



Mark Jackson  
Business Environment  
Department for Business Innovation and Skills  
1 Victoria Street  
London  
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25 November 2011

Dear Mr Jackson

### **The future of narrative reporting: Consulting on a new reporting framework**

PwC welcomes the opportunity to respond to this consultation. As auditors and business advisers to many of the UK's leading companies we support initiatives to drive improved corporate reporting. Indeed, we have invested in over a decade of research into the information needs of preparers and investors. In conjunction with our annual review of the narrative reporting practice of the FTSE350, as part of our Building Public Trust Awards, most recently for the 2010 reporting cycle, we believe we are equipped with sufficient insights to provide a meaningful response.

The Building Public Trust Awards shine a light on narrative reporting by recognising excellence. In addition, we use the output of our surveys to provide FTSE 350 companies with a measure of the effectiveness of their current reporting benchmarked against their peers and to provide insight that allows them to improve their reporting in all areas, from strategy to sustainability to remuneration. We believe that by highlighting 'best in class' reporting and by sharing our detailed findings, we have contributed to significant improvements in narrative reporting.

### **Innovation is building momentum for change**

We believe that we are currently in a period of significant innovation in reporting. Where once we had to work hard to engage others on this agenda, we have in recent times seen an increased focus on governance and stewardship and the importance of understanding a company's business model, strategy and results. This movement towards improved reporting is now being advanced on several fronts, building a momentum that we believe may herald a tipping point in corporate reporting. The best reporters in the FTSE 350 are already driving real improvements in the effectiveness of their reporting on the quality and sustainability of their performance and future prospects. Alongside companies' own innovation, we believe that recent initiatives from government, regulators and other stakeholders, such as the FRC Reporting Lab and the International Integrated Reporting Committee's pilot programme have the potential to transform corporate reporting in the next decade and that the changes suggested in this consultation represent an important step towards driving high quality and credible reporting.

A clear message from our research is that regulation can provide the foundation for developments in reporting. Though it may not immediately deliver better quality reporting or transparency, regulation does appear to have an indirect positive impact by increasing everyone's attention on those areas, which ultimately improves quality. When KPI disclosures were first required, for example, they very

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often appeared in isolation from strategic priorities. Yet, over time, stakeholder focus has challenged this gap and we've seen it gradually close.

Whilst regulation alone is unlikely to precipitate fundamental improvements in reporting - commitment and challenge by stakeholders will be needed to bring about real improvement - we believe nevertheless that regulation has a key role to play in establishing the key principles for good quality reporting. However, we would caution that overly prescriptive requirements can lead to a checklist mentality and 'boiler plate' disclosure.

We also believe that creating the right environment for experimentation and innovation to occur is very important. We are encouraged by developments in this area, such as the recently launched FRC Reporting Lab. This initiative might provide a suitable environment where new corporate reporting solutions can be developed, piloted and evaluated. The Lab would provide a 'safe environment' for experimentation, providing guidance and promoting best practice.

We believe that the incremental changes suggested in this consultation can be an important staging point in a more radical move to an integrated reporting model. We would encourage BIS's involvement in the global debate around integrated reporting. We also support alongside this an examination of the role of assurance to ensure that as corporate reporting evolves, the assurance model remains of relevance and value to market needs.

### **A new reporting framework**

As discussed in our response to BIS's previous consultation on narrative reporting, we support the development of a concise narrative section, which provides the board's high level overview of the business and its performance and a route map to all other elements of information reported. Our extensive research with investors and companies, to determine the information they need to understand the quality and sustainability of corporate performance, is codified in our integrated reporting model. The content of this model is broadly consistent with the information requirements of the Strategic Report.

In effective integrated reporting, narrative reporting connects to the financial statements such that together they illustrate various aspects of the company, including the business model, objectives, strategy and quality and sustainability of earnings. Whilst this consultation focuses on narrative reporting only, and we do not believe it was BIS's intention to seek to diminish the importance of the financial statements, we strongly believe that the position of the audited financial statements at the heart of reporting should be emphasised.

We agree with the view in the consultation that the Strategic Report should be produced primarily for the use of investors and other providers of capital, to assist in their investment decisions as well as providing valuable information about management's stewardship of assets. Whilst a company's annual report may be used by various stakeholders, each will have different information needs and an attempt to meet all of these can lead to clutter and confusion. Therefore, we believe it is important that information is only included in the Strategic Report to the extent necessary for the understanding of the overall strategy and long-term sustainable performance of the company. Other information can, as suggested in this consultation, be segregated to the Annual Directors' Statement or to the company's website (subject to the latter being permissible in law). However, in order to reduce the overall



reporting burden on companies, we would encourage BIS to continue to challenge what information is required to be reported and to remove all immaterial disclosure requirements.

As companies move further towards online reporting, where users can 'click' from one web page to another, this has the potential to greatly improve users ability to access the information that they need and bypass information that is not of interest to them. With this type of reporting, key items can be highlighted, whilst allowing users to drill down to more detailed information as required.

### **Reporting of remuneration**

The consultation explores a number of potential new disclosures about remuneration for inclusion in the Strategic Report. We note that through its recently issued discussion paper, to which we will respond separately, BIS is also seeking views on how a stronger link between executive remuneration and company performance could be achieved and whether shareholders should be empowered to hold companies to account in this respect. In balancing the objectives of enhancing governance and improving reporting in this area, we recommend that from a reporting perspective BIS concentrates on ensuring that the Strategic Report remains true to its intended objective; that is, to provide a concise summary of key strategic data about a company. In this context, we would support inclusion of information about a company's remuneration strategy and illustration of the linkages between strategy and remuneration. Other information should be provided in the Annual Directors' Statement. We would caution that additional reporting in the Strategic Report may simply increase the volume of disclosure without necessarily providing valuable information for the intended users of the Strategic Report.

### **Effective date**

We believe that one of the most important challenges BIS will face as it finalises the revised reporting model will be in determining what information belongs in the Strategic Report and what in the Annual Directors' Statement. In practice, a period of field testing is likely to be required to help to ensure that information is reported in the most appropriate location and format. With this in mind, we would encourage BIS to reconsider the suggested effective date for new regulation, of periods beginning on or after 1 October 2012.

### **Insight from the audit**

With the proposal that reporting is split between the Strategic Report, Annual Directors' Statement, financial statements and the company website, BIS will need to consider which information should be subject to audit or consistency review and the most appropriate way to ensure that this is transparent to investors. We would encourage BIS to seek the views of investors to make sure that these decisions informed by their views. As noted above, this may require a period of time to work through and resolve appropriately.

In the longer term, we believe that as the corporate reporting model is re-examined it is important that auditor reporting is not just tweaked to overcome short-term practical issues but that the audit model too is re-calibrated to respond to new demands and to recognise the importance of narrative reporting. We have described how the audited financial statements currently form the bedrock of investor information. As the corporate reporting model evolves in response to market demands, there should also be a market-led debate over the role of auditor reporting to determine how the audit, or broader



assurance, could provide enhanced value to users of accounts and increase the reliability of the information an entity provides in its public reporting.

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Our detailed responses to the questions raised in the consultation are set out in Appendix I.

We would be delighted to help with the furtherance of the objectives set out in this consultation. If you have any questions or would like to discuss any of the points raised in this letter in more detail, please contact Peter Hogarth (020 7213 1654) or Mark O'Sullivan (020 7804 3459).

Yours sincerely

PricewaterhouseCoopers LLP



## ***Appendix I – Responses to consultation questions***

### **Question 1**

#### **Do you agree in principle with restructuring the current reporting framework into a Strategic Report and an Annual Directors' Statement?**

Yes, we agree in principle with the restructuring of the reporting framework proposed in this consultation.

As stated in our response to the previous BIS consultation on the *Future of Narrative Reporting* and also in our responses to the FRC to their consultations on *Cutting Clutter* and *Effective Stewardship*, we fully support the proposal to require a Strategic Report, an executive summary to provide a snapshot of the performance and strategic issues facing the company. We also support the segregation of standing data, either to a separate section of the report or to the company's website. Neither of these proposals necessarily reduces the importance of the audited financial statements and we strongly believe that their position at the heart of reporting should be emphasised.

We believe that the incremental change proposed by BIS will facilitate real improvements in narrative reporting. However, in the longer term we believe that there should be a broader public debate about both the corporate reporting model and the assurance model and that BIS should be at the forefront of that debate.

### **Question 2**

#### **Do you agree that the Strategic Report should include information on:**

- **company performance**
- **principal risks and uncertainties**
- **key performance indicators**
- **key financial information (similar to that currently required for the Summary Financial Statements)**

#### **and for quoted companies should include:**

- **strategy,**
- **business model,**
- **environmental and social information,**
- **key information on executive remuneration and its link to performance?**

Yes, we agree that the Strategic Report should include information under the broad headings set out above. We have invested in over a decade of research with investors and companies to determine the information they need to understand the quality and sustainability of corporate performance. This research is codified in our integrated reporting model the content of which is broadly consistent with the proposed information requirements of the Strategic Report.



We believe it is important that information should only be included in the Strategic Report to the extent necessary for an understanding of the overall strategy and long-term sustainable performance of the company. Whilst a company's annual report may be used by various stakeholders, each will have different information needs. We do not believe that the Strategic Report should be used as a vehicle to satisfy all of these various needs but should remain true to its intended purpose, that is, to provide a 'concise description of the company's strategy, risks and business model'. Other information should be provided in the Annual Directors' Statement or even independently of the annual financial reporting cycle. We return to this subject in our specific responses to questions 11 and 12 below.

We also believe that just as important as the individual disclosures is the linkage between the various strands of information so that the Strategic Report provides an integrated, cohesive description of the company's strategy and performance, providing a forward looking insight into the sustainability of that performance. This will improve the understanding of a company's business and financial performance and facilitates more efficient and effective analysis of the business as an investment proposition.

The findings from our latest Building Public Trust Awards survey of the narrative reporting practices of the FTSE 350 show ongoing improvements in content, with the vast majority of companies continuing to cover the core foundations. Encouragingly, our review shows some progress, albeit from a low base, towards companies providing a more integrated picture. For example, 35% of companies (compared to 25% in 2010) now clearly align KPIs with strategic priorities. But challenges remain: only 16% clearly integrate strategic themes and intent throughout their reports; and one in five (19%) demonstrate a link from external drivers and opportunities to the company's strategic choices. Two-thirds of companies fail to outline any links between risk reporting and other aspects, such as strategic priorities, external trends and performance.

#### *Corporate governance*

We note that corporate governance does not appear to be addressed within the Strategic Report despite the fact that demanding market conditions have focused attention on this area. Too often, the governance content of an annual report can become a compliance exercise, merely describing process and procedure. Although it should touch on many areas, governance can often seem disconnected from the rest of the narrative. Major developments impacting the business during the year and major challenges for the future often fail to rate even a mention in governance reporting. The result is that investors often say the last place they would look to determine how well governed a company is, is the governance statement.

The UK Corporate Governance Code encourages personal reporting by the chairman on how the principles of the Code dealing with leadership and effectiveness have been addressed. As set out in the Report Leadership publication, *Corporate Governance – simple, practical proposals for better reporting of corporate governance*, and consistent with the FRC's *Cutting Clutter*, we believe an opportunity exists for the Strategic Report to be used as a vehicle for the Chairman to set out a short summary that provides the 'tone from the top', his perspective on the board, its culture and overall effectiveness – highlighting particular actions during the year to support this picture.

#### *Key financial information*

The consultation proposes that information equivalent to summary financial statements should be included in the Strategic Report. It is unclear whether the intention is to make publication of a document equivalent to summary financial statements mandatory for all companies, whereas there is currently a choice as to whether to produce such a report. We do not believe that this would be appropriate as discussed below.



Of course, for a company to explain its performance and financial position, it will need to give key financial information in the Strategic Report. The required content of summary financial statements, being essentially a summary profit and loss account and balance sheet, will not add greatly to the disclosure burden on companies. However, this information is unlikely to provide a great insight into performance or position; for example, summary financial statements do not require disclosure of a cash flow, segmental information or other notes. Companies will therefore need to provide further key financial information; what is 'key' will vary according to each company's specific circumstances and should not be prescribed. However, we would encourage BIS to consider whether the current disclosure requirements for summary financial statements are sufficient.

In a more integrated reporting model, we would envisage greater inclusion of the financial statements into narrative reporting, reformatted if necessary, illustrating the strategy and adding to the credibility of the narrative by providing the comparison of actual results to management's strategic objectives.

In the shorter term, within the structure of reporting proposed, we would also note that most quoted companies do not currently prepare summary financial statements, preferring to notify members of the availability of the full annual report on their websites. The preparation of full financial statements is mandatory and summary financial statements are therefore seen as an unnecessary additional document. Where a company does not seek to hold out the Strategic Report as equivalent to summary financial statements, the inclusion of prescribed financial information may result in duplication of disclosure of this information in the annual report, with it appearing first in the Strategic Report and then again in the financial statements. Therefore, where the Strategic Report is not held out as equivalent to summary financial statements we would suggest that inclusion of a summary profit and loss account and balance sheet is not mandated.

Where key financial information comprises information from the financial statements that has been adjusted, for example revenue or profit measures, current guidance in the ASB's Reporting Statement, *Operating and Financial Review*, requires that a reconciliation to the financial statements is provided. In our 2007 survey, *Performance statement: Coming together to shape the future*, support was expressed by both investment professionals and corporate respondents for ground rules to be established around non-GAAP financial information. For example, over 80% of participating investors and analysts thought that non-GAAP information should be reconciled to the equivalent GAAP measures. Notwithstanding our view, expressed in response to question 33, that non-mandatory guidance would be preferable, we believe that in the case of non-GAAP information BIS should consider introducing a reconciliation requirement similar to that in the ASB's Reporting Statement in order to ensure that, where non-GAAP measures are used, their relationship to audited financial data is transparent. However, we would not support any restriction on the use of non-GAAP measures, nor would we support development of a list of standard measures that all companies should report.

#### *Environmental and social reporting*

We believe that companies should only report environmental and social information in the Strategic Report when it is considered important to an overall understanding of a company's strategy and long-term sustainable performance. However, what is evident from our review of the FTSE 350 is that many companies see the provision of such information as an exercise in good corporate citizenship or a response to specific information requests from stakeholders and lobbyists. This is evidenced by the fact that, whilst there are a growing number of companies presenting such information in their annual reports, only 15% provide a clear link between the impact of sustainability issues and the delivery of core business strategy. We believe that the Strategic Report should focus on the strategically important and material information, whether environmental, social or any other category, and place other information in the Annual Directors' Statement or online.

We note that the consultation highlights the Coalition Agreement commitment to ensure that "*directors' environmental and social duties have to be covered in company reporting*" and would welcome



clarification of the proposed requirements and how they would interact with s417 and s172 of the Companies Act 2006.

S417 of the Act states that the purpose of the Business Review (or Strategic Report) is to inform members and help them assess how the directors have performed their s172 duty. Directors have a duty under s172 of the Act to promote the success of the company for the benefit of the members as a whole and, in doing so, to have regard for the impact of the company's operations on the community and the environment.

This duty applies to directors of all classes of company but the requirement to disclose information about environmental and social matters (where necessary for an understanding of the development, performance or position of the company) applies only to quoted companies.

In drafting the Companies Act 2006, it was evident that care was taken to ensure that the duty to promote the success of the company was expressed as a single duty, albeit with the directors having to consider various specific matters. We believe it would be useful to clarify that no duty additional to that contained in s172 is envisaged and that the requirement to report on environmental and social matters (where relevant) is not extended beyond quoted companies.

### **Question 3**

**Do you agree that the proposed Strategic Report should replace the Summary Financial Statements?**

Yes. In practice, as discussed above, summary financial statements are seldom prepared. We also note in our response to question 2 above that BIS should consider whether the financial information currently required to be included in summary financial statements is sufficient. However, in principle we believe that the Strategic Report should be capable of satisfying the information needs of many of the stakeholders who currently find summary financial statements helpful.

### **Question 4**

**Do you agree that the Strategic Report should be signed off by each director individually?**

No. Since the Annual Report is already approved by the entire Board, then signed on the Board's behalf, the proposal would add to the administrative burden. We are not aware of any evidence that would suggest that Board members would take their approval of this document more seriously simply because their signature would be public.

### **Question 5**

**Do you agree that the Annual Directors' Statement for quoted companies should include:**

- **disclosures required, regardless of materiality, by the Companies Act, the Listing Rules etc.**
- **the Corporate Governance Statement**
- **the Directors' Remuneration Report**
- **financial information (for example, post-balance sheet events etc)**



- **information provided voluntarily by companies (for example, additional environmental and social disclosures)?**

Yes, we agree that the Annual Directors' Statement should include the information as set out above, although we have observations on certain aspects of this, which we set out below.

#### *Immaterial information*

We agree that where disclosures are required by law or regulation but are not essential to an understanding of the business, they should be presented in the Annual Directors' Statement and not the Strategic Report. However, we would urge BIS to work with legislators and regulators to remove the requirement to disclose immaterial information as far as possible. Without a materiality restriction, there is a danger that the Annual Directors' Statement becomes cluttered with unhelpful information rather than a repository of information that is of genuine use and interest to investors and other stakeholders.

We note that the assessment of what is material can be highly judgemental and can vary from user to user. As set out in our response to the FRC's *Cutting Clutter* consultation, we believe that the FRC can, through its Financial Reporting Review Panel, continue to provide valuable leadership in identifying where it believes that disclosure is excessive.

#### *Corporate governance*

We agreed that detailed corporate governance reporting should be included within the Annual Directors' Statement. However, as discussed in our response to question 2 above, we believe that it would be appropriate to include a short summary describing the board's culture and overall effectiveness within the Strategic Report. In our response to question 32, we also suggest how corporate governance reporting could be improved, specifically through enhanced audit committee reporting, at least some of which might be appropriate for inclusion in the Strategic Report.

#### *Financial information*

Key financial information should be provided in the Strategic Report. More detailed financial information is provided in the financial statements.

The current requirement to disclose post balance sheet events in the directors' report is derived from a disclosure requirement in the EU 4<sup>th</sup> Directive. This requirement is outdated in the UK, since it has been superseded by the disclosure requirements of FRS 21, *Events after the balance sheet date*, and IAS 10, *Events after the reporting period*. Post balance sheet events that are significant should be dealt with in the Strategic Report, otherwise disclosure in the financial statements should suffice. Ideally, the law should be changed to facilitate this approach.

#### *Voluntary disclosures*

We agree that it should be permissible for voluntary disclosures (such as environmental and social disclosures) to be available as part of the Annual Directors' Statement. However, BIS should consider whether this might make it more difficult to achieve the stated aim of facilitating greater comparability between companies' reporting.



### Question 6

**Do you agree that companies should be able to include material in the Annual Directors' Statement (for example information on policies and procedures) by cross reference to information published elsewhere (for example on the company's website)?**

Yes. We agree that this could help to reduce 'clutter' in reporting. We note that this may require changes to UK and in some instances to EU law.

More broadly we believe that online reporting, where users can 'click' from one web page to another, has the potential to greatly improve users ability to access the information that they need and bypass information that is not of interest to them. With this type of reporting, key items can be highlighted, whilst allowing users to drill down to more detailed information as required.

However, we note that fragmenting data in this way may lead to certain practical issues, in particular where audit opinions are required to cover all or part of the information contained in the Strategic Report, Annual Directors' Statement or published elsewhere. We discuss this further in our response to question 29.

### Question 7

**If companies are able to include material in the Annual Directors' Statement by cross reference (question 6), do you agree that they should make an annual statement confirming it has reviewed that information and noting any significant changes?**

Yes, we agree that this would be a sensible requirement. As noted above, our response to question 29 raises certain potential practical issues that will need to be addressed where information is fragmented and/or potentially changes between reporting dates.

### Question 8

**Do you agree that the Annual Directors' Statement should be presented online with a hard copy available to shareholders only on request?**

At present, certain persons (including members) are entitled to receive the annual financial statements and reports. This requirement may be fulfilled, subject to the agreement of the person, by sending an email notifying the member of the website address where the documents can be found. Regardless of whether the members agree to receive the documents this way, quoted companies are required to make them available on their websites.

We believe that the Strategic Report and Annual Directors' Statement should be dealt with in the same way. Since we anticipate that these reports will be published at the same time as the financial statements, it makes sense for all the documents to be subject to the same delivery requirements.

### Question 9

**Do you support removal of the disclosure requirements arising from company law identified in Table 1? If not, please provide evidence of their relevance to users, including why disclosure in the Annual Directors' Statement is necessary for meeting their needs.**

**Are there any other disclosure requirements arising from company law that in your view could be simplified or removed?**



Yes, we support the removal of the disclosure requirements identified in Table 1.

There are a number of disclosure requirements in the directors' report which are derived from the EU 4<sup>th</sup> Directive, and could be removed, (subject to any necessary amendment to EU law):

- Description of the principal activities of the company. [Sec 416 (1)(b)]. This should be included in the Strategic Report and, for quoted companies, will be included in the description of the business model.
- An indication of future developments of the company. [SI 2008/410 7 Sch 7(1)(b)]. This should be included in the Strategic Report.
- An indication of the activities (if any) of the company in the field of research and development. [SI 2008/410 7 Sch 7(1)(c)]. Where research and development is of strategic importance, it should be included in the Strategic Report. Otherwise, we believe such disclosures are clutter and should be removed.
- An indication of the existence of branches of the company outside the UK. [SI 2008/410 7 Sch 7(1)(d)]. Again, where branches are of strategic importance, their existence should be included in the Strategic Report. Otherwise, we believe such disclosures are clutter and should be removed.

#### **Question 10**

**Are there areas where the Listing Rules, IFRS, company law and the Corporate Governance Code are inconsistent or require similar disclosures? If so, how could these best be resolved?**

We would support the removal of all remaining duplication. In particular we highlight requirements for reporting remuneration. Whilst the Companies Act and the Listing Rules are generally consistent, there is some duplication, which could usefully be removed. Please refer to our response to question 27 where these matters are set out in more detail.

#### **Question 11**

**Should quoted companies be explicitly required to include information about human rights (to the extent necessary for an understanding of the development, performance or position of the company's business) in the Strategic Report?**

We believe that it is appropriate for quoted companies to be required to include information about human rights on the same basis that they provide information on environmental, social and community matters, that is, to the extent it is necessary for an understanding of the development, performance and position of the business. If human rights are not seen as a key risk to the future success of a company, it should not be required to provide information in the Strategic Report but encouraged to place the information in the Annual Directors Statement or online.

#### **Question 12**

**Do you support the Government's proposals for company disclosure of the proportion of women on boards and in companies as a whole?**

We believe that, consistent with our views on the proposed requirement for providing information on human rights, companies should only report information on gender diversity in the Strategic Report when it is considered important to an overall understanding of strategy and long-term sustainable



performance. In other cases, the information should be provided in the Annual Directors' Statement or online.

Further, we believe that the diversity debate should be broader than just gender. This is consistent with the views expressed in the FRC's feedback statement, *Gender Diversity on Boards*, which has proposed revised wording to the Governance Code requiring the nomination committee section to 'include a description of the board's policy on diversity, including gender'.

### Question 13

**Do you agree that the current UK liability regime does not discourage companies from making meaningful forward looking statements? If you believe that there are issues with the current regime, do these relate to:**

- **companies listing in the US as well as in the UK,**
- **companies contemplating a prospectus,**
- **common misunderstandings about the UK liability regimes**
- **other concerns?**

We agree that the UK liability regime does not of itself discourage companies from making meaningful forward looking statements. The safe harbour provisions of the Companies Act 2006 currently apply only to the directors' report and directors' remuneration report (and summary financial statements insofar as they are derived from those reports). If a new reporting structure as suggested in this consultation is introduced, these safe harbour provisions should be amended to reflect the new reporting requirements. In addition, we recommend that BIS look at the effectiveness of the existing safe harbour provisions and take action if any changes are shown to be needed with a view to ensuring appropriate safe harbour is included in any new reporting regime.

We note that currently, some companies label the whole of the 'front half' of their annual reports as the 'directors' report', which we believe may in part be in order to obtain safe harbour coverage for all narrative reporting. We believe that this may indicate some level of concern over liability. Anecdotally, we believe companies may be reluctant to make forward looking statements for a number of reasons. These include: the normal concerns regarding confidentiality and competitive advantage; the challenges of the current conventions of reporting formality and rigour (where such disclosures often have to go through legal counsel review); and a view that company directors may expose themselves or the company to liability if they make voluntary forward looking statements beyond those required by law and regulation.

These concerns tend to affect all companies, though they are more pronounced where companies have a US listing or are raising capital in the markets.

We believe that insight around strategy, market trends and non-financial information could provide a forward looking orientation to reporting without the need for targets or other information, which may be considered commercially sensitive. Our perspective as to how concerns around provision of forward looking information can be addressed is covered in more detail in our publication, *Guide to forward-looking information*.



#### Question 14

**Would improved understanding and awareness of the UK liability regime help encourage more meaningful, forward looking statements? Are there other activities or changes that the UK Government could make that you believe may be necessary?**

Please refer to our response to question 13 above.

#### Question 15

**Do you agree that the key information on remuneration should be included in the new Strategic Report? If so, would a standard format for this information be helpful?**

In our view, directors' remuneration is an important feature of a company's overall strategy and we endorse the inclusion of key information on remuneration in the Strategic Report. We consider that the focus of the remuneration disclosures in the Strategic Report should be forward looking with greater emphasis on the strategic alignment of performance measures for incentive arrangements and the outcomes of the relevant financial year than is currently required. We have included in Annex 1 a suggestion for the structure and content of directors' remuneration reporting in the Strategic Report.

While there is merit in providing guidance to companies on the structure and content of the remuneration aspects of the Strategic Report, we believe that companies should be given the flexibility to determine the format that is consistent with their overall approach. Standardisation of format can lead to 'boiler-plate' disclosures which would destroy some of the value of this new more discursive document.

#### Question 16

**Which elements of the current disclosure requirements could be moved to the Annual Directors' Statement or removed entirely?**

As noted in our response to question 15 above, we believe that the focus of remuneration disclosures in the Strategic Report should be on remuneration strategy and the link between pay and performance. In our view, most other disclosures should be presented in the Annual Directors' Statement or the company's website. Our suggestion with regard to the split of the current remuneration disclosure requirements between the Annual Directors' Statement and the company's website is set out in the Annex 2. We have also set out in Annex 3 certain disclosure requirements that we believe are currently not perceived by shareholders as adding value and which BIS could consider for deletion.

We note that on page 16 of the consultation that the financial statements are considered to include the audited remuneration information. Whilst we agree that the information falls within the scope of the audit report, quoted companies rarely locate it 'within the pages' of the financial statements. Such companies are required by s420 of the Companies Act 2006 to prepare a directors' remuneration report, which will typically form a separate section of the annual report. Remuneration disclosure that is required to be included in the financial statements under sch5 of SI 2008/10 is often incorporated into the notes by a simple cross reference to the remuneration report. If the requirement for quoted companies to prepare a remuneration report is to be retained, we believe it should form a section of the Annual Directors' Statement and should not drive the content requirements of the Strategic Report.

#### Question 17

**Should quoted companies be required to disclose the total remuneration of each director in a single cumulative figure?**



**If so, how should it be calculated so that it accounts appropriately for the various elements of remuneration packages, including share options, LTIPs and pensions?**

The existing remuneration reporting regulations do not provide an overall picture of the remuneration package earned or paid to an individual director during the year under review and we support the concept of the disclosure of all remuneration in one table with a cumulative total, subject to the following qualification.

There should be a simple, transparent and consistent methodology prescribed for determining the single cumulative figure. This is essential as it is likely that the single cumulative figure will be compared across roles and organisations on a year on year basis. We recommend that two approaches are considered (together or as alternatives).

The first approach is an extension of the existing disclosure in the emoluments table. Two additional columns would be added to the emoluments table for disclosure of:

- the grant date fair value of long-term incentive awards (including options and deferred bonus and matching awards treated as long-term incentives) made during the year; and
- the value of pensions-related benefits.

Grant date fair value allows shareholders to assimilate the 'target' or 'expected' value of remuneration awarded in the year. However, we note that where there are 'non-market' performance conditions such as earnings per share or return on capital employed, these are not included when estimating the fair value of the awards under IFRS. To reflect the non-market conditions the company is required to make an estimate of how many of the awards will vest and this estimate can change over time. IFRS 2, *Share-based payment*, requires disclosure in this area but we believe that in reporting directors' remuneration there should be some specific disclosure about these estimates and how they impact the directors concerned.

For this reason, consideration should also be given to an alternative approach requiring disclosure of a single figure for the value of payments vesting in the year. This approach has the advantage of giving an unambiguous disclosure of the amount to which an executive became entitled during the year, which can be compared meaningfully with performance, as opposed to an 'expected' value which may never materialise. Some consideration would need to be given as to whether 'expected' value or the gain on options or awards vesting is the most appropriate approach. 'Expected' value would give a more complete picture but the gain on options or awards vesting has the benefit of simplicity.

The second approach could include:

- Base salary received in the year.
- Benefits and allowances received in the year.
- Annual bonus paid in respect of the year.
- Deferred bonus vesting in the year.
- Long-term incentives (including options) vesting in the year.
- Value of pension entitlements.

An example of the proposed disclosure is included in Annex 2.

**Question 18**

**Would there be benefits in introducing a requirement to disclose the pay of the highest earning executive officers below board level and, if so, to which companies and individuals should such an obligation be extended?**



**Are there alternative ways of improving shareholder oversight of the performance and pay of influential non-board executive officers?**

We are not persuaded of the benefits of introducing a requirement for all companies to disclose the pay of the highest earning executive officers below board level. Such disclosure may be of value where there are employees below board level who are incentivised in such a way as to influence how they assess and manage risk and where they are sufficiently senior and have enough autonomy to have a significant impact on the strategy and results of the company. In our view, this is almost entirely a financial sector issue. New remuneration disclosure requirements have been put in place for 'Code Staff' (i.e. risk-takers) in institutions regulated by the Financial Services Authority which will form part of their Pillar 3 regulatory disclosures and we believe that these requirements are sufficient.

There is already a requirement for companies reporting under IFRS (specifically IAS 24, *Related party disclosures*) to disclose the aggregate remuneration of their key management personnel. The introduction of a requirement to disclose remuneration for a fixed number of executives could lead to confusion and greater 'clutter' in the remuneration report without much additional value to the reader.

There is also a concern that the introduction of disclosure for a wider group of executives will lead to further ratchet in pay levels, similar to that observed over the period since the individual disclosure requirements were brought in for directors.

Until recently, there was a similar requirement in Australia for companies to disclose individual remuneration packages for the five most highly paid executives below the board, but it has been withdrawn this year as part of an initiative to simplify remuneration reporting. In practice, this is not regarded as a significant change because the Australian equivalent of IAS 24 captures broadly the same population of executives.

If it were considered desirable to have more information about executive pay arrangements for influential non-board members, disclosure could be required of the nature of the arrangements in which the senior executives participate and how they dovetail with those for main board executives.

**Question 19**

**Do you agree that quoted companies should be required to disclose how remuneration awarded relates to performance in the relevant financial year and to the company's strategic objectives?**

Yes. As part of our Building Public Trust Awards and associated consulting, we have been encouraging companies for several years to provide disclosure of the relationship between reward and performance and the alignment of performance measures with the company's strategic objectives. We are pleased to note that some companies now provide clear evidence of this. As noted in our response to question 15 above, we would support inclusion of such information in the Strategic Report. We would recommend that companies be given flexibility over how they meet this requirement and would not support development of a prescriptive disclosure framework.

**Question 20**

**Should quoted companies be required to illustrate performance and the total remuneration of the CEO for the last five financial years, to enable shareholders to assess the relationship between total pay and performance over time?**



**If so, which performance measure would be the most appropriate?**

It is widely recognised that the existing requirement, to include a five year graph of the company's total shareholder return compared with a broad equity market index, is rarely a valuable disclosure. The proposal to include a requirement for companies to plot total CEO remuneration against a graph of a relevant performance indicator of the company's choosing may provide a more meaningful disclosure of the relationship between executive reward and corporate performance.

Nevertheless, there is still scope for the proposed disclosure to provide little of value and therefore the requirement would need to be carefully drafted. The determination of total remuneration would need to be codified in a way that provides a consistent result and would only really be of value where total CEO remuneration is determined by reference to amounts 'vested' in the year (the second approach in our response to question 17 above).

It would be important that companies were given flexibility to choose a performance metric that was appropriate to their business and industry. There may be merit in requiring companies to explain the rationale for their choice of metric (in the same way as they are currently required to explain their choice of broad equity market index for the TSR graph). Consideration should be given to disclosure of performance over the period from the CEO's appointment (rather than a potentially arbitrary five year period which may cover the tenure of more than one CEO).

**Question 21**

**Should quoted companies be required to explain how the performance criteria for remuneration policy for the year ahead relates to the company's strategic objectives, as set out in the new Strategic Report?**

Yes. Some companies already explain how the performance criteria forming part of their forward looking policy are aligned with the company's strategic objectives. Any new requirements should reflect this existing good practice and would form a major part of our recommendation for the remuneration content of the Strategic Report (see Annex 1).

**Question 22**

**Should quoted companies be required to provide estimates of the total future remuneration of executive directors if they exceed, meet or do not meet their performance criteria?**

Many companies provide information similar to this proposal in meeting the existing requirement to disclose the relative importance of fixed and variable pay. We recommend that the proposed disclosure replace the existing fixed/variable disclosure and that companies are permitted to provide the information in tabular format or in the form of a chart, inclusive of values. We suggest that this disclosure is included in the forward looking policy statement in the Strategic Report and have included an example in Annex 1.

**Question 23**

**Should quoted companies be required to disclose the performance criteria for annual bonuses?**

**If so, should companies be permitted to delay the publication of commercially sensitive performance criteria for up to two years?**

Yes. The absence of a requirement to disclose the key performance indicators for annual bonuses in the current legislation has always appeared to be an anomaly when compared with the detailed information



required in respect of long-term performance conditions. With the substantial increase in the quantum of bonuses over the past ten years, shareholders (not unreasonably) expect full disclosure.

Over the past several years, we have been encouraging companies to make clear disclosure of the following information in advance of the bonus year:

- The key performance measures (and, where not commercially sensitive, the targets).
- Their relative weighting.
- The percentage of salary payable against each measure at target and maximum performance.

After the end of the performance year, we encourage companies to explain the outcome from the bonus arrangements in terms of:

- The extent to which the key performance measures were met (and targets met where not commercially sensitive).
- The bonus payable under each measure as a percentage of salary.
- The aggregate bonus payable as a percentage of salary.
- The amount of the bonus payable as a percentage of the maximum.

We have seen a marked shift in disclosure over the past three years with most companies in the FTSE 350 now providing a reasonable amount of detail.

We would not recommend prescription of disclosure of commercially sensitive information in the year following the bonus year or its delay for up to two years and any legislation would need to be sufficiently flexible to reflect the differing nature of bonus plans. For example, whilst some bonus plans have explicit pre-set targets and weightings, others are more discretionary in nature.

We suggest a best practice provision to disclose performance targets on a 'comply or explain' basis to allow companies with commercially sensitive targets to explain their non-disclosure or the delay to a subsequent year of the disclosure of this information.

#### **Question 24**

**Would disclosure by quoted companies of the ratio between the pay of the company's Chief Executive and the median earnings of the organisation's workforce provide useful information to shareholders?**

**If so, how should the ratio be calculated?**

We do not support the proposal to require disclosure by quoted companies of the ratio between the pay of the company's chief executive and the median earnings of the organisation's workforce. A similar requirement was proposed in the United States under the Dodd-Frank Act and there have been representations for its repeal or significant modification before implementation because of difficulties in identifying median earnings of the workforce.

The ratio between the pay of the CEO and median employee is subject to significant variation due to aspects of business model, for example geographical spread of business, in-house versus out-sourced activity and franchise versus proprietary outlets. These factors will lead to significant variations in the ratio, even between companies in the same sector. Therefore, we believe that disclosure of this ratio is likely to lead to ill-informed comparisons between companies which are more likely to obscure rather than enlighten the debate on executive pay practices.

We also note that external observers are already able to calculate the ratio of CEO pay to average (not median) employee pay with relative ease, using existing disclosures in the financial statements. While



this ratio is something a remuneration committee may wish to track over time to inform their deliberations, we do not believe that external disclosure is useful.

#### **Question 25**

##### **Do you agree that quoted companies should be required to disclose the total spend on directors' remuneration as a proportion of profit for the relevant financial year?**

No. We do not support this disclosure. The inclusion of some form of disclosure of the proportion of the company's revenues that was allocated in the form of directors' remuneration would be valuable to shareholders to highlight trends but, again, comparisons between companies are unlikely to be meaningful. We note that the information to calculate this ratio is readily available should users want this information.

In our view, a more insightful disclosure would be the relative proportions allocated to, for example:

- dividends;
- total remuneration; and
- tax.

However, all of this information is already available in the financial statements so it is not immediately clear what additional value this disclosure would add. What could be more valuable is a statement in the remuneration report of the company's policy with regard to the sharing of value between these elements, including the share of remuneration available to the executive directors compared with the wider employee population.

#### **Question 26**

##### **Should the amount of fees paid by companies to remuneration consultants be disclosed and is there any further information which should be disclosed by companies in relation to the procedure for setting directors' remuneration?**

We recognise that there are perceived, and at times actual, conflicts of interest arising from the relationship remuneration consultants have with the companies they are advising when they are also providing other services to those companies. In our view, the key is in understanding how conflicts arise and ensuring that any actual or perceived conflicts are addressed by the remuneration committee. We do not believe that the disclosure of fees paid to remuneration consultants gives helpful insight into how these conflicts are being managed and, indeed, could have unproductive and unintended consequences by focusing attention on just one of many issues that determine whether a remuneration committee is appropriately managing its relationship with advisers.

The relationship between fees in respect of remuneration advice and other fees is just one consideration. A further important factor is the overall exposure of a firm to a single client, which could be a more significant impediment to independence. If disclosure of remuneration fees and fees for other services provided by remuneration consultants were required, we would also recommend that there be a requirement to disclose the total fee received from the client (for remuneration and non-remuneration services combined) as a percentage of the total fees earned by the adviser's UK operation.

The Remuneration Consultant's Code recognises the potential for conflicts of interest and aims to minimise these. We believe that if further measures are needed to improve transparency in relation to the resolution of conflicts of interest within the practices of remuneration consultants, this issue should be addressed through the medium of the Remuneration Consultant's Code.



Remuneration Committees should be encouraged to confirm in the remuneration report (or Annual Directors' Statement) whether the remuneration consultants that they appointed support the Remuneration Consultant's Code and whether the Remuneration Committee took into account the provisions of the Remuneration Consultant's Code in regard to the consultants' appointment process.

Remuneration Committees should also be encouraged to describe in the remuneration report (or Annual Directors' Statement) the process they have followed in appointing remuneration consultants, confirming, where relevant, that the Remuneration Committee has taken into account the potential for actual or perceived conflicts of interest in relation to the appointment.

Where conflicts have arisen, Remuneration Committees should be encouraged to disclose that they have been addressed and resolved. In addition, Remuneration Committees should be encouraged to confirm that the appointment of the advisers was led by the remuneration committee and was free from any undue influence from management.

In relation to Remuneration Committees' disclosures relating to remuneration consultants' appointments, if it is decided that further steps should be taken to improve transparency and demonstrate independence to shareholders, we believe that this should be by amendment of the UK Corporate Governance Code.

#### **Question 27**

**Do you agree that company law and the Listing Rule disclosure requirements on remuneration should be made fully consistent?**

Yes. There are a handful of inconsistencies between the company law and Listing Rules disclosure requirements which could be eliminated with relative ease. However, it is not necessarily the case that the legislative requirements are more appropriate in all cases. We set out in Annex 3 our views on how the inconsistencies should be dealt with.

#### **Question 28**

**Would reporting under International Financial Reporting Standards provide an appropriate basis for disclosure of remuneration in the preceding financial year if this were required on both an aggregate and individual basis?**

The IFRS's that apply specifically to remuneration are:

- IFRS 2, *Share-based payment*
- IAS 19, *Employee benefits*
- IAS 24, *Related party disclosures*

IFRS 2 and IAS 19 are predicated on establishing a fair value of the expected future outcome of long-term incentives for corporate cost purposes. The fair value is derived using mathematical models and the result is unlikely to reflect the actual value accruing to employees on vesting. Under IFRS 2 there can also be significant judgements taken around non-market conditions (see our response to question 17)

As discussed in our response to question 17 with regard to directors' long term incentive awards, disclosure of the value of payments vesting in the year may be a more meaningful and comparable disclosure than the 'expected' value of awards granted in the year as calculated under IFRS 2. Therefore, our preferred approach is that vested amounts are included in the disclosure of remuneration for the



financial year. However, we believe it would still be appropriate for grant date fair values, as calculated under IFRS 2, to be disclosed in an extended emoluments table.

#### **Question 29**

**Do you agree that the current legislative regime for audit and assurance for narrative reporting is adequate for your needs?**

**If you support assurance beyond the consistency of the Strategic Report and the Annual Directors' Statement with the accounts, then please explain what you believe assurance should be provided on and the benefits that you believe will ensue.**

In the short term, we would support maintaining the current requirement for auditors to state whether, in their opinion, the information given in the Strategic Report and the Annual Directors' Statement is consistent with the accounts. We understand that the IAASB is currently considering whether a requirement in relation to information that accompanies the financial statements, more akin to the broader statement initially envisaged in relation to the OFR (that is, consistency with other information that has come to the auditors' attention in performance of their functions as auditors of the company), should be brought into auditing standards. We would encourage BIS to keep abreast of these discussions.

It will be necessary to consider practical implications. An audit opinion, including a consistency opinion over information in the directors' report, is currently given in the context of an annual report containing all the relevant elements 'within the covers'. It would appear that the reporting framework proposed in this consultation could lead to the fragmentation of information across different reports and online repositories. Further, if there is a move to keep standing data online, this will be most useful if it is kept up to date on a 'real time' basis. Since an assurance opinion is given at a fixed point in time, it is important that consideration is given as to how this might impact opinions.

However, we believe that such practical issues can be satisfactorily addressed and would be happy to work with BIS and other stakeholders to consider the best approach, which may consist of consideration of which information is required to be disclosed where, as well as which information should be subject to audit or review and the form of the opinions given.

As indicated previously, we believe that work should continue to examine the whole corporate reporting and assurance model to ensure that it is kept relevant and responsive to evolving market needs. Our own research with investment professionals is summarised in our report, *Audit today and tomorrow*, which sets out how further value might be derived from audit and assurance services, both through incremental changes to the current regime as well as through a potential extension of assurance scope to data included in narrative reporting. These views are set out in more detail in our response to the IAASB consultation paper, *Enhancing the value of auditor reporting: Exploring options for change*, a copy of which can be found here:

[http://www.pwc.co.uk/eng/aboutus/consultation\\_responses\\_september\\_2011.html](http://www.pwc.co.uk/eng/aboutus/consultation_responses_september_2011.html).

A period of innovation is needed and the FRC's Financial Reporting Lab can play a useful role in developing and testing new mechanisms for reporting and assurance.



### Question 30

**Are there any actions that the Government could take to make the process of obtaining additional assurance on specific information in company narrative reports easier or less costly?**

We refer to our response to question 29 above.

### Question 31

**Do you agree that the Audit Committee Report should contain, in addition to existing requirements:**

- **How long the current auditor has been in post; and when a tender was last conducted.**
- **The length of time since the directors, including members of the audit committee, have held discussions with principal shareholders about the company's relationship with its auditors, including the quality of service provided?**

We would not object to the proposed disclosures, which would be in line with the FRC's 2010 *Guidance on Audit Committees*.

The audit committee, made up of independent non-executives appointed by the shareholders, should recommend the appointment of the auditors to the board. In this role the committee acts as a representative of the shareholders, who have the opportunity to ratify the appointment subsequently. We believe the audit committee provides an important mechanism to separate the appointment of auditors from undue management influence, and we are not aware of any evidence that this safeguard is not working. We believe that the committee should report on the process by which it reached its recommendation to appoint or reappoint the external auditors and the reasons for the recommendation.

While audit committees may choose to conduct tendering at reasonable intervals, it is worth emphasising that our experience is that audit committees pay close attention to the quality of the audit service they receive and evaluate the service annually in accordance with the Code and FRC guidance for audit committees. The auditor's mandate in the UK is effectively renewed by the audit committee and subject to a shareholder vote each year.

We make further recommendations regarding how we believe reporting by audit committees could be improved in our response to question 32 below.

### Question 32

**The Government would also welcome views on the impact of these proposals, both on the cost of preparation of the Audit Committee Report, and of the benefits to investors of having access to this information.**

We refer to our response to question 31 above. However, we believe there is a need for further improvement to reporting by audit committees and support the general direction towards enhanced audit committee reporting taken by the FRC in its *Effective Company Stewardship* project. In our response to that consultation, we set out the actions we have taken with our own client base to encourage more expansive reporting by audit committees, promoting the idea of using the audit committee's report to describe in more detail the risks of misstatement and key areas of judgment in the financial statements and the principal subjects of discussion with the external auditors. We attach, in



Annex 4, an illustrative example of how such enhanced reporting by the audit committee might look. We believe that much of the information that could be contained in such a report would be of great value to investors and other stakeholders and, accordingly, it would warrant inclusion in the Strategic Report. This could be as an element of the discussion of governance to which we refer in our response to question 2 above.

### **Question 33**

**What guidance should be provided for preparers of the Strategic Report and the Annual Directors Statement? For example, what form should the guidance take (case studies, best practice, minimum compliance requirements), how should it be disseminated and should it be high-level and principles-based or more detailed and specific?**

Current guidance for narrative reporting can be found in the ASB's Reporting Statement. We believe that this guidance works well in general and would support it being updated to align it with the new requirements.

As stated in our response to the previous BIS consultation on the *Future of Narrative Reporting* we believe that more effort should be focused on ensuring all those involved in the reporting process understand what constitutes best practice, and are encouraged to embrace and promote this thinking in their reporting. However, we do not believe that this should lead to the development of prescriptive guidance, or agreed KPIs that all companies report. Instead it is about highlighting how the best reporters present information in a way that is accessible, understandable and by its nature more credible.

However, as the findings from our latest review of the narrative reporting practices of the FTSE 350 shows, there are areas where more specific guidance may be required to encourage greater transparency, awareness and consistency. One such area is around the requirement to discuss a company's business model. Our latest findings show that the requirement in the UK Governance Code seems to have caused some confusion, highlighting the apparent need for explicit guidance. Business models have been defined in a variety of different ways by early adopters. Companies appear to be focusing on presenting information to comply with the requirement, rather than making its relevance clear and linking the information to other parts of the narrative.

This disjointed picture is emphasised by limited linkage between the business model and other key elements of the business. Only 13% explicitly tie the business model to measurement, 7% link their business model to risks, and only 14% make the connection with corporate social responsibility (CSR). Just 7% of companies explain the role of the corporate centre in delivering the business model.

As the findings show, with the regulation in its infancy, we have seen many of the early adopters embrace the requirement with a tick-box mindset and little apparent thought for how the disclosure might fit with the rest of the information being communicated. The result is that many companies present investors with an unclear and ultimately confusing picture of their business model. The unintended consequence of the legislation has therefore been for reports to often show uncertainty over the basic definition of the business model and raise questions about management thinking and the clarity of a company's purpose.

Clearly a degree of standardisation within the market and a reduction in the spread of business model definitions will evolve in time, as market participants challenge the new information and good practices emerge. However, we believe an opportunity exists to create the right mechanisms to encourage such a shift through providing clear guidance on what constitutes an effective business model description and promoting best practice.

Key to enhancing the quality of UK corporate reporting is the creation of the necessary legal environment and incentive structure to encourage the right behaviours. Here more work is needed to



ensure we produce the right environment in which reporting can evolve, where experimentation and innovation undertaken in the name of increased transparency is encouraged and rewarded. In the same breath, some challenge is needed in the system where companies consistently fall short of the expected norms. It is for this reason that we are encouraged by the recent launches of the FRC Reporting Lab, here in the UK, and the International Integrated Reporting Committee's pilot programme, globally. Both these initiatives are raising awareness of the need for change and providing mechanisms to achieve it by experimenting with the structure and content of reporting.

#### **Question 34**

**Do you agree with the Government's proposal that the reporting statement and supporting guidance should remain voluntary? If you support a mandatory statement, please explain why that is necessary for your requirements.**

Yes, we agree that the reporting statement and supporting guidance should remain voluntary. Companies need to be able to flex their reporting to meet their own particular circumstances and the needs of their users. Mandatory requirements would inevitably lead to a tick box approach, most likely increasing the volume of clutter in the reports.

#### **Question 35**

**Do you agree that understanding of the profile and working practices of the FRRP should be enhanced, but that the remit of the FRRP should remain unchanged?**

We note that the FRC is currently consulting both on changes to its structure and to the operating procedures of the FRRP. We will respond to those consultations in due course, however in the meantime we would welcome a greater dialogue between the FRRP and users of accounts such that the FRRP is able to better understand the concerns of users and users have a better understanding of the panel's remit.

### Suggested remuneration disclosure in the Strategic Report

The strategic report is intended to provide key strategic information about the company including key risks and forward looking analysis together with a summary of the remuneration paid against key performance metrics for the year under review.

In view of its intended purpose, we consider that it should include the following information (assuming reporting on FY2011):

- A high level statement from Remuneration Committee chair on remuneration strategy and how that aligns with business strategy.
- How the Remuneration Committee has set remuneration policy for next year *et seq.*
- Any changes in remuneration policy that the Remuneration Committee has agreed for 2012.
- Details of performance conditions attaching to the annual bonus for 2012 and to long-term incentives awarded in 2012 to demonstrate alignment with strategy.
- Total expected remuneration for each director in 2012 on a scenario basis.
- Proportion of above that would be payable in compensation if individual left during year, an example of which is shown below.

BELOW TARGET PERFORMANCE	Salary*	Benefits*	Annual Bonus	LTI award	TOTAL	Pension	<b>Notes:</b> 1. Salary at annual rate for 2012 2. Benefits disclosure is annual value of non-cash benefits 3. Pension is: a. estimated transfer value of increase (net of inflation) of defined benefit pension for 2012; b. company contributions to defined contribution arrangements; or c. annual cash allowance in lieu of pension.
	£	£	£	£	£	£	
Director 1	750,000	15,000	0	0	990,000	225,000	
Director 2	600,000	12,000	0	0	792,000	180,000	
Director 3	450,000	10,000	0	0	595,000	135,000	
Director 4	420,000	10,000	0	0	556,000	126,000	
TARGET PERFORMANCE	Salary*	Benefits*	Annual Bonus	LTI award	TOTAL	Pension	
	£	£	£	£	£	£	
Director 1	750,000	15,000	562,500	375,000	1,927,500	225,000	
Director 2	600,000	12,000	450,000	150,000	1,392,000	180,000	
Director 3	450,000	10,000	337,500	112,500	1,045,000	135,000	
Director 4	420,000	10,000	315,000	105,000	976,000	126,000	
MAXIMUM PERFORMANCE	Salary*	Benefits*	Annual Bonus	LTI award	TOTAL	Pension	
	£	£	£	£	£	£	
Director 1	750,000	15,000	1,125,000	1,500,000	3,615,000	225,000	
Director 2	600,000	12,000	900,000	600,000	2,292,000	180,000	
Director 3	450,000	10,000	675,000	450,000	1,720,000	135,000	
Director 4	420,000	10,000	630,000	420,000	1,606,000	126,000	

\*- payable in the event of severance

- FY2011 outcomes, and example of which is shown below.

#### Company performance

Metric	Outcome
EPS	15.0
TSR ranking	3 <sup>rd</sup> out of peer group of 20

#### Remuneration outcomes

	Bonus % of salary	Bonus £	LTI vesting No of shares	LTI vesting @ £4 per share
Director 1	86%	£625,000	150,000	£675,000
Director 2	78%	£455,000	112,500	£506,250
Director 3	75%	£325,000	75,000	£337,500
Director 4	76%	£315,000	75,000	£337,500

### ***Suggested remuneration disclosure in the Annual Directors' Statement***

The Annual Directors' Statement should cover remuneration policy and outcomes for the year under review. Assuming reporting in FY2011, we recommend that the Annual Directors' Statement includes the following:

- Membership of Remuneration Committee and names of advisers (could be maintained on website).
- Activities of the Remuneration Committee during FY2011.
- Details of remuneration policy in 2011 for each element of the package for executive directors and policy on Non-Executive Director fees.
- Details of remuneration policy for next tier of management in FY2011.
- Detailed information on remuneration for directors for FY2011 as follows:
  - **Base salary**
    - Base salary rates in 2011 and increases taking place in year or proposed at year end.
    - Rationale for increase in salary and comparison with rest of employee population (instead of CEO : Median employee pay ratio).
    - Non-executive Director fee rates and any increases.
  - **Benefits**
    - Value of benefits (taxable value in absence of other evidence).
    - Cash allowances (including allowances in lieu of pension).
  - **Annual bonus**
    - Structure for 2011 bonus (target and maximum in terms of % of salary).
    - KPIs for 2011 bonus and extent to which met.
    - Bonus payable to each director as a result of above.
  - **LTI**s
    - Detail of LTIs vesting in respect of FY2011 (that is, where FY2011 is the last year of the performance period).
    - Extent to which KPIs met.
    - LTI vesting as a result of achievement of performance conditions in FY2011.
    - Value accruing to each director as a result of LTIs vesting.
    - Any discretion exercised by Remuneration Committee in respect of LTIs vesting.
  - **Pension and other benefits**
    - Pension allowance paid in FY2011; or
    - Pension contributions paid in FY2011; or
    - Transfer value of increase in accrued DB pension for year (net of inflation and directors' contributions).
  - **Compensation for loss of office**
    - Details of any amounts paid as compensation for loss of office (for example, 12 months' salary or bonus forgone).
    - Any discretion with regard to vesting of LTIs.
  - **Total remuneration**
    - Amounts detailed above for each director captured in a table with total and comparative for prior year (an example is set out below).
    - CEO total disclosed against performance graph for last five years on similar basis; and
    - Total directors' remuneration spend as proportion of profit (together with other major spend).

Total remuneration received in FY 2011	Annual LTI				TOTAL	Pension
	Salary	Benefits	Bonus	vesting		
	£	£	£	£		
Director 1	725,000	15,000	625,000	675,000	2,257,500	217,500
Director 2	585,000	12,000	455,000	506,250	1,733,750	175,500
Director 3	430,000	10,000	325,000	337,500	1,231,500	129,000
Director 4	415,000	10,000	315,000	337,500	1,202,000	124,500

**Notes:**  
Salary received in FY 2011  
Bonus paid in FY 2011  
LTI vesting in FY 2011  
Pension benefit in FY 2011

LTI Vesting	No of shares awarded		No of shares vesting		Share value at vesting date
	TSR	EPS	TSR	EPS	
	Director 1	100,000	100,000	100,000	
Director 2	75,000	75,000	75,000	37,500	£506,250
Director 3	50,000	50,000	50,000	25,000	£337,500
Director 4	50,000	50,000	50,000	25,000	£337,500

**Notes:**  
Share price at vesting £4.50  
Share price at award £2.50  
TSR performance: 20th out of FTSE 100 - 100% vesting  
EPS performance Real growth of 4% pa - 50% vesting

The following information could be held on the company's website:

- Tables of share options
- Tables of LTIP awards
- Tables of directors' interests in shares
- Details of service contracts
- Information on shareholder dilution

### ***Inconsistencies between company law and Listing Rules***

In the table below we highlight areas of inconsistency between the Companies Act disclosure requirements and the UKLA Listing Rules requirements. We have highlighted the disclosure that we consider should be retained (or to which both disclosure requirements should be aligned) in bold.

<b>Area</b>	<b>Company law</b>	<b>Listing Rules</b>
Former directors	Significant award (Sch 8 para 14)	<b>Significant payment (LR9.8.8)</b>
LTI disclosure	<b>Detailed disclosure of performance metrics for LTIs and prescriptive disclosure in tables for awards that vest by reference to qualifying services (Sch 8 paras 3, 11,12)</b>	Details of LTI awards b/f, awarded, received, c/f (LR9.8.8)
Long-term incentive grant policy	No requirement to disclose	<b>Statement of company's policy on granting options and LTI awards explaining and justifying any departure from that policy or any change from previous year(LR9.8.8)</b>
Details of service contracts	<b>Disclosure of terms of contracts and likely compensation on termination (Sch 8 para 6)</b>	Justification for any contracts > 1 year and outstanding term for all directors up for re-election (LR 9.8.8)
Directors' interests	No requirement to disclose	<b>Details of all interests the subject of notifications under DTR 3.1 (LR 9.8.6)</b>
Defined benefit pension	Increase in pension accrual (gross) Increase in transfer value (net of director's contributions) (Sch 8 para 13)	<b>Increase in pension accrual (net of inflation)</b> <b>Transfer value of increase in accrued pension (net of inflation and director's contributions) (LR 9.8.8)</b>
Pensionable pay	None	<b>Justification for any element of pay that is pensionable apart from base salary</b>

Areas of legislation that could be considered for deletion:

- Requirement to disclose why performance conditions chosen (will be explained by alignment with strategy in new Strategic Report) (Sch 8 para 3).
- Requirement to disclose how performance conditions will be assessed and why the methodology has been chosen (Sch 8 para 3).
- Performance graph (Sch 8 para 5).

## ILLUSTRATIVE EXTRACT FROM AUDIT COMMITTEE REPORT FOR XYZ PLC

### External Audit

During the year, we:

- Reviewed the effectiveness and independence of the Group's statutory auditor; we are satisfied that the auditor provides effective independent challenge to management;
- Approved the re-appointment, remuneration, and engagement letter with the Group statutory auditor; and
- Considered the provision of non-audit services by the Group statutory auditor. Further details on this can be found on page X below.

We also discussed the planning, conduct and conclusions of the external audit as it proceeded as explained below.

We approved the auditor's group audit plan after discussion with them. They identified the following risks of misstatement of the Group's financial statements which they judged to be significant:

- Impairment of the goodwill arising on the acquisition last year of ABC S.A. which is based in Greece, following the deterioration of the economic conditions in that country.
- Revenue recognition particularly in the long-term contracts business where management assumptions and estimates are necessary.
- The realisable value of the accounts receivable from DEF Inc is dependent upon the outcome of pending litigation in the US courts.
- The Group's ultimate tax liability to UK tax in relation to the transfer of goods between members of the Group is subject to continuing negotiation with HMRC.
- The potential for breakdown in the internal controls of our recently established businesses in Eastern Europe which are growing very strongly.

We also had a discussion with the auditors of the risks of fraud in the Group.

The auditors explained to us the programme of work they planned to undertake to address these and the other risks they had identified to provide reasonable assurance that these risks did not lead to a material misstatement of the financial statements. Where they thought it would be effective to do so, this work included the evaluation and testing of the Group's own internal controls. They also explained where they planned to obtain direct external evidence.

We discussed these issues with them at the time of their review of the half-year summary financial statements and again at the conclusion of their audit of the financial statements for the year. As they concluded their audit, they explained to us:

- The work they had done to test management's evaluation of the value of the goodwill arising on the acquisition of ABC S.A. and why they were satisfied with the adequacy of the impairment provision made by management based on our current assessment of that business and the Greek economy.

- They had reviewed the Group's application of its accounting policy for the capitalisation of pre-contract costs whereby a threshold of £x is applied before any costs are capitalised.
- The work they had done to test management's assumptions and estimates in relation to revenue recognition in the long-term contracts business and how they had satisfied themselves that these were reasonable.
- The results of their testing of the controls in our Eastern European businesses and the issues they had found there. As described on page XX, a rectification programme is now underway to bring these controls up to the Group's standard. The auditors also explained the other procedures they had carried out, using independent external evidence to ensure that that had been no misstatement of the financial statements as result of these difficulties.

As discussed on page XX our litigation with DEF Inc and our discussion with HMRC concluded before the year-end. The auditors informed us that they were satisfied that these financial statements appropriately properly reflect those outcomes.

The auditors also reported to us the misstatements that they had found in the course of their work and we confirmed that there no such material items remaining unadjusted in these financial statements.