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Recommendation: change

Management board and supervisory board remuneration

New PwC study

PwC's 2016 remuneration study is now available. It contains an analysis of information published by DAX and MDAX companies for 2014 and 2015.

Board member remuneration trends varied in 2015. While total median remuneration for DAX CEOs was up 3% at €5.6 million, total remuneration for other management board members was down 2% at €2.9 million. CEOs' total pay is 1.9 times (pay multiple) that of ordinary management board members.

Total median remuneration for MDAX CEOs is €2.5 million, 9% less than in the previous year. For ordinary management board members the figure is down 6% on the previous year at €1.3 million. So the pay multiple in MDAX is 1.8 a little lower than the DAX figure.

The average composition of management board remuneration in the DAX and MDAX shows that the mix of fixed and variable remuneration is virtually identical across all board members. Fixed items such as basic pay, fringe benefits and pensions account for around 40% of total remuneration. 60% of pay is covered by short-term (STI) and long-term (LTI) variable items. The DAX tends to be more weighted towards LTI and MDAX towards STI.

An analysis of total remuneration for DAX supervisory boards in 2015 shows that median pay for chairs is €311,000, deputy chairs €230,000 and other supervisory board members €128,000. The chair is thus paid 2.4 times ordinary members.

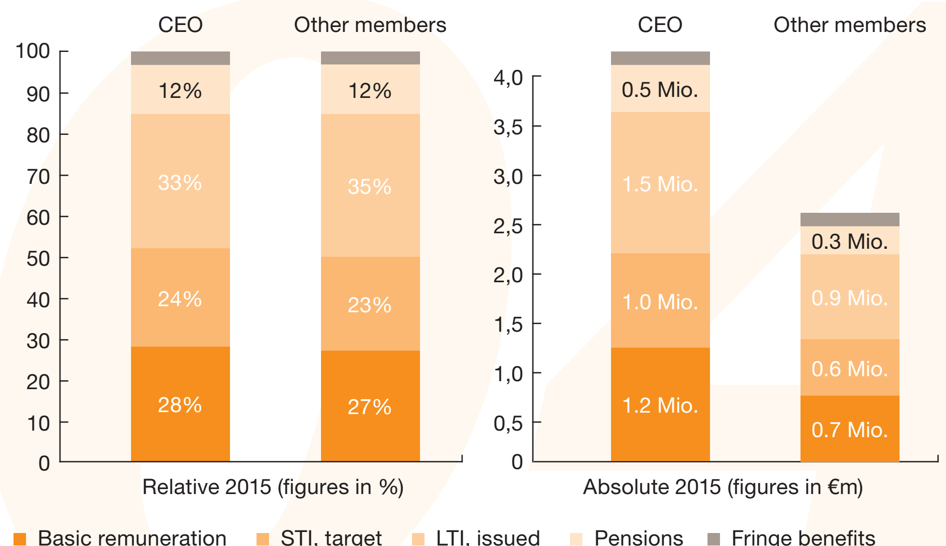
Total median remuneration in the MDAX in 2015 was €183,500 for chairs of supervisory boards, €121,500 for deputies and €75,000 for other supervisory board members. This represents a pay multiple of 2.4, the same as in the DAX.

Variable remuneration continues to decline as a percentage of supervisory board remuneration. 40% of DAX companies had retained variable remuneration for their supervisory board members in 2014 but only 30% in 2015 (just 28% for MDAX companies).

The study's most controversial recommendations were on reducing the complexity and increasing sustainability of management board remuneration. It recommends more genuine shareholdings under variable pay arrangements, combined with share ownership guidelines. On supervisory board remuneration, the authors advise against variable items to avoid conflicts of interest and promote input-based pay policies. Fixed remuneration packages for supervisory board members could include share allocations to align remuneration with long-term company success.

You can find out more details and an online analysis and also download the study at pwc-tools.de/verguetungsstudie-2016.

Fig. Composition of total remuneration of DAX and MDAX Management Board members (average)



Series

Getting to the heart of the matter

What the audit reform means for supervisory boards

New audit report is coming

The audit report (*Bestätigungsvermerk*) is still relatively brief and standardised. It is set to become much more informative in future with copious details and key audit matters.

The EU, IAASB and PCAOB launched wide-ranging reforms of auditing procedures following the 2008 financial markets and economic crisis. One result of this is that the audit report has been revised with the following aims:

- Enhanced communication between auditors, supervisory board and external users of financial statements
- Increased informational value of audit report with clarification of responsibilities of legal representatives, supervisory board and auditor
- Customised audit report with report on specific key audit matters

In Germany, Article 322 of the German Commercial Code (Handelsgesetzbuch, or HGB) forms the legal basis for audit reports on statutory year-end or consolidated financial statement audits. Audit reports for audits of financial statements by public interest entities (PIEs) must meet the requirements in the EU Statutory Audit Regulation. The relevant audit standard sets out detailed requirements for layout and wording. In the case of statutory audits these are the German Principles of Proper Auditing (GoA) issued by the German Institute of Public Auditors (Institut der Wirtschaftsprüfer, or IDW) and the International Standards on Auditing (ISAs), the latter only for explicitly ISA-compliant audits.

Whereas audit reports were previously seldom longer than two printed pages, in the case of PIEs they will generally be seven to nine printed pages in future. The layout is based on the significance of the statements, with the audit opinion at the top of each section, and clearly distinguishes between year-end and consolidated financial statements, (consolidated) management report and information in accordance with Article 10 of the EU Statutory Audit Regulation.

The major innovation with respect to content is the auditor's obligation to communicate key audit matters (KAMs) in the report for PIEs. These are matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements for the current reporting period. and which were communicated with the supervisory board. These include the "most significant assessed risks of material misstatement". As required by point (c) of Article 10(2) of the EU Statutory Audit Regulation, these must be described in the audit report in support of the audit opinion.

The matters to be identified shall be selected in three steps:

1. Identification of the matters communicated and to be communicated with the supervisory board
2. Determination of matters which required special attention during the audit of the financial statement, for example due to increased complexity or due to a large degree of discretionary judgment being required and the resulting considerable risk of error
3. Selection of the matters which are the most significant in the auditor's view

Communicating key audit matters is intended to enhance the informational value of the audit report. It also creates more transparency regarding the annual audit. In addition, it allows communication on these matters to be improved between auditors and supervisory board or company auditors. Finally, the legal representatives and the supervisory board will also become more alert to information in the financial statement highlighted in the audit report.

Communication of key audit matters by individual companies has been mandatory in the United Kingdom since 2013. Empirical studies have shown that on average, four key audit matters have been communicated. These frequently concerned impairments, revenues, taxation, provisions and acquisitions and disposals.

Pursuant to the EU Statutory Audit Regulation, the new PIE audit reports must be issued for business years starting after 16 June 2016. Under the ISAs, the rules apply from the cut-off dates for financial statements which ended on or after 15 December 2016.

Study

Expectations at previous year's level

20th Annual Global CEO Survey

Confidence, uncertainty, scepticism

Despite many areas of uncertainty, 29% of top managers in the global survey are confident that the global economy will grow over the coming year. This finding from PwC's annual CEO survey is the same as that of the previous year. But all decision-makers are increasingly sceptical on globalisation.

For the 20th time, PwC surveyed more than 1,300 top managers from 80 countries in the run-up to the World Economic Forum in Davos. Globalisation and technological advances have significantly transformed the world in recent years. The benefits of globalisations are now being questioned by many managers, with many fearing a return to nationalism and with it political and cultural insularity.

Striking the right balance between free trade and increasing national insularity is seen as problematic by 43% of those surveyed, whilst one in ten rejected this statement. 44% are particularly doubtful about closing the gap between rich and poor. 95% of managers see positive effects of globalisation in universal networking and free movement of capital, goods, people and information.

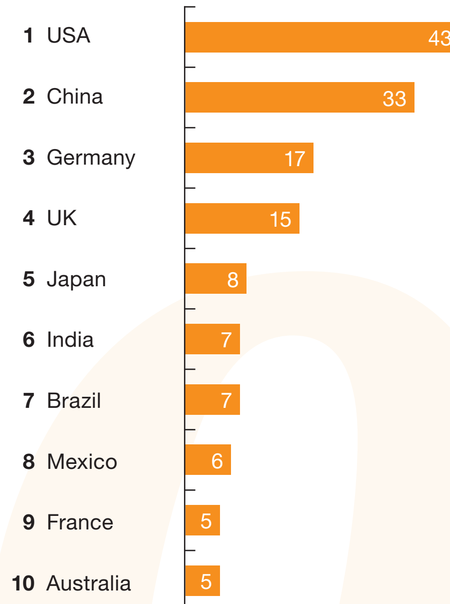
The German managers are pessimistic about their own economic situation. Just 31% are confident they will be able to achieve growth for their company in the coming year. That's 7% down since 2016. This fall in sentiment is also evidence by the cost-cutting programmes planned by 88% of German CEOs over the next twelve months. The main concerns are geopolitical uncertainty (81%), over-regulation (73%), protectionism (69%) and the future of the eurozone (67%).

Fig. Question: Which three countries, excluding the one in which you are based, do you consider most important for your organisation's overall growth prospects over the next 12 months?

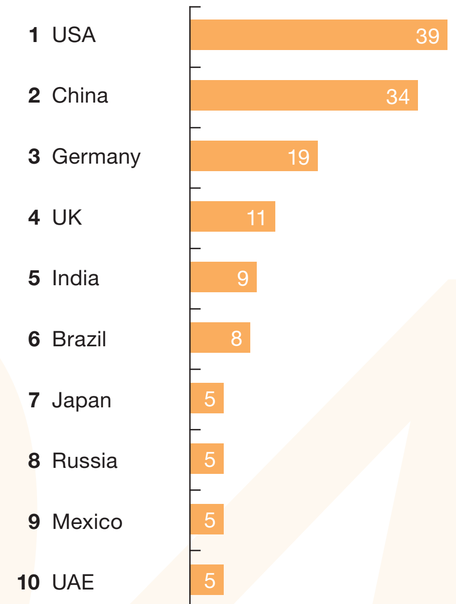
CEOs see the USA as the most important country for global growth prospects. Russia has fallen down the ranking and is out of the top 10.

in %

2017 ranking



2016 ranking



Basis: all survey participants (2017 = 1,39; 2016 = 1,409)
Source: 20th Annual Global CEO Survey 2017

On global comparisons German CEOs are more optimistic on issues such as cyber security or availability of key skills. 58% of German managers (61% worldwide) are concerned about cyber threats, 54% are concerned about the availability of key skills (worldwide 77%).

When asked about which countries they considered most important for their organisation's overall growth prospects, 43% worldwide cited the USA, closely followed by China with 33%. Germany followed in 3rd place in the top sources of growth (see Fig. 1). Despite the Brexit decision the United Kingdom remains the third most important source of growth for German CEOs after the USA and China. It should however be pointed out that the survey was held before the US presidential elections.

For the first time, consumers were asked about key topics in the CEO survey: 5,351 people from the 21 top markets, 29% of them from Western Europe. Consumers were more optimistic (34%) than the CEOs (29%) about short-term growth prospects. However, more than half of the consumers surveyed classed the growth rate as having a negligible impact on their personal wellbeing.

The two groups agreed on the impact technology is having on employment rates. Four out of five of those surveyed in both groups were worried that it will lead to major job losses. 88% of managers see social networks as an increasing risk and are concerned about a loss of trust. But 60% of consumers surveyed said they have never used social media for negative communication about companies.

Find out more at www.pwc.com/ceosurvey

Orderly vote

Elections to the supervisory board
Enforceability of resolutions

Under the provisions of the Articles of Association the leader of the Annual General Meeting can exercise considerable discretion on the format of elections to the supervisory board, from the order of voting to voting arrangements. This was confirmed by the Munich State Court (Ruling 5 HK O 14432/15 in Spring 2016).

The case before the court dealt with appointments to three seats on the supervisory board of a listed company where the supervisory board already nominated candidates. In the course of the Annual General Meeting an additional candidate was nominated by a shareholder. The chairman of the Annual General Meeting determined at the start of voting that the three candidates nominated by the supervisory board would stand for election first. A vote would only be held on the candidate nominated by the shareholder if they were not elected. The alternative candidate demanded his election take precedence, which the chair refused.

The candidates nominated by the supervisory board were each elected by majority vote and as advised the alternative candidate was not put to a vote. He brought an action against this. Grounds: The leader of the Annual General Meeting had a duty to conduct run-off elections between him and each candidate nominated by the supervisory board. The court disagreed. Every shareholder had the opportunity to vote "no" to the first three candidates during voting and consequently all of them had had an alternative.

In accordance with section 134(4) of the German Stock Corporation Act (Aktiengesetz, or AktG) the exercise of voting rights must be governed by the Articles of Association. The defendant's Articles of Association determined that the leader of the Annual General Meeting sets the order of the agenda items as well as the nature and format of elections. The court stated that this particularly includes the order of motions to be put to a vote. An exception would only apply under section 137 AktG which states that a shareholder's motion must be put to a vote prior to the supervisory board's proposal provided that the nomination was submitted prior to the Annual General Meeting and that a minority of the shareholders whose aggregate holding equals or exceeds one tenth of the share capital represented at the meeting so requests. In the case before the court neither of these requirements was met.

The plaintiff's argument that the method of counting during the vote was unlawful was similarly fruitless. The leader of the Annual General Meeting had chosen to conduct the voting using the so-called subtraction method, where abstentions and "no" votes are deducted from the total number of those attending the Annual General Meeting and the "yes" votes calculated from the difference. In the court's view this method was on the one hand governed by the Articles of Association, on the other hand it was clear from the notarised transcript that the method was also adequately explained and that there were no queries in response to it.

Contrary to the plaintiff, the court also did not take the view that the principle of equal treatment as set out in the German Stock Corporation Act was violated. In particular, the fact that no opportunity was afforded to the plaintiff to address the Annual General Meeting did not entail any such violation. There is no such obligation under the German Stock Corporation Act.

Finally the court also failed to determine any violation of the German Corporate Governance Code (Deutscher Corporate Governance Kodex, or DCGK) which could have laid the election open to challenge. The plaintiff had objected to the fact that the election of the three other candidates had been conducted in a single voting round (simultaneous voting) while No. 5.4.3 of the DCGK recommends single votes. According to the court however it is accepted that the simultaneous voting can also be classed as a single vote, since this merely refers to a single round of voting.

Year-end Letter Accounting 2016

In this season of financial statements, there are only a few guidelines or special developments those filing HGB and IFRS accounts need to bear in mind. We have therefore decided not to issue a separate Year-end Letter for supervisory boards.

But in the following pages we inform you of what may be key factors when the year end and consolidated accounts are audited by the supervisory board. We make no claim as to completeness. Instead, our priority has been to provide you with a concentrated summary of the central issues.

Pension problems

Pensions funded by external providers should be reviewed

After recovering slightly at the end of 2015, the actuarial interest rate for pensions under IFRS collapsed dramatically in the first half of 2016. It fell to a historic low in summer at around just 1%.

The turbulence of the previous year increased pension commitments to their highest ever level to date. Falls in actuarial interest rates require increases in commitments. The 1% fall in the actuarial interest rate increases the commitment by around 20% depending on the spread of stocks.

The actuarial interest rate has recovered since then, with the fluctuations in pension commitments almost becoming routine. However another aspect hove into view for the first time in 2016: pensions funded by external providers.

Many companies use external providers such as pension funds to run their company pension schemes. These act like an insurance company into which sums are paid regularly. The later payment to beneficiaries is made by the external providers.

The problem is that the external providers are subject to sometimes strict regulatory requirements and are restricted in where they can invest. With the current extremely low yields from quasi risk-free government bonds, it will be difficult for external providers to maintain historic rate guarantees in future.

However employees are normally liable for their company pension schemes even when they are run by an external provider. As the low-interest phase persists the liability risk increases.

Current reporting on company pension schemes run by external providers should therefore be scrutinised and the current risks evaluated.

What's new with the HGB

Accounting Directive Implementing Act to be implemented in full for the first time

The Accounting Directive Implementing Act (Bilanzrichtlinie-Umsetzungsgesetz, or BilRUG) implements the EU Accounting Directive into German law. It came into force in summer 2015. The new regulations on financial statements and management reports under German commercial law can and must however only be applied in full for business years beginning from 31 December 2015.

The BilRUG contains many detailed regulatory changes, in particular

- a broader definition of sales revenues, which now also include revenue from services that are not part of the company's usual business activities;
- the change in requirements if exemptions on preparing, auditing and/or disclosure of annual financial statements of subsidiary corporations and limited liability trading partnerships are taken up; however, an obligation to assume losses under section 302 of the AktG will continue to be sufficient to meet the so-called obligation to assume liabilities (Einstandspflicht);
- abolition of the requirement for separate presentation of extraordinary results in the income statement;
- additional disclosures in the Notes, for example on substantial expenditures or revenues of an extraordinary order of magnitude or significance and on proposed utilisation of profits;
- a statement on corporate management where the parent company is a publicly listed AG or SE; this requirement previously only applied for individual companies.

The BilRUG also has new regulations concerning the payment reporting for companies engaged in the extractive industries or logging in primeval forests (country-by-country reporting). These are to be compiled for the first time for business years beginning after 23 July 2015.

Revised rules on discounting pensions reserves

The revision of the rules on discounting pension reserves came into force in Spring 2016. Pension reserves must now be discounted at the average market interest rate over the last ten fiscal years. Previously the average market interest rate over the last seven years applied.

Since the ten-year average interest rate is currently higher than the seven-year average interest rate, in the next few years, other things being equal, this will lead to lower reserves and thus to a corresponding improvement in net income.

The difference between the interest rates is non-distributable, however. Profits can only be distributed if free reserves remaining after the distribution plus profits carried forward and minus losses carried forward are equal to or greater than this difference.

According to the German Ministry of Finance (Bundesministerium der Finanzen, or BMF) letter dated 23 December 2016 the situation is a little different for profit transfers where a profit transfer agreement is in place. The bar on dividend distribution cannot be applied in this case. In fact, profits arising from the new rules on discounting pension reserves are in principle also to be transferred to the Controlling Company. They may in some cases be allocated to retained earnings if this is commercially justifiable based on sound business judgement.

The new German commercial law regulations apply to all financial statements for business years that end after 31 December 2015.

ESMA Guidelines on Alternative Performance Measures now in force

The Alternative Performance Measures of the European Securities and Markets Authority (ESMA) have been in force since July 2016. They are aimed at issuers with securities traded on regulated markets.

Regular financial reporting only affects management reports and not financial statements. Apart from this, the guidelines are particularly relevant for prospectuses and ad-hoc disclosures. They are only valid for financial measures that are not defined under IFRS, for example adjusted EBIT.

The guidelines contain many detailed recommendations on these measures. These include that they should be given meaningful labels; that an explanation should be given as to why they provide useful information and what they are used for; they should not be displayed with more prominence than the measures from the financial statement; that a justification be provided if measures are no longer published or superseded.

Some of the recommendations go further than the requirements for management reports set out in German Accounting Standard No. 20, although the vast majority comply with these.

The guidelines are not binding for the purposes of preparing management reports. However, issuers should make every effort necessary to comply with them. This applies not least since the ESMA Guidelines form part of the focus areas of the German Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung, or DPR) for 2017 adopted from the ESMA.

Minimum quota for appointments to supervisory board now in force

Parts of the Law on the Equal Participation of Women and Men in Leadership Positions in the Private Sector and the Public Sector (law on women's quota), which was published in the Federal Law Gazette back in 2015, did not come into force until the start of 2016.

The delayed sections affect the staffing of supervisory boards of publicly traded companies subject to the principle of parity of co-determination. In these cases at least 30% of supervisory board members must be women and at least 30% men.

The statement on corporate management must include a report on whether these minimum quotas have been met. If not, the reasons for this must be stated. The report is required in the statement on corporate management for business years with a cut-off date for financial statements after 31 December 2015.

DPR focus areas

Presentation of financial performance measures and other areas

The European Securities and Markets Authority (ESMA) published the standardised European focus areas in Autumn last year. Shortly afterwards they were adopted by the German Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung, or DPR), which added two national focus areas.

The European focus areas compiled by the national enforcers jointly with the ESMA. The focus areas are:
1. Presentation of financial performance measures
2. Financial instruments – distinction between equity instruments and financial liabilities
3. Notes on the impact of the new IFRS on the consolidated financial statement

The first focus area is highly relevant for the ESMA but in summer 2016 the ESMA Guidelines on Alternative Performance Measures (APMs) came into force. These guidelines set principles for presenting financial measures which are not defined in the relevant accounting standards. All information contained in the financial statements must comply with the basic IFRS guidelines and one-sided presentation by the omission of exclusively negative impacts should be avoided. In addition, headings and subtotals are required in the balance sheet and income statement as well as additional explanations on movements in other comprehensive income (OCI), board views on segment information and a presentation of how earnings per share is calculated.

On point 2 the ESMA emphasises that a financial liability exists when a company cannot release itself from performing its contractual obligations through a settlement in cash or transfer of other financial assets.

The third focus area relates to the new standards IFRS 9 Financial Instruments, IFRS 15 Revenue from Contracts with Customers and IFRS 16 Leases, which do not enter into force until January 2018/2019 but require considerable lead time for implementation. The ESMA expects companies to have taken all actions necessary to apply the new IFRS by the time they come into force and also expects that they can now issue meaningful information in Notes on the potential impact of the new standards and on leases.

The ESMA also expects the companies to provide information on the likely risks and impact of Brexit on their business.

The DPR's national focus areas are:
1. Shares in other companies
2. Impairment testing of fixed assets

On shares, this mainly involves assessing discretionary decisions in atypical cases (IFRS 10, IFRS 11 and IAS 28) takes priority. This relates to controlling influence that does not reflect share ownership. The information in the relevant Notes will also be audited for completeness. Changes in control of an investee company and the assessment of quantitative and qualitative relevance of non-consolidated subsidiaries, as well as their presentation at initial recognition will also be investigated.

In the past, the DPR has repeatedly issued findings on the failure to conduct impairment tests despite their being an indication of impairment of an asset. The DPR audits continue to focus hard on the plausibility of key assumptions which form the basis for the calculation of the amounts recoverable using a cash-generating unit (CGU). Another aspects is the inclusion of debts in calculations of the CGU's fair value and value in use. If the impairment of a substantial CGU is not fully recognised, evidence of the lower limit on the value will be scrutinised in more detail.

The DPR will analyse each individual company's financial statement and may also audit other sections of the accounts. Companies preparing for a DPR audit should therefore concentrate not just on the published focus areas.

About us

Our clients face diverse challenges, strive to put new ideas into practice and seek expert advice. They turn to us for comprehensive support and practical solutions that deliver maximum value. Whether for a global player, a family business or a public institution, we leverage all of our assets: experience, industry knowledge, high standards of quality, commitment to innovation and the resources of our expert network in 157 countries. Building a trusting and cooperative relationship with our clients is particularly important to us – the better we know and understand our clients' needs, the more effectively we can support them.

PwC. More than 10,300 dedicated people at 22 locations. €1.9 billion in turnover. The leading auditing and consulting firm in Germany.

Information, networking, exchanging views

PwC Boardroom. The programme for supervisory board members.

The responsibility and the significance of regulatory bodies have increased significantly in recent years. This development has been accompanied by numerous regulatory changes and a sharp rise in the expectations of the general public. We have introduced PwC Boardroom to keep you up to date on current issues and offer you an exclusive platform for networking and exchanging ideas and perspectives. The programme is aimed at members of supervisory boards, boards of directors and advisory boards with a monitoring function.

Publications

- *Die Unternehmensüberwachung – Überblick und Praxistipps* gives you a concise look at the work to be carried out by the supervisory board (available in German).
- *Der Prüfungsausschuss – Best Practices einer effizienten Überwachung* is our standard reference on how to create an audit committee and ensure it functions correctly and efficiently (available in German).
- *404 – Latest news for supervisory boards* is published regularly and keeps you abreast of the latest developments in corporate governance, accounting standards and capital market regulation – short, concise and relevant.

Events

- Regular meetings for supervisory board members:
  Exclusive events give you the opportunity to learn about the latest developments and to network with other supervisory board members from companies like yours. At the same time, you can also expand your supervisory board network.
- Workshops and seminars:
  Whether you are interested in training on the fundamentals, updates on accounting standards, or seminars on new regulations concerning the supervisory board's work, we can provide the ideal customised solution, from exclusive one-to-one conversations to events for the entire board.

Imprint

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