

Hutton Review of Fair Pay - Implementation guidance

Summary

1. Following FRAB approval on 25 January 2012, the FReM requires the disclosure by public sector entities of top to median staff pay multiples (ratio) as part of the Remuneration Report from 2011-12:

FReM requirement to disclose –

“The mid-point of the banded remuneration of the highest paid director (see paragraph 5.2.6), whether or not this is the Accounting Officer or Chief Executive, and the ratio between this and the median remuneration of the reporting entity’s staff. The calculation is based on the full-time equivalent staff of the reporting entity at the reporting period end date on an annualised basis. For departments, the calculation should exclude arm’s length bodies within the consolidation boundary. Entities shall disclose information explaining the calculation, including the causes of significant variances where applicable. Further guidance is provided on this Manual’s dedicated website.”

(FReM Paragraph 5.2.20)

2. This note provides additional guidance on applying this FReM requirement.

Principles

3. The disclosure is intended to hold organisations to account for remuneration policy, and in particular, the remuneration of the highest paid director compared with the median remuneration of staff (as defined in paragraph 10).
4. The disclosure will also allow some comparability over time and across the public sector and private sector, where similar disclosures of Chief Executive remuneration and pay multiples are made. Direct comparisons should, however be treated with caution given the different services provided, workforce skills, geographical locations and organisational structures. A balance is therefore needed between standardising calculations and the supporting narrative giving sufficient explanation and justification to ensure users can understand the intricacies of the organisation’s pay policy.
5. Guidance issued by the Relevant Authorities is expected to be consistent with the FReM, unless statute dictates otherwise, such as the Localism Act and Code of Recommended Practice for Local Authorities on Data Transparency requirements for local authorities in England.

FReM amendment

6. The FReM change (5.2.19e) extends the Remuneration Report by disclosing:
 - a. the banded, Full Time Equivalent, annualised, total remuneration of the highest paid director, already included in the main body of the Remuneration Report;
 - b. the median, FTE total remuneration of the staff, excluding the highest paid director;

- c. the pay multiple (ratio) between the two, all as at the reporting period end date;
 - d. additional narrative explaining the calculation, as appropriate.
7. Comparative information is required. A suggested format is included in Appendix A.

Basis of calculation

8. This disclosure is an additional task in the preparation of year end Annual Reports and Accounts. Entities should consider the most practical way in which the necessary information can be collected and analysed. As the financial audit of the Remuneration Report will cover this disclosure and early engagement with external auditors is encouraged to discuss the proposed approach such that any estimates used in the calculation are supportable and robust.
9. If a reporting entity believes that any pay arrangements will give rise to distorted results, such as, the use of agency staff or shared executives, the supporting narrative should be used to provide clarification.
10. To ensure that information is comparable the following specifications should be applied as appropriate:
 - **Median** – The median remuneration of the reporting entity's staff is the total remuneration of the staff member(s) lying in the middle of the linear distribution of the total staff, excluding the highest paid director. This is based on annualised, full-time equivalent remuneration as at the reporting period date. A median will not be significantly affected by large or small salaries that may skew an average (mean) – hence it is more transparent in highlighting whether a director is being paid significantly more than the middle staff in the organisation.
 - **Boundary:**
 - For departments, the calculation should not include staff employed by arm's length bodies, as this may distort the disclosure where pay arrangements are made independently of departmental control, and the boundary should thus be limited to the department and agency. Whilst the median calculation should include employees within agencies of the department, the scope of the highest paid director is limited to the directors of the departmental group and does not include directors of the agencies, unless they are present on the departmental group management board.
 - Most ALBs are required to follow the principles of the FReM and provide the additional disclosures required by the Manual where these go beyond the Companies Act or Charities SORP. For charities, the scope of the definition of the highest paid director should include the senior management team, not just the Board of Trustees. Other ALBs should be encouraged by their sponsor departments or equivalent to provide similar disclosure, as recommended by the Hutton Review, to ensure transparency and accountability.
 - **'Highest paid director or highest paid employee'**

- There are arguments for using either of these titles as the basis for the pay multiple. The latter provides an absolute figure that would provide useful information where individuals not responsible for directing the organisation receive the highest remuneration, usually due to the specialist skills or expertise held.
- However, although this may be applicable in certain industries, limiting the highest paid to director-level will allow for more consistent comparison across organisations within the public sector and with the private sector. Legislative precedents (e.g. Dodd-Frank Wall Street Reform and Consumer Protection Act (USA), Localism Act (UK)), and Will Hutton's recommendation all advocate using the most senior officer's remuneration in the executive pay disclosures. It is the directors who have significant responsibility for remuneration policy and act in the long-term interests of the organisation. There may also be legal concerns involving the disclosure of the salaries of some non-directors, leading to an inconsistency in approach across the public sector. It is important to keep this link between executive remuneration and strategy and performance disclosed in the annual report.
- Limiting the highest-paid solely to Chief Executive remuneration might 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 employee, or in ALBs where director-level positions are shared across more than one organisation. Broadening the basis of the calculation to include the highest-paid director gives some scope to avoid either of the above complications. This scope should be limited to those directors responsible for the organisation's strategy, consistent with Remuneration Report disclosure.
- Additional disclosure of non-director level employees with remuneration in excess of the highest paid director is encouraged to be provided as part of the narrative accompanying the calculation, to the extent that this does not contravene the Data Protection Act (DPA). Organisations should seek legal advice where disclosure may cause harm to an individual in accordance with the DPA (or equivalent legislation). Suggested text is included in Appendix B.
- **'Total remuneration'**
 - For all remuneration calculations, 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) – this includes, 'salary', non-consolidated performance-related pay and benefits-in-kind allowances. This should not include severance payments that will impact on comparability. Disclosure of the severance payments of directors is otherwise required in line with FReM paragraph 5.2.20c).
 - The calculation should exclude employer pension contributions and cash equivalent transfer values. Inclusion of pension figures will likely exaggerate the pay multiple in an area where there is less organisational control. This exclusion should be noted in the narrative disclosure, as suggested in Appendix B.
- **Rounding** - The calculation should be rounded appropriately to provide users with clarity on the information without breaching: confidentiality agreements; prejudice the rights, freedoms or legitimate interest of the individual; or cause or be likely to cause unwarranted damage or distress to an individual. On this basis, it is suggested that:

- As the highest paid director remuneration is already disclosed as a banded amount (£5,000), using the mid-point remuneration of this band rather than the exact remuneration in calculating the pay multiple should ensure a level of anonymity consistent with the rest of the Remuneration Report; and
 - The median remuneration should be disclosed to the nearest £1, or as otherwise appropriate, to identify significant changes in the median between reporting periods. This calculation should exclude the highest paid director.
- **Full-time equivalent and annualised remuneration**
 - The **full-time equivalent (FTE)** measurement of staff is specified to ensure a level of comparability that would otherwise be distorted if a member of staff represented a whole unit, irrespective of the hours worked.
 - Total remuneration should be calculated on an **annualised** basis to remove any fluctuations caused by employee turnover, which do not reflect changes in pay policy. Any premium paid to an employee to cover a vacancy on a short-term basis should be included within the median calculation.
 - In determining the highest-paid director, where a director's services are shared between two or more separate reporting entities, the cost to each entity of remunerating the director is key, not the overall remuneration received by the director.
 - In determining the highest-paid director, where non-executive's receive an annual remuneration for a time-commitment below the reporting entity's normal contractual hours, the annualised, FTE calculation should reflect the different employment terms. For example, if the Non-executive receives £5,000 remuneration for each monthly Board meeting, the total annualised remuneration is £60,000pa, and should not be based on a daily rate of £5,000.
 - The calculation should **include agency and other temporary employees** covering staff vacancies, but exclude consultancy services. Only the remuneration paid to the employee should be included, not agency fees. An estimate may be appropriate to ascertain a reasonable split where this information is not available on entity payroll systems.
 - **Narrative disclosure**
 - Narrative disclosure in the annual report should accompany the calculations included in the Remuneration Report to ensure appropriate information is provided to assist users' understanding of the calculations and the reporting entity's scope for controlling pay policy arrangements.
 - To maintain consistency across departments, Public Expenditure Systems (PES) guidance will be issued, requiring additional narrative to explain the basis of the calculation, as appropriate, and to provide a context for users, such as where contractors and agency staff have a significant impact on the calculation. The suggested narrative should be tailored to the needs of other reporting entities as appropriate. Where an organisation has more than one pay structure, disclosing median and pay multiple calculations for each rather than a lengthy narrative may provide greater clarity to users.

- The 2011-12 PES guidance is attached at appendix 2 below.

Please contact your usual departmental or HMT Financial Reporting Policy representative for further guidance.

Financial Management and Reporting
HM Treasury

February 2012 (updated October 2012)

Example Remuneration Report:

	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
Band of Highest Paid Director's Total Remuneration (£ '000)		180-185		Band of Highest Paid Director's Total Remuneration		170-175	
Median Total Remuneration		21,358		Median Total Remuneration		20,121	
Ratio		8.5		Ratio		8.6	

PES Guidance on Pay Multiples

- 16.1 Departments should include in their Annual Report and Accounts a narrative highlighting the reasons for any variance in year-on-year multiples. This is because:
- it describes the purpose of including the ratios, and what they mean;
 - it ensures transparency in executive remuneration;
 - it allows citizens to hold government to account for their use of public funds; and
 - it provides departments an opportunity to monitor their own remuneration and note any adverse or anomalous trends.
- 16.2 The narrative should be concise and clearly linked to the figures disclosed in the remuneration report, and use terms that are easily understandable by the public.
- 16.3 The narrative should be introduced by the following text:
- “Reporting bodies are required to disclose the relationship between the remuneration of the highest-paid director in their organisation and the median remuneration of the organisation’s workforce.*
- The banded remuneration of the highest-paid director in [the organisation] in the financial year 201X-1Y was £xx (201W-1X, £xx). This was – times (201W-1X,-) the median remuneration of the workforce, which was £xx (201W-1X, £xx).*
- In 201X-1Y, xx (201W-1X, xx) employees received remuneration in excess of the highest-paid director. Remuneration ranged from £xx to £xx (201W-1X £xx-£xx)*
- Total remuneration includes salary, non-consolidated performance-related pay and benefits-in-kind. It does not include severance payments, employer pension contributions and the cash equivalent transfer value of pensions.”*
- 16.4 It should then be followed by a **concise and factual** explanation of the changes on either side of the ratio, taking into account where relevant:
- Adjustment to the number or composition of the general workforce (e.g. through restructuring, downsizing and outsourcing);
 - A change to the remuneration of the most highly paid director. Departments should note that this may not necessarily be an increase to base pay, but a change in taxable expenses or allowances. Where the allowance is temporary (e.g. relocation allowance), departments should note this and its likely impact on the pay multiple.
 - A change of the most highly paid director (e.g. a new appointment, or the previously highest paid post having been vacated and/or eliminated); and
 - The impact of any pay freeze on the multiple (e.g. senior pay freeze that does not affect the majority of staff).

- The relationship between the remuneration of most highly paid director and that of employees who are not directors but receive remuneration in excess of the most highly paid director.

16.5 The above list is not exhaustive and should be treated only as general guidance. It is not intended to act as a checklist of justifications for higher multiples.

16.6 Questions on this section of the guidance should be addressed to Civil Service Workforce in the Cabinet Office:

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