Financial Reporting LAB

Lab implementation study:

Disclosure of dividends – policy and practice

October 2017

Financial Reporting Council

Introduction

The objective of this report is to examine how companies have responded (in the second year of reporting) to suggestions for enhanced disclosure which were made in the Financial Reporting Lab's (Lab) *'Disclosure of dividends – policy and practice'* report.

This implementation study covers four areas:

1. A summary of the findings from the ***'Disclosure of dividends - policy and practice'*** report and highlights from the previous implementation study;
2. How practice has improved based on the Lab's review of dividend disclosures in 2016 annual reports;
3. Some examples of developing practice; and
4. Opportunities to take things further.

Summary of findings from the project report

In November 2015, the Lab published a report ***'Disclosure of dividends – policy and practice'***

The project involved input from **19** companies and **31** investment organisations. The report recommended enhancements to dividend policy and dividend practice disclosures.

Dividend policy disclosures - Lab project participants identified good disclosure as providing:

- an understanding of the board's considerations in setting the policy,
- the rationale for the approach selected, and
- sufficient detail to understand how the policy will operate.

Dividend practice disclosures - Lab project participants identified good disclosure as including:

- the key judgements and constraints considered by the board in applying the dividend policy,
- the availability of dividend resources, including cash and distributable profits, to pay dividends (this was considered particularly useful in situations where either was a constraining factor), and
- clear linkage from the disclosed policy to its application in the period.

Bringing together various elements of disclosure to provide a focused narrative is considered helpful to investors.

Highlights from the previous implementation study

Scope of the review

In summer 2016 we undertook a review of FTSE 350 dividend disclosures to assess how early practice developed following our November 2015 report.

In that study we saw that of the 177 companies that published their annual reports in the scope period, 28 companies made enhancements to disclosure.

Key areas where companies enhanced disclosure included examples that:

- explained the details of the dividend policy and how it was intended to operate;
- added context on factors considered in adopting the policy, with some including the approach to capital management;
- explained the relevance of dividend resources by:
  - providing a distributable profits figure for the parent company; or
  - confirming the sufficiency of distributable profits (and for some cash) for dividends; or
  - providing insight on the availability of distributable profits at the level of significant operations below the parent;
- brought together disclosure related to dividends.

How practice has developed in 2016/17

For the purposes of this review we reviewed all the FTSE 350 annual reports published in 2016 that were also in the FTSE 350 at the end of 2015 (313 companies in total) to assess the extent to which disclosure practice had changed. We looked for indications of change, either in the amount or nature of reporting. By comparing the results to 2015 annual reports we identified the following areas of practice:

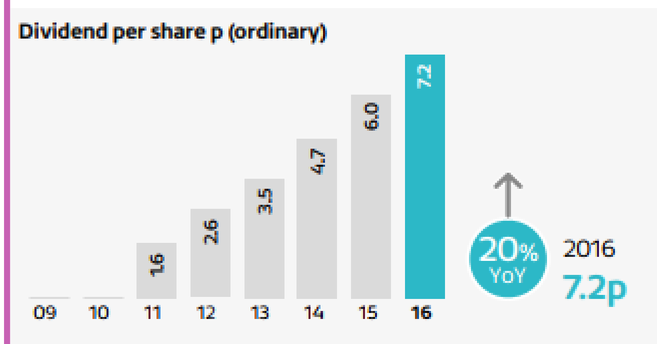
- 132 companies have now implemented some of the disclosure recommendations from the dividends report.
- The most noticeable change has been the inclusion of reference to distributable profits or distributable reserves with 58% of the FTSE 100 making some level of disclosure (up from 40% in 2015), and 48% disclosing:
    - The specific level of distributable profits/reserves of the holding company; or
    - The elements of distributable profits/reserves which are not distributable; or
    - Reference to distributable reserves as sufficient or significant.
- This level of change has not been seen in the FTSE 250 with, for example, only 30% of companies making some disclosure on distributable profits / reserves.
- Some companies (across the FTSE 350) have improved disclosure of the risks to dividend or the factors that were considered in setting the dividend policy.
- Some companies (across the FTSE 350) have enhanced descriptions of what the stated dividend policy means in practice, although further improvements could be made in this area.

Examples of practice - disclosure that details the policy and provides insight into factors relevant to the setting of the dividend

ITV plc Annual Report 2016

Reflecting ITV's strong cash generation and the Board's confidence in the business, the Board is proposing a special dividend of 5p per share worth just over £200 million, bringing the total special dividends since 2012 to almost £1.2 billion.

Looking ahead the Board is committed to a long-term sustainable dividend policy. Ordinary dividends will grow broadly in line with earnings, targeting dividend cover of around 2x adjusted earnings per share over the medium term. ITV has £1.7 billion of distributable reserves at 31st December 2016 available immediately to support the dividend policy.



They describe the policy in more detail and make the explicit link to the level of reserves.

Keeping it simple

ITV plc is a non-trading investment holding company and derives its profits from dividends paid by subsidiary companies.

The Directors consider the Group's capital structure and dividend policy at least twice a year ahead of announcing results and do so in the context of its ability to continue as a going concern, to execute the strategy and to invest in opportunities to grow the business and enhance shareholder value.

The dividend policy is influenced by a number of the principal risks as identified on pages 50 to 56 that could have a negative impact on the performance of the Group.

In determining the level of dividend in any year the Directors follow the dividend policy and also consider a number of other factors that influence the proposed dividend, including:

- The level of retained distributable reserves in ITV plc the Company,
- Availability of cash resources (as disclosed in note 4.1 to the consolidated financial statements),
- Future cash commitments and investment plans, in line with Group's strategic plan.

Equity

The retained earnings reserve includes profit after tax for the year of £1,475 million (2015: £671 million profit) which includes dividends of £1,500 million from subsidiaries in 2016 (2015: £700 million). Other reserves of £28 million (2015: £36 million) relate to share-buy backs in prior periods and foreign currency translation net of cashflow hedging.

Dividends

The Directors of the Company propose a final dividend of 7.2p per share and a special dividend of 5p per share.

Distributable reserves

The distributable reserves of ITV plc approximate to the balance of the retained earnings reserve of £1,702 million as at 31 December 2016.

What is useful?

ITV explain the background of the company and highlight a link to the risks.

ITV identify some other factors which influence dividend decisions.

They confirm the approximate level of distributable reserves and source of retained earnings.

Examples of practice - disclosure which provides information about factors relevant to setting dividend and level of reserves

Moneysupermarket.com Group
Annual Report 2016

Dividends

The Group has a progressive dividend policy which aims to increase the ordinary dividend each year broadly in line with the growth in underlying earnings per share. In addition, the Group expects to generate significant surplus cash over time. Available surpluses, after taking into account the matters set out below will be distributed to shareholders over time, and historically this has been done by way of special dividend payments. Whilst the Board continues to consider dividends to be the primary method of returning capital to shareholders, it will also undertake share repurchases when advantageous.

In determining the level of dividend in any year in accordance with the policy, the Board also considers a number of other factors that influence the proposed dividend, which include but are not limited to:

- the level of available distributable reserves in the parent company;
- future cash commitments and investment needs (including for technology investment) to sustain the long-term growth prospects of the business;
- potential strategic opportunities;
- prudent buffer; and
- the level of dividend cover.

Moneysupermarket.com Group (MSG) detail at a high-level some of the key determining factors that the board consider in setting the dividend policy.

Moneysupermarket.com Group PLC, the parent company of the Group, is a non-trading investment holding company which derives its distributable reserves from dividends paid by subsidiary companies. The Board reviews the level of distributable reserves in the parent company bi-annually, to align with the proposed interim and final dividend payment dates, and aims to maintain distributable reserves that provide adequate cover for dividend payments. The distributable reserves of the parent company approximate to the balance on the profit and loss account reserve, which at 31 December 2016 amounted to £160.5 million (as disclosed in the Company balance sheet on page 105).

The Group is well positioned to continue to fund its dividend which continues to be well covered by cash generated by the business. Details on the Group's continuing viability and going concern can be found on pages 25 to 26.

The ability of the Board to maintain future dividend policy will be influenced by a number of the principal risks identified on pages 30 to 31 that could adversely impact the performance of the Group. The risks that could specifically have an adverse impact on the dividend policy are competition, changing consumer behaviour, brand strength, product offering, customer trust including cyber, relevance to partners and economic uncertainty, although we believe we have the ability to mitigate those risks as outlined on pages 30 to 31.

What is useful?

MSG explain how they manage their distributable reserves and confirm the level of reserves.

MSG comment on the sustainability of the dividend by referencing cash generation.

Examples of practice - disclosure which highlights level of reserves

Hammerson plc Annual Report 2016

The capacity of the Company to make dividend payments is primarily determined by the availability of retained distributable reserves and cash resources. As at 31 December 2016 the Company had distributable reserves of £783.1 million (2015: £1,243.7 million) and the total external dividends declared in 2016 amounted to £180.1 million. The Company's distributable reserves support over four times this annual dividend. When required the Company can receive dividends from its subsidiaries to further increase distributable reserves.

What is useful?

Hammerson confirm the level of reserves and provide context by referencing the total of the current-year dividend.

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Examples of practice - disclosure which highlights link between risk and distributable reserves

Rathbone Annual Report 2016

42 Dividends

Details of the company's dividends paid and proposed for approval at the AGM are set out in note 12 to the financial statements.

The company's dividend policy is described in the directors' report on page 90.

Reserves available for distribution as at 31 December were comprised as follows.

	2016 £'000	2015 £'000
Net assets	**185,339**	157,925
Less:		
– share capital	**(2,535)**	(2,407)
– share premium	**(139,991)**	(97,643)
Distributable reserves	**42,813**	57,875

Movements in reserves available for distribution were as follows.

	2016 £'000	2015 £'000
As at 1 January	**57,875**	37,140
Profit for the year	**40,950**	42,853
Net remeasurement of defined benefit liability	**(31,382)**	5,015
Net gain on revaluation of available for sale investment securities	**79**	43
Dividends paid	**(26,479)**	(25,836)
Other movements	**1,770**	(1,340)
As at 31 December	**42,813**	57,875

What is useful?

Rathbone has a table providing the movements in distributable reserves. The movements table allows investors to understand the significant impact that the re-measurement of the defined benefit scheme had during the year and therefore points to other relevant elements of the report.

Taking things forward

Through the course of the review we have identified a number of areas where we feel improvements could still be made, or where there are opportunities to take disclosures even further.

Key areas include:

- **Identifying the explicit links between dividend, principal risks and viability** – The Lab's upcoming Risk and Viability report (Q4 2017) notes the importance of connections between the business model, risk to the business model and potential impacts on viability. Dividend strategy should be a clear element of all three, either as one of the outcomes (business model), something that may be impacted by risks or as an important part of potential mitigation response (viability).
- **Enhancing disclosure on constraints** - Either by providing details on the sustainability of the dividend or by clarifying the level of distributable profits/cash or other constraining factor (especially in the FTSE 250);
- **Explaining more fully what policy means in practice** - Either by explaining what a 'progressive' policy (or equivalent description) means in terms of growth (i.e. what makes it progressive) or clarifying how 'pay-out ratios' are calculated; and
- **Enhancing understanding of structure and process** - By clarifying where profit is generated in the group, how profits might flow to the top company and any relevant constraints (current or potential) to that flow.

Conclusion

We are encouraged by the continuing improvements made by companies identified in this study. We are particularly pleased to see companies responding to investor calls to add clarity to disclosures around distributable profit/reserves. This demonstrates how Lab projects can be useful for both companies and investors.

However, there remain a number of companies who might benefit from implementing our original findings, especially those within the FTSE 250. Best practice also continues to develop and we encourage companies to continue to enhance disclosures in this area.

We hope more companies improve their disclosure in the coming reporting season.

The Lab has published reports covering a wide range of reporting topics.

Our most recent reports include:


Financial Reporting
LAB
Digital Future
A framework for future digital reporting
May 2017
FRC Financial Reporting Council


Clear & Concise
Financial Reporting
LAB
Lab project report:
Business model reporting
October 2016
FRC Financial Reporting Council

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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