A photograph of a staircase with pink walls and a yellow sign. The sign is positioned in the upper left quadrant of the image. The staircase is made of grey steps and pink walls, leading downwards. The background is a solid pink wall.

# Governance in large private companies and the Wates Principles

# Foreword



**James Wates, CBE**  
Chairman, Wates Group  
of Companies and Chair  
of the Coalition Group  
of the Wates Principles

I feel passionately that good business, well done, is a force for good in society, and I am pleased that so many other leaders of private companies share that belief. Still, in an environment where the bad apples of corporate behaviour taint the reputations of the private sector as a whole, we need to press continually for more transparency and better corporate governance in our companies to rebuild trust with all our stakeholders.

The *Wates Corporate Governance Principles for Large Private Companies* (“the Wates Principles”) were launched in December 2018 following twelve months of work by a coalition group, supported by the Financial Reporting Council as secretariat, and chaired by me. In those principles you won’t find a set of boxes to tick. They were developed as six broad principles, able to be flexibly applied to a very wide range of companies – first by applying the principles, then by explaining – in the company’s own words – how they have been incorporated into the running of the business.

Our aspiration is that these Principles would not just help private companies meet new reporting requirements, but also really help companies to improve how they govern themselves, and to allow them to showcase in their annual reporting all the great work they are already doing. Those that do so genuinely and with integrity will be doing their part to raise public trust to levels that the business community deserves.

# Introduction

From 2020 large private companies in the UK will for the first time have to make public disclosures on their governance arrangements. This forms part of the wider corporate governance reform agenda initiated by the Prime Minister in 2017 to improve trust in business. Under the Companies (Miscellaneous Reporting Regulations) 2018 (“The Regulations”), all UK incorporated companies over a certain size will be required to make a statement on their corporate governance arrangements for financial years beginning on or after 1 January 2019.

To help companies subject to the thresholds make a corporate governance statement in compliance with the Regulations, the Government appointed James Wates, CBE to chair a coalition of industry and professional bodies representing a cross-section of interests related to private business, with secretariat support from the Financial Reporting Council (FRC), to develop a voluntary set of governance principles that were proportionate.

There are six high level principles:

- ▶ Purpose and Leadership
- ▶ Board Composition
- ▶ Director Responsibilities
- ▶ Opportunity and Risk
- ▶ Remuneration
- ▶ Stakeholder Relationships and Engagement

with associated guidance for each.

The Wates Principles represent one “code” that large private companies that meet the thresholds can follow. It may be appropriate – or desirable – for companies to choose an alternative code including the UK Corporate Governance Code,

the Quoted Companies Alliance Code or a foreign code.

This paper provides an overview of the new legislative requirements under the Regulations, examines the ‘corporate governance statement’ in detail and the Wates Principles.

The Regulations also require companies to disclose:

- ▶ how their boards have discharged their s172 duties
- ▶ how they engaged with and had regard to the interest of stakeholders and employees when making key decisions
- ▶ their CEO pay ratio.

The applicability of these vary depending on the size of the company, and these are detailed in the Appendix. The Department for Business, Energy & Industrial Strategy (BEIS) also provide a useful **Q&A document** which provides greater detail on the Regulations. It is important that companies consider all the requirements under the Regulations together as there are some inter-dependencies with the corporate governance statement.

## Which companies need to make a ‘corporate governance statement’?

Under the Regulations, a UK company needs to make a statement of corporate governance arrangements if it meets the qualifying conditions for the financial year, and is not otherwise exempt. The conditions are met if the company satisfies either or both of the following:

- ▶ It has more than 2,000 (global) employees (based on monthly average totals).
- ▶ It has (1) a turnover<sup>1</sup> of more than £200 million and (2) a balance sheet total (i.e. total assets) of more than £2bn.

The qualifying conditions are determined for the company itself (rather than the group it heads, if the company is a parent). This means that the statement would not be required in the group annual report, if the parent company did

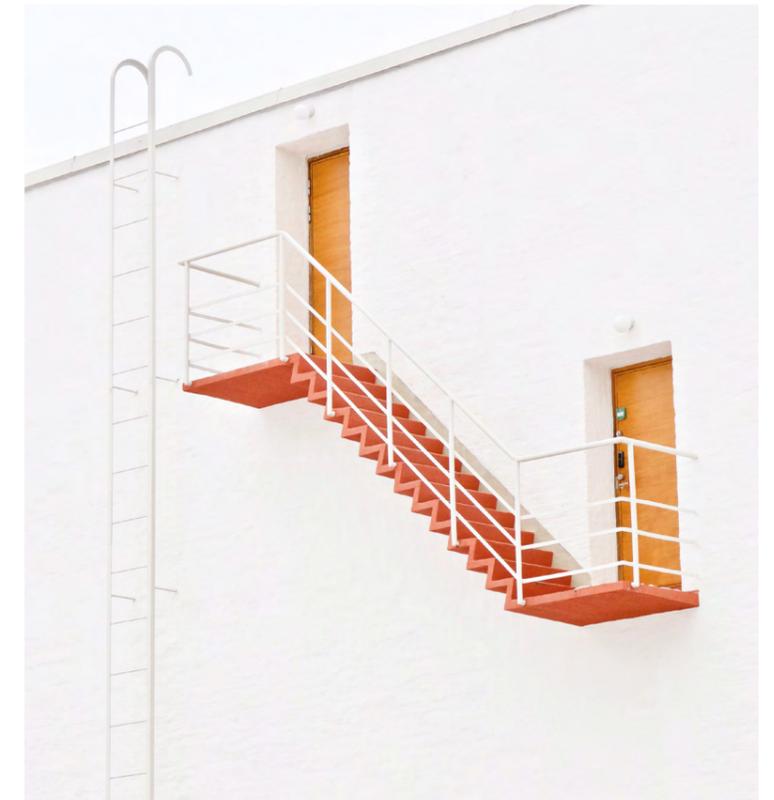
not itself meet the criteria. However, a subsidiary company meeting the qualifying conditions would need to make its own statement even if its parent company made a statement in the group annual report.

There are provisions to address companies which fluctuate in and out of the qualifying conditions. If the qualifying conditions are met in the first financial year, a statement is required in that year. In subsequent years, the statement is made if the qualifying conditions are met in both that year and the preceding financial year. Further detail can be found in the **Regulations**.

## Exemptions

Premium and standard listed companies which are already required to provide a corporate governance statement (pursuant to the Disclosure Guidance and Transparency Rules – DTR 7.2.1) are exempt. However, this exemption does not extend to other corporate governance statements made by companies, e.g. under the AIM Rules. There are also exemptions for community interest companies and charitable companies.

The Wates Principles represent one “code” that large private companies that meet the thresholds can follow. It may be appropriate – or desirable – for companies to choose an alternative code including the UK Corporate Governance Code, the Quoted Companies Alliance Code or a foreign code.



## When and where does the statement need to be made?

The requirement applies in relation to financial years beginning on or after 1 January 2019. The statement must be in the Directors’ Report or cross referenced from it if disclosed in the Strategic Report (permitted where the directors consider the information to be of strategic importance). For unquoted companies, the statement must also

be made available on a website that is maintained by or on behalf of the company and identifies the company.

From 28 September 2018 – under AIM Rule 26 – all AIM companies are required to provide a website disclosure with details of a recognised corporate governance code they comply with, how they comply and where they depart from it. Whilst the content of this statement for AIM companies is similar in nature (with the exception that they do not have the option not to apply a recognised code), UK incorporated AIM companies that meet the qualifying threshold will also now need to include these disclosures in their Directors’ Report (or cross referenced from it, as above) in order to comply with the legal requirement under the Regulations.

<sup>1</sup> The turnover threshold is pro-rated if the financial year is not in fact a year.

### Who is this reporting for and how will it be monitored?

Many expressed scepticism on the need and benefit for private companies to have more regulation on their governance and reporting. Unlike public companies, private companies have more concentrated share ownership and those owners tend to be closely connected to the company e.g. in its day to day running or management. However, high-profile corporate failures in large private companies have brought to the fore that many of these large companies have a significant footprint in society and the communities from which they draw their workforce and in which they sell their goods and services and there is benefit in introducing greater accountability and transparency. Better governance provides confidence not just to shareholders, but to other key stakeholders including the workforce, customers, suppliers, pensioners etc., that a company is being run well.

The companies that fall under this requirement are not homogenous. A wide range of businesses are captured including solely owned companies, family owned businesses, private equity owned businesses, subsidiaries of groups and more. This was also recognised as part of developing the Wates Principles – both in the make-up of the members of the Coalition Group and the Executive Sounding Board but also the flexibility offered in the high level principles.

It is likely that compliance with the legislation will be monitored by the FRC (or its successor body following the outcome of the Kingman Review). However, as we have seen with other recent disclosure requirements e.g. gender pay gap, modern slavery reporting etc., the court of public opinion will be the ultimate “judge”

In our view, the court of public opinion will be the ultimate “judge” (over a few reporting cycles) and will serve to raise awareness, drive behavioural change and – over time – help companies to raise standards of governance.

(over a few reporting cycles) and will serve to raise awareness, drive behavioural change and – over time – help companies to raise standards of governance.

As noted by James Wates in his foreword this new disclosure requirement represents an opportunity for private companies to demonstrate how their governance contributes to their long term success and use it as a differentiator in the competition for investment and to gain trust from their stakeholders.

### Should boards follow a corporate governance code or explain their own specific governance arrangements?

The Regulations state that the corporate governance statement must detail:

- ▶ which corporate governance code (if any) the company applied in the financial year;
- ▶ how the company applied that code;
- ▶ and if the company departed from that code, both the respects in which it did so, and its reasons for so departing.
- ▶ If no code was applied for the financial year, the statement must explain the reasons for that decision and what corporate governance arrangements were in place for that year.

There is therefore a choice to be made as to whether a code is adopted or not. In some situations, it will be more appropriate to describe specific governance arrangements rather than follow a code. This may be especially relevant for subsidiaries of listed parents e.g. where the listed parent follows a recognised code but given the activities and operations of the subsidiary it is more relevant to publish a high-level description of their governance arrangements. This view is confirmed in the **BEIS Q&A** which state: *“A subsidiary could, in principle, and if the circumstances warranted it, state that it did not apply a code because its parent applied the UK Corporate Governance Code which was applied throughout the group. This might shorten the statement, but the subsidiary would still need to explain how the Code actually applies to governance arrangements in the subsidiary and its directors.”*

Groups which have several subsidiaries in scope for this disclosure requirement will need to make an assessment by subsidiary on what is more appropriate i.e. whether to apply a code e.g. the Wates Principles or whether to explain the governance arrangements that are applicable to the subsidiary. This will depend on the specific circumstances pertaining to the subsidiary e.g. nature of its operations, stakeholders etc.

### What are the Wates Principles?

These new Principles aim to act as a framework for companies of all types and sizes, not just those captured by the Regulations. Boards must apply each Principle by considering them individually within the context of the company’s specific circumstances. They should then explain in their

own words how they have addressed them in their governance practices to achieve the desired outcome for each Principle.

Each Principle has associated supporting guidance to assist companies in explaining their approach to applying each Principle. The guidance does not need to be

reported on in the same way as premium listed companies need to ‘comply or explain’ against Provisions in the UK Corporate Governance Code.

1

#### Principle One – Purpose and Leadership

An effective board develops and promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.

2

#### Principle Two – Board Composition

Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.

3

#### Principle Three – Director Responsibilities

The board and individual directors should have a clear understanding of their accountability and responsibilities. The board’s policies and procedures should support effective decision-making and independent challenge.

4

#### Principle Four – Opportunity and risk

A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.

5

#### Principle Five – Remuneration

A board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company.

6

#### Principle Six – Stakeholder Relationships and Engagement

Directors should foster effective stakeholder relationships aligned to the company’s purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

# Our reflections on the Principles

Whilst there was some resistance to the legal disclosure requirement for a 'corporate governance statement' to be made by large private companies, The Wates Principles should be assessed separately. Do they provide a useful framework against which large private companies can consider their corporate governance arrangements and report on their practices?

Some of the Principles bring in concepts which are also new for listed companies, for example, discussion around purpose and stakeholder engagement both of which are topics where societal expectations are growing.

We have observed with large listed companies that reporting can drive behaviours and processes in a positive direction. Reporting is an outcome of underlying processes which create or protect value e.g., reporting on risk management processes, and having to make certain disclosures e.g. the viability statement has led to useful

discussions and challenge in the board room on key issues. This can be a helpful exercise for all companies, especially those with less mature governance practices looking to develop and improve their governance. Consideration and disclosure in line with the Wates Principles may also present large private companies with the opportunity to make themselves more attractive to private equity investment.

Companies in scope already have to make certain disclosures on their website such as gender pay gap reporting and modern slavery statements and many who seek to demonstrate their impact also have some voluntary disclosures about their social responsibility practices on their website. For these companies, the new

corporate governance requirement may not present as large a challenge and it may make sense to bring these disclosures together in one section of the website. Moreover, for regulated companies, there are often requirements (e.g. Ofwat's Principles for Board leadership, transparency and governance) from regulators which may even go beyond what is required by the 'corporate governance statement' and the disclosures would likely sit side by side.

The aspiration from the Government and the Coalition Group is that these Principles will become a commonly used code of practice for a broad range of private companies to demonstrate good practice rather than being limited to use by companies captured by the Regulations only.

In our view, the Wates Principles are proportionate and high level enough to provide flexibility in the context of a wide variety of ownership structures and there are a number of benefits of using the Principles as a tool for board discussion and improving governance practices.

There are no exemptions for large subsidiaries of listed groups (including UK subsidiaries of foreign head quartered groups) under the Regulations. There is therefore a need to ensure that existing governance processes that often operate on divisional or business unit lines, are appropriate for the subsidiary and take adequate consideration of the nature of operations of the subsidiary as well as its key stakeholders. For larger trading subsidiaries with active operations, the Wates Principles may offer a good framework for subsidiary boards to base their governance practices.

Overall, for companies looking to further enhance their governance and build trust with stakeholders, the Wates Principles represent a helpful framework, however, the impact will depend on the commitment by boards to apply them in spirit to drive better long term outcomes as well as the quality of disclosures and the value the company places in increased transparency with wider stakeholders. It is important for private companies to also consider the interdependencies with other elements of the Regulations which require disclosure on related areas such as stakeholder engagement. See the Appendix for more information.

**To discuss any of the issues in this paper further, please contact EY's Corporate Governance team.**



# Appendix

## Overview of the Companies (Miscellaneous Reporting) Regulations 2018

In July 2018, the Government issued the Companies (Miscellaneous Reporting) Regulations 2018 following Parliamentary approval of statutory instrument 2018/860. Some of the large companies that fall into the scope of the statement of corporate governance will also fall under three of the other requirements. Below we provide a high-level overview of the requirements (excluding the requirements around CEO pay ratios which only impact quoted companies), the scope and considerations for private companies. It is important for companies that fall into scope for the other parts of the Regulations to view them holistically in conjunction with the corporate governance statement. For example, a company may not meet the threshold for employee engagement disclosures but be in scope for the s172(1) statement. The board may therefore need to engage with employees and have regard to their views by virtue of having to make a s172(1) statement even though they may not need to make specific disclosures under 2 below.

Requirement	Scope	Considerations for companies
<b>1. Section 172(1) statement</b>		
<p>A statement in the Strategic Report to set out how directors have had regard to the matters set out in Section 172 (1) (a)-(f). This is now called a 'section 172(1) statement'.</p> <p>For companies that are unquoted, the section 172(1) statement must also be made available on a website and updated each year.</p>	<p>All companies that prepare a Strategic Report unless they qualify as medium-sized.</p> <p>At a high level, this means <b>all public companies</b> and any company which meet any two of the below fall in scope:</p> <ul style="list-style-type: none"> <li>▶ Turnover £36m or more</li> <li>▶ Balance sheet £18m or more</li> <li>▶ 250 employees or more</li> </ul>	<ul style="list-style-type: none"> <li>▶ For subsidiaries, consider the regard to stakeholders which are specific to that subsidiary on the key decisions made as a board e.g. if a subsidiary has a pension deficit, how did the board have regard to this (and the views from pensioners/employees) in making a dividend payment to its parent and what are the long term consequences of that decision?</li> <li>▶ Ensure reporting evolves each year and focuses on outcomes rather than simply the processes involved.</li> </ul>

### Section 172 of Companies Act 2006: Duty to promote the success of the company

(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, | (c) the need to foster the company's business relationships with suppliers, customers and others, | (e) the desirability of the company maintaining a reputation for high standards of business conduct, and |
| (b) the interests of the company's employees,                 | (d) the impact of the company's operations on the community and the environment,                  | (f) the need to act fairly as between members of the company.  |

Requirement	Scope	Considerations for companies
<b>2. Employee engagement</b>		
<p>The Directors' Report must:</p> <ol style="list-style-type: none"> <li>Detail how directors have engaged with employees, and the effect of their regard for employee interests on principal decisions taken by the company.</li> <li>Include information about actions taken during the year to keep employees informed, regularly consulted, involved in performance through share schemes or other means and aware of financial and economic factors affecting the company (<i>part b. is not new</i>).</li> </ol>	<p>All companies with 250 UK employees or more.</p>	<ul style="list-style-type: none"> <li>▶ Many companies will have processes for employee engagement but these may not involve directors. Companies may need to reconsider the operation of their engagement processes such that directors gain the necessary exposure to employees.</li> <li>▶ The challenge for companies will be in articulating how this engagement has impacted board decisions.</li> </ul>
<b>3. Stakeholder interests</b>		
<p>The Directors' Report must summarise how directors have had regard for suppliers, customers and others, and the effect of that regard on principal decisions taken by the company.</p>	<p>Any two of the below:</p> <ul style="list-style-type: none"> <li>▶ Turnover £36m or more</li> <li>▶ Balance sheet £18m or more</li> <li>▶ 250 employees or more</li> </ul>	<ul style="list-style-type: none"> <li>▶ Different in nature to the above as they are not required to detail how they have engaged suppliers, customers and others but they will need to explain how they have had regard to these groups and the impact this had had on the decisions the board has taken.</li> </ul>



## Contacts

### Corporate Governance

**Ken Williamson**

Partner, UK&I

T +44 (0) 20 7951 4641

E [kwilliamson@uk.ey.com](mailto:kwilliamson@uk.ey.com)

**Mala Shah-Coulon**

Associate Partner, UK&I

T +44 (0) 20 7951 0355

E [mshahcoulon@uk.ey.com](mailto:mshahcoulon@uk.ey.com)

## EY | Assurance | Tax | Transactions | Advisory

### About EY

EY is a global leader in assurance, tax, transaction and advisory services.

The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [ey.com](http://ey.com).

### EY's Corporate Governance team

The team provides insights on:

- ▶ Perspectives and trends in governance
- ▶ Board composition and effectiveness
- ▶ Leading practices in corporate reporting
- ▶ Future developments in governance and reporting

[www.ey.com/corporategovernance](http://www.ey.com/corporategovernance)

The **EY UK Centre for Board Matters**, a programme for Non-Executive Directors, delivers timely insights on the current issues and trends UK businesses face. Each quarter it focuses on a theme with a range of on-demand content and a series of invitation-only events. For more information: <https://www.ey.com/uk/en/services/specialty-services/ey-uk-centre-for-boardmatters>

### Ernst & Young LLP

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

© 2019 Ernst & Young LLP. Published in the UK.

All Rights Reserved.

Information in this publication is intended to provide only a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. Ernst & Young LLP accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.

[ey.com/UK](http://ey.com/UK)