

Tackling s.172 reporting – A brief guide for boards

September 2019

Purpose of this guide

Section 172 ('s.172') was one of the most debated aspects of the major revision to the Companies Act in 2006. It has subsequently slipped down the order of priority for many boards, but the concept of 'enlightened shareholder value' that s.172 introduced is now once again a high-profile issue, with its range of factors that directors need to have regard to when promoting the success of the company for the benefit of the members (that is, the shareholders). In particular, the relationship between companies and their employees and external stakeholders has been at the heart of the governance reform debate. And investor groups, proxy advisers and a range of other pressure groups are increasingly focusing on 'ESG' in their interactions with companies.

New disclosure requirements

So s.172 has been in the Companies Act for many years. What has now changed is the introduction into the Act of a specific requirement for boards to make a statement, as part of the strategic report, on **how** they have had regard to the matters in s.172. The revised UK Corporate Governance Code ('the 2018 Code') also contains a similar reporting requirement.

This brief guide is primarily intended to provide boards of FTSE 350 companies with a starting point for tackling s.172 under both the Companies Act and the 2018 Code, and includes a number of specific tips for boards to consider.

Companies Act 2006, Section 172

Duty to promote the success of the company

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.

Tip 1

Revisit the duties s.172 imposes upon directors. The range of matters to be considered is broader than simply stakeholder relations, for instance.

The new requirements are about reporting, so they do not necessarily mean that changes are needed to boardroom processes and activities. It is important, however, for each board to consider for itself whether any such changes are needed.

Tip 2

Consider whether the existing board processes and activities allow s.172 to be addressed appropriately. Is there a need for additional information or training (at management or board level), for instance?

Purpose, culture and values and s.172

The purpose, culture and values that a board establishes in an organisation should guide how the factors in s.172 are applied in its decision making.

Purpose, culture and values are also a major area of emphasis in the revised UK Corporate Governance Code. The balance that boards strike between the various matters that they must consider under s.172 will be very relevant to how they apply Principle A of the new Code.

“[The role of the board] is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.” [2018 Code, Principle A (extract)]

Tip 3

Consider whether the board has sufficiently clearly established the desired purpose, culture and values of the organisation.

Putting the board in a position to make a s.172 statement

As the new requirement relates to reporting, it makes sense to start the preparation for it by thinking about what information will be included in the annual report.

The specific requirement in the Companies Act is:

“...a statement (a “section 172(1) statement”) which describes how the directors have had regard to the matters set out in section 172(1) (a) to (f) when performing their duty under section 172.” [Companies Act 2006, s.414CZA]

A confirmation *that* s.172 has been considered is therefore not enough. The disclosure must also explain **how** the directors have carried out their duties.

What this means in practice is not explained further in the Act, but it is likely to include information both on:

- The process or processes used by the board to ensure s.172 is addressed in decision making; and
- What the process or processes were applied to.

We consider each of these in turn below.

Tip 4

When considering whether the existing board processes and activities allow s.172 to be addressed appropriately, think also about what will be disclosed in the annual report. This could influence what the board actually does.

Process for considering s.172

Nobody wants to create process for its own sake but, equally, good corporate reporting should only reflect what is done in practice within an organisation. So it is important for boards not only to be confident that they are ‘doing the right thing’ in their deliberations, but also to be able to identify and express for disclosure purposes how s.172 has been considered.

In order to provide evidence that s.172 has been factored into their discussions some boards have put in place checklists that are applied to major decisions, and there is no doubt that this can help to structure debate. The key, however, is that the relevant factors are considered, even if not under a formal s.172 banner.

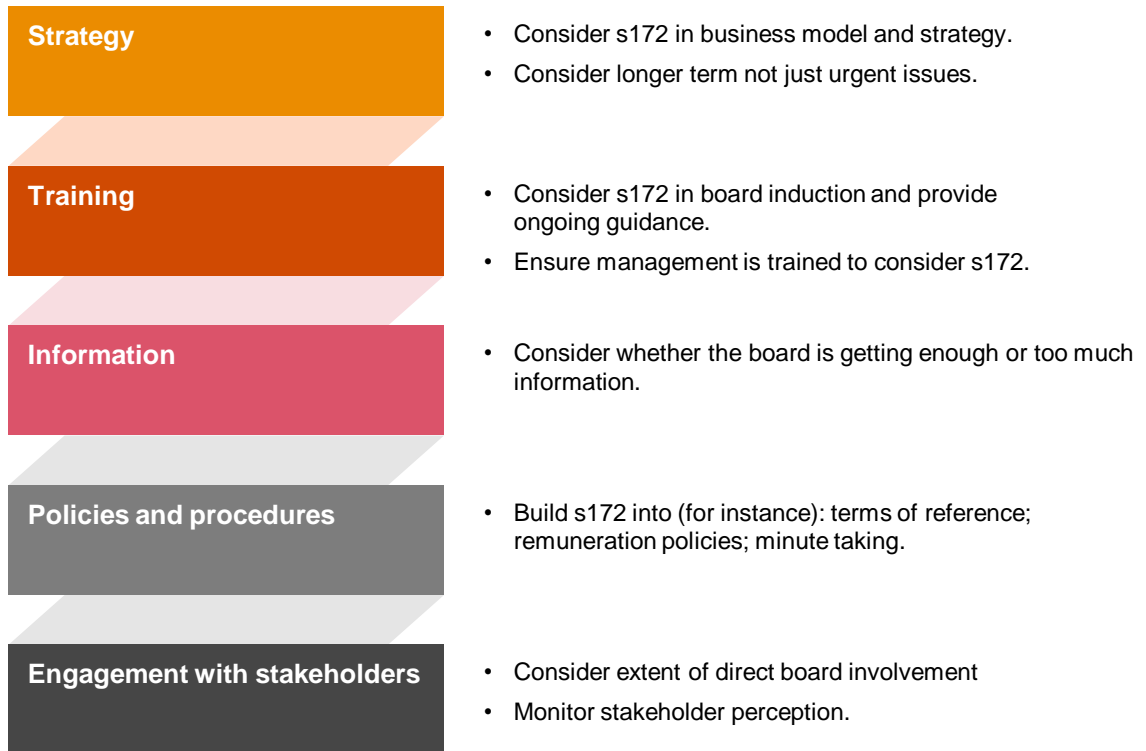
The General Counsels of FTSE 100 companies (‘the GC100’) issued **Guidance on directors’ duties > Section 172 and stakeholder considerations** in October 2018, updating their earlier advice and including an illustrative example of a board applying its s.172 duties. It is clear from the GC100 guidance that they do not believe it is necessary to explicitly consider s.172, as long as the relevant factors are dealt with by the board in their discussions of a topic.

Tip 5

Consider whether board and committee minutes appropriately demonstrate s.172 duties being applied, even if this is integrated into other aspects of decision making.

Figure 1 – GC 100 guidance

The GC100 Guidance also identifies five areas in which practical steps can be taken by boards in relation to carrying out their duties under s.172:



What the process is applied to

The s.172 statement is required to be in the strategic report section of the annual report (subject to the recommendations about the use of cross-referencing below). As with the rest of the strategic report, therefore, it should relate to matters that are of strategic significance.

In practice, issues that are strategically important should be those that the board deals with, so there is a built-in filter in the requirements focusing the disclosures on matters in respect of which directors can reasonably be expected to carry out their s.172 duties. These might include, for example, M&A activity or particular risks or opportunities relevant to the achievement of an ongoing strategic objective.

Dealing with matters of this sort in the s.172 disclosures will also help with the revised UK Corporate Governance Code, which requires boards to:

“...describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company’s business model and how its governance contributes to the delivery of its strategy.” [2018 Code, Provision 1]

Tip 6

Consider which matters considered by the board during the period should be addressed in the s.172 statement disclosures.

Figure 2 – Applying s.172 – an overview of the board’s role



What the statement will look like

No format for the s.172 statement is specified in the Companies Act but, because of the need for the content to cover both process and the issues to which the process is applied, we think there will often be a description in the corporate governance report of the processes used to ensure s.172 is considered. This positioning makes sense, as s.172 relates to directors' duties.

This disclosure could also explain how s.172 was considered in connection with the chosen strategic issues, risks or opportunities, or it could cross-refer to information elsewhere in the annual report – the strategic report in most cases.

Because the statement is technically required to be in the strategic report, appropriate cross-references will also need to be made from the strategic report, and it will need to be sufficiently clear in the strategic report what content constitutes the s.172 statement (wherever in the annual report that content might be). We would always recommend using a 's.172 statement' heading or sub-heading to make it easy to identify the starting point.

Utilising information already in the annual report

Where other information in the annual report provides evidence for how s.172 has been applied to strategic issues, risks or opportunities it will be helpful to refer to it in the s.172 disclosures – either by incorporating it directly, or by cross-reference. Such information can also help to show how s.172 is dealt with more generally by the board, and the balance set by its purpose, culture and values.

The key is to explain clearly why matters have been chosen for disclosure and how the processes used have applied the s.172 factors appropriately.

Figure 3 – Other information relevant to s.172 matters



Tip 7

Consider what other information in the annual report might help to show how s.172 has been considered.

Further information and contacts

For more information on s.172 reporting and the stakeholder agenda more broadly (including emerging practice) please visit our [webpage](#).

Information on subsidiary companies and other private businesses and boards can be found [here](#).

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