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**Governance reporting – Moving it forward**

This report grew out of discussions with a range of companies late in 2012 and at the start of 2013 during which it was apparent that there is widespread frustration with the content of governance reporting in today’s annual reports. Though this may sound negative, we took away a positive message: everyone we spoke to saw the value in making a change and there was a real appetite to understand what might be done.

This report seeks to answer that question. Our answers are not revolutionary; they are built around demonstrating compliance and are intended to be practical steps that any company can take now.

**What’s the issue?**

Premium listed companies could be forgiven for concluding that they receive mixed messages from the regulators when it comes to preparing the corporate governance report.

The DTR would allow them to make the report available exclusively on their website, while the FRC in ‘Cutting Clutter’ advocated focusing on the key messages in the governance report and moving the rest into an appendix. And yet the UK Corporate Governance Code ('the Code') and the Listing Rules combine to prevent either of these approaches at the present time.

Online reporting could help to allow companies to focus on the key messages in their annual report but it now appears unlikely to be addressed when the revised narrative reporting regulations are finalised in the next few months.

Appendix 1 to this Guide sets out an analysis of the current corporate governance reporting framework in the UK, so that readers can understand for themselves the various competing requirements that companies have to deal with.

**How to address the issue**

Though we understand the challenges involved, in this Guide we suggest that it is perfectly possible to move governance reporting forward within the current framework.

We do this by providing an example of a 'skeleton' governance report that we believe can achieve the twin aims of compliance and effective communication of the key messages on governance.

We strongly support the concepts set out in the FRC’s ‘Cutting Clutter’ paper: above all, companies should focus on their key messages first and fit compliance around those – not vice versa.

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## Skeleton corporate governance report

### 1. Discussion on how the board leads the organisation

- Board membership and directors’ roles
  - Including senior independent director (‘SID’)
- Setting culture and values of the organisational and tone from the top
- Balance between independent non-executive directors (‘iNEDs’) and others
- Independence criteria applied to NEDs
  - Including tenure
- How the chairman/CEO and board/executive team work together

### 2. Discussion on role of the chairman in areas of emphasis under the 2010 Code

- Achieving a well-functioning board that works as a team, including:
  - Inclusivity – allowing NEDs to provide constructive challenge
  - Induction and training
  - Agenda planning
  - Information provision
- How governance was applied to the key activities and developments in the year in all areas
- Investor relations

### 3. Board evaluation

- Insight into the process, outcomes and follow up in succeeding years

### 4. Nomination committee report

- Including:
  - Succession planning
  - Diversity

### 5. Audit committee report

- Including:
  - Risk appetite and risk management
  - Fair, balanced and understandable corporate reporting

### 6. Remuneration report

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Our proposition is that the skeleton corporate governance report opposite covers off the technical compliance requirements in a way that also deals with the key messages on governance. In other words, it:

- addresses the Listings Rules requirement to show how the Main Principles have been applied; and
- covers most of the specific disclosure provisions of the Code; those that are not covered can easily be dealt with in an appendix to the governance report of the sort that the FRC recommended in Cutting Clutter:

> ‘...we are acutely aware that currently explanatory information cannot be provided on a website. In developing our disclosure aids, we have assumed that progress is made in this area. Unfortunately we are not there yet. Accordingly, in the current environment we suggest moving explanatory information into an appendix within an annual report.’ [FRC ‘Cutting Clutter’ page 33].

Appendix 2 to this Guide maps each Main Principle of the Code and the related disclosure provisions to the skeleton set out above and explains how it covers them – or where specific information may need to be added specifically for compliance purposes.

The skeleton report presented here is not, of course, meant as a template or checklist for a governance report; it is intended only to demonstrate that focusing on a number of key governance messages can actually drive compliant disclosures.

Conclusion

There are some very good governance reporters among UK companies but too many simply roll forward the basic structure of their governance report year on year. Our proposals would allow a move away from this in order to break out of the vicious circle of reporting only for the sake of compliance.

Our earlier publication under the Report Leadership banner ‘Simple, practical proposals for better reporting of corporate governance’ provided ideas for content to help communicate the key governance messages.

In that publication we also suggested a format that could be used for the appendix such as that suggested in ‘Cutting Clutter’ to demonstrate Code compliance.

The PwC Corporate Reporting team can explain more and help to implement these proposals in practice.

Please enquire of your usual PwC contact or the people shown below.

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Although the Code has relatively few provisions that require specific disclosures, the Listing Rules require companies to provide a narrative statement of how they have applied the Main Principles of the Code [LR 9.8.6 (6)]. This has often led companies to run through all the provisions that relate to each Main Principle, including those that do not require specific disclosures, as a means of showing how they have done this.

This Guide particularly encourages companies to move away from this approach.

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Appendices
Appendix 1: Sources of governance reporting requirements and guidance

Requirements/guidance

Source: (FRC) UK Corporate Governance Code (Sept 2012 version)

Schedule B (page 29)
...the Code includes specific requirements for disclosure which must be provided in order to comply. These are summarised below.

The annual report should include:
See Appendix 2 in this guide for specific disclosure provisions arranged under the related main principles of the Code.

Schedule B (page 31)
The following information should be made available (which may be met by placing the information on a website that is maintained by or on behalf of the company):

- The terms of reference of the nomination, audit and remuneration committees, explaining their role and the authority delegated to them by the board (B.2.1, C.3.3 and D.2.1)
- The terms and conditions of appointment of non-executive directors

Preface para 6
Chairmen are encouraged to report personally in their annual statements how the principles relating to the role and effectiveness of the board (in Sections A and B of the Code) have been applied.

Source: (FSA) Listing Rules LR 9.8

LR 9.8.6
In the case of a listed company incorporated in the United Kingdom, the following additional items must be included in its annual financial report:

- A statement of how the listed company has applied the Main Principles set out in the UK Corporate Governance Code, in a manner that would enable shareholders to evaluate how the principles have been applied.
- A statement as to whether the listed company has:
  - Complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code
  - Not complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code and if so, setting out:
    i. Those provisions, if any it has not complied with
    ii. In the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions
    iii. The company's reasons for non-compliance

LR 9.8.7
An overseas company with a premium listing must include in its annual report and accounts the information in LR 9.8.6R (5), LR 9.8.6R (6) and LR 9.8.8R.
**Requirements/guidance**

**LR 9.8.9**
The requirements of LR 9.8.6R (6) and LR 9.8.8 R relating to corporate governance are additional to the information required by law to be included in the listed company's annual report and accounts.

**LR 9.8.10**
A listed company must ensure that the auditors review each of the following before the annual report is published:

1. LR 9.8.6 R (3) (statement by the directors that the business is a going concern)
   - The parts of the statement required by LR 9.8.6R (6) (corporate governance) that relate to the following provisions of the UK Corporate Governance Code:
     - C.1.1
     - C.2.1
     - C.3.1 to C.3.7

**Source:** (FSA) Disclosure Rules and Transparency Rules (‘DTR’) chapter 7

**DTR 7.2.1**
An issuer to which this section applies must include a corporate governance statement in its directors' report. That statement must be included as a specific section of the directors' report...

**DTR 7.2.5**
The corporate governance statement must contain a description of the main features of the issuer's internal control and risk management systems in relation to the financial reporting process.

**DTR 7.2.6**
The corporate governance statement must contain the information required by paragraph 13(2)(c), (d), (f), (l), and (i) of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) (information about share capital required under Directive 2004/25/EC (the Takeover Directive)) where the issuer is subject to the requirements of that paragraph.

**DTR 7.2.9**
An issuer may elect that, instead of including its corporate governance statement in its directors' report, the information required by DTR 7.2.1 R to DTR 7.2.7 R may be set out:

1. In a separate report published together with and in the same manner as its annual report...
   - By means of a reference in its directors' report to where such document is publicly available on the issuer's website

**Source:** Companies Act 2006

**CA06 s419A**
Approval and signing of separate corporate governance statement.

Any separate corporate governance statement must be approved by the board of directors and signed on behalf of the board by a director or the secretary of the company.

**CA06 s447**
Filing obligations of quoted companies.

1. The directors of a quoted company must deliver to the registrar for each financial year of the company a copy of:
   - the company's annual accounts
   - the directors' remuneration report, F27
   - the directors' report,[P28
   - any separate corporate governance statement
**Requirements/guidance**

**CA 06 s497A**

*Auditor’s report on separate corporate governance statement.*

1. Where the company prepares a **separate corporate governance statement** in respect of a financial year the auditor must state in his report on the company’s annual accounts for that year whether in his opinion the information given in the statement in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook issued by the Financial Services Authority (information about internal control and risk management systems in relation to financial reporting processes and about share capital structures) is consistent with those accounts.

**CA 06 s498A**

*Auditor’s duties in relation to separate corporate governance statement.*

Where the company is required to prepare a corporate governance statement in respect of a financial year and no such statement is included in the directors’ report:

1. The company’s auditor, in preparing his report on the company’s annual accounts for that year, must ascertain whether a corporate governance statement has been prepared.
   
   If it appears to the auditor that no such statement has been prepared, he must state that fact in his report.

**Source: (FRC/ASB) Cutting Clutter**

*Page 33*

...we are acutely aware that currently explanatory information cannot be provided on a website. In developing our disclosure aids, we have assumed that progress is made in this area. Unfortunately we are not there yet. Accordingly, in the current environment we suggest moving explanatory information into an appendix within an annual report. While this isn’t ideal, as it requires preparers to continue to produce the information year after year within the annual report, it lessens the clutter effect for users, as the two page summary envisaged effectively does the work for the reader. The full information currently required would still be available, although deeper within the annual report.
## Appendix 2: Mapping the Main Principles and disclosure provisions of the 2012 UK Corporate Governance Code to the skeleton governance report

This appendix maps each Main Principle of the Code and the related disclosure provisions to the skeleton set out on page 2 and explains how it covers them – or where specific information may need to be added specifically for compliance purposes.

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<td><strong>Section A – Leadership</strong></td>
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| A.1 Every company should be headed by an effective board which is collectively responsible for the long-term success of the company. | A.1.1 A statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management. | 1,2,3 | The preface to the Code (para 6) suggests that the chairman reports personally on how the principles relating to the role and effectiveness of the board have been applied, and the chairman’s introduction to the governance report is a good opportunity to address this. We would suggest that the most effective way to do this is for the chairman to explain how the board dealt with the key developments in the business in the year (whether these are backward or forward looking, or both).

The chairman’s introduction to the governance report also commonly summarises the findings of the board evaluation process – it’s significant that the main principle on leadership includes the word ‘effective’ – these are two sides of the same coin.

 Provision A.1.1 appears to ask for a summary of the matters reserved for the board; if the key developments have been addressed then this procedural requirement could be set out in the compliance appendix to the governance report. |
<p>| |  | 2 | The identity, skills and qualifications of board members are of course very important; this information is best combined with the effectiveness disclosures under main principle B.1, however. |
| A.1.2 The names of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees | | | |</p>
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<td>A.1.2</td>
<td>The number of meetings of the board and those committees and individual attendance by directors.</td>
<td>Appendix</td>
<td>Unless there is a particular issue to explain, this disclosure (including the disclosure for committees) is appropriate for the compliance appendix.</td>
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<td>A.2</td>
<td>There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company’s business. No one individual should have unfettered powers of decision.</td>
<td>1</td>
<td>If there is an issue with this main principle, it is highly likely that the chairman will want to explain why there is a departure from the Code, or no departure despite appearances. The relationship between the chairman and CEO is increasingly recognised as a key one, and we recommend that companies focus on explaining how it works in practice.</td>
</tr>
<tr>
<td>A.3</td>
<td>The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.</td>
<td>A.3.1 Where a chief executive is appointed chairman, the reasons for their appointment (this only needs to be done in the annual report following the appointment).</td>
<td>The role of the chairman was developed in the 2010 revision of the Code into a number of specific areas (inclusivity, development and training, investor relations etc.). We recommend that the various aspects of the role are brought together rather than being scattered around the report. It is also ultimately the responsibility of the chairman to ensure that governance is applied to the appropriate matters. If the chief executive goes on to be chairman this is an issue of significance that will be a key issue for the company to explain.</td>
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<td>A.4</td>
<td>As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.</td>
<td>1,2,3</td>
<td>This is a cornerstone of how the board leads the organisation, and a key indicator of good board culture; the NEDs need to be facilitated in carrying out these aspects of their roles and sufficiently involved at the right time to help develop proposals on strategy. The ‘softer’, more behavioural aspects of corporate governance were emphasised in the 2010 version of the Code; few companies provide insightful disclosures around this, but those that do often discuss this within the context of the board evaluation, where the findings of an external facilitator can be reported.</td>
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**Section B – Effectiveness**

<p>| B.1 | The board and its committees should have the appropriate balance of skills, experience, independence and | B.1.1 The names of the non-executive directors whom the board determines to be independent, with reasons where necessary. | The biographies of directors are now commonly expanded to draw out the skill-sets of each director, so that it is possible to see what each ‘brings to the table’ and how the directors blend |</p>
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<td>knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.</td>
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<td>as a team. Independence is still a key criterion for board composition, using the indicators set out in provision B.1.1. In some cases there are particular sensitivities in this area (such as some of the more recent IPOs from overseas) and we advise providing sufficient information to head off any preconceptions in such situations. Succession planning is now recognised as a key part of board effectiveness and most nomination committee reports (or even the chairman’s introduction to the governance report) explain the arrangements in place.</td>
</tr>
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<td>B.2 There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.</td>
<td>B.2.4 A separate section describing the work of the nomination committee, including the process it has used in relation to board appointments; a description of the board’s policy on diversity, including gender; any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used it should be identified and a statement made as to whether it has any other connection with the company.</td>
<td>1,2,4</td>
<td>It’s important to focus these disclosures on any appointments that have been made, and how these were handled; general descriptions of process are not generally very meaningful. The Code suggests that the board’s policy on diversity should be set out in the nomination committee report; where this is of particular significance it may be that the chairman should cover the issue in part (and of course the chairman of the nomination committee and the company chairman are often the same individual). Our advice on the diversity disclosures is to be frank; if there is a real challenge for some reason (industry or geography, for instance) recognise this. Actions to create a pipeline of candidates for senior positions are important to draw out too. The disclosures on the use of external search consultants are an important part of demonstrating a commitment to breaking down the ‘old boys’ network’ and should be done for each appointment.</td>
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<td>B.3 All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.</td>
<td>B.3.1 Any changes to the other significant commitments of the chairman during the year.</td>
<td>3.4</td>
<td>There are specific (non-disclosure) provisions on making the letters of appointment of NEDs available, and setting out in that letter the expected time commitment (provision B.3.2). In the year of appointment it can be advisable to give information on this in the annual report; otherwise this is likely to be covered in the board evaluation. Significant changes to the chairman’s other commitments would likely feature in his or her introduction to the governance report with an explanation of how any issues are being handled.</td>
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<td>B.4 All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.</td>
<td></td>
<td>2</td>
<td>These are both part of the increased focus on the role of the chairman – see main principle A.3 above. They also naturally fit within the board evaluation process. Long descriptions of process are not necessary.</td>
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<td>B.5 The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.</td>
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<td>B.6 The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.</td>
<td>B.6.1 A statement of how performance evaluation of the board, its committees and its directors has been conducted</td>
<td>3</td>
<td>This has become one of the higher profile governance disclosures, and we believe that it represents a good opportunity to confirm that the board has effectively carried out its leadership and effectiveness roles. The Code requires disclosure of how the evaluation has been conducted, and this is important because of the range of providers and techniques used; of most significance, however, are the findings and actions arising and also how these have been followed up in subsequent periods (though these disclosures are not an explicit part of the provision). There are specific requirements around the evaluation of board committees and of individual directors that should not be omitted even if they are outside the main board evaluation process.</td>
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<td>B.6.2 Where an external facilitator has been used, they should be identified and a statement made as to whether they have any other connection to the company.</td>
<td>3, Appendix</td>
<td>Provided there is no connection, this disclosure could be given in the compliance appendix.</td>
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<td>B.7 All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.</td>
<td>Appendix</td>
<td>The annual re-election process is handled via the AGM papers and is not likely to generate significant disclosures unless the company is one of the few not to comply with the provision.</td>
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**Section C – Accountability**

<p>| C.1 The board should present a fair, balanced and understandable assessment of the company’s position and prospects. | C.1.1 An explanation from the directors of their responsibility for preparing the accounts and a statement that they consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess and provide the company’s performance, business model and strategy. There should also be a statement by the auditor about their reporting responsibilities. | n/a | This will affect the directors’ responsibilities statement rather than the governance statement per se. |
| C.1.2 An explanation from the directors of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company. | n/a | Also not directly part of the governance statement. |
| C.1.3 A statement from the directors that the business is a going concern, with supporting assumptions or qualifications as necessary. | n/a | Again, this is not likely to be covered in full within the governance statement as the disclosures generally need to link to funding and liquidity discussions to comply with the FRC’s own guidance, particularly when the Sharman recommendations are implemented. |</p>
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<td><strong>C.2</strong> The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.</td>
<td>C.2.1 A report that the board has conducted a review of the effectiveness of the company’s risk management and internal controls systems.</td>
<td>5</td>
<td>The FRC’s Turnbull Guidance provides assistance with implementing this provision; the disclosures around the main features of the risk management systems are often given alongside the risk reporting in the annual report; the description of how the annual review of the effectiveness of internal control has been conducted is usually included in the audit committee report. The disclosures generated are often less insightful than the main risk disclosures – this may change when the Turnbull Guidance is reviewed later in 2013. The ‘nature and extent of the significant risks’ refers to the company’s ‘risk appetite’; this is most relevant for financial services companies, most of which have a separate risk committee and risk committee reporting. There is a current focus on the governance applied to subsidiaries at the present time, and the FSA also challenges regulated entities on this. Disclosures should demonstrate that appropriate arrangements are in place at significant operations around the group.</td>
</tr>
<tr>
<td><strong>C.3</strong> The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditors.</td>
<td>C.3.6 Where there is no internal audit function, the reasons for the absence of such a function.</td>
<td>Appendix</td>
<td>See C.1 and C.2 above for the corporate reporting and risk management and internal control aspects of this principle. For the relationship with the company’s auditors see provision C.3.8 below. The disclosures for C.3.6 are likely to suitable for the compliance appendix.</td>
</tr>
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<td><strong>C.3.7</strong> Where the board does not accept the audit committee’s recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position.</td>
<td>5</td>
<td></td>
<td>Unlikely to be an issue, and would be covered by chairman of the audit committee (at least) if it arose.</td>
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Main principle | Disclosure provision | Skeleton report section | Comments
---|---|---|---
C.3.8 A separate section describing the work of the audit committee in discharging its responsibilities, including:
• The significant issues that it considered in relation to the financial statements, and how these issues were addressed
• An explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, including the length of tenure of the current audit firm and when a tender was last conducted
• If the external auditor provides non-audit services, an explanation of how auditor objectivity and independence is safeguarded
5 | Note: this requirement for a ‘separate section’ is not new – it was simply included in a different provision within the earlier Codes.

The relationship with the external auditors is likely to be a focus for investors, particularly with the new provision requiring the external audit contract to be put out to tender at least every ten years on a comply-or-explain basis. The disclosure of the assessment of the effectiveness of the external audit process has been strengthened in the 2012 Code to include how this was done, and the provision of non-audit services (often including the ratio of non-audit to audit fees and comments thereon) is of course a frequent focus of investor attention.

The ‘significant issues’ reporting of the key accounting judgements and estimates considered by the audit committee has generated considerable attention. PwC has issued a separate Practical Guide to this area\(^6\) (and to the fair, balanced and understandable reporting under provision C.1.1 above).

Section D – Remuneration

D.1 Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors’ remuneration should be structured so as to link rewards to corporate and individual performance.

D.1.2 A description of the work of the remuneration committee as required under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008, including, where an executive director serves as a non-executive director elsewhere, whether or not the director will retain such earnings and, if so, what the remuneration is.

n/a | This is covered in the remuneration report, which is outside the scope of this paper.

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<tr>
<td>D.2 There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.</td>
<td>D.2.1 Where remuneration consultants are appointed they should be identified and a statement made as to whether they have any other connection with the company.</td>
<td>n/a</td>
<td>Covered in the remuneration report.</td>
</tr>
</tbody>
</table>

**Section E – Relations with shareholders**

| E.1 There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. | E.1.2 The steps the board has taken to ensure that members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company. | 2 | This main principle and provisions E.1.1 and E.1.2 create challenges for many companies as they envisage a role in investor relations for the chairman, SID and NEDs that is more extensive than is generally the case. Where there is a departure from the Code this should form part of the compliance statement. With the increased emphasis on engagement between investors and companies, and the considerable focus on areas such as executive pay, relations with shareholders are an important part of the chairman’s responsibilities under the 2010 Code. |

| E.2 The board should use the AGM to communicate with investors and to encourage their participation. | | 2 | Again, this is part of the chairman’s responsibilities. Note: all directors are expected to attend the AGM (provision E.2.3); any departure from this should be explained in the compliance statement. |