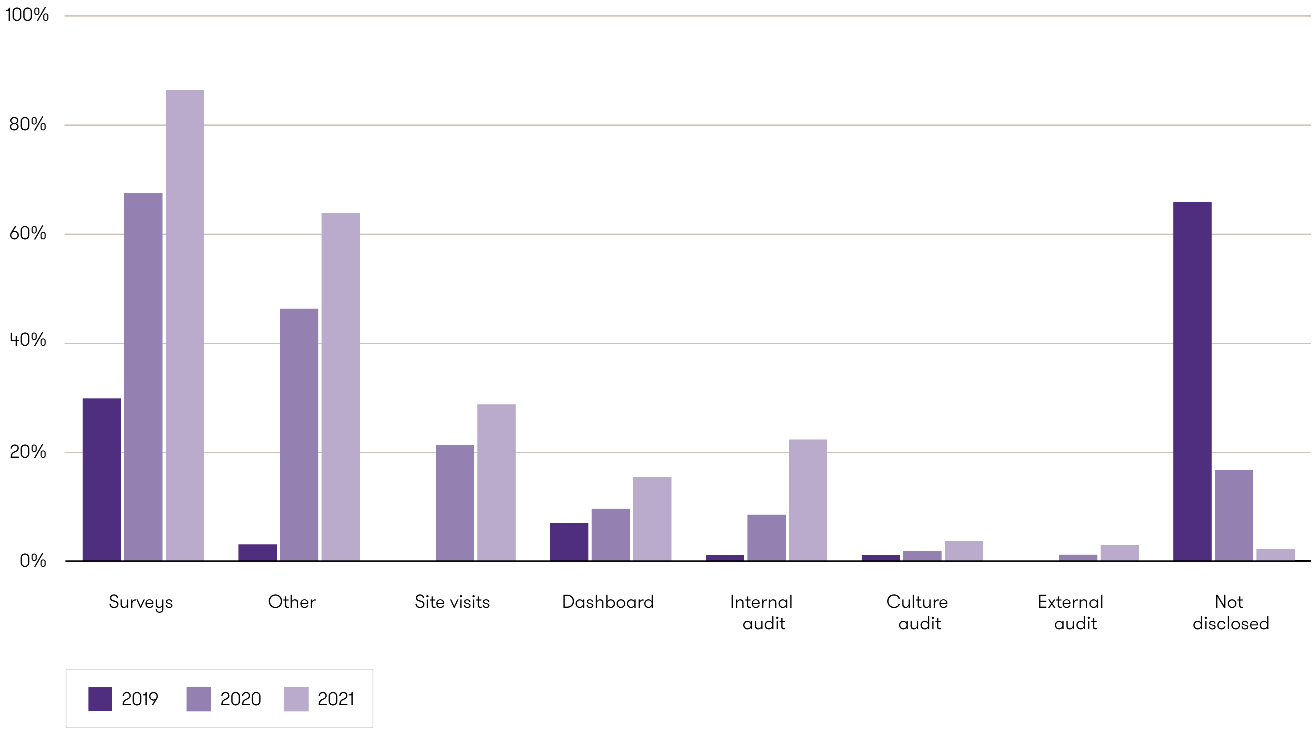
Find out more

We can support your organisation to gain assurance over your culture:

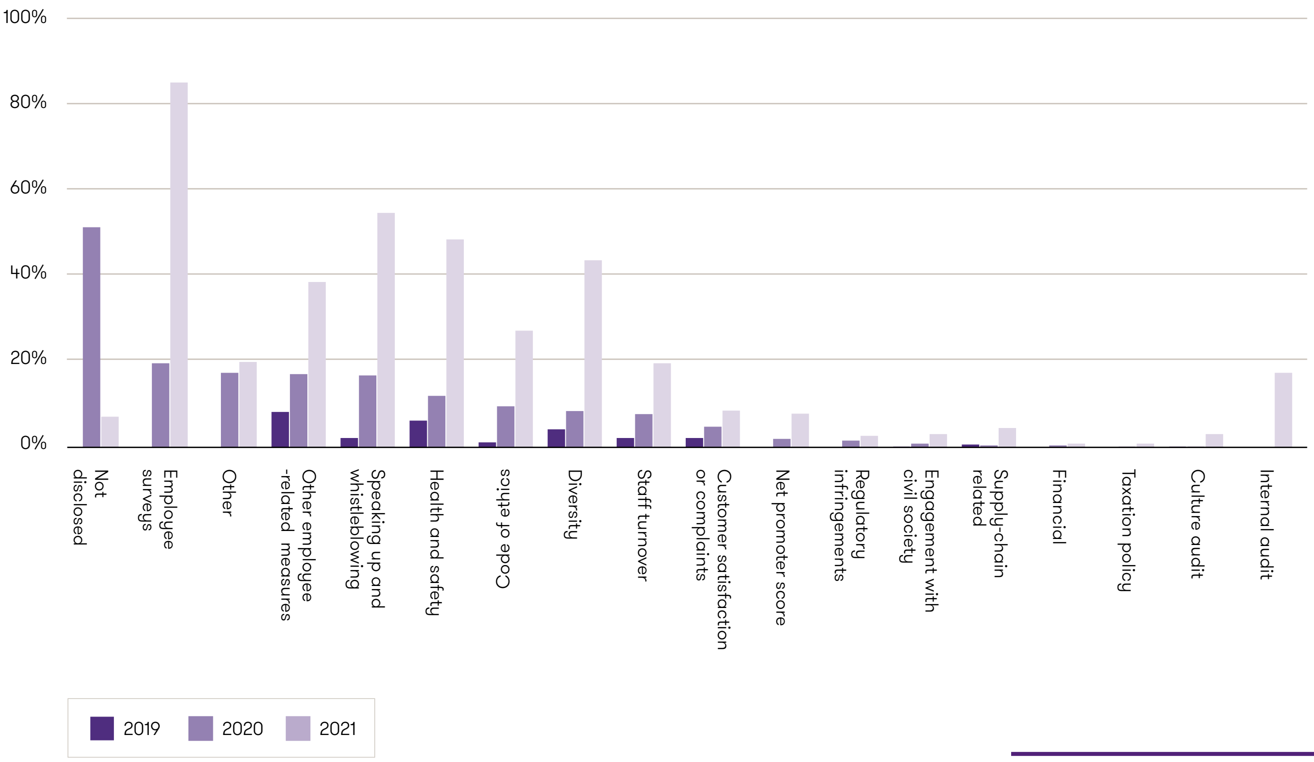
grantthornton.co.uk/services/risk/people-culture-organisation/

2 'A Journey into Auditing Culture: A Story and a Practical Guide', Grant Thornton UK, Susan Jex and Eddie J Best, The Internal Audit Foundation, 2019. See page 68.
3 https://www.cipd.co.uk/knowledge/culture/working-environment/organisation-culture-change-factsheet#gref
4 Workforce Engagement and the UK Corporate Governance Code: A Review of Company Reporting and Practice May 2021 https://www.frc.org.uk/getattachment/56bdd5ed-3b2d-4a6f-a62b-979910a90a10/FRC-Workforce-Engagement-Report_May-2021.pdf

What methods do the board use to monitor culture? (%)



What sources of information do companies use to assess culture? (%)



Best practice toolkit – culture

Elements /content	Things to consider	Reporting tips
Setting the tone from the top	The board and management are responsible for setting the 'tone from the top'. This means understanding and articulating the desired culture framework of the organisation in line with purpose, vision, mission, values and strategy, and beholding to it in their own working practices and interactions within the company and with its stakeholders. The board should be clear what sort of culture is needed to underpin the company's purpose and deliver its outlined long-term success. The board should consider what behaviours are being driven when setting the strategy and financial targets as well as metrics used in long-term incentives for executives and all employees. A two-way, collaborative bottom-up and top-down process consultation involving the board, management and other employees can help build a sense of unity, agreement and clarity around the organisation's current and desired future culture. Focus on culture should be long-term and continuous, not just in times of crisis. A collaborative, consultative process can help everyone feel connected and empowered by the culture and values of the organisation and help join the dots of a cultural narrative throughout the organisation.	Chairs should discuss the company's culture both in their opening statement to the annual report and their introduction to the governance report. Ensure that there is consistency between the chief executive and chair's views on culture within the annual report, to demonstrate leadership and tone from the top. Between the two, the role, framing, embedding, monitoring and measurement should be clear. Culture should be clearly articulated throughout the annual report and demonstrated via a framework and the connectivity of the business model demonstrating how it enables strategic progress. Review the executive remuneration incentives and report what non-financial measures have been introduced to support alignment with culture and strategy in the strategic report. Articulate the organsation's culture journey or process to demonstrate how culture is aligned, mutually agreed and understood.
Embedding	The CEO is responsible for embedding culture in an organisation. At the same time, senior and middle management have the largest direct impact in daily interactions, therefore, they should be identified and supported as cultural mobilisers and influencers within the organisation. The board should consider how management communicate what they consider to be acceptable business practices in order to frame corporate behaviour and values. Think how the company is embedding values and capturing behaviours at every level of an organisation: • recruitment and onboarding process should be aligned with company culture and values, at employee and board level • reward should incentivise desired behaviours • embed strategy and values within HR policies and performance appraisals • training, internal and external communication should be consistent, frequent, clear, understandable and deliver the board's message • culture should be consistent with risk management or internal control systems • establish how middle management is empowered and involved in the process • how company deals with both a lack of breaches and breaches of company rules or codes of conduct. • how other stakeholders and methods are involved in the process of creating trust and embedding culture, i.e. independent employee representation such as union representatives, culture champions or employee forum groups • how different parts of the organisation are working together to embed the culture and values of the organisation • involvement of different business units and an increase of their voices at the board table Do not forget about other stakeholders, for example, what steps have been taken to ensure that suppliers meet expected standards of behaviour and practice, or customer feedback and complaints.	Highlight the link between the organisation's purpose, strategy, values, KPIs, business model, risks, and reward, and show how these act as embedders of culture. Discuss how company and board culture is integrated in recruitment and reward, within the nomination, audit and remuneration committee reporting. Culture should be referred to in risk management disclosures, and referenced to internal controls. Show how culture and behaviours are shaped via training and other activities, such as culture change programmes within the strategic and nomination committee reports. Consider including case studies providing transparency around expected good practice and excellence that can be used to role model standards across the business, reinforcing the role that a healthy culture has in unlocking strategy. Be honest about the organisation's culture journey, highlighting not just the opportunities but also how challenges/misalignment are identified addressed or mitigated. Consider disclosing the feedback and follow-up actions from these other stakeholders with reference to culture as a way of creating trust and transparency Discuss how HR, internal audit, the company secretary and other business units collaborate, engage and 'join the dots' on the information they collect to help embed the desired culture in a cohesive manner

Best practice toolkit – culture

Elements/ content	Things to consider	Reporting tips
Monitoring and measuring	The board should assess culture and challenge the executives on its support of both the strategic objectives and purpose over the short and longer terms. Boards should give careful thought to how culture is monitored and assessed and what sources of information are used. The methods, means and information collected for monitoring and measuring should be drawn together from across the business and its key units through collaboration and consultation, ie employee forums, focus groups, internal audit, HR, ethics and compliance, independent representatives, other key employee metrics beyond engagement surveys. They should be considered cohesively and multi-dimensionally, such as whistle-blowing/speak up, customer feedback, etc. Devote sufficient time and resources to evaluating culture to ensure there is a cycle of reporting that joins the dots to provide trend analysis as opposed to ad hoc assessment. Consider the development of a dashboard. As part of this exercise the framework must ensure that: • senior management are clear and supportive of the culture • values are well defined, well communicated and understood at all levels • actions and behaviours at different levels of the firm are in line with culture • the methods, data and information used are effective, and considered cohesively and in context • there is clear governance around the monitoring and measurement. Commenting on culture should consider quantitative and qualitative information gathered from different sources, rather than reliance on one method or measure and tracked over time. Understand how technology can be used to collect, analyse, interpret, and present information.	Explain how the board seeks to assure itself that behaviours at different levels are in line with the culture. Show how culture is considered when assessing the effectiveness of risk management and internal control systems. Disclose some practical illustrations and numerical metrics or how the company gauges effectiveness of the culture programmes that are used to shape outcomes. Explain how the board has ensured that the sources used present an accurate and as whole as possible assessment of culture. It is important to show how those indicators are relevant for the company and what it wants to achieve. Discuss follow-up actions and results from assessment, measuring and monitoring programmes.

Stakeholder engagement

64%
provide good or detailed section 172 statements

25%
do not articulate an adoption of any of the three employee engagement methods recommended by the Code

61%
provide good or detailed disclosures on shareholder engagement, up 13%

58%
mention shareholders engaging with the remuneration committee chair

47%
explain how engagement with stakeholders has informed board decisions

27%
specify actions prompted by information collected from shareholders, up by 9% last year

Stakeholder engagement has become a focus for boards; enshrined both in the updated 2018 Code and Section 172 reporting, and amplified further by the pandemic and the increasing focus around ESG. Although a relatively new area of reporting, there is a small proportion of the FTSE 350 leading the way, using the annual report to clearly outline key issues raised by stakeholder groups, how information is gained from them, and providing specific examples of their influence on board decisions. Fourteen percent (14%) of companies provide this level of insight, while a further 51% outline the who and how of engagement, the issues raised by particular stakeholder groups, and how decisions are influenced by their input.

Looking at the detail of what statements reveal, the majority (98%) identify their key stakeholders and list the engagement methods. Nearly 70% explain key stakeholder interests, and almost half (47%) give examples of how stakeholders' considerations have influenced key board decisions. However, only 18% clearly outline how consideration of stakeholder groups influence strategy and KPIs, down from 23% last year.

With regard to employees, only four companies don't mention any kind of workforce engagement occurring, (2019:38%) and three quarters of companies have adopted one or more of the three approaches specified in the new Code. As with culture metrics, employee surveys are the most popular method for gathering the views of the workforce, with nearly 90% of companies now mentioning their survey in the annual report. Formal 'meet the board' events and advisory panels have both increased in usage; 44% use the former and 38% use the latter.

Does the board explain in the annual report how stakeholders' interests and matters set out in s172 influenced their decision making? (%)

No disclosure/no s172 report provided	0.4
Provide the who and how of stakeholder engagement, but with minimal detail	5.1
Outline who the stakeholders are, and provide good detail on frequency of engagement	30.3
Who, how, plus outline the issues raised by at least one stakeholder group, and how decisions are influenced by their input	50.5
Who, how, key issues raised by stakeholders, how input and information is gained, and how it influences specific decision, with focus on long term outcomes as well as engagement activity	13.7

The presence of employee representatives or employee directors in the boardroom remain approaches used by a very small minority of companies, with little change. Although there's increasing use of more active, real-time, two-way dialogue to inform board decision making instead of relying on surveys, which are by their nature point in time and backward looking). This is an area where boards should continue to consider the spirit of the guidance: engaging in dialogue to ensure employee interests are part of decision making at every level.

Overall, it appears that the 2020 UK Stewardship Code is starting to increase the depth and breadth of shareholder engagement, reaching a new high after years of decline. This progress is evident across the FTSE 350, primarily influenced by the FTSE 100. Twenty seven percent (27%) of companies outline how information from shareholders is fed back to the board, and explain resulting actions, up by 9% last year. Forty percent (40%) of companies also specifically mention that the chair met with shareholders and summaries discussions, up from only 21% in 2019.

We also see continued accumulation of evidence that non-executives beyond the chair are meeting with shareholders, most commonly the remuneration committee chair (58%) or senior independent director (52%). We've also observed a significant increase in other NEDs (those other than core committee chairs) such as the NED responsible for workforce engagement, or chair of another committee also being involved in shareholder engagement.

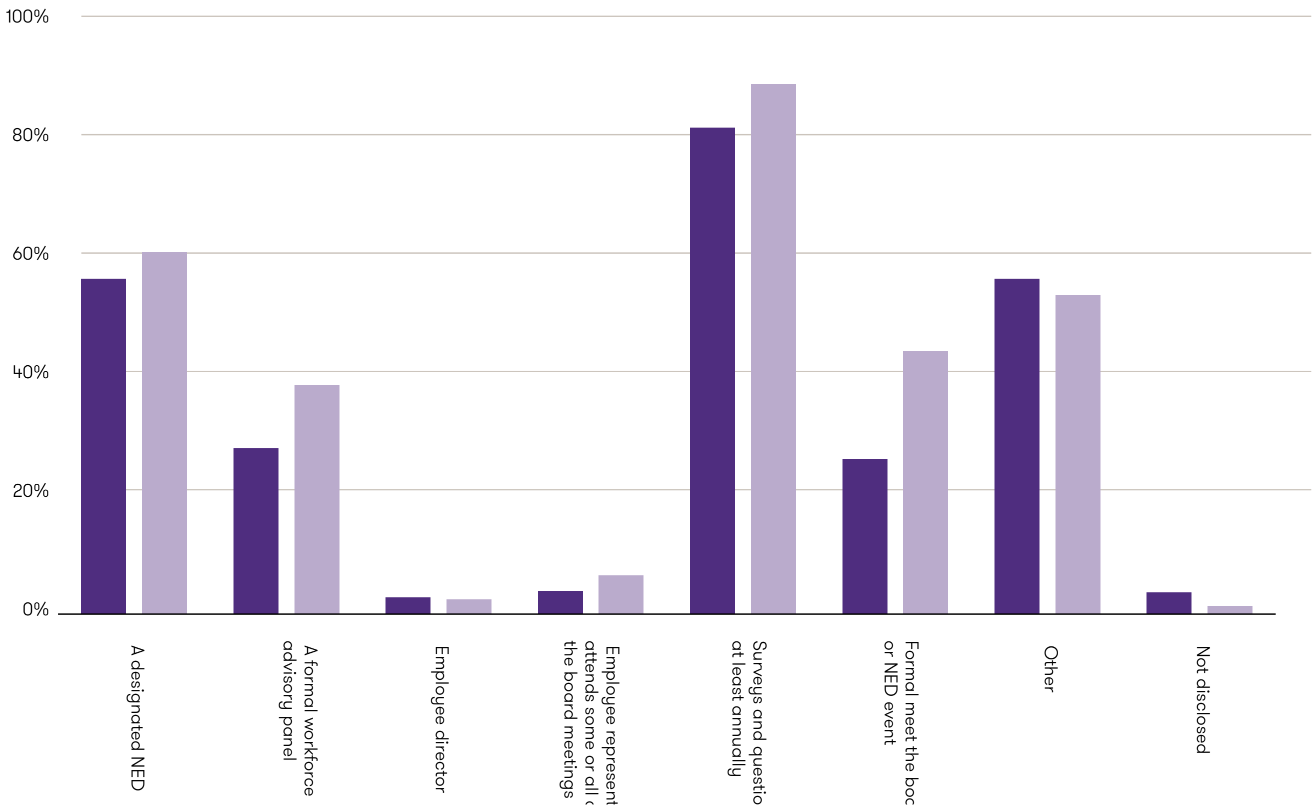
What do companies disclose regarding their stakeholder engagement? (%)

Who their key stakeholder(s) are	99
How they engage	96
Explanation of key stakeholder interests	69
Examples of how stakeholder considerations influenced board decisions	47
Board or company feedback	38
How stakeholder interests connect to strategy, policies, and KPIs	19

Which matters are mentioned in the S172 statement? (%)

Business relationships with suppliers, customers, and others	91.6
Interests of company employees	90.9
Impact on the community and environment	87.08
Long-term consequences of decisions	77.2
Desire to maintain a reputation for high standards of business conduct	67.1
Need to act fairly between company members	64.2

How does the board gather the views of the workforce? (%)



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

FTSE 350	None	Some	More
2018	0.7	68.0	31.3
2019	0.7	55.5	43.8
2020	1.1	50.8	48
2021	1.1	37.5	61.3

Does the chair meet with shareholders, and do they discuss governance and performance against the strategy? (%)

FTSE 350	2019	2020	2021
Not disclosed	11.5	10.3	5.4
Available	29.9	27.8	36.1
Meets, but discussions not disclosed	37.1	22.4	18.4
Yes – discussed	21.5	39.5	40.1

Who attends meetings with major shareholders? (%)

	Met with shareholders			Available to meet with shareholders		
	2019	**2020**	**2021**	**2019**	**2020**	**2021**
Senior Independent Director	25.7	34.5	51.6	44.4	39.8	31.4
Remuneration committee chair	22.2	38.4	58.4	24.0	22.7	24.9
Nomination committee chair	8.7	8.8	19.9	15.6	12.4	13.0
Audit committee chair	4.2	11.3	23.5	9.4	13.1	13.0
Another	5.6	6.7	20.9	16.0	8.8	10.5

Best practice toolkit – shareholder engagement

Elements/content	Things to consider	Reporting tips
Calendar	Summarise the shareholder engagement programme for the past year as well as the main planned events of the forward-looking calendar.	Where possible, include the financial reporting calendar and any upcoming events.
Methods	Take time to reassess how the company engages with shareholders: • how is information communicated? • how is participation encouraged? • how often? • what forms/means?	Provide details on day-to-day processes and interactions that take place outside the planned programme of events. Identify all forms of engagement throughout the year –the annual report, other reports, formal presentations, AGM, conferences, surveys of shareholders' opinion, meetings with brokers and analysts.
People engaged	Consider who is engaged in the dialogue, and who should be engaged. The Code requires the chair to seek engagement with major shareholders in order to understand their views on governance and performance against the strategy. Consider regularity of dialogue. Ensure committee chairs engage on important issues related to their areas of responsibility.	State the timing and rationale for chair-attended meetings, and include information on how the chief executive, company secretary, senior independent director, chairs of committees or other directors engaged with shareholders.
Key features/topics of engagement	Assess feedback from shareholders regarding specific issues, including how this is garnered and achieved. Consider the company's compliance with the Code and if any deviations from the Code were discussed with shareholders.	Report on key issues that investors raised and were invited to engage on. Disclose how many meetings took place, what directors were engaged and what issues were discussed. Reference how previous matters were resolved.
Outcomes	Reassess the board's understanding of shareholder concerns and if those issues are being allocated sufficient time in board meetings. It is the chair's responsibility to ensure that the board as a whole has a clear understanding of major shareholder views.	Provide details on the feedback and any outcomes arising. Explain if any actions/decisions were taken as a result of board/management consideration and how the shareholders were made aware of the outcomes.
Other considerations	Does the explanation of shareholder engagement add to the reader's understanding? Is there more you do that would add to this understanding? When appropriate consider changes in the investor profile – geographic split, investment rationale and whether there are unintended consequences for the company.	Include a final summary on actions taken in relation to any significant votes (20% or more) against a board recommendation for a resolution at a general meeting.

ESG considerations

64%
report against the United Nations Sustainable Development Goals

84
give a good or detailed level of explanation on environmental matters

40%
have an environmental KPI

30%
list climate change as an emerging risk, and 27% have climate change as a principal risk

only
19
companies use climate change or other environmental metrics in executive long-term incentive plans

19%
have a social KPI

The boards of the largest FTSE 350 companies increasingly prioritise their impact on society, responding to pressure from the public and investors to acknowledge that 'purpose' and 'mission' must stretch beyond simple profit and financial return. In addition, ignoring growing societal pressures, climate change, poor labour practices, social inequality, and supply chain problems in developing nations, to name a few will, in the longer term, limit access to both financial and non-financial capitals.

The movement of environmental, social and governance (ESG) matters from fringe PR activities to core business strategies is starting to be reflected in the annual reports. There has undoubtedly been a huge increased demand for ESG reporting which intensified over the pandemic. This requires boards to understand different information sets and information systems which are less mature, less well developed and requires a difference assurance and governance approach. Equally, as the reporting is more long-term, it requires boards to consider their desired trajectory and therefore more judgement and subjectivity needs to be applied.

As well as the vast expansion of reporting on purpose (see page 8) there's an improvement in reporting environmental and social matters. Some 84% of companies now provide detailed explanation around environmental matters. Reporting around social matters is less strong: 68% provide good detail, but only 19% report an associated KPI.

A growing number of companies are quantifying their positive impact using external frameworks or approaches. Sixty-four percent (64%) of companies make specific mention of the UN Sustainable Development Goals (SDGs), although only 31% describe in their annual report how their actions measure progress on SDGs. Eighty three percent (83%) of companies mention the Task Force on Climate-related Financial Disclosures (TCFD). Of these, 41% currently align their reporting to TCFD, and an additional 32% are committed to doing so.

Assurance in this area is challenging given the lack of a recognised framework, however, the increasing reliance on the data shows that it's growing area of focus; 15% report getting some kind of external assurance on their ESG reporting, while 52% use their own internal operational and internal assurance. A third however, report no internal or external assurance relating to non-financial and/or ESG considerations,

Although the quality and length of reporting has increased, companies are lagging on the accountability aspect with direct and clear connections to strategy, through the identification of principal risks, the setting of KPIs, and the linkage to executive performance. Although, as highlighted, it is expected that this is a timing issue given the relatively immature nature of data collection in this space and the absence of a regulatory framework. Many organisations suggest they will likely need to go through four reporting cycles before they get comfortable with the reliability of output.

A third (30%) list climate change as an emerging risk, and only 27% include it as a principal risk. It's encouraging to see an increase in the number of companies including an environmental KPI, up to 40% from 31% last year. Only 38 (14%) companies connect this to executive performance-related pay targets in the annual bonus, and of these only21% further extend this to LTIPs.

The gender composition of the FTSE 350 remains unchanged again since 2019, with an average of 39% women and 61% men. The average headcount has fallen this year, from nearly 20,000 to around 16,000. That said, all but two industries improved their gender balance at senior management level[5]. Telecommunications was notable in the reduced proportion of women in senior management roles.

Board level oversight of employee metrics is expanding, especially across the remuneration committee and nomination committee reports (see individual sections for more detail). Overall reporting in this area is good, with 81% providing detailed accounts of employee related matters, including information on diversity, retention, and health and safety policies. This reporting also includes evidence of progress. However, this reporting does favour narrative over relevant stretch goals that support strategy and purpose. Less than half (49%) include any employee-related KPI, with only 17% linking executive bonuses to employee metrics, and just 14% reference social metrics.

5 'Senior management level' is the first layer of management below the board level, according to the 2018 Code.

To what extent does the company explain environmental matters? (%)

FTSE 350	None	Some	More
2020	1	22	77
2021	0	16	84

To what extent does the company explain employee matters? (%)

FTSE 350	None	Some	More
2019	1	22	77
2020	1.4	18.9	79.7
2021	1.2	17.7	81.6

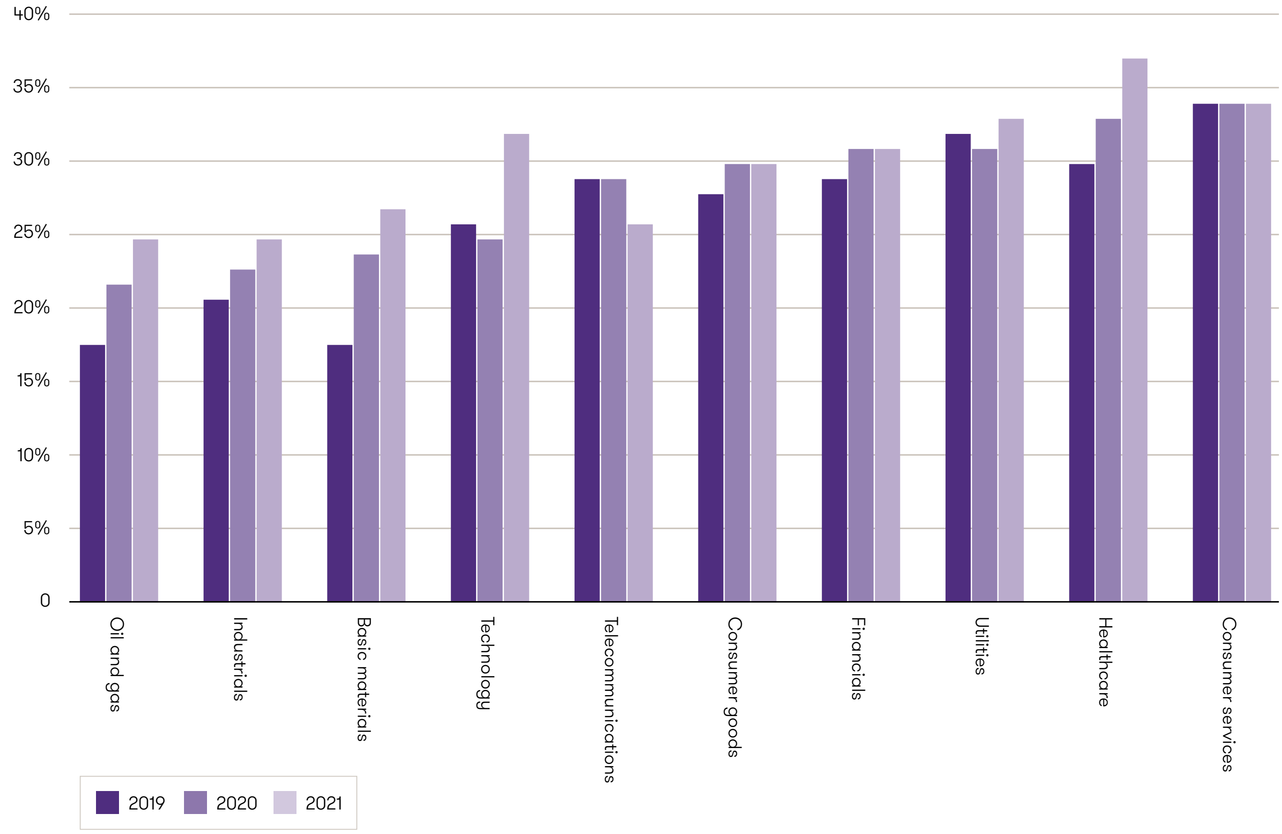
To what extent does the company explain social, community and human rights activities? (%)

FTSE 350	None	Some	More
2019	2	28	70
2020	1.1	30.3	68.7
2021	0.4	31.4	68.2

Find out more

Our ESG services can help you navigate the ESG agenda: grantthornton.co.uk/en/services/environmental-social-and-governance-esg/

Senior management gender split by industry (% women)



Best practice toolkit – ESG reporting

When considering how to integrate ESG into an organisation's business model it is often useful to anchor development in a recognised framework. At Grant Thornton, we have developed the above ESG framework below, built from the Task Force on Climate Related Financial Disclosures (TCDF) outline as recommended by the International Sustainability Standards Board (ISSB).

This framework demonstrates the various areas that leadership may need to consider when establishing their ESG approach. The framework covers establishing priorities, the transition to sustainability and communicating successes.

Best practice toolkit – ESG considerations

Elements/ content	Things to consider	Reporting tips
The ESG agenda	How does your organisation utilise or interface with the five recognised capitals? Engage with stakeholders, both internal and external, in this process, via several means, to understand what issues and impacts are material to them. There are many initiatives and reporting standards. Location of your business, and stakeholder expectations, can help inform which initiatives drive the most impact for your organisation, whether social, governance, financial, reputational, or environmental.	Articulate your ESG journey so far and what has led you to conduct a materiality assessment. Discuss how you conducted your materiality assessment including which stakeholders you engaged which, how you engaged, what they said, how you responded to demonstrate the relevance of the conclusions drawn. Provide a visualisation/materiality matrix to clearly show the issues, the importance/relevance and how they all fit together.
ESG strategy, risk and opportunity identification	The ESG strategy should be defined and linked to purpose and strategy with risks and opportunities appropriately identified and managed. Consider conducting/developing a materiality assessment to identify relevant ESG metrics and potential impact on the value of your organisation. Think about whether the governance structures and frameworks are sufficient based on the risks and opportunities identified – does there need to be a board level committee set-up? Do you need to consider whether ESG-related KPIs or risks integrate with Principal measures or need to be elevated and separately reported? Contemplate whether the organisation's ESG priorities integrate with stakeholders (s172) and reflect incoming regulations (TCFD, the European Directive, etc), your chosen reporting systems, and organisational priorities and whether targets are measurable and credible. Undertake modelling to understand the implications and impacts of any action you take, especially in terms of the risks and opportunities. This will ensure your ESG agendas are an asset to your organisation.	Discuss the outcomes of your modelling assessment to demonstrate the impacts and implications of any actions you have and will take. Outline generally any risks and opportunities that the modelling has elucidated with reference to your ESG agendas, or alternatively with reference to a particular regulation or reporting system (eg TCFD), outline the risks and opportunities created by a regulation or reporting system.
ESG driven business transition	Once your ESG priorities are established and incorporated into your core organisational strategy, you may need to action change. Assess and produce a clear plan of, in collaboration with the board: • What actions you need to take across your value chain to realise your strategy? • What changes to your business model you could make to deliver enhanced ESG outcomes? • What change is needed to your governance policies, operating model, and culture to deliver your ambitions? • Across your supply chain, how you should approach human rights, modern slavery and working conditions? • Does your people strategy attract, retain, and engage the talent you need for success and what changes need to be made to continue this – your people are key? • What skills do you need to support your ESG agenda, where are the gaps and how can you fill these. Importantly how can you use existing routes and pipelines to build the sustainable skills that you need around ESG? How can you get an objective understanding of how inclusive you are as an organisation and what actions you can take which will have the biggest impact in helping you to achieve your inclusion and diversity goals?	Consider integrating insights into these areas and the journey for each in the relevant areas within your annual reporting, to ensure a 'joined-up', cohesive approach to aligning ESG and sustainability with every part of your organisation's operations, policies, practices, and strategy.

Best practice toolkit – ESG considerations

Elements/ content	Things to consider	Reporting tips
ESG metrics and targets	Your goals, and how you measure progress towards them, are of increasing interest to stakeholders in terms of authenticity of message. Take time to assess and ensure you are setting the right targets: • What frameworks, standards (eg science-based targets) and regulation are most relevant to your organisation? • When and what do you need to measure and disclose? • How can you disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities? • Can this be repeated year-on-year to evidence progress? • Do you have the infrastructure in place, ie a data platform or processes to capture, aggregate, measure and report against these targets and metrics? • Do they drive behaviours?	Articulate your targets and metrics, the associated risks and opportunities and how you intend to achieve and measure these targets and metrics, and over what timelines. Be prepared to report annually, periodically (in line with the framework, standards, or regulations requirements) and authentically as to your progress – this will help build trust and accountability. Note whether metrics are being linked through to remuneration.
ESG risk management – regulation and policy	Identify opportunities and risks in your ESG framework and strategy. Consider whether they represent a strategic or operational risk. How do they align with risk appetite? Consider how risks can be measured and the reliability of data. As part of this assessment consider risks across stakeholders in line with s172 and whether these vary per jurisdiction. The key principles of an ESG risk management framework and the alignment between your ESG risk management strategy and the organisation's strategy – are they aligned?	Provide details of the work undertaken to effectively capture and manage risk across your supply chain/when working with partners. When describing your risk management framework, include details on how it successfully captures, manages, and mitigates sustainability-related risks and provides assurance around ESG data. Disclose any sustainability/ESG-related principal and emerging risks, including descriptions, mitigations amongst other key risk indicators.
Non-financial assurance	Is your board confident and ready to supply robust and complete non-financial/ESG information that withstands scrutiny? Non-financial assurance gives your disclosures credibility and reliability. Ensure areas of the organisation which collect and collate any non-financial data understand the role it, and assurance of it, plays in increasing transparency, building trust and being in line with best practice and stakeholder expectations. What assurance on your ESG data is considered appropriate? This might be internal audit or other internal sources (limited), or formal independent scrutiny as part of the audit process. It could also be voluntary independent scrutiny where there is a desire to enhance credibility on stand-alone ESG reporting/metrics/targets.	Report on outcomes, most often found in: • ESG report/section as part of the strategic report • Audit committee report • separate sustainability committee reports Include information on the process and the rationale for this process, i.e., why limited/internal/external/full assurance over the other options. Disclose any findings/failings – changes or review of process as a result of the non-financial assurance process.

Board composition, responsibilities, and effectiveness

67%
provide good or detailed explanations of board evaluation, with 51% providing detail on outcomes

60%
give more detail on the skills and experience of their board, up from 36% last year

only
10%
explain the relevance of directors' skills in the context of strategic risks, regulatory change, and market shifts

84%
now have a director with a background in technology or cyber risk

43
companies have had their chair for more than nine years, down from 74 last year.

26
FTSE chairs were held by women in 2021, up from 17 in 2020.

The quality of reporting on board members' skills and experiences has increased this year: nearly 60% (59.6%) now outline good quality disclosures and detail on each of their directors' relevant experience and skills. There's still room for progress. Only 10% go the extra mile to explain how director skills are relevant in the context of the organisations' strategic priorities.

Eighty-four percent (84%) of companies now say they have a director with a background in technology or cyber risk, up from 66% last year (62% in 2019). For several years our report had highlighted a significant gap between the number of companies recognising technology as a significant risk while seemingly not having appropriate skills on the board. As recently as 2018 79% recognised the risk, but more than half (over 117 companies) continued to operate without these skills. Significant progress has clearly been made as companies have recognised the opportunities and risks offered by technology.

We also found a jump in the number of companies with directors from law, marketing or PR backgrounds, areas that haven't been specifically identified in prior years. Despite the significant widening of attention to culture in the last two years only 22% of the FTSE 350 have a director with a background in HR. It will be interesting to see if the continued constraints around human capital and changes in social mobility drive a more strategic need at board level in future years.

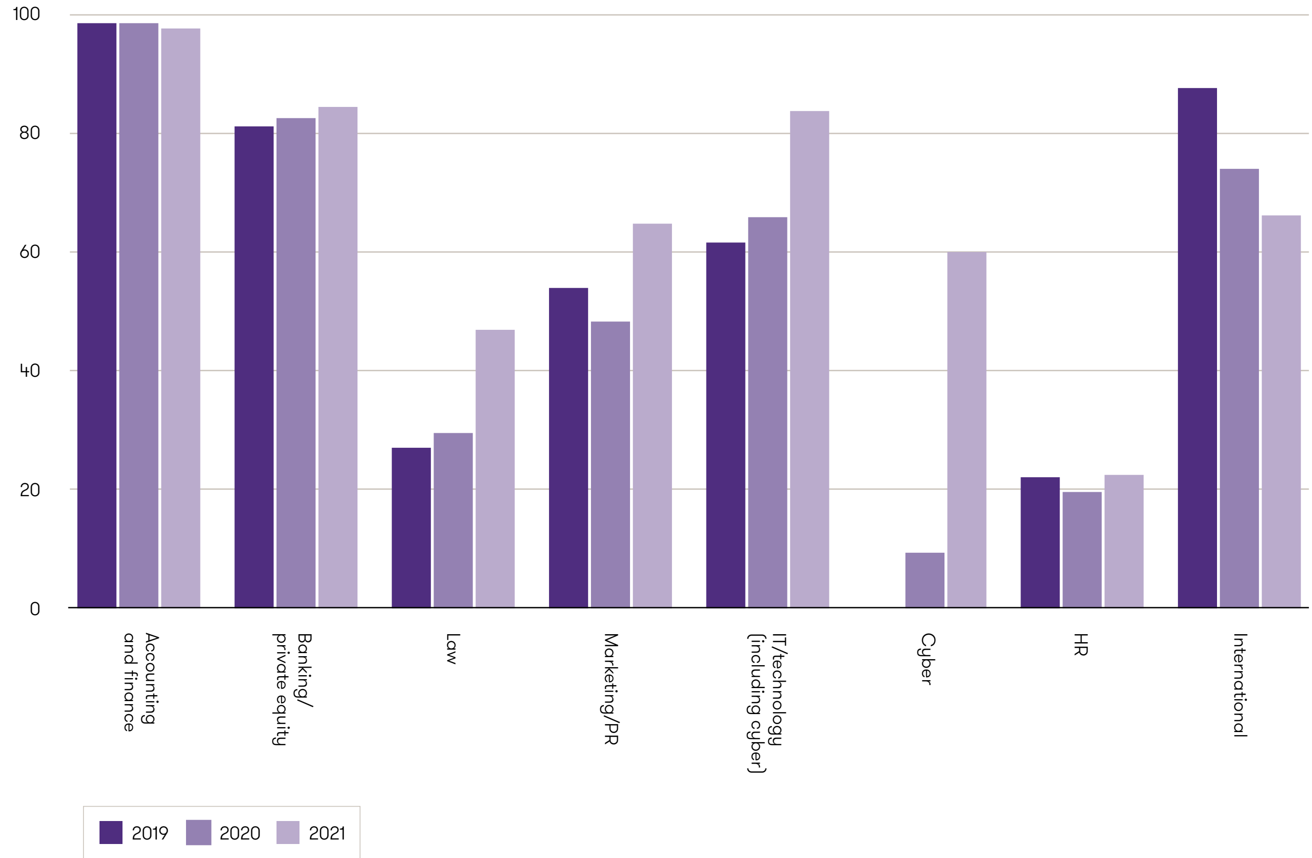
Twenty-six percent of companies (26%) have at least one NED deemed to not be independent. Of these, 25% are over the nine-year mark and 27% have been a company employee in the last five years.

Forty-five companies appointed a new chair this year (2020:35 companies, 2019: 56 companies). All but one of those were independent on appointment. A third were external candidates and two thirds were internal appointments. Only 43 companies have had the same chair for more than nine years, down from seventy-four (74) companies last year. Several of these appointments are women: 26 companies now have a female chair, up from 17 last year and 16 the year before.

When it comes to reviewing board effectiveness, just over two thirds (67) of companies are fully transparent about their approach, but are less comfortable when it comes to giving detail on outcomes of that evaluation. Only half of companies (51%) provide detail on areas for development. When they do, the majority cite broad themes, such as succession planning, strategic focus, and wider stakeholder engagement. Surprisingly, given the still large percentage of companies not using a wider range of metric to monitor culture (see page 16), only 15% identify it as requiring more attention. Likewise,46% of companies provide little information regarding the succession planning beyond the board and yet only 29% recognise this as a priority.

Eighty-nine companies chose to complete an externally facilitated board review, a little under the typical third (32%). Thirty-two board evaluation organisations are active across the FTSE 350 (2020: 32; 2019: 34). The majority are small one or two-person consultancies doing four or fewer reviews in the FTSE 350. One organisation conducted 24 (27%) of all reviews.

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

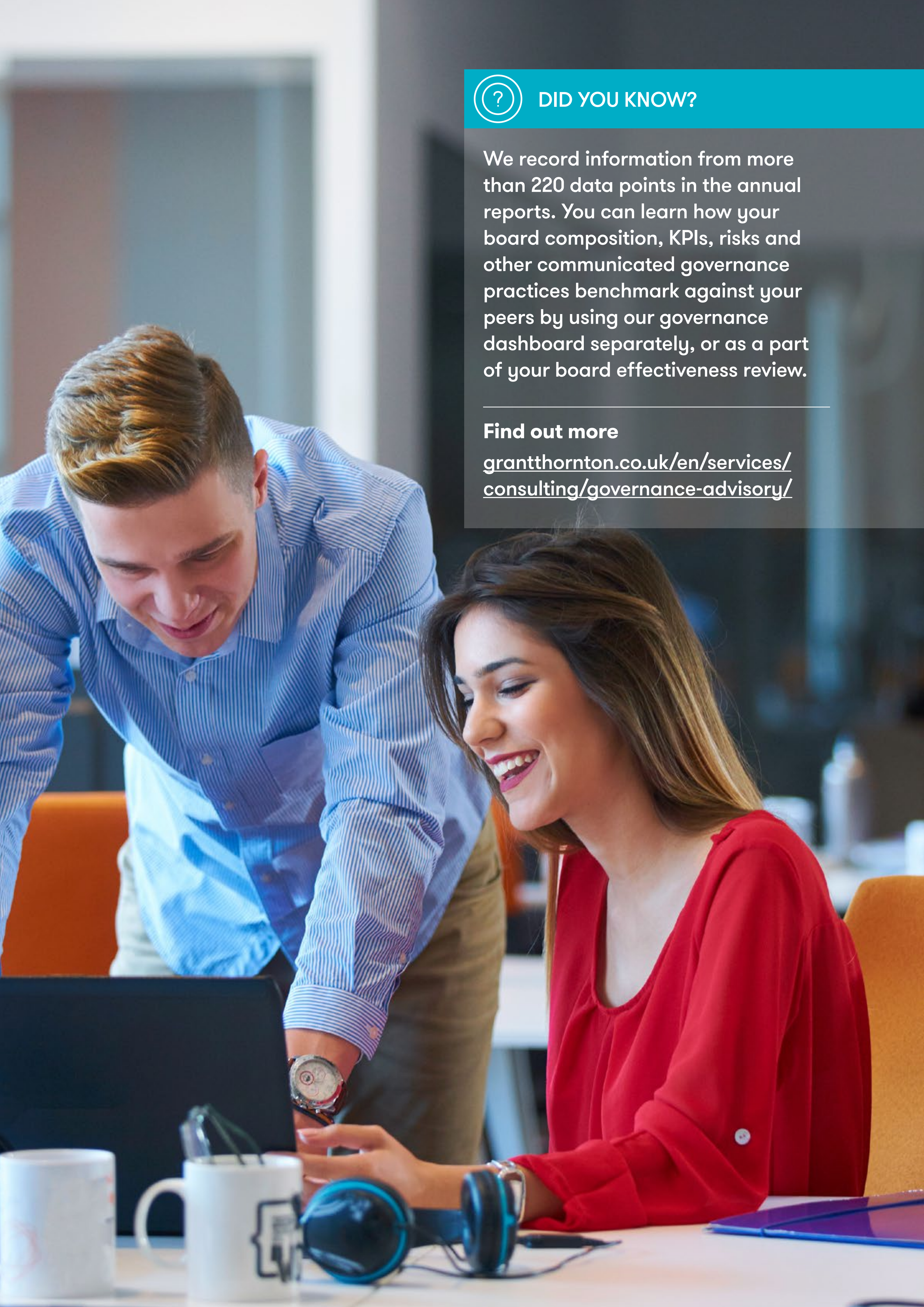


How much explanation is there of how the board, committees, and individual directors are annually formally evaluated for their performance? (%)

FTSE 350	None	Some	More
2019	2.4	50	47.6
2020	0.7	48.4	50.8
2021	1.8	31	67.1

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

FTSE 350	None	Some	More
2019	8.0	49.3	42.7
2020	9.3	45.2	45.5
2021	6.9	41.5	51.6



DID YOU KNOW?

We record information from more than 220 data points in the annual reports. You can learn how your board composition, KPIs, risks and other communicated governance practices benchmark against your peers by using our governance dashboard separately, or as a part of your board effectiveness review.

Find out more

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Best practice toolkit – board effectiveness review

Elements/ content	Things to consider	Reporting tips
Methods	Use the external board evaluation as a learning and development exercise to obtain a fresh perspective on future strengths and considerations based on the strategic objectives and purpose. Whether conducting an internal or external review, it should cover (but not be limited to): • relevance of the mix of skills, experience, knowledge and diversity on the board, in the context of the challenges facing the company • the working relationship and dynamics between key board members, particularly chair/CEO, chair/senior independent director, chair/company secretary and executive/non-executive • effectiveness of individual directors • effectiveness of board committees, and how they are connected with the main board • effectiveness evaluation of the chair by the non-executive directors led by the SID • timeliness and quality of the general information provided on the company its performance • decision-making structure, processes and authorities. The chair should consider ways in which to obtain feedback from the workforce and other stakeholders. Chairs of board committees should be responsible for the evaluation of their committees.	The description of evaluation should explain the mechanism and/or approach used for board evaluation (eg surveys, face-to-face interviews, meeting observation, documents review, psychodynamic tests, external facilitation) and the criteria for assessment. Explain why the chosen approach or method was considered best in measuring the effectiveness of the board at this time.
Outcomes	Produce a clear plan for addressing areas of improvement, including actions planned, timescales, and connection to board training and development, succession planning and future appointments, where appropriate. Discuss the outcomes at the board meeting and demonstrate a feedback loop. The chair should take the responsibility for the process and follow up on the actions for the board as well as individual directors.	Outline the key findings and outcomes, not just a general statement that the board operates effectively. Show that sufficient value is placed on the evaluation process and be specific about the outcomes, areas of excellence and areas for development. Identify planned actions and their timeline (eg 1-3 months, 3-6 months, 6-12 months). Best practice reporting also makes reference to previous year's evaluations and demonstrates how the board have met previous year's actions and if that led to the desired outcome.

Best practice toolkit – board effectiveness review

Elements/ content	Things to consider	Reporting tips
External evaluation	Board evaluations should be externally facilitated triennially in line with the Code. Ensure that an external facilitator provides you with a clear set of recommendations and actions, and a time-period for review of progress at the end of the review. Ideally it should also include views from beyond the boardroom, eg senior executives who regularly interact with the board and perhaps for the audit committee, the external auditor. Agree with an external evaluator what process is to be followed and what information on evaluation outcomes should be disclosed. Consider having a facilitated session or a follow-up with the external evaluator to discuss accountability for action and the progress on agreed outcomes.	Provide the name and details of the independent organisation if the board evaluation was externally facilitated, and an explanation as to why this organisation was chosen. If you do not conduct a triennial board evaluation, state your non-compliance and provide the reason why: the timing may be unsuitable for the board, for example.

Find out more

Our dynamic board evaluation approach can help ensure your boards are ready to meet future challenges. Read more about our approach and our digital tools:

grantthornton.co.uk/insights/board-dynamics-a-guide-to-evaluating-effectiveness/

Code compliance and application of principles

44%
comply with the provisions of the 2018 Code down by 14% against the prior year

43%
of those who declare non-compliance state they plan to comply in the next year

41%
provide a meaningful statement on the application of Code principles

70%
of those who don't comply provide detailed explanations

Key areas of non-compliance include:
46% don't align executive pensions with their workforces'
17% don't comply with the chair's tenure limit provision

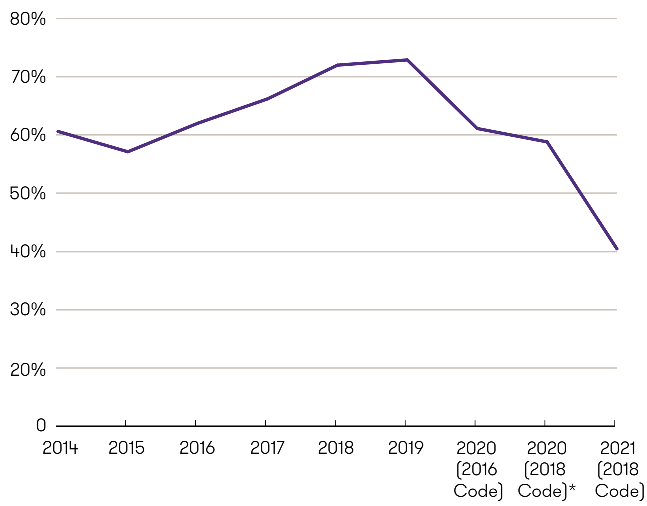
This is the first year that all companies are required to apply the 2018 Code, leading to a predictable drop in companies claiming full compliance: down to 44% from 57% last year and 73% against the 2016 Code. The quality of explanations has improved, suggesting companies are using the spirit of the comply or explain model.

The number of companies declaring non-compliance with provision 19, regarding chair's tenure, has increased 3% to 17%. Chair independence continues to be a common area of non-compliance, with seven companies not declaring non-compliance.

Again, this year non-compliance on executive pensions remains an issue – 128 companies don't have alignment, while 20 companies don't meet the provision surrounding long term shareholding. See page 51 on remuneration committee.

Compliance on the requirement to provide a detailed statement on the application of the principles has increased significantly – nearly three quarters of companies provide this statement (73%), up by 15% from the previous year (2020: 58%). The quality of these statements is also gradually improving; with 41% companies providing a detailed, meaningful explanation, while 32% provide just a basic statement.

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



*combined compliance rate with 2016 Code and 2018 Code

Nomination committee

37%
provide good or detailed reporting into succession planning

46%
provide no or very little explanation for succession planning beneath the board

79%
mention ethnic diversity this year in their policies

51%
provide good or detailed disclosure of gender diversity

only
one
company mentions disability in relation to board diversity

19%
of nomination committee chairs engaged with shareholders

The nomination committee's remit was extended under the 2018 Code, with a particular focus on two areas: succession planning beyond the board, and diversity. This enlarged responsibility is reflected in the improved quality and length of reporting. The nomination committee report is an average of 3.2 pages long, up from 2.8 last year. The average amount of meetings for the nomination committee remains the same (3.9; 2021, 2020; 3.9).

This year we also find improved explanations of boards' succession planning, with 37% now providing good or detailed explanations, up from 23% last year. Many more companies mention different kinds of diversity (beyond gender and ethnicity) and provide better insight into their policies around diversity, too.

There are still some areas that remain patchy, where it's clear some companies are still developing their approach. Although succession planning as it relates to the board has improved, there is still some way to go, with 46% of companies providing no or very little explanation for how they review succession planning beyond the board. This is an area where, anecdotally, there's still a lack of clarity over the boundaries between the remits of boards and executive committees.

Provision 23 requires nomination committee disclosures to include the company's policy on diversity and inclusion – covering objectives and links to strategy; implementation; and progress. Nearly half of companies (47%) now discuss progress against this policy, up from less than a third last year. Thirty eight percent (38%) only refer to the company's diversity policy, while 15% don't make any acknowledgement. Considerable progress has been made when compared to last year's figure of nearly a third omitting it, but in light of the intense public debate around ethnic diversity it's surely surprising that any nomination committee is failing to include it in their annual report.

Ethnicity is a rapidly growing theme in diversity development reporting: 79% of companies now mention it as part of the list of characteristics considered for board diversity, up from just 24% in 2017. The Parker review's most recent update (March 2021) says that 19% of FTSE 100 boards have no ethnic minority representation, meaning these companies may have missed the 'One by 2021' target. This will clearly require more focus, intervention, and detailed disclosure from the nomination committee as this year progresses.

We also see annual reports discussing broader indicators of diversity. More than a third (36%) mention age diversity, up from 12% in 2017, and 42% mention social mobility, the same as last year. As only one company in the FTSE 350 mentions disability in their diversity policies there's, clearly, still a long way to go.

Questions to ask

- How frequently is diversity discussed at board meetings – especially given the link to a company's culture?
- How is diversity of discussion encouraged and embedded?
- Does the board actively encourage sponsorship of minorities within the business?
- How forward-looking is your succession plan? Does it cover short, medium and long-term succession planning? Is it linked to, and regularly reviewed alongside, the strategic priorities of the company or is it driven by tenture?
- What is the action plan for identified diversity gaps? Is this owned and monitored by the nomination committee – and by extension the board as a whole?
- How conversant is the board with recent events with regards to diversity? Are the board and the nomination committee familiar with BAME and LGBTQ+ issues, as well as other aspects of diversity such as cognitive traits?
- Does the composition of the board and senior management reflect the company's diversity of customers and other stakeholder groups?

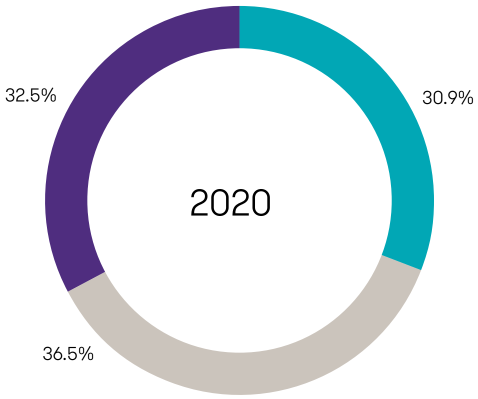
To what extent do companies describe board succession planning? (%)

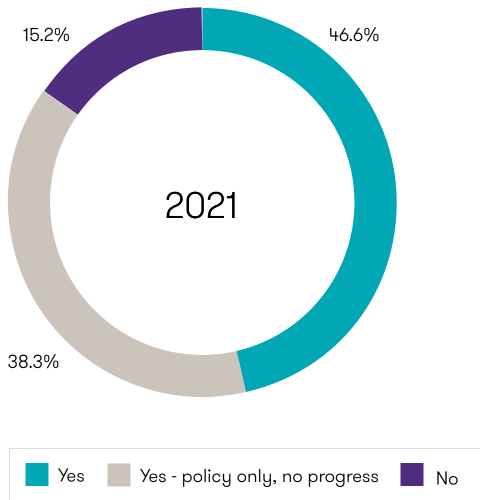
FTSE 350	None	Basic	General	Good	Detailed
2019	4.9	33.3	45.1	15.3	1.4
2020	2.8	24.6	50.2	21.4	1.1
2021	0.7	16.6	45.5	32.5	4.7

To what extent does the board describe the company's succession planning for senior management and development of a diverse pipeline (%)

FTSE 350	None	Basic	General	Good	Detailed
2019	18.8	39.6	28.8	12.8	0.0
2020	12.1	35.9	34.2	17.8	0.0
2021	11.2	34.7	32.5	19.9	1.8

Does the report describe the company policy on diversity and inclusion, its objectives and linkage to company strategy, and progress on achieving the objectives? (%)





Best practice toolkit – succession planning

Elements/ content	Things to consider	Reporting tips
Board	The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management. This should be reviewed not just in line with tenure but when strategic priorities and risks are updated as well. The process of new appointments should be continuous and proactive, not just reactive to tenures. Skills should constantly be mapped to strategy and risks with succession planning and/or learning and development aligned to output. The board's long-term organisational programmes ie, financial, cultural, should be considered in succession planning.	Provide a skills matrix – linking any skills to the strategy of the company. Provide a timeline showing the evolution of skills in line with strategy. Provide a summary of short, medium, and emergency succession plans in the annual report. Link the perceived needs of the board composition to strategic priorities. This area could also include cross-reference to board evaluation, to demonstrate how the committee identifies gaps in the skills or experience mix of the board. Refer to diversity as a factor in succession planning – this should include consideration on diversity of gender and other demographic and cognitive traits, as well as disability, skills, experience, knowledge, and independence against the stakeholder environment and strategic priorities.
Executive pipeline/ talent development	Ensure there is visibility of the talent pipeline at board level. This should include what systemic actions are in place to encourage and ensure development of diversity (cognitive, female, ethnicity, etc), for example, group coaching and sponsorship. Consider a multi-generational shadow board.	Report on how the board engages with the workforce – highlighting how the board interacts with high potential talent. Provide details on talent development programmes, highlighting any board level sponsorship or other board driven initiatives.

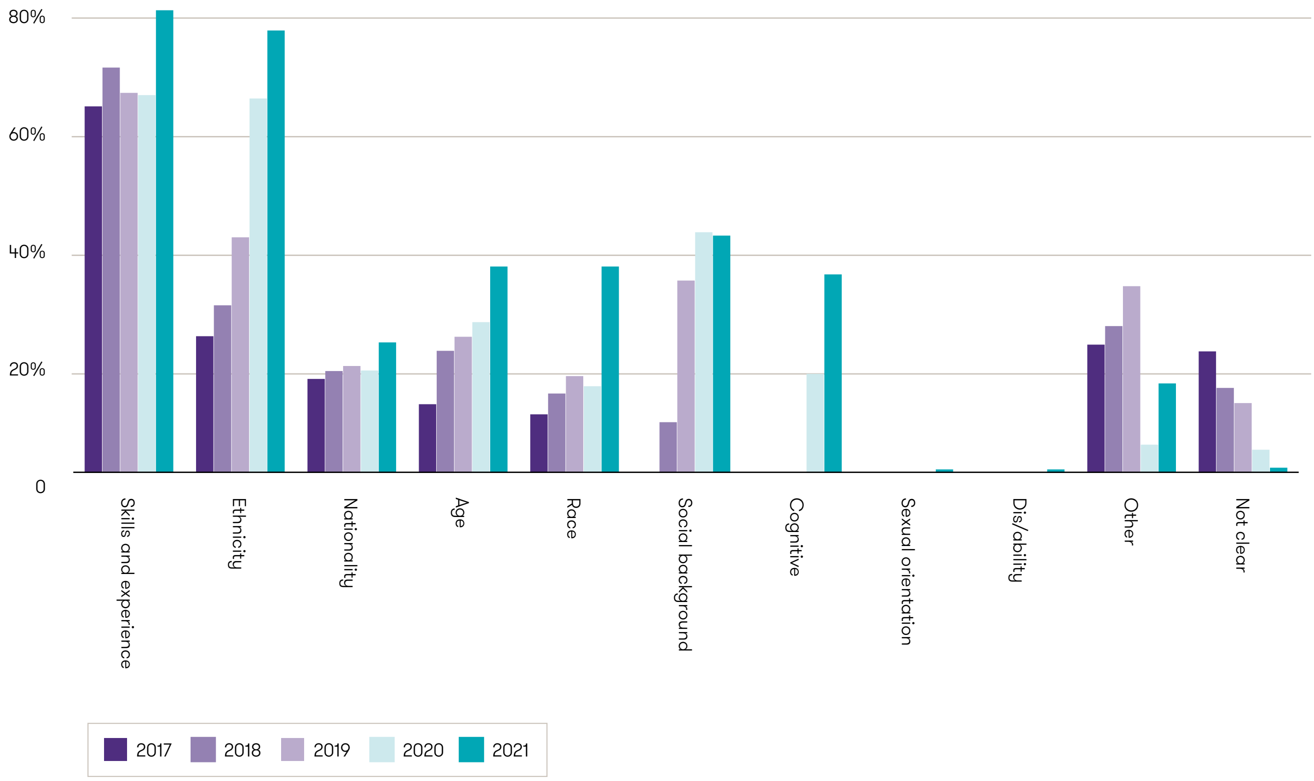
How much explanation is there of the company's policy on gender diversity in the boardroom? (%)

FTSE 350	None	Some	More
2019	4.5	66.3	29.3
2020	3.2	57.6	39.1
2021	1.1	48.0	50.9

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

FTSE 350	None	Basic	General	Good	Detailed
2019	6.3	35.1	44.8	12.2	1.7
2020	6.0	35.0	45.1	12.2	1.8
2021	1.1	24.5	44.0	27.4	2.9

What other kinds of diversity are mentioned? (%)



Audit committee

80%
provide good or detailed reporting around risk management

20
companies identified material uncertainties on their viability as a going concern, up from 4 in the previous year

56%
provide only basic or general explanation of the effectiveness of their internal controls

30%
haven’t changed their auditor in more than a decade; including 15 companies which have retained the same auditor for more than 20 years

12
companies have the chair of the board as a member of their audit committee

The average number of audit committee meetings has risen further to 5.2, reflecting the increasing pressure and challenges these committees have faced through the pandemic, on top of general scrutiny of internal control environments and audit. We're also seeing longer reports, reaching an average of six pages for the first time.

Evidence of uncertainty and volatility in the markets is also building: this year 20 companies identified material uncertainties as to their ability to continue as a going concern, an increase from four last year. This includes seven companies in consumer services (of which three are airlines) and six companies in industrials and manufacturing.

Although we see volatility, the quality of reporting around risk management is higher this year, particularly in the FTSE 250, where over three quarters now have good or detailed reporting, up from 64% last year. Viability statements, an area of reporting that's received mixed reviews from the FRC, no doubt driven by the uncertainties presented by the pandemic, have started to provide improved transparency; 75% companies now give good and detailed statements.

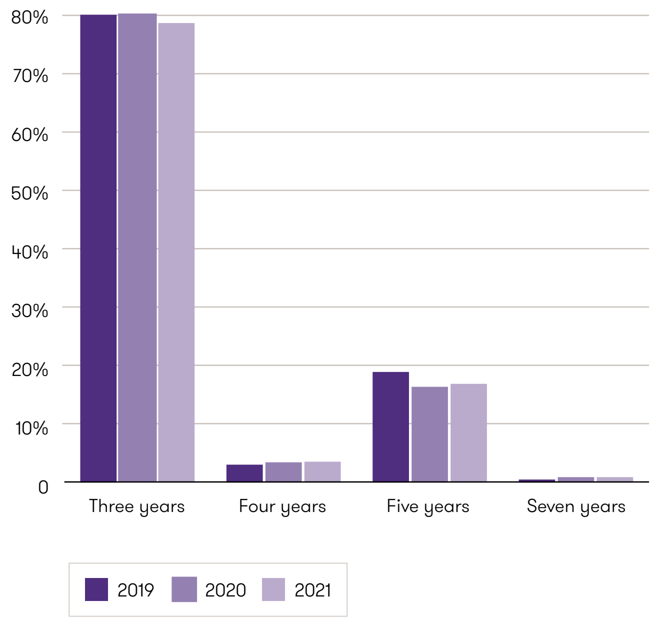
Audit committee reporting on assessing these issues, and key judgments on the financial statements, remains consistent, with; 76% providing good or detailed descriptions.

Internal controls overall are showing some signs of renewed focus, but the quality remains generally poor. Nearly half of the FTSE250 and 40% of the FTSE 100 still provide little detail on their internal control environment. Reporting on board reviews of internal controls effectiveness has also shown limited signs of improvement. With more than half still providing little to no detail on their processes, it may be down to the BEIS white paper to bring about any significant change. Only 5% disclose problematic issues identified in their internal controls and 8% mention insignificant weaknesses. The vast majority (66%) claim no weaknesses, while an additional 21% do not provide any specific disclosure.

Do companies provide a satisfactory viability statement? (%)

FTSE 350	None	Basic	General	Good	Detailed
2019	0.7	2.8	40.6	43	12.8
2020	0.7	0.4	30.6	50.2	18.1
2021	0.7	1.8	22.7	55.2	19.5

How many years are assessed in the company viability statement? (%)



With limited transparency of reporting continuing as the norm, it asks questions of boards' activities in respect of the controls and processes they're relying on to support their decision making and reporting of non- financial data. As ESG reporting starts to attract greater funding (and scrutiny), the need to be sure about the quality, reliability, accuracy, and comparability of that data will accelerate. Whether BEIS introduce a UK SOX type requirement for financial reporting is rapidly becoming yesterday's debate. The more informed boards are now discussing how they can take a "no regrets approach" and apply SOX requirements. It may not be long before we see the first legal claims against company directors for misleading investors who backed their ESG credentials and/or raise concerns regarding remuneration pay-outs linked to unreliable data sets.[6]

Seven companies tendered their audit this year and only one changed their auditor as a result. Eighty-four companies (30%) haven't changed their auditor in more than ten years, up from 26% last year. Fifteen companies have had the same auditor for more than 20 years. As in previous years, the audit market remains constant, with 93% of the FTSE 350 being audited by one of four firms.

Again, the BEIS recommendations, which are expected to promote shared audits as one tool for improving competition, have yet to be made public.

Selection of auditor is an area where recent scrutiny from both the public and regulators has likely compelled improved quality in reporting, with 64% providing good or detailed findings in this area, up from 54% last year. Similarly, 69% now provide enhanced detail around how they safeguard the auditor's objectivity if the auditor also provides non-audit services.

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

	None	Some	More
FTSE 100			
2019	1	17	83
2020	0	13.1	86.9
2021	0	13.0	87.0

	None	Some	More
FTSE 250			
2019	0	44.7	55.3
2020	0	36.3	63.8
2021	0	23.2	76.8

Find out more

Our hub explains all you need to know about UK SOX compliance to help you prepare:
grantthornton.co.uk/insights/uk-sox-a-hub-for-preparing-compliance-requirements/

6 The Independent Review of the Financial Reporting Council, John Kingman, December 2018 www.gov.uk/government/publications/financial-reporting-council-review-2018

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

FTSE 100	None	Some	More
2019	0.0	30.3	69.7
2020	0.0	39.4	60.6
2021	1.0	39.0	60.0

FTSE 250	None	Some	More
2019	0.0	49.7	50.3
2020	0.0	49.7	50.3
2021	0.6	46.3	53.1

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

FTSE 350	None	Some	More
2019	0.7	72.6	26.8
2020	0.0	65.5	34.5
2021	0.7	55.6	43.7

Reporting checklist on reviewing the effectiveness of the internal controls

- Areas of the control environment that have been reviewed and rationale for selection
- Indicate that operational, financial and compliance controls have been reviewed, if material
- Give specific examples of what it involved
- Method used for analysis (eg reports from management and/or internal audit)
- Mention who was involved in the process
- Outline details of the review of internal control internal guidance documents
- Explain why specific areas were given more detailed review, eg due to the nature of the company or strategic priorities and risks
- Discuss findings and areas for improvement

Find out more

We can help you develop a dynamic and robust internal controls framework to ensure your business and people are able to identify future opportunities and manage challenges.

grantthornton.co.uk/services/risk/internal-audit-services/

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? (%)

FTSE 350	None	Some	More
2019	1.4	51.4	47.2
2020	1.4	40.2	58.4
2021	1.1	34.3	64.6

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

FTSE 350	None	Some	More
2019	1.0	43.8	55.2
2020	1.1	34.9	64
2021	1.1	30	69

Remuneration committee

61%
outline how shareholder engagement has impacted remuneration policy and outputs

61%
describe how workforce engagement impacts executive remuneration alignment with wider company pay policy, up from less than 7% in 2019

36
companies have no plan in place to align executive pensions with workforce policies by 2025

35%
link their annual bonuses to one or more non-financial metrics

48%
link their long-term performance plans to one or more non-financial metrics

14%
don't include their CEO pay ratio in the annual report

74%
have introduced post-employment shareholding requirements

The quality of remuneration reporting continues to improve, with remuneration policies accounting for wider stakeholder impact: in terms of board level engagement, measurement of bonuses, and long term incentives

The requirement for remuneration policies to be approved by shareholders every three years seems to have increased board engagement with shareholders. Sixty one percent 61% (up from 38% in 2019 and 52% last year) clearly explain their engagement with shareholders and its impact on remuneration policies.

Transparency on remuneration consultants is improving, with only four companies not disclosing in this area. This practice does raise questions on independence: 57% of companies get remuneration consulting services from one of the four largest audit firms, with two firms advising 54% of the FTSE 350. If nothing else, this similarity is surely a constraining factor on audit rotation.

Ninety three percent (93%) of companies comply with provision 41, mandating that remuneration committee reports state the extent and rationales for discretion on remuneration outcomes. All but 10% of companies also clearly set out the conditions for discretion in their policies. Given in our 2020 review, this was nearly a quarter that did not disclose, companies are clearly getting to grips with new parts of the 2018 Code. See the best practice guidance in this section.

Alignment and involvement of workforce

The biggest changes on remuneration in the 2018 Code is the extension of concern to the workforce. This includes consultation on executive pay, and consideration of pay fairness and appropriateness. Previous committees tended to prioritise external competition pressures, such as comparison to the wider market, and shareholder reactions, but internal engagement is also now a priority. We can see this in FTSE 350 reporting. While in 2019 only 7% companies described workforce engagement on executive remuneration, that percentage has risen dramatically to 61%. Even with obvious scope to improve, this is an impressive jump. And 83% are also reporting how the remuneration committee sets remuneration and pay for senior management, up from just 42% in 2019.

Another consideration lies in pension alignment. Provision 38 of the 2018 Code requires that executives' pensions align with workforce schemes. Nearly half (48%) comply with this provision, and all but 36 companies report timelines for aligning pensions by 2025. Of the 46% who have failed to achieve the compliance requirements on alignment between executive pensions and their workforce, 53% (69 companies) don't declare this as non-compliance. This may be because many of them have a timeline in place to align pensions. Only 13% of companies don't align pensions with the workforce, don't have a plan to do so, and still don't declare non-compliance.

Fourteen percent (39 companies) don't use the annual report to disclose CEO pay ratio. The median pay ratio in our sample was 38:1. This is lower than it was in 2020. Analysis by the High Pay Centre in 2020 found it to be 53:1[7]. The lowest ratio was 5:1 (from an energy company) and four companies have a pay ratio higher than 250:1.

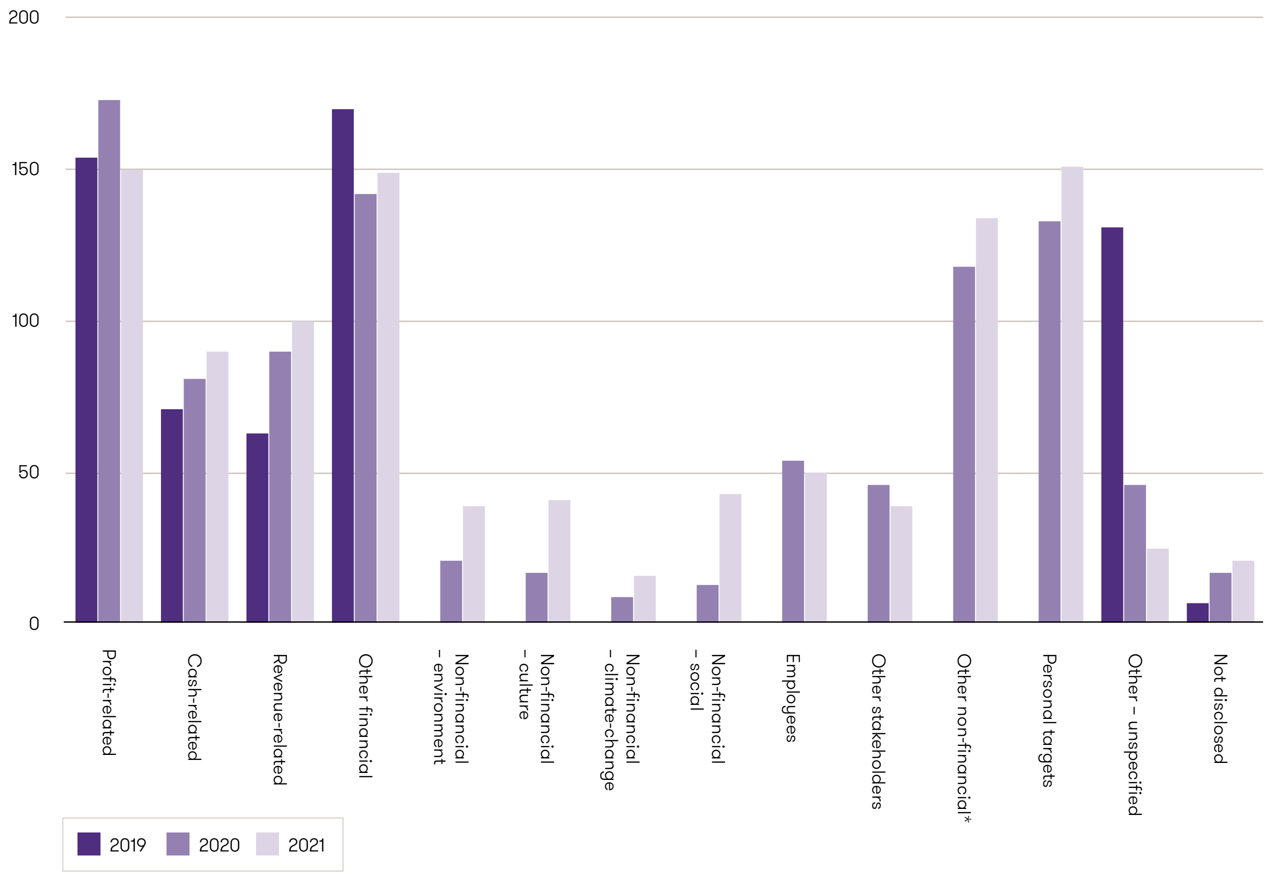
We also see gradual shifts in companies' metrics for performance related bonuses and long-term rewards. 15% of the FTSE 350 connect either or both of these remuneration types directly to a culture metric, while 49 companies connect their executive bonus to an employee metric (typically diversity and inclusion, or health and safety). Climate targets are only linked to executive remuneration in 19% of companies, which does raise questions as to how serious the 81% of companies really are in achieving real change. This limited ambition seems especially stark when 27% of companies identify climate change as a key risk. These numbers are still relatively small, but overall, we're seeing a shift, albeit slow, in the use of non-financial metrics in setting executive pay.

Questions to ask

- How do you ensure executive remuneration is aligned to your purpose, culture and values?
- How do you engage with the workforce on executive remuneration and ensure they feel connected to the company's success?
- What is the board doing to ensure greater alignment between the executive and wider workforce remuneration, including pensions?
- Beyond the workforce, how are other stakeholders reflected in executive remuneration?
- How is the committee ensuring a long-term focus, via executive remuneration, on shareholders and other stakeholders?
- Do the six factors provide an anchor for decisions on executive pay in remuneration committee meetings?
- Do you disclose whether the remuneration committee chair has 12 months' experience before chairing the committee? Only 19% of companies state this at the moment.

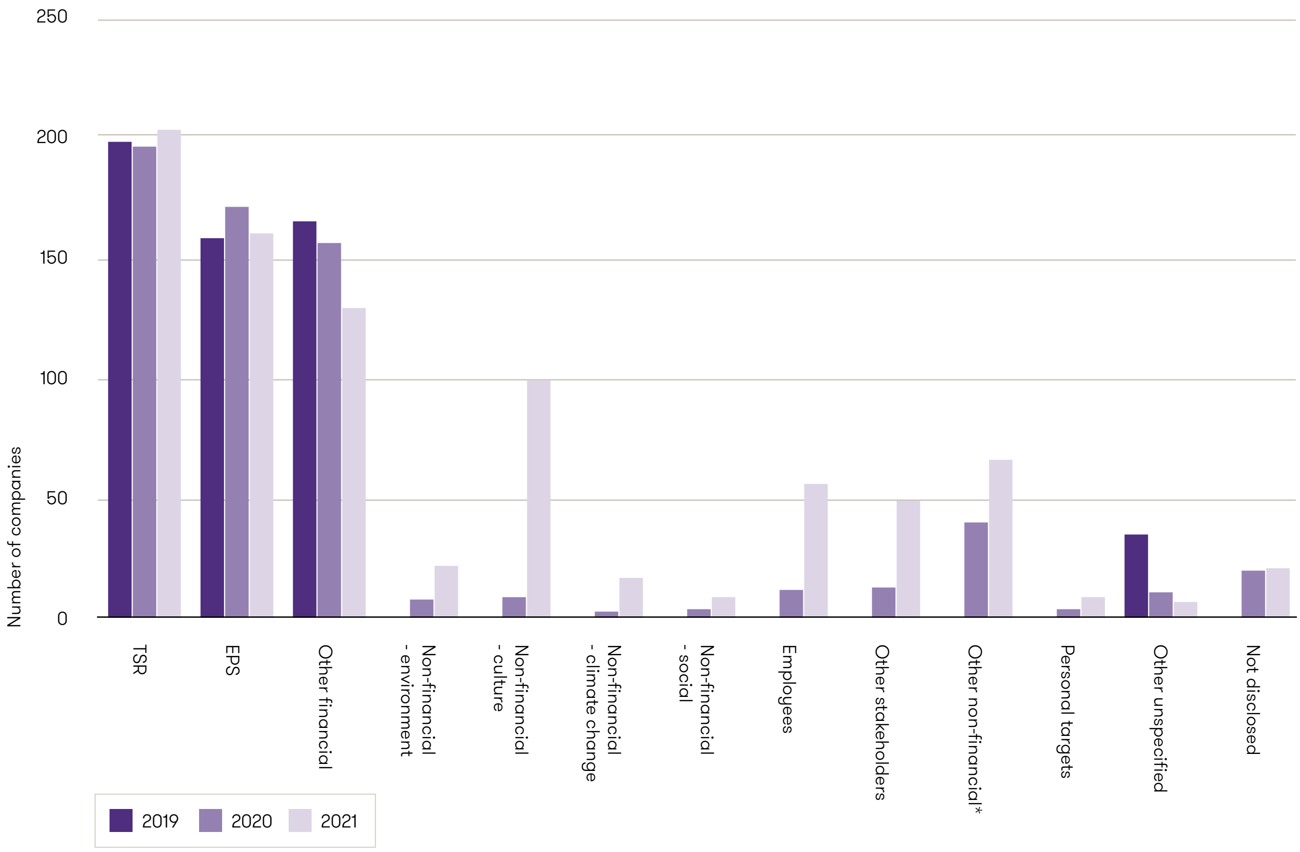
7 https://highpaycentre.org/pay-ratios-and-the-ftse-350-an-analysis-of-the-first-disclosures/

What metrics are used in executive annual bonuses? (Number of companies)



* **2019:** Includes all non-financial categories

What metrics are used in executive long-term performance-based remuneration? (Number of companies)



* **2019:** Includes all non-financial categories

Alignment with long-term shareholder interests
The 2018 Code includes in its provisions a combined vesting and holding period of five years or more, and the use of post-employment shareholding requirements. Seventy-four percent (74%) of companies have a formal policy for post-employment shareholdings. Current practice has mostly settled on a three-year performance period, followed by a two-year holding period.

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

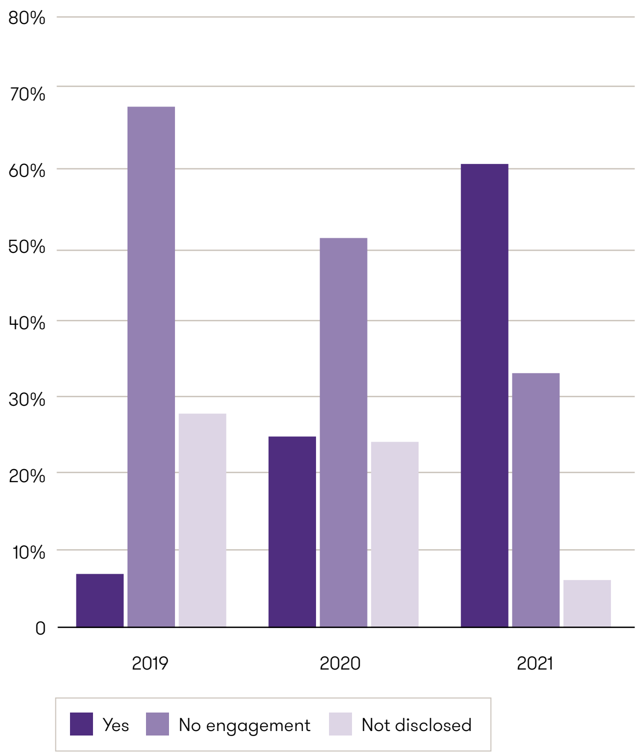
FTSE 350	None	Some	More
2019	0.3	8.7	91.0
2020	0.4	7.4	92.3
2021	0.4	11.5	88.1

Is there a clawback provision? (%)

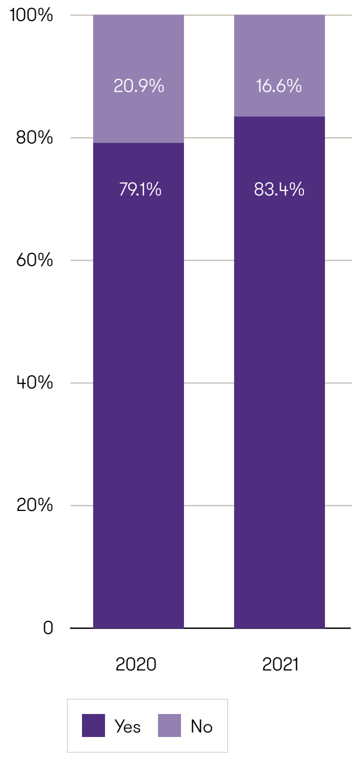
FTSE 350	2019	2020	2021
Yes – bonus and LTIP	83.0	87.9	89.5
Yes – bonus	5.2	4.3	2.9
Yes – PSP	3.8	2.1	3.6
No	8.0	5.7	4.0

The provision on clawback is nearly universal, with 96% of companies having it in place, but historically, we've seen very little evidence of it in practice. It's therefore notable that in 2020 one FTSE 350 company did use their clawback provision.

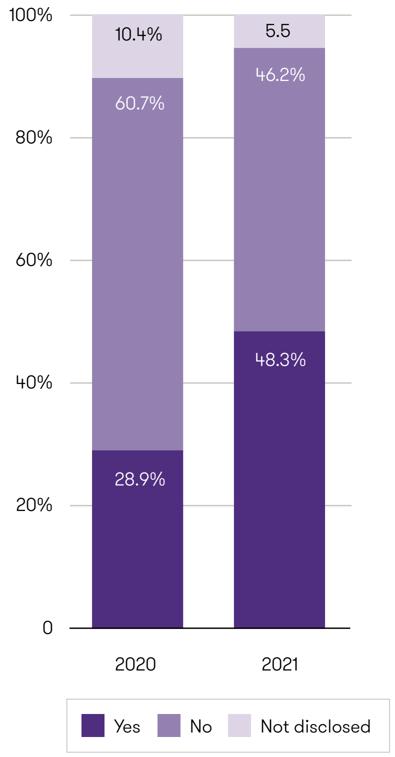
Does the description of the work of the remuneration committee include the details of what engagement has taken place to explain how executive remuneration aligns with the wider workforce (%)?



Does the description of the work of the remuneration committee include the details of how the remuneration committee is involved in senior management pay and reward? (%)



Are executive pensions aligned to workforce pensions? (%)



Does the description of the work of the remuneration committee include the details on what engagement has taken place with shareholders and the impact this has had on remuneration policy and outcomes? (%)

FTSE 350	2020	2021
Yes	52.7	60.6
Yes – engagement only	32.7	32.5
No	14.6	6.9

Best practice toolkit – remuneration

Elements/ content	Things to consider	Reporting tips
Link to strategy	Consider how executives are driven to deliver on strategy.	Align each strategic pillar to an element of remuneration. Explain choice of metrics linking these to strategy per the above.
Link to culture	Think how reward can help to promote right behaviours.	Report on how the board engages with the workforce over the link between executive remuneration and company culture, engages and consults with the workforce. Include culture-related metrics to incentives for directors for example if it is a customer-centric culture, then include customer-related metrics. Signpost linkage to values.
Use of discretion	Consider impact of COVID-19.	Dedicate a subsection of the Committee report to the use of discretion. Provide sufficient detail on the use of discretion due to pandemic to better link it with the workforce remuneration. Describe details of engagement with shareholders over levels of discretion if any. Report meaningfully on any changes to remuneration in the year such as pay cuts. Shareholders can see through any obfuscations! Report on scenarios under which discretion can be used, providing examples if appropriate.
Workforce engagement	Workforce considerations in executive pay determination.	Report on the means of engaging with the workforce over executive remuneration. Demonstrate how the company explains alignment of executive pay with the workforce, providing feedback if any. Report on how you factor in relevant data such as gender pay gaps, pay ratios within the context of executive remuneration outcomes.
Shareholder engagement	Shareholder input in remuneration policies and outcomes.	Report on: • meetings held with shareholders stating who the committee met with and content of meetings. • feedback received and the company's response. • changes made as a result of engagement also providing a strategic context.

Annual report and quality of reporting

The average length of an annual report is now over 200 pages

The average number of strategic report pages has again increased 10%

51%
provide good or detailed explanations on why their annual report is fair, balanced and understandable

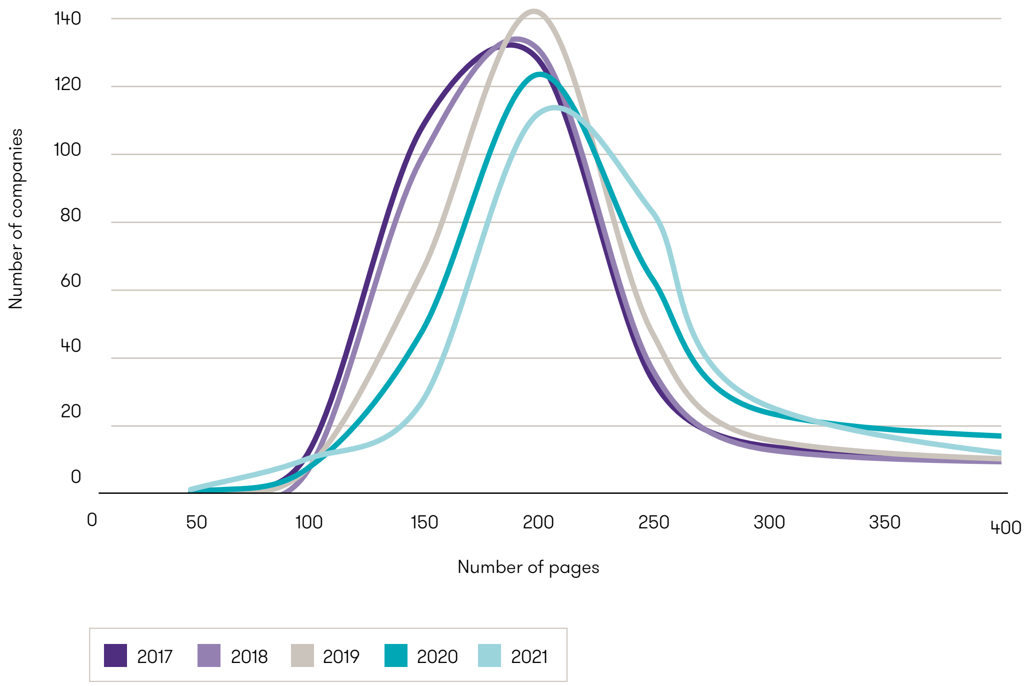
88%
of nomination committee chairs provide personal commentary, up from 17% in 2012

The average number of pages in an annual report continues to rise, reaching over 200 for the first time. This is despite a decrease in the financial statements from last year. This rise is largely found in the strategic report, which reaches an all-time high of nearly 65 pages, up from 59 in 2020, and 40 in 2014.

The governance report has also increased by an average of three pages, likely representing the increased description of stakeholder engagement and remuneration reporting. Nine companies have annual reports over 350 pages, six of which are the largest banks.

Average length of front end

Length of annual reports for the FTSE 350



‘Fair, balanced and understandable’

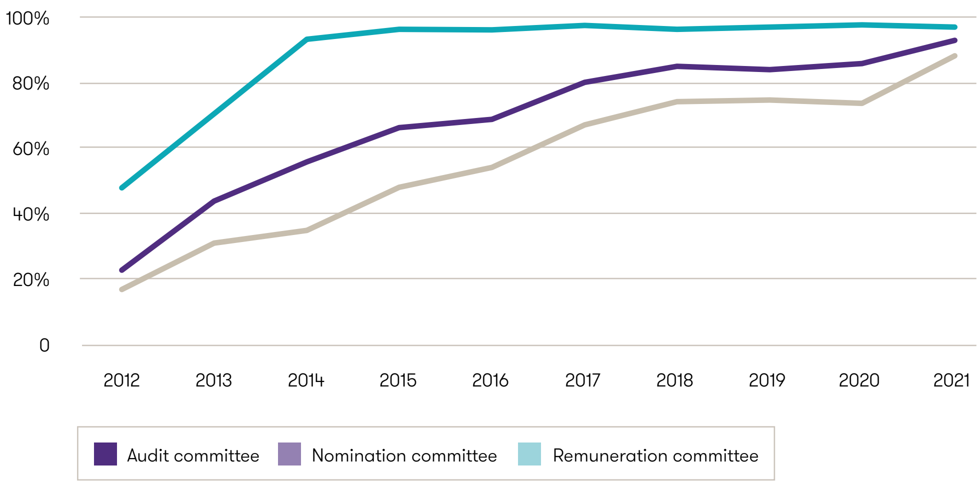
In Principle N, the 2018 Code states that the board should present a fair, balanced, and understandable assessment of the company’s position and prospects in its annual report. Key to this is balance between optimisms and current reality. All except three companies say they consider their report fair, balanced and understandable.

2021 sees improved reporting quality around the board’s conclusion, with half (2020: 35%) now providing detail on the process by which they came to this conclusion, such as explaining what work was done, the sources of assurance and processes that were followed.

How much information does the board provide as to why it considers the annual report fair and balanced? (%)

FTSE 350	None	Basic	General	Good	Detailed
2020	0.7	14.9	49.5	29.5	5.3
2021	1.1	6.1	42.2	44.8	5.8

Personal commentary from the chair (% Yes)



Personal commentaries from committee chairs provide an overview of leadership priorities and workings of the committee. As the 2018 Code requires committee chairs to engage directly with shareholders and wider stakeholders, personal statements offer useful insight on some of these themes.

This year we see more nomination committee chairs meeting with shareholders (20%), and the number of chairs providing personal commentary increasing to be almost aligned with audit and remuneration. After years of being the poor relation, perhaps the nomination committee chair role and remit is finally coming into the same spotlight as the other chairs.

How we can help

Our governance and board advisory team brings its board governance and shareholder relations team together with business psychologists, executive coaches and leadership development specialists.
We support organisations in shaping fit-for-purpose governance structures that build trust and integrity with stakeholders; ensure dynamic performance through leadership for the future; and create environments in which their people and operations can thrive.

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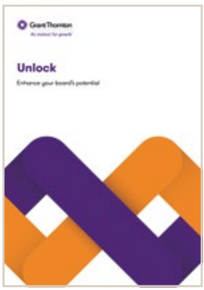
Corporate governance review 2020

Getting smart about governance

Corporate governance and company performance



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