



Governance in Brief

Your summary of the latest corporate governance developments

Headlines

- BIS consults on a new two-tier reporting framework.
- Vince Cable re-ignites debate on executive pay.

BIS consults on a new two-tier reporting framework

In Brief: In a first step along the path to better corporate information, BIS has issued a consultation paper proposing a new, simpler framework for narrative reporting that should reduce burdens on companies. BIS is proposing to introduce a Strategic Report and an Annual Directors' Statement, the latter of which does not have to be included in the annual report.

The Strategic Report

"a clear line of sight from the strategy, business model and risks of the company to the financial results and the resulting rewards for the company's directors"

"the level of prescription of detailed content and format will be kept to the minimum required to allow companies the flexibility to "tell their story"

The Strategic Report will continue to include the existing content required by section 417 of the Companies Act 2006 (The Business Review) but in addition quoted companies will be required to provide:

- a description of the company's strategy;
- a description of the company's business model;
- key information on executive remuneration (including the link between company performance and the remuneration of company directors and senior executives);
- a description of critical changes in the company's governance;
- disclosure on women on boards;
- information regarding human rights matters (in accordance with the newly published Guiding Principles for the "Protect, Respect and Remedy" Framework); and
- comparative information for KPIs for the preceding financial year.

"the Strategic Report will be more concise than the existing narrative report, and will cross-refer to the detailed information in the Annual Directors' Statement"

The Annual Directors' Statement

"the key source of detailed information on specific aspects of company performance"

"a prescribed structure with a set layout and standard headings will increase comparability for users and provide a helpful checklist of required disclosures for companies"

This will include detailed information and statements of policy, including those currently required by:

- the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008;
- the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (including Directors' Remuneration Report Regulations);
- the Listing Rules;
- UK Corporate Governance Code; and
- other relevant legislation and codes

It should therefore provide detailed disclosure on, for example, directors' remuneration, board and company diversity and corporate governance, as well as facilitating voluntary disclosures, for example highlighting charitable giving by the company or its employees as part of a payroll giving programme or voluntary gender equality reporting.

"the repository for reporting requirements which are required disclosures irrespective of materiality or impact on the business as a whole"

Other details in the proposals

Online vs hard copy	BIS does not anticipate that the Annual Directors' Statement will be published in glossy format. The structure of the Annual Directors' Statement will be optimised for online disclosure. However the right to request the information in hard copy will remain.
Financial statements	No changes proposed.
Remuneration report	There will continue to be a requirement for an annual advisory vote by shareholders on the full remuneration report (see next article).
Audit committee report	The audit committee report would be included in the Annual Directors' Statement.
Filing arrangements	The existing filing arrangements for annual reports, and the Annual Directors' Statement, with Companies House will remain unchanged.
Audit	The Strategic Report and Annual Directors' Statement will be reviewed by the company's auditors for consistency with the financial statements as is the case for the current Directors' Report.
Summary Financial Statements	BIS is proposing to amend the Companies Act to replace the summary financial statements with the Strategic Report.
Sign off by the board	BIS is proposing that the new Strategic Report should be signed off by each individual director as well as the company secretary.
Standing data	It should be possible to include sets of data which remain unchanged from year to year into the Annual Directors' Statement by a cross reference or link to where the additional data can be accessed. Directors will be required to confirm in the Annual Directors' Statement that they have reviewed, and where necessary updated, the information.
Liability	BIS is keen to receive views both on what can be done to encourage fuller and more meaningful disclosures and on how best to promote understanding of the protection provided by UK's liability regime.
Disclosure reductions	BIS is proposing that five specific disclosures are removed. These include the creditors' days payment policy and charitable donations.

Following this consultation, the Government will publish draft regulatory and non-regulatory solutions with a view to these becoming effective for years beginning 1 October 2012.

Date: 19 September 2011

Source: Department for Business Innovation and Skills

Deadline for comment: 25 November 2011

Further info: <http://www.bis.gov.uk/Consultations/future-of-narrative-reporting-further-consultation>

Vince Cable re-ignites debate on executive pay

In Brief: The Government continues to have concerns about the disconnect between how the largest companies perform and the rewards that are on offer. Alongside the narrative reporting consultation the Government has published a discussion paper exploring the broader issues around the link between executive remuneration and performance. It looks at the structure of remuneration and the role of shareholders and remuneration committees in setting remuneration, and invites comment on what more can be done to promote a stronger link between pay and performance.

Role of shareholders

- The Government believes that it is time to review the advisory vote on the directors' remuneration report which has been in force since 2002. The paper notes the arguments for and against a binding vote but as a binding vote has been successfully introduced in some countries there is merit in considering this further. The paper asks for views on whether a binding vote would improve shareholders' ability to hold companies to account and, if so, how it could work in practice.
- The paper asks whether there are measures which could be taken to prevent payments for failure. Suggestions that have been put forward include an *ex post* vote on the contracts of new appointments or a vote on termination payments.
- The paper highlights a recent study suggesting that the UK might benefit from adopting the Swedish model where the nomination committee is comprised mainly of major shareholders or their representatives. This enables shareholders to propose non-executive directors that the former believe would actively promote their long-term interests. The paper asks for comments on the advantages and disadvantages of adopting such a model.

Role of remuneration committees

The paper asks whether the role and membership of remuneration committees needs to be changed to respond better to the challenges in setting executive remuneration; for comments on whether there would be benefits in increasing the diversity of the remuneration committee, and; whether stronger guidance on membership to committees should be introduced to prevent conflict issues arising.

Give employees a say on remuneration

Some respondents to the earlier paper suggested that including employee representatives on the remuneration committee would bring a different perspective to the discussion and ensure that pay and conditions elsewhere in the company are genuinely taken into account. The paper asks for comments on whether this would be helpful. Another option put forward is giving employees the opportunity to vote on remuneration report and the Government seeks views on the costs and benefits of this proposal.

Transparency in the role of remuneration committees

The proposals on narrative reporting include providing a more comprehensive explanation of the services used and the fees paid to remuneration consultants and the paper asks whether this is sufficient or whether stronger guidance or regulation is needed to prevent conflicts of interest arising.

Structure of remuneration

The paper proposes a number of options for change relating to the structure of remuneration.

- **Alternative measures of performance** – some respondents to the previous paper suggested that there is too much reliance on TSR and EPS as performance measures and the paper asks whether the link between pay and performance would be improved by companies choosing more appropriate measures of performance.
- **Longer-term view** – is a three year vesting schedule truly long-term or should this be extended to five years or even longer?
- **Complexity** – the paper notes that many companies have more than one incentive plan running in parallel and that plans are increasingly complex. The paper asks whether companies should be encouraged to reduce the frequency with which long-term plans and other elements of remuneration are reviewed. Comments on a further suggestion that a more radical simplification is needed are also invited. The suggestion is that complex incentive plans are replaced by a structure which provides a substantial proportion of remuneration in shares to be held for several years with no further performance conditions. This would incentivise directors to increase the share value over the long-term. The paper also asks whether there are other ways in which remuneration could be simplified.
- **Claw-back** – should all quoted companies be required to put claw-back provisions in place?

Promoting good practice

The Government asks for views on whether there is a role for an independent body to take responsibility for improving the quality of information and, if so, what the remit of this body might cover. This might include coordinating research and developing the knowledge base, and producing an annual report on trends and good practice.

The paper makes it clear that the Government does not believe in setting limits on executive pay and does not see this body advising on levels of remuneration.

Date: 19 September 2011

Source: Department for Business Innovation and Skills

Deadline for comment: 25 November 2011

Further info: <http://www.bis.gov.uk/Consultations/executive-remuneration-discussion-paper?cat=open>

Time to take action

- Discuss the BIS proposals within your company, consider the implications and respond accordingly. BIS is keen to hear your views.

On the horizon

- Deadline for responding to the FRC Cutting Clutter paper (30 September 2011).
- Possible FRC paper on restructuring.
- Output from the Kay review of effect of UK equity markets on the competitiveness of UK business.

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