Linklaters

Annual reports for 2013 and beyond

A guide to the strategic report and other changes

September 2013

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Introduction

For listed companies, the preparation of the annual report has become an increasingly complex task over recent years. Companies have to balance their regulatory responsibilities with investor and other stakeholder expectations – all of which create competing pressures to publish more information in the annual report and yet to make it concise and relevant.

This summer has seen the culmination of several years of policy development with the finalisation of legislation affecting the structure and contents of the annual report and, in particular, the disclosure of directors' remuneration.

This guide considers the impact of these changes on UK-incorporated listed companies preparing their next annual report. The new rules apply to companies reporting on financial years ending on or after 30 September 2013. For calendar year-end companies, this means that the annual report produced in 2014 will need to comply with the new regime.

This guide is based on information available to us on 16 September 2013. However, further developments are expected, in particular, the finalisation of the FRC Draft Guidance intended to help companies to prepare the strategic report. We will update clients on further developments as they occur.

The "*Glossary*" at the end of this guide explains the terms used in this guide and how to access copies of the publications referred to in the text.

This guide is intended merely to highlight issues and not to be comprehensive nor to provide legal advice.

Key points

The main substantive changes that will affect the drafting of the next annual report are set out below. For a table summarising where to find the new rules and relevant guidance and the date from which these must be applied, see Appendix 1.

Strategic report

- The new strategic report replaces the business review.
- New disclosure requirements include:
  - business model and strategy,
  - information on human rights issues, if material, and
  - gender statistics at board and senior management levels and in the workforce as a whole.

Directors' remuneration report

- The remuneration report must be divided into a description of the company's remuneration policy and a report on the implementation of the policy in the preceding year, together with a statement from the chair of the remuneration committee.
- Additional pay disclosures will need to be made, including a single figure for total pay for each director.

Greenhouse gas emissions

- There is a new obligation for quoted companies to disclose greenhouse gas emissions in the directors' report.

Corporate governance statement

- Changes to the UK Corporate Governance Code, published in September 2012, now apply.
- Directors will need to confirm that the annual report and accounts are fair, balanced and understandable.
- The audit committee should report on material issues that arose during the year.
- Additional disclosures will need to be made, including in relation to the company's diversity policy and objectives and its progress against these objectives.

The new regime in context

The changes discussed in this guide are driven by a number of corporate governance and social concerns. Policy-makers see improving the quality of reporting as an important way of making companies and their directors more easily accountable to investors, as well as to wider society. Reporting is also regarded as a lever for changing corporate and investor behaviour, whether in general terms, such as promoting a more long-term culture, or to prompt behavioural change in specific areas.

Background to the changes

Corporate accountability

The Government's Coalition Agreement of May 2010 promised to "reinstate an Operating and Financial Review to ensure that directors' social and environmental duties have to be covered in company reporting", and to "investigate further ways of improving corporate accountability and transparency". Readers may remember that in 2004 an Operating and Financial Review was introduced, but before the provisions had taken effect they were replaced by the slightly less onerous requirements of the business review.[1]

Several consultations on narrative reporting have been carried out since 2010, with a particular focus on encouraging shareholder engagement, facilitating stewardship and countering short-termism in the equity markets. One of the findings of BIS was that it was important to make it "easier to draw out strategic information from the increasing volume of published company data".[2]

The result is the strategic report. This does not require a radical restructuring of the annual report as was originally proposed, but is a clearly defined section of the annual report. It includes a requirement to disclose the company's business model (as recommended by the UK Corporate Governance Code since 2010).

Curbing executive pay

Concerns over "reward for failure" and levels of executive remuneration (which in listed companies have increased over the last decade at a much faster rate than salaries generally) have resulted in shareholders for the first time obtaining a binding vote on remuneration policy.[3] In addition, more comprehensive disclosure of remuneration for directors, including every element of remuneration expressed as a single figure (with a total), is designed to aid the understanding and comparability of pay packages.

Reducing carbon emissions

Under the Climate Change Act 2008, the government was bound to consider whether to mandate greenhouse gas emissions disclosure, in place of the voluntary reporting promoted by DEFRA. The decision, following consultation, was to make such reporting mandatory.

Promoting gender diversity and human rights

The relative scarcity of women on listed company boards has been much discussed in recent years as a result of a number of private sector and government initiatives. Greater diversity is seen as potentially improving corporate governance and economic growth, as well as being necessary to increase equality. The Coalition Agreement committed the government to promoting gender

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1 Currently required by S.417 Companies Act 2006
2 The Future of Narrative Reporting: The Government Response (March 2012), page 3
3 S.439A Companies Act 2006

equality on the boards of listed companies. This is reflected in the new requirement to disclose in the strategic report gender statistics for senior management and in the workforce as a whole.

Human rights, is another topic that has become increasingly important for businesses, particularly since the endorsement by the United Nations of the Business and Human Rights Principles in 2011. The strategic report introduces a requirement to disclose material human rights issues, alongside social and environmental issues.

On-going developments

Although the Government and other groups are keen to encourage better reporting, this is not seen as a task for companies to tackle by themselves. Whilst companies must, of course, comply with the new legislative requirements and comply or explain against best practice recommendations, it is intended that guidance documents will be available to help them do so.

Some of these have already been issued, including in relation to remuneration the BIS Remuneration FAQs and the recently published GC100 and Investor Group Remuneration Reporting Guidance and in relation to greenhouse gas emissions the DEFRA Guidance. Others, including the final form of the FRC Draft Guidance on the strategic report and any further guidance the ABI may issue on remuneration, are yet to appear. For a summary of the key elements of the FRC Draft Guidance, see Appendix 2.

The desire to improve corporate reporting also means that other initiatives continue to be developed. We have not discussed these here as they are not directly relevant to the preparation of next year's annual report. An update on some developments of which companies may wish to be mindful is available in Appendix 3.

Preparation, approval and distribution of the annual report

Before looking in detail at the new content requirements, it is worth considering how the structure, approval and distribution of annual reports will be affected by the strategic report.

What will annual reports look like from 2013 onwards?

The short answer is that next year's annual report may not at first glance look very different from last year's. The key structural difference is that the business review, which was part of the directors' report, will now be in the strategic report. This should be a separately identifiable section of the report, since it must be signed by a director or secretary (in the same way as the directors' report and the directors' remuneration report).

The contents of a premium listed UK-incorporated company's annual reporting document under the new rules will therefore include the following:

- strategic report,
- remuneration report, comprising a policy report and an implementation report,
- directors' report,
- corporate governance report, including an introduction by the company's Chairman,
- audit committee report,
- auditors' report, and
- financial statements.

In addition to these, the document may include letters from the Chairman and/or Chief Executive, and there may be other specific reports such as a risk committee or health and safety committee report.

The corporate governance report and audit committee reports will normally be constituted as part of the directors' report in order to take advantage of the liability safe harbour for directors (see *"Directors' responsibilities – Liability for false and misleading statements"* below).

There is flexibility for companies in how the various components are structured and arranged. The FRC Draft Guidance encourages cross-referring from one section to another and even suggests that the directors' report, or parts of it, could be positioned as an appendix to the annual report document, so as to give greater prominence to the more important information in the document.

A strategic report may be issued as a separate publication, since companies are permitted to send it to shareholders (together with certain supplementary information) as an alternative to sending the full hard copy report and accounts (see "*Distribution, filing and publication – Sending the strategic report instead of the full report and accounts"* below). It is not, however, required to be published separately.

Directors' responsibilities

Directors should carefully consider the reporting changes and the disclosures made under them in accordance with their obligations to give statements of responsibility and approve the reports and accounts.

In particular, boards should ensure that they take time to consider the annual reports and accounts as a whole, even if work on different sections is being carried out by separate parts of the management team.

__Purpose of the strategic report__

Directors should bear in mind that the strategic report has a stated statutory purpose. This is the same as the purpose of the business review which the strategic report replaces, namely, to inform members of the company and help them assess how the directors have performed their legal duty to promote the success of the company.[4]

The FRC Draft Guidance expands on this by emphasising that the addressees of the report are the shareholders and that information of interest to other stakeholders should be published separately.

__Statements of responsibility__

Directors of listed companies must give a number of specific confirmations in the annual report. These have not changed under the new regime, although the scope of the confirmation to be given under the UK Corporate Governance Code has been extended (see "*Directors' report – Corporate governance statement*").

In particular, the directors must confirm that:

– the financial statements give a true and fair view of the assets, liabilities, financial position and profit/loss of the company and its subsidiaries as a whole, [5]

– the report includes a fair review of the development and performance of the business and position of the issuer and its subsidiaries taken as a whole and a description of the principal risks and uncertainties that they face,[6]

– the report and accounts, taken as a whole, are fair, balanced and understandable and provide the necessary information for shareholders to assess the company's performance, business model and strategy,[7] and

– they know of no information which would be relevant to the auditors for the purpose of their audit report and of which the auditors are not aware and that they have taken all necessary steps to make themselves aware of such information and to establish that the auditors are aware of it.[8]

__Approval and signing__

The strategic report must be approved by the board and signed on behalf of the board by a director or the company secretary.[9] This means that the strategic report, unlike the business review, needs to be dealt with separately when the accounts, directors' report and remuneration report are put before the board for approval and signing. Copies of the strategic report must also, like the other signed documents, state the name of the person who signed it on behalf of the board.[10]

As part of the approval process, directors should be reminded that, as with the other parts of the report and accounts which require approval, it is an offence for directors to approve a strategic report which does not comply with the Companies Act requirements. In line with the existing regime, however, individual directors will only be liable if they know that the strategic report does

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4 S.414C(1) Companies Act 2006
5 DTR 4.1.12(3)(a)
6 DTR 4.1.12(3)(b)
7 UK Corporate Governance Code, C.1.1
8 S.418 Companies Act 2006
9 S.414D(1) Companies Act 2006
10 S.433 Companies Act 2006

not comply with the relevant requirements, or are reckless as to whether it complies and fail to take reasonable steps to secure compliance with the requirements or prevent the report from being approved.[11]

Liability for false and misleading statements

Separately from the criminal liability directors may incur if they wrongfully approve a strategic report which does not comply with the provisions of the Companies Act, directors may incur civil liability for any untrue or misleading statements in the strategic report. Specifically, directors will need to compensate the company for any loss it suffers as a result of any untrue or misleading statement in, or omission from, the strategic report.

Liability only attaches, however, if the director knew (or was reckless as to whether) the statement was untrue or misleading, or knew the omission to be a dishonest concealment of a material fact. There is also a safe harbour in that, in the absence of knowledge or recklessness, directors are protected from liability to any other persons.[12]

These provisions were originally introduced in relation to the directors' report and remuneration report to clarify the liability of directors and listed companies to investors. The aim is to encourage meaningful narrative reporting by keeping the trigger for liability high. It is helpful, therefore, that they have been extended to the strategic report as well.

Distribution, filing and publication

Sending the strategic report instead of the full report and accounts

Under the new regime, companies have the option of sending the strategic report (together with certain supplementary information) to shareholders in place of the full annual report and accounts[13], unless this is prohibited by the company's constitution or the shareholders specifically elect otherwise.

The supplementary information must point out that the strategic report is only part of the annual report and accounts and also explain how shareholders can obtain the full report and accounts. Details of any qualifications in the auditor's report should also be given, together with the single total figure table for directors' remuneration.

This option is likely to interest companies with many retail shareholders and/or companies whose shareholders continue to receive hard copies of the report and accounts, rather than accessing them electronically.

Companies which wish to provide a strategic report with supplementary information to shareholders should also note that the relevant Listing Rule[14] is being updated to refer to this, rather than to the summary financial statement. As before, information sent to shareholders in place of the full report and accounts must disclose earnings per share.

Shareholder elections

Previously, if companies wanted to send shareholders a reduced version of the report and accounts they could send a summary financial statement. This option has now been removed. However, if shareholders have previously elected to receive the summary financial statement, in

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11 S.414D(2) Companies Act 2006
12 S.463 Companies Act 2006
13 Ss.426 and 426A Companies Act 2006
14 Listing Rule 9.8.13

place of the full annual report and accounts, these elections can be relied on for sending the strategic report. This is helpful as it means no additional consents need to be sought. In practice, it is unlikely to benefit the many companies which stopped sending out summary financial statements, preferring instead to cut the costs of producing hard copy documents by sending out the report and accounts using electronic communications.

Where elections are not in place, the relevant regulations[15] set out two alternative procedures for ascertaining that shareholders do not wish to receive the full report and accounts. The simpler procedure is a freestanding consultation where the company notifies a shareholder that they will in future receive a copy of the strategic report with supplementary information, unless they notify the company that they wish to receive the full report and accounts within the period specified in the notice. The consultation must take place at least 28 days before copies of the next report and accounts are circulated to shareholders.

The other procedure involves a similar notice but takes place as part of the circulation of the annual report and accounts and relates to future years. Under both procedures, shareholders have to specifically elect to continue to receive the full report and accounts.

Filings and other distributions

The usual provisions for filings and distribution of the accounts remain unchanged. Companies will therefore need to file the annual report and accounts, including the strategic report, with Companies House, making sure that the strategic report has been properly and separately signed.

They will also need to send copies of the annual report and accounts (or strategic report and supplementary information) to all those entitled to receive them, as well as making them available on the company's website.

15 The Companies (Receipt of Accounts and Reports) Regulations 2013 (SI 2013/1973)

Strategic report

The strategic report replaces the business review but is intended as a separate section of the annual report, distinct from the directors' report.

The new content requirements

The prescribed contents of the strategic report are largely the same as the business review, except that quoted companies will also have to include:

- a description of the company's strategy and business model (thus making mandatory the existing comply or explain disclosure in the UK Corporate Governance Code),
- to the extent necessary for an understanding of the development, performance or position of their business, information about human rights alongside social and community issues (including information on any human rights policy and its effectiveness),
- the number of persons of each sex in the following categories at the end of the financial year:
  - directors of the company,
  - senior managers of the company and of the undertakings consolidated in its accounts (senior manager for this purpose includes directors of those undertakings), and
  - employees of the company and of its consolidated undertakings.

To offset the additional disclosures, at least in part, the disclosure by quoted companies of their essential contractual arrangements is no longer required.

Companies will also be able to include in the strategic report matters required to be disclosed in the directors' report if they are of strategic importance. It will not be necessary to include the disclosure twice as the directors' report can cross-refer to the strategic report.

Business model

The UK Corporate Governance Code already recommends that companies should describe their business models in the annual report, by including an explanation of the basis on which the company generates or preserves value over the longer term.[16] The FRC Draft Guidance adopts the definition of the business model in the UK Corporate Governance Code but adds a further component. Disclosure is required not just of the basis on which the company generates or preserves value but also how it captures value (i.e. how the value generated by business activities is captured and converted into financial benefits).

In practice, the FRC Draft Guidance suggests that the directors should describe what the company does and why it does it and what makes it different from, or the basis on which it competes with, its peers. This includes:

- how the company is structured,
- the markets it operates in and how it engages with them,
- the nature of the relationships, resources and other inputs that are necessary for the successful continuation of the business, and

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16 UK Corporate Governance Code, C.1.2

– the parts of the company's business process that are most important to the generation, preservation or capture of value.

Strategy

According to the FRC Draft Guidance, the disclosure of strategy should include a description of the company's principal objectives, and its strategies for achieving those objectives. While objectives may be expressed in financial terms, non-financial objectives should also be disclosed where achieving them is important for the company's future development, performance and position.

The FRC Draft Guidance stresses that objectives, strategy and business model are inter-related. A company will decide on its objectives and select strategies to achieve those objectives before applying its business model to its activities in pursuit of its objectives and strategies. Companies may use different terms for these concepts but overall the disclosure should cover "what an entity does and how and why it does it".[17]

Human rights issues

Many companies have adopted policies on human rights and seek to embed respect for human rights into their business practices, particularly following the Business and Human Rights Principles. Companies should consider what disclosure they need to make to address these matters. Discussions on this will not necessarily be required in every company's strategic report.

The FRC Draft Guidance includes an example of a business that sources products from overseas where there are customer concerns over local labour practices. If the effect of the risk on the business is such that it would be of interest to shareholders, it should be included in the strategic report, together with information on the company's human rights policy and the effectiveness of that policy (for example, by reference to a key performance indicator). The strategic report should make clear why disclosure is considered necessary. It should also include information on the policies of the company and the effectiveness of those policies. If the directors consider such information important, but not material, to shareholders it should be located elsewhere, such as in a sustainability report.

As is the case for issues relating to the environment, employees and social/community issues, the obligation to disclose human rights issues applies where necessary for an understanding of the development, performance or future prospects of the business (i.e. where material).

Diversity

As mentioned above, quoted companies will need to provide a breakdown by gender of the directors of the company and both the "senior managers" and employees of the company and its subsidiary undertakings taken as a whole, as at the year-end.

For the purposes of the strategic report, senior managers include directors of subsidiary undertakings and employees who otherwise have responsibility for planning, directing or controlling the activities of the group or a strategically significant part of it.

Companies should note that this definition is wider than the definition of key management personnel in UK and international accounting standards and may include, for example, a person responsible for a particular business segment. As a result, companies will need to make sure they have properly identified who is covered, as well as collating the necessary details.

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17 FRC Draft Guidance, paragraph 6.30

Remuneration report

Revised rules for the disclosure of remuneration are one of the most significant elements of the new reporting regime. This section gives an overview of the main changes affecting pay disclosures, as well as indicating where to find further information and advice. All UK-incorporated quoted companies will need to comply with the new rules. Non UK-incorporated companies may choose to comply.

The business of the Annual General Meeting in 2014 will be affected by the new binding vote on remuneration policy, in addition to the advisory vote on remuneration paid during the year. We will report on this aspect of the new regime in our next AGM Alert client publication.

Directors' remuneration report

Under the new rules, information about the remuneration of directors will be split into two separate parts, namely:

– a policy report, which is forward-looking, with details of all elements of the company's remuneration policy and key factors that were taken into account in setting the policy, and

– a report on how the policy was implemented in the previous financial year, with details of actual payments to directors and the link between company performance and pay.

There should also be a statement from the chair of the remuneration committee setting out the major decisions on directors' remuneration, the major changes during the year, and the context in which the changes occurred and decisions have been taken. Most companies already include such a statement in their reports; they are now required to do so.

The policy report

The following must be included in the policy section of the remuneration report:

– The company's remuneration policy for all directors, set out in a table showing each component of the pay package and how it works, including how the pay policy supports company strategy, the maximum which may be paid and details of performance conditions.

– An explanation of why the specific performance conditions were chosen.

– Recruitment pay policy, including potential maximum payments for bonuses and awards.

– Termination pay policy.

– Any service contract provisions which impact on remuneration or loss of office payments.

– Bar charts for each director showing the total remuneration receivable, separated into fixed and variable pay and performance measures being met in line with expectations and fully met.

– How pay and employment conditions of employees generally were taken into account when setting the directors' pay policy and whether the company consulted employees.

– Whether and how shareholders' views expressed to the company have been taken into account when setting directors' pay policy.

The implementation report

The following must be included in the implementation section of the remuneration report:

– A single figure for each component of pay for each director and a total, as well as the figures for the preceding financial year.

- Payments to past directors.
- Full details of any termination payments.
- An explanation of how executive pay compares to other costs (such as group employees, tax, dividends, share buy backs and retained profits).
- The percentage increase in the chief executive officer's pay relative to the employees' total remuneration since the previous financial year.
- The total shareholder return comparator graph already required under the current disclosure rules (starting with five years and increasing to 10), plus a separate table setting out, for each year of that period, total chief executive officer remuneration (determined as for the single figure table), and the bonuses and incentive awards shown in the table expressed as a percentage of the maximum possible bonuses and incentive awards.
- Details of directors' shareholding requirements.
- A table showing directors' interests in company shares.
- Remuneration committee details.
- How shareholders have voted on both sections of the remuneration report in the previous financial year, including the number of abstentions, and where there was a significant percentage of votes against, the reasons for shareholder dissent (if known) and any resulting action which the remuneration committee has taken.

Listing Rules consultation

The FCA has published a consultation paper which proposes changes to the Listing Rules due to the overlap between some of these and the new remuneration reporting regulations. As the new regulations apply only to UK-incorporated companies, the FCA intends to retain the limited Listing Rules requirements on remuneration applying to both UK and overseas companies.

As a result, the FCA proposes to delete almost all of the requirements for information on directors' remuneration to be included in the annual financial report.[18] The requirement for UK and overseas companies to include details of the unexpired term of a director's service contract where the director is proposed for election or re-election at the forthcoming Annual General Meeting will be retained.[19]

The FCA has requested comments on the consultation by 9 October 2013 and intends to publish feedback later this year. The final rules changes are intended to be implemented on 1 January 2014, for companies with financial years ending on or after that date.

This creates a situation where companies with financial years ending before 1 January 2014 (including all calendar year-end companies) still have to comply with the current Listing Rules requirements, despite reporting under the new statutory regime in 2014. The discrepancy may be ironed out in the final rules and, in practice, should not impose any additional reporting burdens. Nevertheless, companies may need to bear in mind that their reports on pay in 2014 should be checked for compliance with the existing Listing Rules.

18 LR 9.8.8R
19 LR 9.8.8(9)R

Guidance on remuneration reporting

BIS Remuneration FAQs

In March 2013 the BIS Remuneration FAQs were published to answer questions commonly arising on the Government's remuneration reforms. These are helpful in explaining the details of the new statutory framework and how it is to be applied, but focus on the new shareholder voting rights, rather than the revised disclosure regime.

GC100 and Investor Group guidance

The GC100 and Investor Group, representing both large companies and institutional investors, issued detailed Remuneration Reporting Guidance on 12 September. This was produced in response to a call from the Government for the business and investor communities to agree on the level of detail and type of information to be disclosed within the new legislative framework.

The Remuneration Reporting Guidance is comprehensive and should assist companies in implementing the new disclosure regime, whilst bearing in mind investors' views. The main points to note are as follows:

– The policy report should be put to a shareholders' vote once every three years, as envisaged by the new rules, and not annually. Policy reports should be structured to stand the test of time and be broad and flexible enough to allow companies to respond to events without needing to be amended (though the annual remuneration report should include the policy report so pay disclosures may be seen in context).

– The mandatory requirements of the legislation are distinguished from desirable additional disclosures expected by investors (for example, the circumstances in which a discretion has been exercised and why this was required).

– There is a useful discussion of the terms "flexibility", "discretion" and "judgement" which are viewed as crucial for the successful design and implementation of pay policy.

– Policies on termination payments should set out how the remuneration committee classifies leavers but, to ensure that the policy is flexible enough to cover similar situations, the Remuneration Reporting Guidance suggests that these are set out merely as examples.

– Boilerplate disclosures are to be avoided and innovation in reporting is encouraged, with a view to eliciting meaningful and concise disclosures, relevant to the company and its particular circumstances.

The Remuneration Reporting Guidance is intended to be relevant and useful. As a result the GC100 and Investor Group have committed to reviewing it and issuing updates from time to time.

The GC100 and Investor Group have also said that the success of the Remuneration Reporting Guidance will not be measured by the number of remuneration reports voted down, but by the quality of engagement and stewardship between investors and remuneration committees. The new regime is seen as a real opportunity for companies to stand back and see how directors' pay fits with their overall strategy, before approaching investors with fully formed proposals. Investors also need to rise to the challenge by engaging in consultation with companies more and focussing on the key issues.

ABI Principles of Executive Remuneration

The most recent version of the ABI Principles of Executive Remuneration was published in November 2012, before the new pay reform legislation had been finalised. As a result, the document set out some general expectations of investors, but also stated that it was too early at that time to give detailed guidance on the new remuneration regime.

Useful key messages in the ABI Principles of Executive Remuneration include the following:

- The variable element of remuneration should be kept as simple as possible.
- The remuneration committee should protect and promote the interests of shareholders.
- Performance measures should be linked to company strategy and not encourage risk taking.
- Companies should consider the impact of total employee pay costs on the finances of the company, its investment and capital needs and returns to shareholders.

The ABI generally review and update their guidance on remuneration annually, therefore a statement or publication on this is likely to be issued later this year.

In any case, the ABI was part of the working group which developed the GC100 and Investor Group's Remuneration Reporting Guidance. It is to be hoped, therefore, that any revised ABI Principles which are published will dovetail with the Remuneration Reporting Guidance.

Linklaters guides to directors' remuneration

Linklaters have produced two Navigating Change guides to the new rules. A free summary guide, available here, contains an explanation of how to calculate the single figure and an overview of how the rules will work.

Our detailed Navigating Change subscription guide has been updated twice since it was first issued and is currently being updated again to include the GC100 and Investor Group's Remuneration Reporting Guidance. The fully updated guide will shortly be available via our remuneration micro-site and will include a detailed description of the new rules and commentary on how to comply, together with a summary in tabular form of how to complete the single figure table and commentary on the new Remuneration Reporting Guidance. Those who have already subscribed for our Navigating Change guide will be notified once it has been updated and will be able to view the update at no extra cost.

Linklaters also offers a comprehensive compliance check for implementation reports and policy reports.

For access to our detailed Navigating Change guide and remuneration micro-site and/or our compliance check service, please see the contact names of the remuneration specialists given in the *"Further information"* section at the end of this document.

Directors’ report

The revised reporting rules require quoted companies to include disclosures on greenhouse gas emissions in the directors’ report. In compensation, a number of unwanted disclosure requirements have been removed.

In addition, companies which have not pre-complied with the changes to the corporate governance statement, introduced in November 2012, must get to grips with them this year.

Greenhouse gas emissions

The scope of the new rules

The directors’ report must disclose emissions of the company that are attributable to human activity in tonnes of carbon dioxide equivalent for all six greenhouse gases.[20]

The disclosure should include emissions:

- from activities across the world for which the company is responsible, including the combustion of fuel and the operation of its facilities, and
- resulting from the purchase of electricity, heat, steam or cooling by the company for its own use.

These are in effect “comply or explain” obligations, as they apply only to the extent that it is practical for the company to obtain the information. The report must explain the basis of disclosure and, if information is not included, why this is so.

The DEFRA Guidance has been published to help companies make their greenhouse gas disclosures. However, it is not clear on the meaning of the term: “activities for which the company is responsible”. It gives several examples of when a company might not be responsible, including where the relevant activities have been outsourced and are under the control of a third party. This suggests that the “responsible for” test may be related to operational control.

Companies should consider all emission sources, not just permanent or stationary ones. Mobile, temporary and offshore emission sources should be addressed, in respect of both process emissions and fugitive emissions (such as equipment leaks from joints or seals or emissions from coal piles or cooling towers). This goes beyond what many companies have been reporting on voluntarily. In particular, fugitive emissions will be problematic to quantify, and companies with many mobile and temporary emission sources (such as in the construction sector) could find data collection onerous.

The DEFRA Guidance specifies that companies must make every reasonable effort to acquire all material data. If the company cannot report on all material emissions, the company is recommended to state what steps it is taking to acquire the missing data.

Emissions of suppliers or of downstream users of products or services are not reportable, though companies may do so voluntarily.

Once a company has established the boundary within which it will report its emissions, the DEFRA Guidance states that it can consider whether particular emissions are material to total company

20 These are: carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF_6)

emissions. This depends on individual circumstances, such as the nature of an operation, and is a judgement for the company.

Disclosures must state emissions for an annual period. This need not be the same as the financial reporting period, but the report must state if this is the case. The majority of the period reported on must be within the financial reporting period.

Methodologies

Companies can choose which methodologies to use, provided they are robust and generally accepted. They must be specified in the report. Widely recognised independent standards are recommended.

Companies can use information from regulatory reporting processes, provided the data source is disclosed, though companies should consider whether additional data is required and whether data gaps are material.

Intensity ratios/comparators

The directors' report must state one or more ratios which express annual greenhouse gas emissions in relation to a quantifiable factor associated with the company's activities. This might be a financial measure such as turnover, or a factor more closely related to business activities, such as the number of units produced or, for a retailer, square metres of floor space.

From the second reporting year, companies will have to report on emissions for the year under review, against reported emissions for the preceding year. It is permissible to re-calculate the preceding year's emissions to address structural changes since then, but if this is done, it should be explained.

Verification

There is no regulatory requirement for verification, but many companies are considering independent assurance. The company's auditors have limited obligations in relation to greenhouse gas reporting but, as with other information in the directors' report, will consider its consistency with the financial statements and apparent material inconsistencies or mistakes based on the knowledge they have from the audit.

Transitional provisions

Companies which do not have emissions data for the period before 1 October 2013 can either provide an estimate extrapolated from the company's own data or from generic data not specific to the company and explain the methodology used, or explain why they are unable to provide data.

Disclosures abolished

To offset the additional disclosures which must now be included in the strategic and directors' report, certain reporting requirements have been deleted, on the basis that they duplicate other provisions or are no longer considered to provide significant information.

It is, therefore, no longer necessary for companies to include in the directors' report information about:

– their essential contractual arrangements (quoted companies),

– their principal activities (although quoted companies are now required to disclose the business model in the strategic report),

– asset values,

- charitable donations,
- the acquisition of their own shares (private companies), and
- policy and practice on payments to creditors.

Corporate governance statement

The FRC published amendments to the UK Corporate Governance Code and the FRC Guidance on Audit Committees in September 2012. The changes take effect for financial years commencing on or after 1 October 2012, which ties in with the introduction of the strategic report and other statutory reporting changes. Many companies have pre-complied with these requirements in their 2013 reports, but, for convenience, we have set out a reminder of the main points for companies to consider.

Board confirmation that report and accounts are fair, balanced and understandable

Boards must confirm that the report and accounts are not only balanced and understandable, but also fair, and that they provide the necessary information for shareholders to assess the company's performance, business model and strategy. As a result, directors should take care to ensure that there is an appropriate level of review of the annual report and accounts as a whole.

Providing a good explanation

The 2012 UK Corporate Governance Code contains additional guidance on what constitutes a good explanation of non-compliance. Companies may wish to consider the examples of good explanations given in the FRC Report on Corporate Governance 2012 and the ABI Comply or Explain Report. The ABI has found that disclosure is generally better when the chairman provides an introduction to the corporate governance statement. More recently, in July 2013, the ABI Corporate Governance Report recommended that the FRC consider incorporating this into the UK Corporate Governance Code as a provision.

The ABI Corporate Governance Report also calls for companies to focus more on explaining how they apply the principles of the UK Corporate Governance Code, whether or not they are complying or explaining against the Code.

Audit committee reporting

The UK Corporate Governance Code now requires the audit committee to report to shareholders on how it has discharged its responsibilities. This includes reporting on the significant issues that it has considered in relation to the financial statements and how these issues were addressed. The audit committee report should also give details of how the committee assessed the effectiveness of the external audit process, the approach taken to the appointment or reappointment of the external audit firm and when a tender was last conducted.

A particular issue for audit committees is the requirement to report on significant issues. The FRC Guidance on Audit Committees confirms that this is a matter for the audit committee to judge, but that it should include matters that have informed the board's assessment of whether the company is a going concern. The disclosure by the audit committee should be concise and understandable, and may cross-refer to other information in the annual report. The audit committee is not required to disclose information that would be prejudicial to the interests of the company (for example, because it relates to impending developments or matters in negotiation).

Audit committees should note the emphasis in the FRC Guidance on Audit Committees on formal reporting to the board. The requirements dovetail with the audit committee's report to shareholders, for example, in relation to significant issues arising from the audit and their assessment of the effectiveness of the audit process.

The Financial Reporting Lab launched a project in December 2012 to investigate what investors find most useful in audit committee reports and whether additional information would add value. The aim is to enable companies to provide the information that shareholders need in order to have an informed discussion about the work of the audit committee and how it promotes shareholder interests. A report is expected later this year.

Diversity and succession planning

While noting examples of good practice, the ABI Report on Board Effectiveness 2012 concluded that the majority of diversity disclosures are boilerplate. To improve disclosure, as is now required by the UK Corporate Governance Code, the ABI recommended that companies should, for example:

– disclose the steps they are taking to promote a diversity of perspective and to ensure they have the right balance of skills and experience in their boardrooms,

– provide meaningful disclosure about the board appointment process, the barriers they face in appointing women to their boards and how they seek to address this issue, and

– give details of the initiatives they have in place to develop women in the organisation.

Diversity is an area on which investors will continue to focus, especially given recent statistics that appear to show that the rate of appointments of women to FTSE 350 boards is slowing down.[21]

21 See the update by Lord Davies “Women on boards. April 2013”

Action points

The following list sets out some of the main action points for companies to consider when preparing for the next annual report. The list is not exhaustive and should be adapted for each company's individual procedures and requirements.

Action	✓/x
Structure	
Consider the structure of the annual report as a whole – are changes required to ensure effective communication with shareholders?	
Consider how to lay out the annual report. Should the company produce a stand-alone strategic report and/or include it in the same document as the rest of the annual report? How does this impact on printing times and costs?	
Does the annual report include appropriate cross references and linkages between different sections?	
Approval and signing	
Review procedures for drawing up and approving the annual report as a whole – can the directors confirm it is fair, balanced and understandable and contains all necessary information?	
Establish a process for approving and signing the strategic report – this should be done alongside the other reports.	
Distribution	
Consider whether shareholders should be encouraged to receive the strategic report with supplementary information, rather than the full report and accounts.	
Check whether shareholder elections are already in place to allow the company to send shareholders just the strategic report with supplementary information and/or begin a process of consultation with shareholders.	
Remuneration	
Consider what needs to go in the policy report: is it broad and flexible enough to allow the company to respond to events over the next three years without needing to be amended? Will the company be able to honour existing contractual obligations?	
Check that the implementation report is drafted in line with the new requirements and guidance.	
Greenhouse gas emissions	
Identify greenhouse gas emissions on which the company must report. Collect all material data for the current year or determine what must be done to acquire missing data.	
Choose robust and generally accepted methodologies and appropriate intensity ratios/comparators.	
Consider auditing/verification.	
Diversity and human rights	
Check that all directors and members of senior management covered by diversity disclosures have been identified.	
Do additional processes need to be put in place to collect new diversity data?	
Consider whether human rights issues are material to the business – develop a human rights policy and establish processes to implement it and monitor on-going risks.	

Glossary

ABI	Association of British Insurers.
ABI Comply or Explain Report	The ABI report on investor expectations and comply or explain disclosures, published in December 2012 and available at www.ivis.co.uk
ABI Corporate Governance Report	The ABI report on, among other things, the purpose of corporate governance and reporting, published in July 2013 and available at www.abi.org.uk
ABI Principles of Executive Remuneration	ABI guidelines on executive remuneration policies and practices, dated November 2012, and available at www.ivis.co.uk
ABI Report on Board Effectiveness 2012	The ABI report on board effectiveness, published in December 2012 and available at www.ivis.co.uk
BIS	The UK government's Department for Business, Innovation and Skills.
BIS Remuneration FAQs	The BIS Frequently Asked Questions guidance on its directors' remuneration reforms, published in March 2013 and available at www.gov.uk
Business and Human Rights Principles	The Guiding Principles on Business and Human Rights, endorsed by the United Nations in 2011 and available at www.ohchr.org
DEFRA	The UK government's Department for Environment, Food and Rural Affairs.
DEFRA Guidance	"Environmental Reporting Guidelines: Including mandatory greenhouse gas emissions reporting guidance" published by DEFRA in July 2013 and available at www.gov.uk
FCA	Financial Conduct Authority.
Financial Reporting Lab	The Financial Reporting Lab, set up by the FRC in 2011 as a forum for investors and companies to improve reporting. More information is available at www.frc.org.uk
FRC	Financial Reporting Council.
FRC Draft Guidance	The FRC's exposure draft guidance on the strategic report, dated August 2013 and available at www.frc.org.uk
FRC Guidance on Audit Committees	The FRC's guidance to assist boards in making suitable arrangements for audit committees, updated in September 2012 and available at www.frc.org.uk
FRC Report on Corporate Governance 2012	The FRC's report on developments in corporate governance in 2012, dated December 2012 and available at www.frc.org.uk

GC100	Association of General Counsel and Company Secretaries of the FTSE 100
GC100 and Investor Group	A collaboration to agree remuneration reporting practices between the GC100, representing FTSE100 companies, and the Corporate Governance Forum network of leading institutional investors.
quoted companies	Companies which are incorporated in the UK and are listed in the UK, the EU or on the NYSE or Nasdaq. The definition does not cover AIM quoted companies.
Remuneration Reporting Guidance	Directors' Remuneration Reporting Guidance issued by the GC100 and Investor Group in September 2013 and available at www.uk.practicallaw.com/groups/uk-gc100-investor-group
UK Corporate Governance Code	The UK Corporate Governance Code, last issued by the FRC in September 2012 and available at www.frc.org.uk

Appendix 1: Summary table of new rules, guidance and timing

Topic	Effect on annual report	Timing	New rules	Guidance
Strategic report	• Business review replaced by strategic report. • New disclosures required (strategy and business model, human rights, diversity).	• Applies to financial years ending on or after 30 September 2013.	• Ss. 414A–D and 426–426A Companies Act 2006 • Receipt of Accounts and Reports Regulations 2013	• FRC Draft Guidance (open for consultation until 15 November 2013)
Remuneration	• Remuneration report split into two sections (policy report and implementation report) plus remuneration committee chair statement. • Additional pay disclosures must be made (including single pay figures for directors).	• Applies to financial years ending on or after 30 September 2013.	• Ss. 226A–F, 422A and 439A Companies Act 2006 • Schedule 8, Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008	• BIS FAQs (March 2013) • GC100/Investor Group Guidance (September 2013) • ABI Principles (November 2012)
Greenhouse gas emissions (“GHGs”)	• Directors’ report must state annual quantity of GHGs for which the company is responsible.	• Applies to financial years ending on or after 30 September 2013. • GHG year can differ from the reporting year but the report must state this.	• Schedule 7, Part 7, Large and Medium–sized Companies and Groups (Accounts and Reports) Regulations 2008	• DEFRA Guidance (July 2013)
Corporate governance	• The corporate governance statement must include new director confirmations and also disclosures on diversity, external evaluation and remuneration consultants. • A separate section of the corporate governance statement should describe the work of the audit committee.	• Applies to financial years beginning on or after 1 October 2012 (effectively the same as the other timing requirements). • Companies encouraged to pre-comply in 2013 and many will be more familiar with these new rules.	• UK Corporate Governance Code, September 2012 edition	
Others	• Certain reporting requirements deleted from the directors’ report (principal activities, asset values, charitable donations, creditor payments).	• Applies to financial years ending on or after 30 September 2013.	• S.416 Companies Act 2006 • Schedule 7, Large and Medium–sized Companies and Groups (Accounts and Reports) Regulations 2008	

Appendix 2: Summary of FRC Draft Guidance

The FRC Draft Guidance was published for consultation in August 2013 and aims to help companies to prepare the new strategic report, as well as improve the quality of narrative reporting generally. This follows a request from BIS for the FRC to develop non-mandatory guidance. The consultation is open for comments until 15 November 2013. Guidance is expected to be finalised in early 2014 and will replace the Accounting Standard Board's 2006 guidance on the Operating and Financial Review. For convenience, the key elements of the guidance are summarised below. Companies should bear in mind that these may change as a result of the process of consultation.

Materiality and the strategic report

The FRC Draft Guidance stresses that the strategic report should only include information relevant to shareholders' needs, meaning information which if omitted or misrepresented might reasonably be expected to influence the economic decisions of shareholders. The inclusion of too much detail can obscure important messages.

Material information is called for where information is required "to the extent necessary for an understanding of", for example, trends and factors or where there are references to "key" or "principal" matters (such as key performance indicators or principal risks and uncertainties). The number of items disclosed as a result should be relatively small.

In a group report, matters should only be disclosed if they are material to an understanding of the development, performance, position or future prospects of the company and its subsidiaries taken as a whole. This may, however, require disclosure of a single business segment if it meets the materiality threshold for the group.

The concept of materiality cannot, however, be applied to disclosures required by law or regulation (such as diversity information) unless explicitly allowed, for example, by use of the term "to the extent necessary for an understanding" or "principal".

Linkages

One of the main aims of the FRC Draft Guidance is to encourage the preparation of "cohesive" reports. The strategic report should highlight relationships and interdependencies (or "linkages") between information presented in different parts of the annual report. The use of cross references to link related information is encouraged, as is combining information required from different sources to avoid duplication. Non-exhaustive examples of possible linkages are given throughout the FRC Draft Guidance. For example, where the funding of a defined benefit pension scheme deficit is included in the discussion of principal risks and uncertainties in the strategic report, the FRC Draft Guidance suggests that it may be helpful to cross refer to more detailed scheme disclosures in the notes to the financial statements. Where an entity has an objective to reduce its greenhouse gas emissions, the FRC Draft Guidance suggests combining the disclosures that meet the strategic report requirement to describe the company's strategy on emissions with the disclosure of greenhouse gas data required in the directors' report.

Communication principles

The FRC Draft Guidance includes a number of communication principles. These relate to the strategic report but will also be relevant in the drafting of the annual report as a whole. The principles include the following:

- The report should be fair, balanced and understandable, covering positive and negative aspects, use plain language and adopt different methods of presentation (such as tabular, graphical or pictorial methods) to convey information.

– The report should be concise, only covering strategic information that is relevant to how the directors performed their duty to promote the success of the company as a whole. Although the report must be comprehensive, this does not mean it should cover all matters in substantial detail.

– The report should have a forward looking orientation. It should not focus on a single timeframe and should give due regard to the short-, medium- or long-term implications of the fact or circumstance being described.

– The report should be company specific and avoid generic information, but provide information on how the company will be affected which gives insights into the company's prospects.

– Preparers should avoid a checklist style as the order will be driven by the disclosure requirements and this often leads to too much detail that obscures important requirements.

The following highlights the key points of the FRC Draft Guidance on the specific content of the strategic report. It is a summary and is not a substitute for reading the full document.

Topic	Summary of FRC Draft Guidance
Principal risks and uncertainties *Paras 6.49–6.54*	The risks and uncertainties included in the strategic report should be limited to those considered by the company's management to be the most important. They will generally be matters that the directors regularly monitor and discuss. They can be risks resulting from internal factors (such as strategic decisions, operations, organisation or behaviour) or external factors. Principal risks or uncertainties that may threaten the company's solvency and/or liquidity should be explained fully and given due prominence. Descriptions should be sufficiently specific that a shareholder can understand why they are important to the company. This might include a description of the likelihood of the risk, an indication of when the risk might be most relevant to the company and its possible effects. Significant changes in principal risks, such as a change in likelihood or possible effect, or the inclusion of new risks, should be highlighted and explained. An explanation of how the principal risks and uncertainties are managed or mitigated should also be included.
Analysis of development, performance and position of company's business *Paras 6.60–6.63*	This should provide additional explanations of amounts recorded in the financial statements and the conditions and events that shaped the information contained in them. It should aim to answer the questions that are commonly asked by shareholders at an Annual General Meeting or at results presentations. The analysis should make reference to cash flows during the year and factors that may affect future cash flows. Where appropriate, the strategic report should discuss the company's current and prospective liquidity and its ability to fund its stated strategies. The strategic report should set out the key strengths and tangible and intangible resources available to the company, especially if not reflected in the financial statements, such as corporate reputation and brand strength, natural resources, employees, research and development, intellectual capital (licences, patents, copyrights and trademarks) and market position.
Analysis using key performance indicators ("KPIs") *Paras 6.55 – 6.59*	KPIs should be those that the directors judge are most effective in assessing progress against objectives or strategies. Where possible, they should be accepted and widely used, either within the company's industry sector or more generally.

Topic	Summary of FRC Draft Guidance
	Comparatives should be included for KPIs and the reasons for any significant changes from year-to-year explained. Information should be provided to enable shareholders to understand each KPI (for example, how it is calculated, the source of the data and significant assumptions). Where a line item from the financial statements, or a commonly used KPI, has been adjusted, this should be explained and a reconciliation provided.
Main trends and factors likely to affect the future development, performance and position of the business *Paras 6.42–6.48*	Trends and factors affecting the business may arise either as a result of the external environment in which the company operates (for example, arising from the company's competitive position in main markets) or from internal sources (such as benefits expected from capital investment). Given the influence trends might have on many aspects of the business, linkages to other areas of the annual report will be particularly important. Directors should consider the potential future significance of trends or factors in deciding whether or not to include an analysis of them in the strategic report. Where practicable and relevant, the trend or factor should be quantified and supporting evidence identified.
Description of business model *Paras 6.37–6.41*	Provides context for the annual report as a cohesive document. Disclosure is required not just of the basis on which the company generates or preserves value but also how it captures value (i.e. how the value generated by business activities is captured and converted into financial benefits). The report should describe what the company does and why it does it and what makes the company different from, or the basis on which it competes with, its peers. The description should explain how the company is structured, the market it operates in and its products, services, customers and distribution methods, the nature of the relationships, resources and other inputs that are necessary for the successful continuation of the business and the parts of the company's business process that are most important to the generation, preservation or capture of value.
Description of strategy *Paras 6.31–6.36*	This should include a description of the company's principal objectives and its strategies for achieving those objectives. Non-financial objectives should also be disclosed where achieving them is important for the company's future development, performance and position. Objectives, strategy and business model are inter-related. A company will decide on its objectives and select strategies to achieve those objectives before applying its business model to its activities in pursuit of its objectives and strategies. Companies may use different terms for these concepts but overall the disclosure should cover what a company does and how and why it does it.
Environmental, employee, social / community and human rights issues *Paras 6.64–6.67*	The strategic report should make clear why disclosure is considered necessary. It should also include information on the policies of the company on those matters and the effectiveness of those policies. Information that is important but not material to shareholders should be placed elsewhere; for example, in a sustainability report.
Breakdown of directors, senior managers and employees by gender *Paras 6.68–6.71*	Senior managers include employees who are directors of subsidiary undertakings or who otherwise have responsibility for planning, directing or controlling the activities of the group or a strategically significant part of it. This may include those with responsibility for a reportable segment of the business. The disclosure should enable shareholders to ascertain the number of persons of each sex who might, in due course, become directors of the parent company.

Appendix 3: Reporting proposals in the pipeline

The following developments will not, for the most part, affect the next annual report of UK incorporated companies, but companies may wish to be aware of the trends they represent.

Country by country reporting

Under the EU's latest capital requirements reform package, known as CRD 4, banks and credit institutions will be required to publish annual information, including on their profit or loss before tax, tax on profit or loss and public subsidies received on a country by country basis from 1 January 2015. Information on activities, turnover and employees must be published by 1 July 2014. Global systemically important institutions are to disclose further information to the EU Commission on a confidential basis by 1 July 2014. The Commission must then determine whether there are any negative effects arising from the disclosure by 31 December 2014, in which case it may defer or propose modifications to the reporting obligations.

Payments to governments by extractive and logging companies, disclosure regarding conflict minerals

Under amendments to existing EU legislation, EU listed companies and large EEA companies in the extractive and logging of forestry industries will be required to publish an annual report on the payments they make to governments.[22] The new rules will apply from 1 January 2016, but unlisted companies may be given a further year to comply.

SEC rules which would also have required resource extraction issuers to disclose the payments they make to governments have been invalidated, following a successful legal challenge in July 2013. The SEC has decided not to appeal and will propose new rules consistent with the court's decision at some point, although a timetable has not been published.

By contrast, SEC rules that require SEC reporting companies to make disclosures relating to the use of certain "conflict minerals" financing conflict in the Democratic Republic of the Congo and adjoining countries were upheld in July 2013, following a legal challenge. Unless the plaintiffs appeal and obtain a stay of the rule, affected companies must file a report with the SEC of their use of conflict minerals for the 2013 calendar year, on or before 31 May 2014.

Non-financial reporting proposals

The European Commission published a draft directive in April 2013 which, if approved, would require large and listed companies to include additional disclosures of non-financial information in their annual reports. This will not become law until at least 2016. If implemented in its current form, the directive would require large and listed companies to disclose information on anti-corruption and bribery matters, information on risks regarding non-financial matters and additional information on diversity based on a broad definition that goes beyond gender and covers age, geographical diversity, education and professional background. The Commission has also indicated it intends to add a further provision to the draft directive requiring large and listed companies to disclose tax payments on a country by country basis, similar to that in CRD 4.

Integrated reporting

The International Integrated Reporting Council, a coalition of regulators, companies, investors, accountants and non-governmental organisations, consulted in April 2013 on a framework for

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22 Amending directive 2011/0307 (COD), awaiting publication in the Official Journal

integrated reporting. A final draft of the framework is expected by the end of the year. Integrated reporting is intended to achieve a "concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term".[23]

It is possible that the finalised framework may affect narrative reporting in the future, although the strategic report reflects to some degree already the guiding principles and content elements of the draft framework. The guiding principles include strategic focus and future orientation, connectivity of information, materiality and conciseness. The content elements include organisational overview and external environment, opportunities and risks and strategy, business model and future outlook.

The FRC met with the International Integrated Reporting Council when developing the FRC Draft Guidance and believes that, whilst the purpose and content of the strategic report is largely determined by legislation, the FRC Draft Guidance and the International Integrated Reporting Council's draft framework encourage similar qualitative characteristics and content.[24]

Going concern

The FRC consulted in January 2013 on updating its 2009 guidance on going concern to implement the conclusions of the Sharman Inquiry, published in June 2012. These recommended that listed companies reporting on whether the company is a going concern should give more disclosure in their annual reports on the risks to the viability of the business over their full business cycle.

Final guidance was expected in the summer but has been delayed because of criticism of the FRC's approach. In particular, respondents disliked the FRC's use of the term "going concern" to describe both the specific assessment required when preparing the financial statements (that the going concern basis of accounting was appropriate) and the broader assessment of risks affecting a company's viability. Some respondents also felt that the FRC had set the hurdle for the going concern test so high, that almost no companies would be able to confirm that the company was a "going concern" as required by the Listing Rules and the UK Corporate Governance Code.

To address these points, the FRC plans to publish a consultation in the autumn on changes to the UK Corporate Governance Code to make the distinction between the going concern assessment and the viability of the business model clearer. It is also expected to consult on the development of integrated going concern and risk management guidance to make a clearer link between the assessment of business viability and the broader risk assessment that should form part of the company's normal risk management and reporting processes.

Any changes to the UK Corporate Governance Code or the going concern guidance will take effect in October 2014 so will not affect the next reporting season.

23 See Overview in the "Consultation draft of the International (IR) Framework". April 2013
24 FRC Draft Guidance, page 29

Further information

If you would like any further information or to discuss any of the issues arising from this guide, please contact Lucy Fergusson, Vanessa Havard-Williams, Wilma Rix or Judy Pink or any of your usual contacts at Linklaters.

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For more information about directors' remuneration, or to obtain a copy of our updated Navigating Change guide, or if you would like us to review your remuneration report for compliance with relevant regulations, please contact Gillian Chapman, Graham Rowlands-Hempel, Mirit Ehrenstein or Alexandra Beidas.

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