

27 October 2011

**GOVERNMENT FINANCIAL REPORTING  
MANUAL (FReM) EXPOSURE DRAFT No:**

**(11)05**

EXPOSURE DRAFT OF PROPOSED

**AMENDMENTS TO THE FReM**

**Implementation of the Hutton Review of Fair  
Pay: pay multiples, transparency and public  
accountability improvements**

Comments to be received by 16 November 2011



**HM TREASURY**

## **FINANCIAL MANAGEMENT AND REPORTING GROUP HM TREASURY**

This exposure draft of proposed amendments to the Government Financial Reporting Manual (FReM) is published by HM Treasury for comment only. The proposals may be modified in the light of comments received in this consultation process before being presented to the Financial Reporting Advisory Board for its approval. Final proposals approved by the Financial Reporting Advisory Board will be published as amendments to the FReM from the proposed effective date.

Comments on this exposure draft should be submitted in writing so as to be received by **16 November 2011**. Respondents are asked to send their comments electronically to [FReM.consultation@hmtreasury.gsi.gov.uk](mailto:FReM.consultation@hmtreasury.gsi.gov.uk)

All responses will be published on the FReM website unless the respondent requests confidentiality.



**HM TREASURY**

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## **Proposed amendments to the FReM**

### **Introduction**

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Assurance and Financial Reporting Policy team, HM Treasury, has published this exposure draft of proposed amendments to the Government Financial Reporting Manual (FReM) as part of its ongoing work in ensuring that the Manual reflects the latest developments in government financial reporting.

### **Structure of exposure draft**

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The exposure draft includes a section for each FReM chapter for which an amendment is proposed. Each section includes:

- (a) An explanation of why the amendment is proposed;
- (b) When necessary any specific additional questions unique to that proposed amendment;
- (c) The paragraphs of the FReM chapter that are affected by the proposed amendment;
- (d) The proposed effective date of each proposed amendment.

### **Invitation to comment**

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HM Treasury invites comments on the proposed amendments. It would particularly welcome answers to the questions set out below. Comments are most helpful if they:

- (a) Answer the question as stated;
- (b) Indicate the specific paragraph or paragraphs to which they relate;
- (c) Contain a clear rationale; and
- (d) Describe any alternative HM Treasury should consider.

HM Treasury will consider all comments received in writing by **16 November 2011**. In considering the comments, HM Treasury will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

<b>Apply to the FReM Hutton Fair Pay Review recommendations</b>	
Why the amendment is proposed	The Hutton Fair Pay Review recommended that from 2011-12, all public service organisations publish their top to median pay multiples each year to hold them to account.
Paragraphs affected by the amendment	5.2.19 e) and f)
Proposed date	1 April 2011

### **Summary**

1. The purpose of this paper is to provide the background to and details of proposed changes to the FReM to hold public service organisations to account for executive pay, by tracking it against that of all employees of the organisation. This additional reporting requirement is an extension of the scope of the existing disclosure requirements in the Remuneration Report. The proposed revised format is set out in Annex A.

### **Background**

2. The Hutton's Fair Pay Review, published on 15 March 2011, considered whether a pay multiple cap, in which no manager could earn more than twenty times the lowest paid person in the organisation, would lead to fairer pay. This was found to be inoperable in the diverse range of public sector organisations, so the report instead proposed that organisations disclose their own pay multiples – as defined below to enable pay comparisons to be made. Hutton's Report outlines that a multiple would be a clear statement of fairness, compelling organisations to justify trends in their own multiple in the face of public scrutiny.
3. The Fair Pay Review was welcomed by Government in the 2011 Budget and the Chancellor and Chief Secretary to the Treasury have both subsequently committed Government to taking forward Hutton's recommendations.
4. The proposal set out herein adopts the Hutton recommendation (at Annex B) in full, recognising that inclusion in annual report and accounts is the method that will most efficiently and effectively provide consistent disclosure across the central government organisations that apply the FReM.

### **Disclosure**

5. In formulating the reporting proposal a number of issues were considered:
  - a. Presentation. The Remuneration Report is an interpretation of the Directors Remuneration Report Regulations 2002 and the Companies Act 2006.
  - b. Commitment to Transparency This proposal provides an opportunity to demonstrate further the ongoing commitment to reform government through the release of data relating to how public funds are spent, thus allowing citizens to hold government to account.

- c. The Localism Bill - In response to Will Hutton's recommendation, the Department of Communities and Local Government has amended the Localism Bill to 'expand the scope of senior pay policy statements [...] to include a relevant authority's policy in relation to pay multiples', which may impact disclosure requirements in the CIPFA-LASAAC Code of Practice on Local Authority Accounting From 2012-13. The text of this amendment is at Annex C.
- d. Dodd-Frank Wall Street Reform Act - The Wall Street Reform Act, which became law in the United States in July 2010, includes a provision requiring all listed companies, from the date of enactment, to publish the ratio of CEO compensation to the median compensation level of all employees with Executive Compensation disclosure in annual reports as per the Code of Federal Regulations. The Companies Act has not implemented a similar requirement yet, but many private sector organisations do disclose such pay multiples. The text of this provision is at Annex D.

### **Basis for Calculation**

- 6. The following definitions should be applied in calculating the pay multiples in the format proposed at Annex A:
  - a. 'Most highly-paid' versus 'accounting officer' - While the two legislative precedents, and Will Hutton's recommendation, advocate using the most senior officer's remuneration in the pay multiple calculation, this would limit the effectiveness of pay multiples in respect of Civil Service organisations – particularly central departments – where the most senior officer, i.e. Accounting Officer (Permanent Secretary or Chief Executive) may not be the most highly-paid director. The multiple should be based on the highest paid Director.
  - b. 'Total remuneration' - This is the sum of the amounts already required to be disclosed for Director's as per the FReM at 5.2.19 a)-d) – that is, 'salary', non-consolidated performance-related pay and benefits-in-kind. This is also in keeping with Will Hutton's recommendation.

For consistency, this figure would be expressed as a £5,000 banding, and consequently the pay multiple would compare the median point of this banding with the median total remuneration of the organisation (expressed as an actual figure).

- c. Scope of calculations – The scope of the highest paid employee is limited to that of the Remuneration Report, and the workforce, using full-time equivalent employees, is limited to the legal entity organisation, not the group boundary.
  - d. Median – The median workforce earning is the total remuneration of the employee(s) lying in the middle of the linear distribution of the workforce.
- 7. The proposed change to the format of an organisations Remuneration Report is provided at Annex A.

### **Additional Related Requirements**

8. In conjunction with this proposal, HM Treasury intend to amend Public Expenditure Systems (PES) guidance in order to require departments to include a narrative in their annual report which explains openly and in terms clearly understandable to the public any trend in their pay multiples.

## **General questions**

### **Question 1**

Do you agree with HM Treasury's proposals to amend the FReM as described in the exposure draft? If not, why not, and what alternative do you propose?

### **Question 2**

Do you agree with the proposed effective date of 1 April 2011, detailed in the exposure draft? If not, why not, and what alternative do you propose?

## **FReM chapters addressed**

The following table shows the topics addressed by these proposed amendments.

<b>FReM Chapter</b>	<b>Subject of amendments</b>
Chapter 5, <i>form and content of annual report and accounts</i>	Paragraphs 5.2.19 e) and f) have been amended to reflect the new requirement to disclose the median earnings of the workforce and the ratio of this to the highest paid Director's earnings, regardless of whether this is the Accounting Officer or Chief Executive.

## **Proposed amendment to Government Financial Reporting Manual Chapter 5, *Form and content of Annual Report and Accounts***

### **Introduction**

An amendment to Chapter 5, *Form and content of Annual Report and Accounts* is proposed.

### **Why the amendments are proposed**

The amendments proposed in this Exposure Draft seek to amend the FReM to apply the Hutton Fair Pay Review recommendation.

### **Proposed amendments**

- 5.2.19 The following interpretations [to section 421 of the Companies Act 2006] apply:
- a) ...
  - d) ...;
  - e) the median earnings of the organisation's workforce and the ratio between this and the earnings of the highest paid Director, whether or not this is the Accounting Officer or Chief Executive; and
  - f) ...

The effective date of the proposed amendment is 1 April 2011.

## Annex A

## Proposed Addition to the Remuneration Report Template

	200X-0Y			200W-0X			
	Salary (exc. non-consol perf pay)	Non-Consolidated Performance Pay	Benefits in Kind		Salary (exc. non-consol perf pay)	Non-Consolidated Performance Pay	Benefits in Kind
	£ '000	£ '000	nearest £100		£ '000	£ '000	nearest £100
Member 2 - Director General (From 1 March)	180-185 (FYE)	-	Nil	Member 1 - Permanent Secretary	160-165	5-10	2,800
Member 1 - Permanent Secretary	165-170	5-10	3,900	Member 2 - Director General (Until 28 Feb)	150-155 (FYE)	0-5	800
Member 3 - Director General	130-135	0-5	Nil	Member 3 - Director General	125-135	0-5	Nil
Member 4 - Director General	125-130	0-5	600	Member 4 - Director General	120-125	0-5	Nil
Member 5 - Director General	125-130	-	Nil	Member 5 - Director General	120-125	-	Nil
<b>Highest Earner's Total Remuneration (£ '000)</b>		<b>180-185</b>		<b>Highest Earner's Total Remuneration</b>		<b>175-180</b>	
<b>Median Total Remuneration</b>		<b>21,358</b>		<b>Median Total Remuneration</b>		<b>20,121</b>	
<b>Ratio</b>		<b>8.54</b>		<b>Ratio</b>		<b>8.82</b>	

**Will Hutton Fair Pay Review Report - Recommendation****RECOMMENDATION 1: Using pay multiples to track executive pay against that of all employees**

The Government should not cap pay across public services, but should require that from 2011-12 all public service organisations publish their top to median pay multiples each year to allow the public to hold them to account.

The Government should require that public bodies annually publish chief executive's (or equivalent) earnings, median earnings of the organisation's workforce, and the ratio between these two figures in their annual remuneration reports. All taxable earnings should be included within this multiple. Year-on-year movements in the chief executive's earnings and median earnings should be disclosed and explained. Disclosures should begin in remuneration reports covering the financial year 2011-12, including prior year comparators.

To this end, the Government, with advice from the Financial Reporting Advisory Board, should at the earliest opportunity amend the disclosure requirements in the Financial Reporting Manual (FRoM) to require organisations to include the disclosures above, and should work with relevant bodies to make similar amendments to other relevant guidance including the NHS Manuals, the NHSFT FRoM the IFRS based Code of Practice on Local Authority Accounting, and guidance for remuneration reports by NDPBs not covered by the FRoM.

The Government should encourage major suppliers to the public sector, and organisations that play a major role in delivering public services, but which are not subject to public sector financial reporting requirements, to include such disclosures on a voluntary basis, such that tracking and explaining senior pay in this way can become a norm across all public services.

**Text of Localism Bill ‘Pay Multiple’ Amendment**

*(Localism Bill (Volume 1), Chapter 6, Clause 22)*

**CHAPTER 6**

**PAY ACCOUNTABILITY**

**22 Pay policy statements**

- (1) A relevant authority must prepare a pay policy statement for the financial year 2012-2013 and each subsequent financial year.
- (2) A pay policy statement for a financial year must set out the authority’s policies for the financial year relating to—
  - (a) the remuneration of its chief officers,
  - (b) the remuneration of its lowest-paid employees, and
  - (c) the relationship between—
    - (i) the remuneration of its chief officers, and
    - (ii) the remuneration of its employees who are not chief officers.

**Text of ‘Pay Multiple’ Provision of the US Wall Street Reform Act**  
(*Dodd-Frank Wall Street Reform Act, Title IX, Subtitle D, Section 953*)

(b) **ADDITIONAL DISCLOSURE REQUIREMENTS.**—

(1) **IN GENERAL.**—The Commission shall amend section 229.402 of title 17, Code of Federal Regulations, to require each issuer to disclose in any filing of the issuer described in section 229.10(a) of title 17, Code of Federal Regulations (or any successor thereto)—

(A) the median of the annual total compensation of all employees of the issuer, except the chief executive officer (or any equivalent position) of the issuer;

(B) the annual total compensation of the chief executive officer (or any equivalent position) of the issuer; and

(C) the ratio of the amount described in subparagraph (A) to the amount described in subparagraph (B).

(2) **TOTAL COMPENSATION.**—For purposes of this subsection, the total compensation of an employee of an issuer shall be determined in accordance with section 229.402(c)(2)(x) of title 17, Code of Federal Regulations, as in effect on the day before the date of enactment of this Act.