This briefing discusses the new rules which require 2019 annual reports to include information about stakeholders and governance arrangements. UK companies, whether private or public, as well as UK subsidiaries that meet relevant thresholds, must comply with these new provisions under company law.

Overlaps between some of the new rules mean groups need to identify which entities are caught and, for each affected company, the stakeholder disclosures needed and how best to allocate the information to different parts of the annual report.

**Section 172 statement**

**The legal requirement** – A Section 172 statement should describe how the directors have had regard to the matters set out in Section 172(1) of the Companies Act 2006 when carrying out their duty to promote the company’s success during the financial year.

The factors listed in Section 172(1) are the:
- likely long-term consequences of decisions
- interests of the company’s employees
- need to foster business relationships with customers, suppliers, etc
- operational impacts on the community and environment
- desirability of maintaining a reputation for high standards of business conduct
- need to act fairly in the treatment of shareholders

**Which companies are caught?** – A Section 172 statement must be made by all UK-incorporated companies which prepare a strategic report, unless they are entitled to rely on a “medium-sized” company exemption.

The exemption applies only if a company does not exceed certain size thresholds and is not otherwise prevented from relying on the exemption, because, for example, it is a public company or a member of a group which contains a listed or regulated company.

**Content** – The law does not set out further details of the type of information that should be disclosed in the Section 172 statement, but BEIS and the FRC have produced guidance encouraging companies to include information within the categories set out in the table overleaf.

**Style and level of detail** – Companies should judge what is appropriate but, in line with the approach recommended generally for the strategic report, make sure that the statement is:
- meaningful and informative
- shedding light on matters that are of strategic importance to the company
- consistent with the size and complexity of the business

Companies are encouraged to use cross-references and, in particular, to consider how to split their employee, customer and other supplier information between the strategic report and the directors’ report (see Employee and business relationship disclosures below) so as to avoid repetition and provide a cohesive narrative.

If the company considers that stakeholder information is strategic it should include it in the Section 172 statement and explain in the directors’ report where that information can be found.

**Location** – The Section 172 statement itself must be placed in the strategic report and not in other areas, such as in a corporate governance statement. Within the strategic report it can be placed at any point.

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1. Two of the following three: £36m turnover; £18m balance sheet total; 250 employees.
### What should the Section 172 statement cover?

#### Stakeholders

- Information about key stakeholders and issues.
- How the directors have identified these particular stakeholders and issues.

- Stakeholders typically include investors, customers, the employees and other workforce (such as contractors or agency staff), suppliers, regulators, the government, the community and the environment. Companies may want to identify them using a matrix or map which explains which parts of the business they relate to and the extent of the impact they may have.
- It is important to consider all the factors in Section 172 and not just the most obvious, such as employees. Companies may, for example, wish to consider how to report on their payment practices, following pronouncements this year from the Government on the need to do more to create a responsible payment culture.
- Companies should also consider whether there are other important groups or issues which can affect the company’s operations or will be affected by the company, even if they do not fall within the factors listed in Section 172. The law is clear that this is not an exhaustive list of matters that directors should have regard to.

#### Engagement methods and outcomes

- The main methods the directors have used to engage with stakeholders.
- The outcomes/understanding this engagement has led to.

- These might include:
  - live interactions, such as meetings with suppliers and community groups, site visits, employee town halls, forums
  - reports e.g. from management and third-party experts
  - surveys and consultations
  - communications and publications

- Formal engagement structures (such as committees or a designated director) for the workforce and potentially other important issues, including ESG and climate change.
- The use of technology (smartphone apps, interactive surveys, blogs).
- Training and diversity and inclusion initiatives.

- Companies should consider and report on the learnings gained and feedback loops and not just list engagement processes.

#### Decisions and strategy

- The effect of the regard for stakeholders on the company’s decisions during the financial year.
- The effect of the regard for stakeholders on the company’s strategies during the financial year.

- Issues to consider include: capital allocation decisions, distributions, special dividends, major transactions, major restructuring, R&D, pension funding arrangements, board appointments, major regulatory or legal matters, major product line decisions, reputational issues and environmental and sustainability matters.
- Companies must decide which decisions are important enough to be included in this strategic overview (rather than elsewhere in the annual report).

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**Group subsidiaries** – Large corporate groups may include one or more subsidiaries that will need to produce their own individual Section 172 statement. It is important to note that the requirement may apply even to smaller companies if the medium-sized company exemption from this requirement does not apply to the company itself (because it is a public company or an insurer or a regulated business) or because it is in an “ineligible” group. Broadly speaking, a group is ineligible if any of its members are listed or involved in financial services activities.

It is not possible for the parent company to make a Section 172 statement on behalf of a subsidiary, even where the parent produces a group strategic report.

In theory, the guidance on the contents of a statement applies to any statement made by a subsidiary company. In reality, BEIS has acknowledged that where group arrangements apply, Section 172 statements made by subsidiaries can refer to the statement made by the top company in the group. The subsidiary must still, however, explain how it has applied group policies and procedures to its own operations. Subsidiaries which are required to make a statement but have limited operations are likely to produce a reduced description of their activities.

**Publication on the company’s website** – The legislation requires all companies to make their Section 172 statement available on the company’s website.

Unlisted groups may need to make specific arrangements for group companies to comply with this requirement as it is likely that their annual reports are not made public on a website.

They should also note that, Section 172 statements by group companies must be capable of being understood as stand-alone statements. They must, therefore, make sure that where disclosures cross-refer to other parts of the annual report, the necessary information is included with the statement, or the whole of the annual report is published on the website.

It is not necessary for each subsidiary to have its own individual website and we expect that most groups will list all the statements made on a dedicated section of their parent company website.
Employee and business relationship disclosures

Under two separate statutory requirements in the Miscellaneous Reporting Regulations 2018, additional information about UK employees and the company’s business relationships with suppliers, customers and others must be provided in the directors’ report of all group companies in scope. It is also necessary to report on the effects that the directors have regard to employees and business relationships had, including on the principal decisions taken by the company during the financial year. Companies do not need to disclose impending developments or matters under negotiation if this would be seriously prejudicial to the interests of the company. The term “employee” for the purposes of this requirement means only those that are based in the UK and are employed under a contract of service (i.e. not other types of workers, such as agency or self-employed workers).

What must be disclosed? Which companies are caught?

| Employee engagement – companies must give details of: | All UK-incorporated companies which meet two of these conditions: |
| > how directors engaged with employees | > turnover over £36m |
| > how directors had regard to employee interests | > balance sheet total over £18m |
| > the effect of that regard, including on principal decisions taken | > over 250 employees of the company (whether UK-based or not) |

| Business relationships – companies must give details of: | All UK-incorporated companies which have at least 250 UK-based employees in their company or in the group they head up. Companies caught by these rules should be easy to identify as they should already be making employee disclosures under existing requirements. |
| > how directors have had regard to the need to foster business relationships with suppliers, customers and others | |
| > the effect of that regard, including on principal decisions taken |

Non-listed subsidiary corporate governance reports

The Miscellaneous Reporting Regulations 2018 require very large UK-incorporated companies, including group subsidiaries, to report on their corporate governance arrangements. This is separate from the obligation to publish a Section 172 statement and make other stakeholder disclosures.

What must be disclosed? – A statement about the company’s corporate governance arrangements must be included in the annual directors’ report and published separately on the company’s website. It should explain:
> which, if any, corporate governance code the company applies
> how the company applies it
> if the company departs from the code, in which way it departs from it and why it does so

If the directors have decided not to apply any code, the statement of corporate governance arrangements must explain the reasons for that decision and what corporate governance arrangements have been applied for the financial year.

Corporate governance in this context means how the management structures of the company (such as the board and its committees) operate, what requirements are imposed on them, how they interact with each other and how they interact with the company’s owners.

Which companies are caught? – All UK-incorporated companies meeting any of two thresholds must report, unless they are already required to report on corporate governance as an individual company.

The relevant thresholds are:
> over 2,000 company employees (whether UK-based or not)
> turnover over £200m and a balance sheet total of over £2bn

Overlap with the Section 172 statement – These requirements cover the same information as is required for the Section 172 statement but put a specific emphasis on a company’s interactions with its UK employees and with others with which the company has a business relationship. For examples of the types of “principal decisions” companies should consider, see the commentary on Section 172 statements above.

Whilst having additional requirements encourages companies to provide more details in these specific stakeholder areas, the Government expects that in practice companies may want to report on employee, customer and supplier issues as part of their Section 172 statement in the strategic report. It has, therefore, confirmed that in such cases there is no need to duplicate this information in the directors’ report.

The legal requirement – The employee and business relationship requirements apply to different categories of company as set out in the table below.

Which code to use? – References in the legislation to a code can mean any code of practice on corporate governance. An important consideration for many companies is whether to report against a particular code, and if so, which code to adopt. Approaches vary and we are aware of a number of different codes being considered, including non-UK codes for companies with a strong overseas link.

The main option for many large unlisted companies is the Wates Principles. The Wates Principles, finalised last December, provide a convenient alternative to reporting against the full UK Corporate Governance Code as they address key areas at a high level and without the detailed Provisions which apply to listed companies under the UK Corporate Governance Code. Companies reporting against the Wates Principles are encouraged to provide a short statement for each Principle which explains how it has been applied to achieve better outcomes. The Principles were developed by a working group led by Sir James Wates, chair of Wates Group Limited. The Wates Group was the first private company to report using these Principles in July and its governance statement is a helpful example of what to cover.

The Wates Principles – areas covered

| Company purpose and leadership | Board composition | Responsibilities and decision-making |
| Opportunity and risk management | Remuneration | Stakeholder engagement |

Companies in regulated sectors, such as financial institutions and utilities and energy providers, must also consider specific governance requirements which are applied to them by individual regulators. As a result, some of these groups are preferring to report in accordance with their own specific arrangements and regulator guidance, but without reference to an established governance code.
All of these new reporting requirements apply for the first time to financial years beginning on or after 1 January 2019. This means that companies will begin to publish their first reports in 2020 on the activities and information gathered in 2019.

Useful links

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A number of companies, particularly listed companies, have been reporting in recent years on their stakeholder activities. In addition, a few have pre-complied with the obligation to make a Section 172 statement by including one in their reports issued in 2019 (on the 2018 reporting year). These examples provide a useful starting point, although we expect best practice to develop over time.

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