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# Charities Alert

## New reporting requirements for large charitable companies - a reminder

## In a nutshell

- Four new governance-related reporting requirements for large private companies will be required (subject to size criteria – see full details below) in annual reports for periods commencing on or after 1 January 2019. Three of these will apply to charitable companies:
  - Section 172(1) statement
  - Employee engagement
  - Business relationships
- Although charitable companies have been excluded from the requirement to provide the fourth element, a statement of corporate governance arrangements, there is a charity governance code available to the sector which the largest charitable companies are expected to voluntarily apply
- The reach of these new requirements is considerable and there is no exemption for subsidiary companies. Very large private companies will be undertaking most of these activities already but for companies at the lower end of the scoping criteria, more attention and effort will be required.  Trustees will need to review the requirements carefully and assess where there are gaps in arrangements
- The Charity Commission has provided guidance on each of the three requirements in Information sheet 3 published in September 2019
- In addition, large charitable companies, together with large private companies and LLPs, will be required to disclose information about their UK greenhouse gas emissions, energy consumption and energy efficiency for periods commencing on or after 1 April 2019.

Guidance for large private companies is available on the Deloitte website

www.deloitte.com/corporate-governance

## Section 172(1) statement

**Scope:** Companies qualifying as large under the Companies Act 2006 (including charitable companies), i.e. those that meet at least two of the following criteria[1]:

- Turnover of more than £36m;
- Balance sheet total of more than £18m;
- More than 250 employees

There is no exemption for subsidiary companies. All qualifying companies, including subsidiaries, need to meet the new reporting requirements.

**Requirement:** A strategic report for a financial year of a company must include a 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.

This applies to large charitable companies

[1] This requirement also applies to medium sized companies that are ineligible under section 467(1) of Companies Act 2006, such as those which are traded.

| Section 172 – Duty to promote the success of the company | | Section 172 matters |
|---|---|---|
| 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 benefits of its members as a whole, and in doing so have regard (amongst other matters) to factors (a) to (f). | **HAVE REGARD TO** | a. the likely consequences of any decision in the long term,<br>b. the interests of the company's employees,<br>c. the need to foster the company's business relationships with suppliers, customers and others,<br>d. the impact of the company's operations on the community and the environment,<br>e. the desirability of the company maintaining a reputation for high standards of business conduct, and<br>f. the need to act fairly as between members of the company. |

**Timing:** For periods commencing on or after 1 January 2019.

**Charity interpretation:**

Section 172(1) of the Act is consistent with the principle of enlightened shareholder value, recognising the perspective of companies run for the benefit of their members. However, Section 172(2) of the Act considers a director's duties where the purpose of the company is something other than the benefit of its members. In the case of a charitable company, this will be its charitable purposes. The directors must act in the way they consider, in good faith, would be most likely to achieve these purposes. Therefore the director's duties should be modified to be promoting the success of the charity to achieve its charitable purposes.[1]

Trustees should be clear about the relevant matters and the methods they have used to engage with shareholders

**In practice:** The Department for Business, Energy and Industrial Strategy (BEIS) has issued some FAQs to assist in interpreting the new reporting requirements. The key points from those guidelines are as follow:

"Depending on the individual circumstances, companies will probably want to include information on some or all of the following:

- the issues, factors and stakeholders the directors consider relevant in complying with section 172 (1) (a) to (f) and how they have formed that opinion;
- the main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and
- information on the effect of that regard on the company's decisions and strategies during the financial year.

Companies will need to judge what is appropriate, but the statement should be meaningful and informative for shareholders, shed light on matters that are of strategic importance to the company and be consistent with the size and complexity of the business."

Charities do not have shareholders but there are many stakeholders in the success of the charity and trustees will need to identify what matters are relevant to which stakeholders and how they engage other stakeholders on these matters and the impact of that engagement.

Guidance on how to approach the statement is provided in Section 8 of the FRC's Guide to the Strategic Report and the Deloitte publication 'Board briefing on the new Section 172(1) statement'. Whilst written for companies the steps set out will equally support trustees in developing the statement.

[1]Information Sheet 3 – 4:13

**Reporting:** The statement should be included in the strategic report. Where the trustees' report presents a combined Strategic and Directors' report in accordance with paragraph 15.6 of the SORP, the statement should be included under the heading **'achievements and performance'**.

# Statement on employee engagement

**Scope:** All UK companies incorporated under the Companies Act 2006 (including charitable companies) where the monthly average number of UK-based employees exceeds 250.

There is no exemption for subsidiary companies. All qualifying companies, including subsidiaries, need to meet the new reporting requirements.

**Requirement:** The directors' report for a financial year must contain a statement summarising:

(i) how the directors have engaged with employees; and

(ii) how the directors have had regard to employee interests, and the effect of that regard, including on the principal decisions taken by the company during the financial year.

The statement should cover how employees are provided with information on matters of concern to them as employees, how they are consulted and their views taken into account in decision making that may affect their interests, how employees are involved in the company's performance through rewards and benefits, and how the charity achieves a common awareness of financial and economic factors affecting performance.

This extends the existing employee disclosures and may overlap with the section 172 factor (b)

**Timing:** For periods commencing on or after 1 January 2019.

**Charity interpretation:**

The statement is considered relevant in the context of a charitable company. However, it is recommended that the following is considered by charities when providing this information:

- The existence of employees' share schemes within a charitable company would not apply. Therefore other employees' reward or incentive schemes should be considered under this statement.
- It is acknowledged that factors, other than economic and financial factors, may affect the performance of a charitable company. Therefore other factors should be considered under this statement.
- Charities often rely on the contribution of unpaid general volunteers in carrying out their activities. Therefore this statement may describe the action aimed at engagement with volunteers as well as paid staff.[2]

**In practice:** This requirement builds on an existing disclosure requirement for the trustees' report but it also overlaps with section 172 factor (b). For some charitable companies, it is likely that employee matters will be of strategic importance and will be covered in the Section 172(1) statement. In these circumstances cross references will be required between the sections of the report.

[2]Information Sheet 3 – 4:23

**Reporting:** The statement should be included in the diretors' report. Where the trustees' report presents a combined Strategic and Directors' report in accordance with paragraph 15.6 of the SORP, the statement should be included under the heading **'structure, governance and management'**.

# Statement on business relationships

**Scope:** Companies qualifying as large under the Companies Act 2006 (including charitable companies), i.e. those that meet at least two of the following criteria:

- Turnover of more than £36m;
- Balance sheet total of more than £18m;
- More than 250 employees.

There is no exemption for subsidiary companies. All qualifying companies, including subsidiaries, need to meet the new reporting requirements.

This overlaps with the requirements of section 172 factor (c)

**Requirement:** The trustees' report for the financial year must contain a statement summarising how the directors have had regard to the need to foster the charity's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the charity during the financial year.

**Timing:** For periods commencing on or after 1 January 2019.

**Charity interpretation:**

The statement is considered relevant in the context of a charitable company. However, it is recommended that charities consider expanding the statement to cover the charity's relationship with other stakeholders, for example service users, beneficiaries, funders and the wider community. This may be combined with the charity's reporting on those relationships that have affected the achievement of its objectives under paragraph 1.45 of the SORP.[3]

**In practice:** This requirement overlaps with section 172 factor (c). For some charities, it is likely that relationships with, for example, service users, beneficiaries, funders and the wider community will be of strategic importance and will be covered in the Section 172(1) statement. In these circumstances cross references will be required between the sections of the report, if they are included in separate sections.

This is a new requirement for periods commencing on or after 1 April 2019

# Energy and carbon reporting

**Scope:** Companies and LLPs qualifying as large under the Companies Act 2006 (including charitable companies), i.e. those that meet at least two of the following criteria:

- Turnover of more than £36m;
- Balance sheet total of more than £18m;
- More than 250 employees

[3] Information Sheet 3 – 4:30

**Requirement:** The following new disclosure requirements in relation to UK energy use and carbon emissions will be required in the trustees' report:

- The annual quantity of emissions in tonnes of carbon dioxide equivalent resulting from activities for which the company is responsible involving the combustion of gas or the consumption of fuel for the purposes of transport.
- The annual quantity of emissions in tonnes of carbon dioxide equivalent resulting from the purchase of electricity by the company for its own use, including for the purposes of transport.
- A figure, in kWh, which is the aggregate of the annual quantity of energy consumed from activities for which the company is responsible involving the combustion of gas or the consumption of fuel for the purposes of transport and the annual quantity of energy consumed resulting from the purchase of electricity by the company for its own use, including for the purposes of transport.
- The methodologies used to calculate the information disclosed above.
- At least one ratio which expresses the company's annual emissions in relation to a quantifiable factor associated with the company's activities.
- If the company has in the financial year to which the report relates taken any measures for the purpose of increasing the company's energy efficiency, the report must contain a description of the principal measures taken for that purpose.

**Timing:** For periods commencing on or after 1 April 2019.

**In practice:** The key difference between the requirements for large private companies, including charitable companies, and LLPs and those for quoted companies is that quoted companies must also provide data for energy use and emissions outside of the UK.

**Subject to certain exemptions set out below**, the disclosures must be provided by all entities in scope, irrespective of materiality. There is no threshold referencing "to the extent necessary for an understanding of the position and performance of the business". If a charity prepares two reports this information can be elevated from the directors' report element to the strategic report if of strategic importance to the charity.

The exemptions are as follow:

- If the charity consumed less than 40,000kWh of energy during the period or if the disclosure would be seriously prejudicial to the interests of the charity, then they may state that the information is not disclosed for this reason.
- For the report of a group, the required statements must be made on the basis of the charity's information and its in-scope subsidiaries. There is no need to report on subsidiaries that fall outside of the scope of the Regulations.
- A subsidiary is not required to provide this information if it is included within the group reporting of a parent company which has provided the relevant reporting as part of the group accounts.

For further information on Energy and Carbon reporting, please see Need to know: Government enacts new energy and carbon reporting requirements for all large companies and limited liability partnerships.

For further information on what does climate change means for business, please see our new website www.deloitte.co.uk/climatechange.

A large charitable company may be exempt if it consumes less than 40,000kWh of energy during the period

# For further information:

The Miscellaneous Reporting Regulations

The FRC Strategic Report Guidance

Board briefing on the new Section 172(1) Statement

Energy and carbon reporting regulations

Need to know: Government enacts new energy and carbon reporting requirements for all large companies and limited liability partnerships

What does climate change mean for business?

Charity governance code

# Next steps

We recommend that charities consider the impact of these new requirements on their reporting.

In particular trustees may find the following steps useful:

1. Is the statement included in the Strategic Report?
2. Is the statement separately identifiable?
3. Does it explain the issues, factors and stakeholders which you, the directors, have considered relevant in complying with your section 172 duty? Does the statement explain how the board came to that view on relevance?
4. How consistent is the list of relevant issues, factors and stakeholders to the existing disclosures of key dependencies (resources and relationships) in the business model (objectives and activities) section of the annual report?
5. For each relevant stakeholder, is the statement cross-referencing to appropriate and meaningful existing annual report disclosures which describe the engagement mechanisms used to understand the issues to which the trustees should have regard?
6. Is it made clear in the statement how the board uses the output of that engagement in the board decision-making process?
7. Does the statement include specific examples which demonstrate the effect of that regard on the charity's decisions and strategies during the financial year?
8. How well do the examples provided align to key events which took place during the year? The Chair and Chief Executive's statements (if included) are likely to be good reference points for key events.
9. Is the statement reflective of and consistent with the size and complexity of the business?
10. Overall, are you, as a trustee, comfortable that the statement accurately captures the considerations taken into account by the board when making decisions during the year?

Trustees and management should prepare early drafts of these disclosures for review and consider the impact and messaging of the new disclosures.

# Contacts

If you would like further, more detailed information or advice and to discuss how this will affect you, please contact your local Deloitte partner or:

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