



Need to know

Government publishes new company reporting requirements for private and public companies in response to its consultation on Corporate Governance Reform

Contents

Background

Reporting on matters in section 172(1) of the Companies Act 2006

Corporate Governance reporting for large privately-held and unlisted companies

Executive pay

Effective date

Further information

The Companies (Miscellaneous reporting) Regulations 2018 (the draft Regulations) have been laid before Parliament and make the legal changes necessary for the Government's package of corporate governance reforms announced by the Department for Business, Energy and Industrial Strategy (BEIS) in August 2017.

- The draft Regulations are part of the Government's package of corporate governance reforms.
- All large companies (private as well as public) must include a section 172(1) statement in their strategic report which describes how their directors have complied with their duty to promote the success of the company for the benefit of its members whilst having regard to the matters set out in section 172(1) (a)-(f). These matters include a number of non-financial considerations.
- The directors' report of all large companies (private as well as public) must include more information on how directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard on the principal decisions taken by the company during the financial year. Requirements are also added in respect of how directors have engaged with employees, had regard to employee interests, and the effect of that regard on the principal decisions taken by the company during the financial year.
- All companies of a "significant size" must disclose their corporate governance arrangements in their directors' report and on their website, including whether they follow any formal code (excluding companies such as listed companies which are already required to report on their corporate governance arrangements).

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

- All quoted companies must also:
 - report annually the ratio of CEO pay to the average pay of their UK workforce, along with a narrative explaining changes to that ratio from year to year and setting the ratio in the context of pay and conditions across the wider workforce; and
 - provide a clearer explanation in remuneration policies of a range of potential outcomes from complex, share-based incentive schemes.
- The new requirements are effective for financial years commencing on or after 1 January 2019.

Background

In 2017 the Government issued a [Green Paper](#) to consider what changes might be appropriate in the UK corporate governance regime to help ensure that the economy works for everyone. It focused on three main areas:

- Ensuring that executive pay is properly aligned to long-term performance
- Giving greater voice to employees and consumers in the boardroom
- Raising the bar for governance standards in large privately-held companies

The Companies (Miscellaneous reporting) Regulations 2018 (the draft Regulations) have now been laid before Parliament and make the legal changes necessary for the Government's package of corporate governance reforms announced by the Department for Business, Energy and Industrial Strategy (BEIS) in their August 2017 [response to the consultation](#) on the green paper.

The draft Regulations, aimed at building confidence in the way that large private and quoted companies are run, introduce new content for the directors' report, strategic report and directors' remuneration report.

Reporting on matters in section 172(1) of the Companies Act 2006

There is increasing demand from investors and the public for information as to how companies are taking account of the matters in section 172 of the Companies Act because they are important to a company's sustainable long-term success and the contribution it makes to wider society. The reporting requirements are aimed at strengthening company reporting in this area. The following new requirements are introduced.

1. Strategic report – a statement which describes how directors have complied with their duty to have regard to the matters set out in section 172(1) (a)-(f).
2. Directors' report – a statement in respect of how directors have engaged with employees, had regard to employee interests, and the effect of that regard on the principal decisions taken by the company during the financial year.
3. Directors' report – a statement summarising how directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard on the principal decisions taken by the company during the financial year.

Strategic report requirement – section 172(1) statement

Requirements

All large companies (see ‘Scope’ below) must include a section 172(1) statement in their strategic report. It must describe how their directors have complied with their duty to have regard to the matters set out in section 172(1) (a)-(f). [New s414CZA in the Companies Act 2006]

Duty to promote the success of the company (s172 Companies Act 2006)

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –

- a. the likely consequences of any decision in the long term;*
- b. the interests of the company's employees;*
- c. the need to foster the company's business relationships with suppliers, customers and others;*
- d. the impact of the company's operations on the community and the environment;*
- e. the desirability of the company maintaining a reputation for high standards of business conduct; and*
- f. the need to act fairly as between members of the company.*

Companies within scope must make their section 172(1) statement available on a website, free of charge, and ensure it remains available until the statement for the next financial year is made available. It must be made available as soon as reasonably practicable. The website must be maintained by or on behalf of the company and must identify the company in question.

Unquoted companies, who are not currently required to publish their annual report on a website, will need to make arrangements to ensure that this statement is made available, either by making the whole annual report available or just the statement itself. Quoted companies are already required to make their annual report available on a website.

Applying the draft Regulations

The FRC will be issuing guidance on the application of the new legal requirement as part of their revised Guidance on the Strategic Report which is expected later this year.

In the [Frequently Asked Questions](#) (FAQs) accompanying the draft Regulations, BEIS has indicated that they expect that:

1. The statement will be a separate component of the strategic report. Where appropriate companies can cross-refer to other parts of the report. However, unquoted companies that choose to publish just the s172(1) statement on the website rather than the full annual report will need to ensure that cross-referenced disclosures are included with the statement to ensure that it can be understood as a standalone statement.
2. The statement will be meaningful and informative for shareholders. The disclosures should be tailored to the individual circumstances of the company, focusing on matters of strategic importance to the company which are consistent with the size and complexity of the business.
3. In practice, decisions and policies affecting employees, the environment and suppliers etc. will often be taken at group level. It is anticipated that subsidiary companies will be able to make cross-references to group statements and policies where appropriate.

4. The contents of the statement will depend on the individual circumstances of the company, but might include:
 - a. the issues, factors and stakeholders the directors consider relevant in complying with section 172 (1) (a)-(f) and how they have formed that opinion;
 - b. the main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and
 - c. information on the effect of that regard on the company's decisions and strategies during the financial year.

Directors' report requirements – engagement with employees, suppliers and others

Requirements

Additional reporting requirements have been added to the directors' report to help increase transparency of directors' engagement with and the regard they have had to employees, suppliers, customers and others with whom the company has a business relationship.

The draft Regulations:

1. Require large companies to report on their engagement with suppliers, customers and others in a business relationship with the company. This will comprise a statement summarising how directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard on the principal decisions taken by the company during the financial year. [New paragraph 11B of Schedule 7 of the Accounting Regulations]
2. Build on the current directors' report requirement to discuss employee involvement matters by requiring information on how directors have engaged with employees, how directors have had regard to employee interests, and the effect of that regard on the principal decisions taken by the company during the financial year. [Amended paragraph 11 of Schedule 7 of the Accounting Regulations]

Applying the draft Regulations

Although these are new directors' report requirements, BEIS appreciates that companies may wish to report this additional information in their strategic report s172(1) statement where the information is of material interest to members. Where this is the case the information need not be included in the directors report as well, but companies will need to ensure that where they have taken this approach they state that they have done so in the directors' report (as required by paragraph 1A of Schedule 7 of the Accounting Regulations).

These requirements are mandatory and must be discussed even where the directors do not judge the information to be of sufficient strategic importance to be included in the strategic report that year.

Scope

Criteria	Requirement
Size	<p>Strategic report – Section 172(1) statement</p> <p>All those already required to produce a strategic report, except those qualifying as medium-sized (refer to sections 465-467 Companies Act 2006) in relation to a financial year, are within scope.</p> <p>The definition of ‘large’ is as set out in the Companies Act – a company is large if it meets 2 out of 3 of the following:</p> <p><i>Turnover of more than £36m</i></p> <p><i>Balance sheet total of more than £18m</i></p> <p><i>More than 250 employees</i></p> <p>A company may also be treated as large below these size limits if it is an ineligible company (e.g. a PLC whether listed or not or a company with permission to perform certain financial services).</p>
	<p>Directors’ report – requirement to report on their engagement with suppliers, customers and others in a business relationship with the company.</p> <p>A company meeting the large company size limits as set out in the Companies Act 2006. A company is large if it meets 2 out of 3 of the following:</p> <p><i>Turnover of more than £36m</i></p> <p><i>Balance sheet total of more than £18m</i></p> <p><i>More than 250 employees</i></p> <p>Companies that are below the limits but an ‘ineligible company’ are exempt from this requirement.</p>
	<p>Directors’ report – requirement to summarise how directors have engaged with employees and taken account of their interests</p> <p>Applies to all companies employing on average more than 250 employees in the UK.</p> <p>This is consistent with the current scope for the existing directors’ report disclosure on employee involvement (as required by paragraph 11 of Schedule 7 of the Accounting Regulations).</p> <p>The method of calculating the average number of persons employed has been simplified slightly as part of the draft Regulations to make it easier to understand. This makes it consistent with the basis for disclosing information about employee numbers in the notes to the accounts, which is helpful. [s411 CA2006]</p>

Criteria	Requirement
Subsidiary companies	<p>All qualifying companies, including subsidiaries and intermediate holding companies, need to comply, even if the company is included in a group strategic or directors' report. This is because under the Companies Act the duty of directors is owed to their own company.</p> <p>This is consistent with the current requirement for all qualifying subsidiaries to prepare a strategic report. [s414A(3)]</p> <p>In practice, decisions and policies affecting employees, the environment and suppliers etc. will often be taken at group level. It is anticipated that companies will be able to make cross-references to group statements and policies where appropriate.</p>
Businesses that are not companies	<p>The draft Regulations apply only to companies. So Limited Liability Partnerships, for example, are not in scope.</p>

Observation

The population of companies caught by the s172 requirements in the draft Regulations is broad as, in general, most large UK companies are captured. The amount of work required to meet the new requirements should not be underestimated.

Investors now use a wider set of data when making investment decisions. Given the increasing reliance on non-financial information, we support measures that seek to encourage material, high quality, investor grade information which contribute to investors' understanding of how the company is creating value for the long term.

There is an element of overlap between the original strategic report requirements, those stemming from the NFR directive and these new regulations, in particular in respect of stakeholder engagement. Companies will want to consider carefully how they structure their first strategic report under the new requirements to ensure that all the relevant regulatory requirements are met in a way such that the strategic report continues to tell a clear and concise story.

Corporate Governance reporting for large privately-held and unlisted companies

The response to the government's consultation revealed support for encouraging high standards of corporate governance in the UK's largest private companies given the significant impact they have on employees, suppliers, customers and others, even though they do not have securities traded on a market.

The new reporting requirement for companies of a significant size is to disclose their corporate governance arrangements in their directors' report and on their website, including whether they follow any formal code. This requirement, which aims to make corporate governance arrangements in the UK's largest companies more visible, will apply to all companies of a significant size unless they are subject to an existing corporate governance reporting requirement. The Government will also consider extending a similar requirement to Limited Liability Partnerships (LLPs) of equivalent scale.

The Government invited the FRC to work with a variety of organisations, under the leadership of James Wates CBE, to develop a voluntary set of corporate governance principles for large private companies. [The Wates Corporate Governance Principles for Large Private Companies](#) have been developed and are currently open for consultation. It is intended that these principles become the Code against which most large privately-owned companies will choose to report.

Scope

Companies will be in scope if they have either:

- 2,000 or more global employees; or
- A turnover over £200m globally and a balance sheet over £2bn globally.

Companies already required to report on their corporate governance will be exempt from the new requirement. Subsidiaries are not exempt and will need to comply with the new requirement if the scope criteria are met.

For further information on the new reporting requirements, including how to determine whether a company is within scope, see the [Deloitte Governance in Brief publication](#).

Executive pay

The draft Regulations introduce new reporting requirements on CEO pay ratios and long-term incentive outcomes.

Pay ratios

All UK quoted companies with more than 250 UK employees will be required to report annually, in their directors' remuneration report the ratio of their CEO's pay (the 'single figure') to the median, 25th and 75th percentile total remuneration of their full-time equivalent UK employees. Various supporting information including narrative explaining changes to that ratio from year to year and setting the ratio in the context of pay and conditions across the wider workforce, and the methodology used to calculate the ratios, will also be required.

Other reporting requirements

In the next new remuneration policy, there will be a requirement for quoted companies to provide an illustration in the Directors' Remuneration Report of the impact of potential future share price increases on executive pay outcomes that are linked to performance periods of more than one financial year (e.g. LTIP awards), assuming share price growth of 50% over the period.

Remuneration committees will be required to provide a summary explanation of any discretion used in respect of executive remuneration outcomes reported in the year.

In the notes to the single figure table, which are audited, there will be a requirement to provide:

- an estimate of the amount of remuneration that is attributable to share price growth; and
- an explanation of whether, and if so how, discretion has been exercised to determine remuneration as a result of either share price appreciation or depreciation.

This [Deloitte article](#) discusses the new requirements in more detail.

Scope

"Quoted" is as defined by the Companies Act 2006: this means UK registered companies that are quoted on the UK Official List, the New York Stock Exchange, NASDAQ or a recognised, regulated stock exchange in the European Economic Area. It does not include companies listed on the Alternative Investment Market.

Effective date

All the new requirements apply to companies reporting on financial years starting on or after 1 January 2019. This aligns with the proposed effective date for the FRC's revised Corporate Governance Code.

The draft Regulations will not become law until approved by Parliament. However, publication of the draft gives companies and stakeholders as much time as possible to understand the proposed changes to the law. Crucially, the approval process is a yes/no vote – the draft Regulations cannot be amended.

Further information

The draft Regulations, along with a draft explanatory memorandum and impact assessment are available [here](#).

The Corporate Governance: The Companies (Miscellaneous Reporting) regulations 2018 – frequently asked questions are available [here](#).

If you have any questions about the proposals, please speak to your usual Deloitte contact.



This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NWE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NWE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2018 Deloitte LLP. All rights reserved.

Designed and produced by Deloitte CoRe Creative Services, London. 129032