BEIS consultation

Restoring trust in corporate governance

Implications for directors' over dividends, distributable reserves and corporate reporting

Introduction

The government's Department of Business & Energy Industrial Strategy (BEIS) has published its long-awaited proposals following the rigorous and critical findings identified by Sir John Kingman, Sir Donald Brydon and the Competition and Markets Authority in their independent reports on different aspects of the corporate governance and the audit regime.

Whilst these proposals cover some significant and highly impacting proposals relating to, interalia, audit competition, audit quality and a stronger financial reporting regulator, this technical publication focuses solely on the corporate reporting aspects of the proposals.

Overview of the proposals for corporate reporting

There are two main areas within these proposals that look to increase the responsibilities placed on directors and transform corporate reporting information for investors.

1. Increasing directors' accountability over dividends and distributable reserves

Compliance with company law legislation surrounding declaring dividends and ensuring there are sufficient distributable reserves within a company is nothing new for directors. However, from recent high-profile business failures and cases that are linked to either unlawful dividends being paid or dividend payments that have impacted the solvency of a business, investors and other stakeholders are becoming increasingly concerned.

The new proposals aim to restore and boost investor and other stakeholder confidence, specifically facilitating them to more clearly understand directors' dividend decision-making processes, ensure directors have complied with company law legislation and provide more assurance that proposed dividend payments will not negatively impact the future solvency of the business.

At this stage, the proposals aim to keep the current legislation and technical guidance[1] in place surrounding how to determine distributable reserves and what should be treated as realised profits and losses, but instead give responsibility to the new regulator, the Audit, Reporting and Governance Authority (ARGA), over maintaining and governing its legal status.

2. Transforming the reliability of corporate reporting

There are three areas identified within the proposals that seek to improve corporate reporting requirements. These centre around:

- providing existing, and potential, investors and other stakeholders with greater confidence in the resilience of the business, particularly as a result of long-term threats and challenges to its business model;
- increasing user expectations as to the reliability of the reporting within the annual report and other company disclosures that fall outside of the statutory audit; and
- improving reporting on payment policies and performance, which build upon the current requirements of the Payment Practices Reporting Duty (PPRD).

What are the proposed new requirements that impact businesses?

There are four key areas that directly impact businesses in relation to increasing directors' accountability over dividends and distributable reserves.

Dividends and distributable reserves

1. Disclosure of distributable reserves in the financial statements

This is a new requirement for an individual company, or the parent company only within a group, to disclose the total amount of reserves that are distributable. This disclosure would be subject to statutory audit.

2. Disclosure of group estimated dividend-paying capacity in the financial statements

This is a new requirement for a parent company within a group to estimate and disclose the amount of potential distributable profits across the group and to explain, narratively, any major constraints on the ability of a subsidiary to pay its distributable reserves to the parent. This disclosure would be subject to statutory audit.

3. Directors compliance and solvency statement

This is a new requirement for directors, when proposing or declaring an interim or final dividend, to make a statement about the legality of the dividend and the effects on the future solvency of the company, covering a period of two years.

4. Disclosure of dividend decisions and capital allocation policies and practices

This is not a new requirement; however, the three new proposed requirements are envisaged to encourage companies to provide fuller narrative disclosures for investors and other stakeholders about dividend decisions and capital allocation strategies, in line with existing best practice guidance[2].

Who are the proposed new requirements applicable to? The proposed requirements would potentially only be applicable to listed and AIM companies, however they may also be extended to all PIEs or even certain large private companies.

[1] ICAEW/ICAS TECH 02/07BL Technical release: Guidance on realised and distributable profits under the Companies Act 2006

[2] FRC Lab project report: Disclosure of dividends policy and practice (November 2015) and The Investment Association Long Term Reporting Guidance (May 2017)

There are three key areas that directly impact businesses in relation to transforming the reliability of corporate reporting.

Corporate reporting

1. Prepare an annual resilience statement

This is a new requirement for companies to prepare a resilience statement that addresses how the business is building resilience to deal with severe, yet plausible, scenarios in the short and medium term, and how the directors are exploring and preparing for likely threats and challenges over the long term.

This would include reporting over a five-year period, including reverse stress testing and considering resilience matters relating to digital security risks, supply chain dependency, threats to solvency and business continuity and climate change risk.

2. Publish an annual audit and assurance policy

This is a new requirement for companies to explain whether they are obtaining any independent assurance, and if so how, on corporate reporting outside of that required by the annual statutory audit, for instance regarding the resilience statement and/or the enhanced reporting on payment practices.

It also requires companies to explain their approach and processes to internal audit and assurance, and policies surrounding the appointment of the statutory auditor.

The policy will cover a three-year period and be subject to an advisory shareholder vote.

3. Report on supplier payment practices

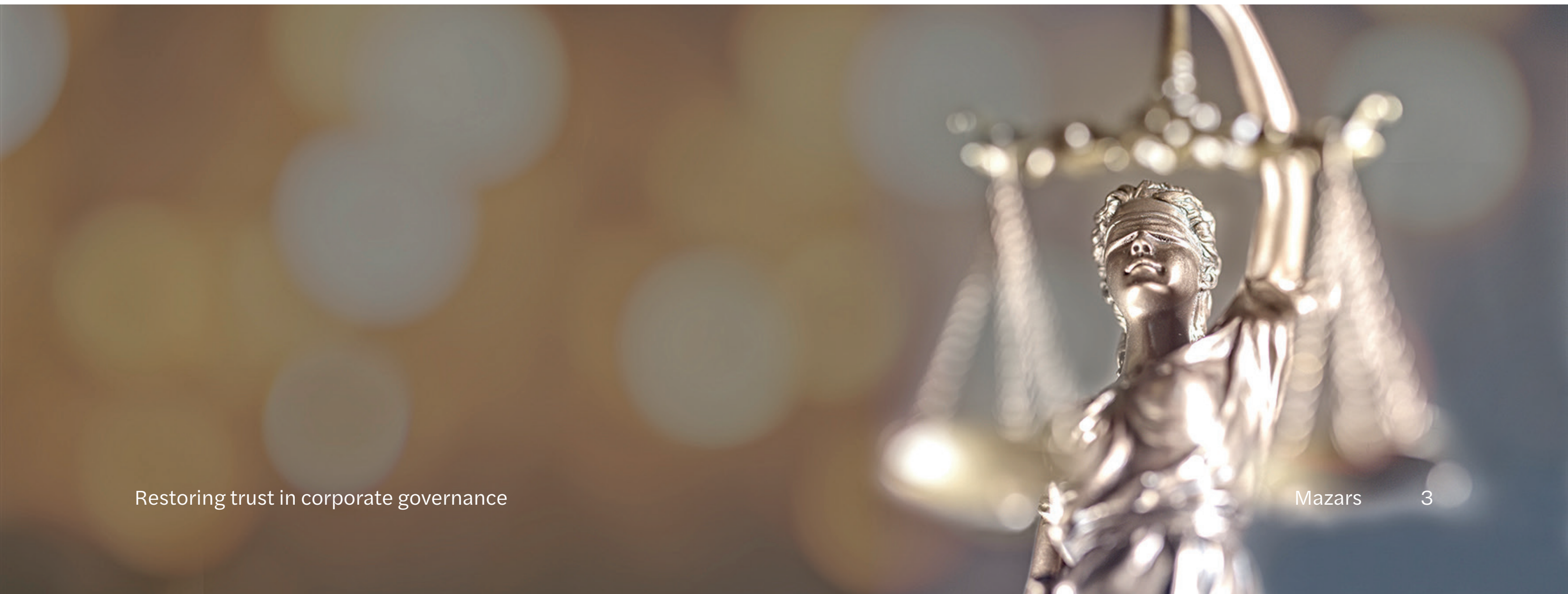
This is a new requirement for companies to provide, in the strategic report, a summary of how the company, or group in the case of a parent company, has performed with regard to supplier payments over the reporting year, with explanations on comparability to the prior year.

This could include the company's supplier payments policy, the percentage of the company's supplier payments that met its standard terms and explanations where the payment record is sub-standard.

This new requirement builds upon the current requirements of the Payment Practices Reporting Duty (PPRD).

Who are the proposed new requirements applicable to? The proposed requirements would be applicable to all PIEs (although they would apply only to premium listed companies initially). Recently listed companies would be exempt from the new requirement to prepare a resilience statement.

Who are the proposed new requirements applicable to? The proposed requirements would be applicable to either large PIEs, or PIEs with over 500 employees.



What can companies do now to prepare for the proposed changes?

In preparation for the proposed new requirements, companies can act now to ensure they are compliant with current legislation, are in line with best practice guidance and have a sound technical starting point on which the new requirements are proposed to be based.

Distributable reserves and dividend policy and practices

Benefits	How we can support you
• Compliance with company law legislation • Prevention of making an unlawful dividend • Assurance of having adequate dividend headroom • Improve investor confidence • Enhance board focus • Alignment with best practice guidance	We can develop an approach that is tailored to your business needs, whether on an individual company or group basis: • **Considerations analysis** – This provides you with a high-level technical paper that sets out the specific areas of consideration that will impact the level of profits available for distribution within the business. • **Checklist approach** – This tailored checklist approach, with guidance, provides a series of questions for you to complete, with our support, in order to carry out your own assessment of what profits are available for distribution within the business. • **Integrated project support** – This approach involves full project management support, including producing a tailored checklist setting out all the relevant areas for consideration, management of the checklist completion within your business, assistance with calculations, where applicable, and documenting findings and conclusions for your records. • **Training and board briefings** – This provides you with tailored training courses for your finance team, or briefing sessions for the board, to help you understand the requirements and the implications for your business. • **Policy and practices disclosure review** – We can carry out a compliance and best practice disclosure review of your existing policy and practices, in line with Section 172 reporting, regulatory best practice guidance and benchmark analysis with other organisations within your section, to improve the disclosures within your annual report.

Narrative reporting in the front-end of the annual report

Benefits	How we can support you
• Improve investor confidence and restore potential mistrust • Attract potential new investors • Compliance with legislation and best practice reporting guidance • Reduce the risk of negative feedback from a regulator review	We can work together with you to develop an approach that fits your business. We have designed two different types of approaches that we can use to enhance your annual report's front-end reporting, each having its own benefits depending upon your business needs: • **4-step improvement model** – This approach to improving your narrative reporting involves a 4-step process that involves: 1. Scoping and applicability; 2. Consultation and investigation, including a detailed workshop; 3. Deliberation and drafting; and 4. Review and completion. This model aims to enhance each aspect of your annual report's front-end reporting, whether from your business model and strategy, to your viability statement, to your risk reporting, or it can be used to enhance the reporting on an integrated basis. • **Scoring analysis review** – Our in-house proprietary scoring methodology involves a holistic approach to improving your annual report's front-end reporting. Our analysis will present a score for your current narrative reporting, looking at both compliance and best practice guidance, on which we can support you to improve your overall narrative reporting and how best to present your story.

What will boards need to consider should the proposed changes become effective?

A key driver for the proposed changes is to make directors more accountable for the decisions they make. Specifically, how those decisions will impact on the future liquidity, solvency and operational risks of the business, and what actions boards will need to make today to prepare for risks and challenges that will impact the business' resilience and business model over the medium and long term.

We see that boards will be best prepared if they have a positive mindset about how the proposed changes can benefit the business, particularly the businesses' long-term viability and success, including:

- To focus the board's mindset on the capital allocation and investment plans and future solvency of the business.
- To provide greater assurance when declaring a dividend that the distribution is lawful and supportable for the business.
- To prepare the business for long-term challenges and prolonged periods of uncertainty.
- To promote investor confidence in the long-term planning and resilience of the business.
- To better plan for business continuity against significant risks and threats facing the business.

Action plan checklist: Start preparing for the proposed changes

Proposed new requirements	How companies can start to prepare for the proposed changes at this stage
Disclosure of the company's distributable reserves and the group's estimated dividend-paying capacity in the financial statements	• Do you understand the amount of the company's (or individual companies within a group) reserves that are distributable and non-distributable? • Do you understand where there are any restrictions or dividend blocks within the group which may prevent profits being distributed? • Do you feel the annual report could better describe the company's dividend policy and practices to support investor needs and expectations? • Do you and the board understand, from a high-level perspective, the legal requirements surrounding dividends and capital maintenance? • Do you and your finance team understand the detailed requirements for determining realised profits and losses?
Directors compliance and solvency statement	• Do you have the capability and resources in place to prepare sufficient risk analyses for supporting dividend payments, which cover a forward-looking period of two years? • Do you have a sound understanding of the legal requirements surrounding distributable reserves and lawful distributions?
Preparation of an annual resilience statement	• Do you understand the proposed new requirements to prepare a new resilience statement, focusing on the short-term, medium-term and long-term risks, threats and challenges facing the business and the business model? • Do you have the capability and resources in place to prepare adequate forecasts analysis, including reverse stress testing scenarios?
Reporting on supplier payment practices	• Do you understand the proposed enhanced requirements to report on supplier payment practices and whether you may fall within the new proposed scope? • Do you have the systems and/or processes in place to collect relevant data to be able to report?

The new requirements will be very challenging for some companies, and less so for others, depending on the complexities of the business, such as group structure and size, locations and jurisdictions, industry-sector and nature of operations and activities. Whatever your business need, we can support you with your accounting and corporate reporting challenges.

What is the timeline for the proposals to become effective?

Consultation period	BEIS response	Implementation	Transition approach
Comments raised by stakeholders prior to consultation ending on 8 July 2021	Government deliberates and responses to feedback and prepares relevant legislation	The new regulator, ARGA, expected April 2023 to begin implementation of changes	General approach to first bring in new requirements for premium listed companies and then over two year to other applicable companies

As yet, there is no clear timeline for when the various aspects of the proposed changes may come into effect, however implementation is planned to commence from April 2023 with the general approach to quickly bring in the measures that do not directly impact businesses, with all other measures being brought in with a transition period and/or a phasing-in approach.

For the proposals in respect of dividends and capital maintenance and the new corporate reporting requirements, there will likely be a phasing-in approach, for example applying the new requirements to premium listed companies and then, over time, to other companies falling within the scope.

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