The publication for listed businesses and their advisors.

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PKF

CapitalQuarter

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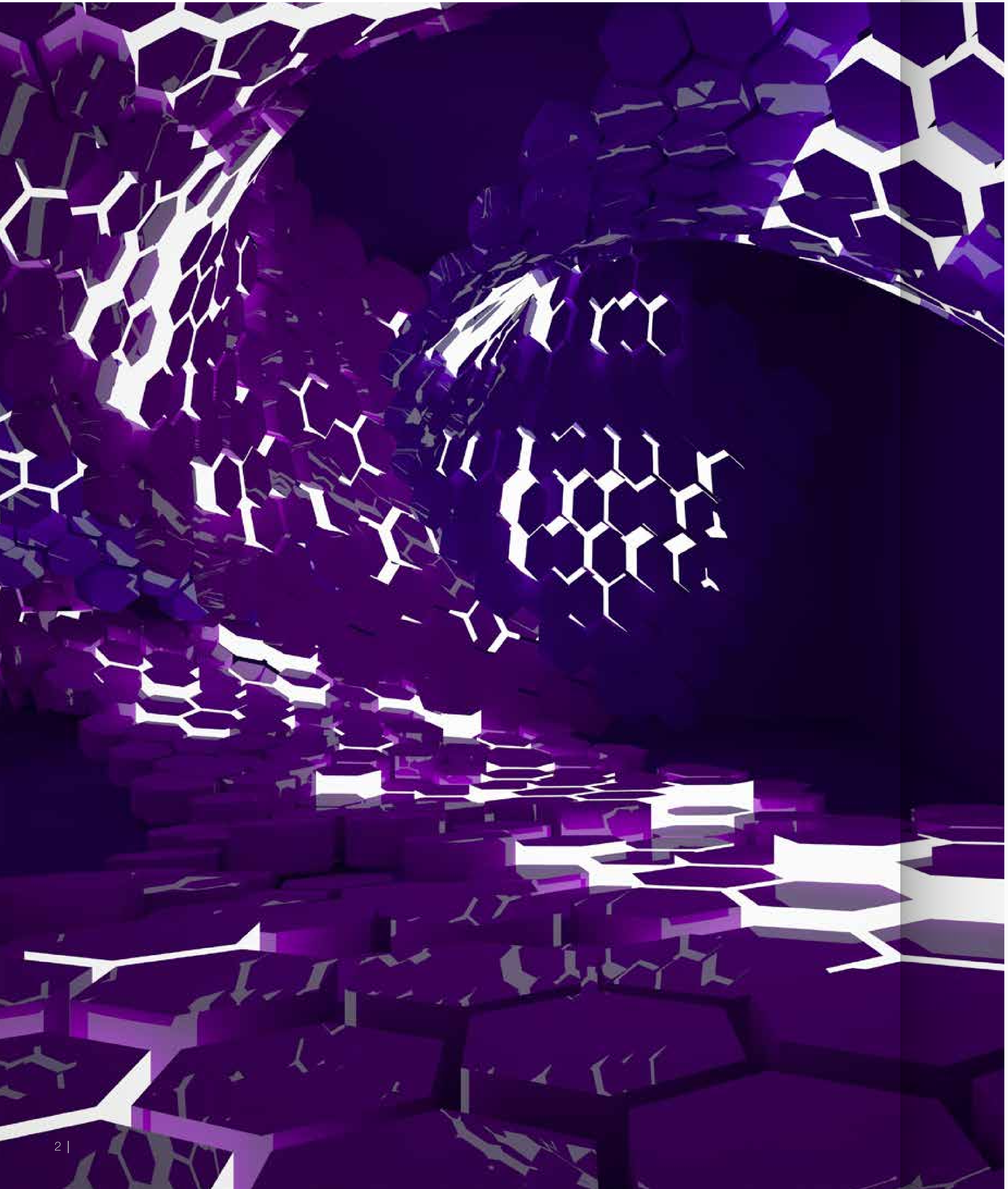

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Welcome to May's issue of CapitalQuarter...

With international travel now firmly back on the agenda, the lure of a foreign posting is likely to be stronger than ever.

It's all too easy for employers to miss some of the tax implications that need to be addressed, so we asked Head of Global Mobility, Louise Fryer to highlight the key tax and social security considerations when working overseas.

Financial reporting is always front of mind for listed companies. Of all the statements that a company is required to make about its business, there is none likely to be more important than a reasoned assessment of whether the company will survive into another year. Nick Joel, a director in our Capital Markets team, looks at the FRC's new requirement for companies to be much more transparent in explaining how they've come to their conclusions.

The FRC's 52 page Annual Review of Corporate Reporting 2021/22 doesn't make for light reading so we have distilled their top ten common errors and areas for improvement into a practical checklist to help you get the ball rolling…

We hope you find this edition useful, and we are always keen to hear your comments and suggestions for future articles.

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A significant slowdown in market activity

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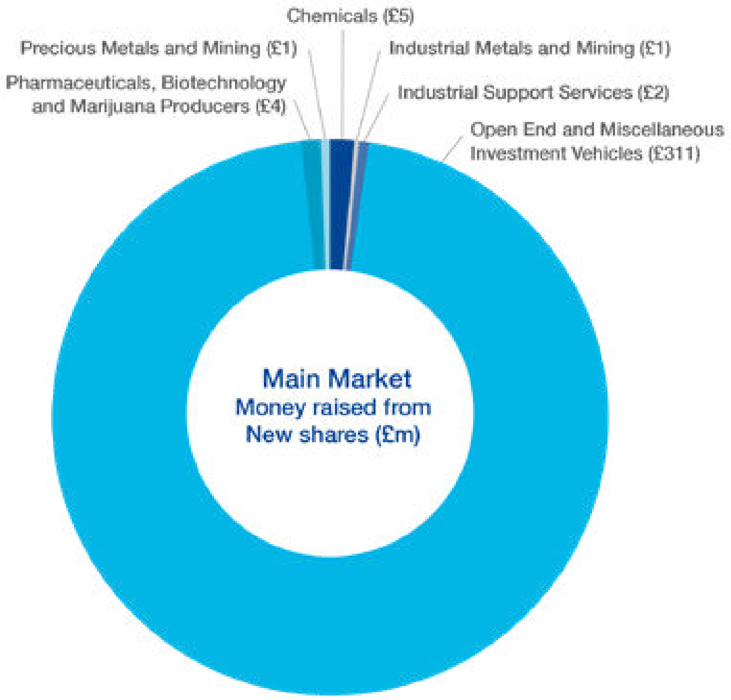
The quarter to March 2022 saw a reduced level of activity in the markets compared to the previous year, following a record year in 2021 across LSE markets since 2007.

The quarter to March 2022 saw a total amount raised through new and further issues of £2.6bn across AIM and the Main Market (Q1 2021: £6.9bn). Last year, the quarter to March 2021 was the most lucrative out of the equivalent periods of the most recent five years prior; in keeping with the success of 2021 as a full calendar year. As such, it is not surprising the equivalent period in 2022 has experienced a significant slowdown in market activity.

Activity during the quarter to March 2022 was similar to the comparative period in 2020. This was not least due to rising geopolitical tensions and uncertainty across global markets.

There were a total of 10 new issues on AIM and 17 new issues on the Main Market. New issues on raised £87m (Q1 2021: £111m) and £324m in the first quarter (Q1 2021: £1.3bn) on AIM and the Main Market respectively. On the Main Market, the vast majority (£311m) was raised by open end and miscellaneous investment vehicles, accounting for 10 of the 17 new Main Market issues.



The start of the year saw a particular drive towards investment vehicles or 'Special Purpose Acquisitions Companies' (SPACs), as a result of the changes to the Listing Rules effective 3 December 2021, with a transitional period of 18 months for existing applicants and listed shell companies. A key change being an increase to the minimum market capitalisation (MMC) threshold for both the premium and standard listing segments, for shares in ordinary commercial companies from £0.7m to £30m. While raising the MMC is intended to give investors greater trust and clarity about the types of company with shares admitted to different markets, in the short run it has resulted in a number of transactions being advanced, with companies racing to raise capital prior to the effect of the rule changes.

Main market new issues included Ondo InsurTech Plc (formerly Spinnaker Acquisitions Plc) raising £3.4m in March 2022 and becoming the first "insurtech" company on LSE, as well as Graft Polymer (UK) Plc, which successfully raised £5m in January this year to accelerate its growth in sales of polymer modification products and development of drug delivery systems. PKF were delighted to support the aforementioned companies in their successful transactions. PKF also supported Net Zero PLC with its admission to AIM, raising £10.7m in February 2022. Net Zero Plc aims to provide a "positive, scalable, measurable and sustainable impact" on the environment through energy transition, and sustainability in the built environment.

The largest IPO in the quarter, by total amount raised, was New Energy One Acquisition Corporation Plc (NEOA), raising gross proceeds of £175m on IPO, and accounting for around 54% of total new issue money raised on the Main Market in the quarter. NEOA is one of many investment vehicles looking to grasp the opportunity arising from the increasing government support for renewables, awareness of climate crisis following the recent COP26 conference, as well as the increased demand for decarbonisation and alternative energy, driven by the global decarbonisation requirement, as governments target Net Zero globally.

“Could do better”

Errors and failings the FRC wants to see preparers of corporate reports and accounts avoid in next year’s corporate reporting.

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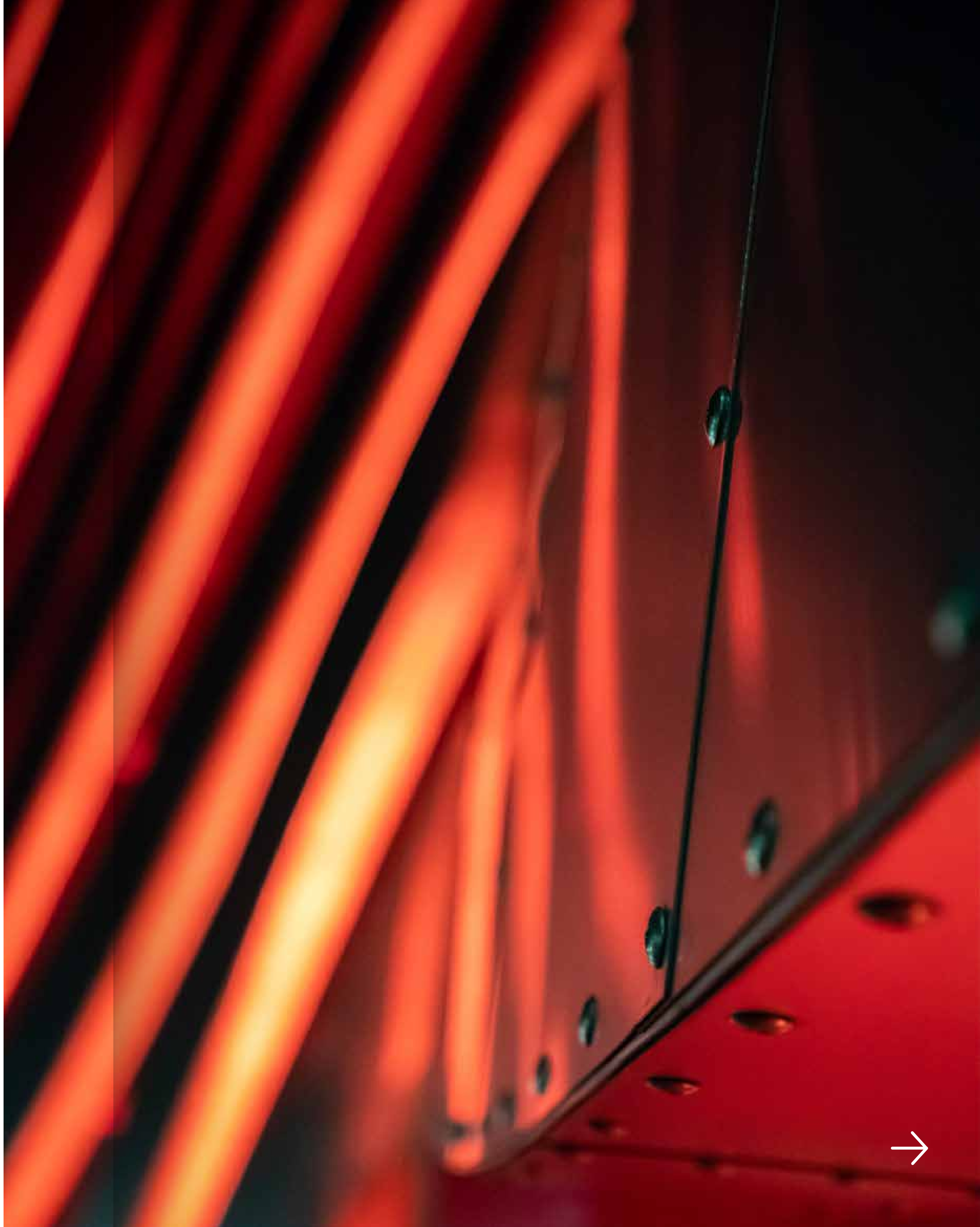
Every year the Financial Reporting Council (FRC) randomly selects a handful of company report and accounts for review and publishes its findings in an Annual Review of Corporate Reporting on the FRC website, in an effort to promote best practice. The best and worst examples of reporting are highlighted for praise and damnation.

The FRC’s Corporate Reporting Review team looked at 246 reports to produce its 2021/22 Annual Review published in October last year, a 14 percent increase in the number of reports reviewed compared to the previous year which demonstrates the expanding resources the FRC is now dedicating to review and its growing emphasis on better quality reporting.
Having effectively marked the homework of those responsible for preparing corporate reports and accounts, the FRC has drawn-up a list of the top ten most persistent problems that need to be high on the agenda for improvement and where preparers of corporate reports and accounts, and auditors, “could do better”.

This top ten should not be ignored! The list gives an insight into the areas of focus for the FRC in future, and where it will be trouble-spotting for poor practice in forthcoming reviews of corporate reports. Typically, they include aspects of reports and accounts that are overly complicated, or deliberately obfuscatory.

Failure to come-up to scratch could result in a request for further explanation and additional information from the FRC, and potentially spark the launch of a deeper investigation. Either way, it means extra work to respond to the FRC’s questions, time to research and prepare answers, and a significant increase in worry and stress for all concerned.
Ultimately, the FRC’s goal is greater clarity to help corporate report users better understand the company. This aim is one that should be shared by preparers of corporate reports and auditors: the more effectively a company can communicate its story, the more useful and comprehensible its reporting, then the more attractive it will be to potential investors. To this end, companies should give serious consideration to adopting the FRC’s recommendations.

The 52 page Annual Review of Corporate Reporting 2021/22, doesn’t make for light reading, so we have distilled the FRC’s top ten common errors and areas for improvement into a practical checklist, to get the ball rolling…



Estimates and Judgements

This area tops the list for 2021/22. It has become of increased importance because of the uncertainty around the future impact of Covid-19 on the economy.

Do	Don't

Provide:
• Critical Judgements: tailored disclosures that explain the impact of the judgements made and identify the amounts at risk of material mistatement.
• Sources of estimation uncertainty:
  • quantify through sensitivity analysis; and
  • assign values to key inputs and assumptions.
	• Repeat the standard; and
	• Give limited information.

Revenue

Revenue recognition policies and related disclosures continue to be problematic and are one of the top areas requiring additional queries.

Do	Don't
Provide: • Revenue recognised over time: give the basis for choosing this method and how performance obligations are monitored over time; • Revenue recognised at a point in time: give a clear explanation e.g., why the dispatch of goods coincides with the transfer of control; • Arrangements with multiple elements: explain the significant judgements made in identifying relevant performance obligations; and • Variable consideration: explain the nature of any variable considerations and how it is estimated.	Give insufficient explanations. Common unexplained areas include: • Contract modifications; • Contract assets and liabilities; and • Acting as a principal vs. agent.

Financial Instruments

Do	Don't
• Disclose the recoverability of other financial assets and the methodology used to assess this; • When estimating ECL provisions and credit risk, quantify the weightings used in any forward looking scenario and quantify any variables. Explain the factors considered wherever there is a change in risk. • As we come out of the Covid-19 pandemic, clear explanations are expected regarding companies' positions and the liquidity available to them; • Show the impact of factoring and reverse factoring on the balance sheet and cash flows, the accounting policies applied and impact on covenants.	Give a boilerplate commentary with no disclosures around the impact of changes in year on year risk and the considerations made.

Alternative Performance Measures (APMs)

Reconciliations and calculations continue to be poorly dealt with and disclosed within financial statements

Do	Don't
• Provide reconciliations to known GAAP measures for all APMs including ratios; • Any adjustments made should include gains and losses where relevant; • Provide descriptions of APMs, but these should not be similar to IFRS measures, to avoid confusion; • Rationale for making use of APMs should be clearly explained; • Definitions should be provided for all APMs.	• Give APMs undue prominence – there needs to be a balance between IFRS and APM measures; • Give an unfair view eg adjusting for costs that are part of normal operations.

Impairment of Assets

An area of particular focus in light of Covid-19 uncertainty. Disclosures are key.

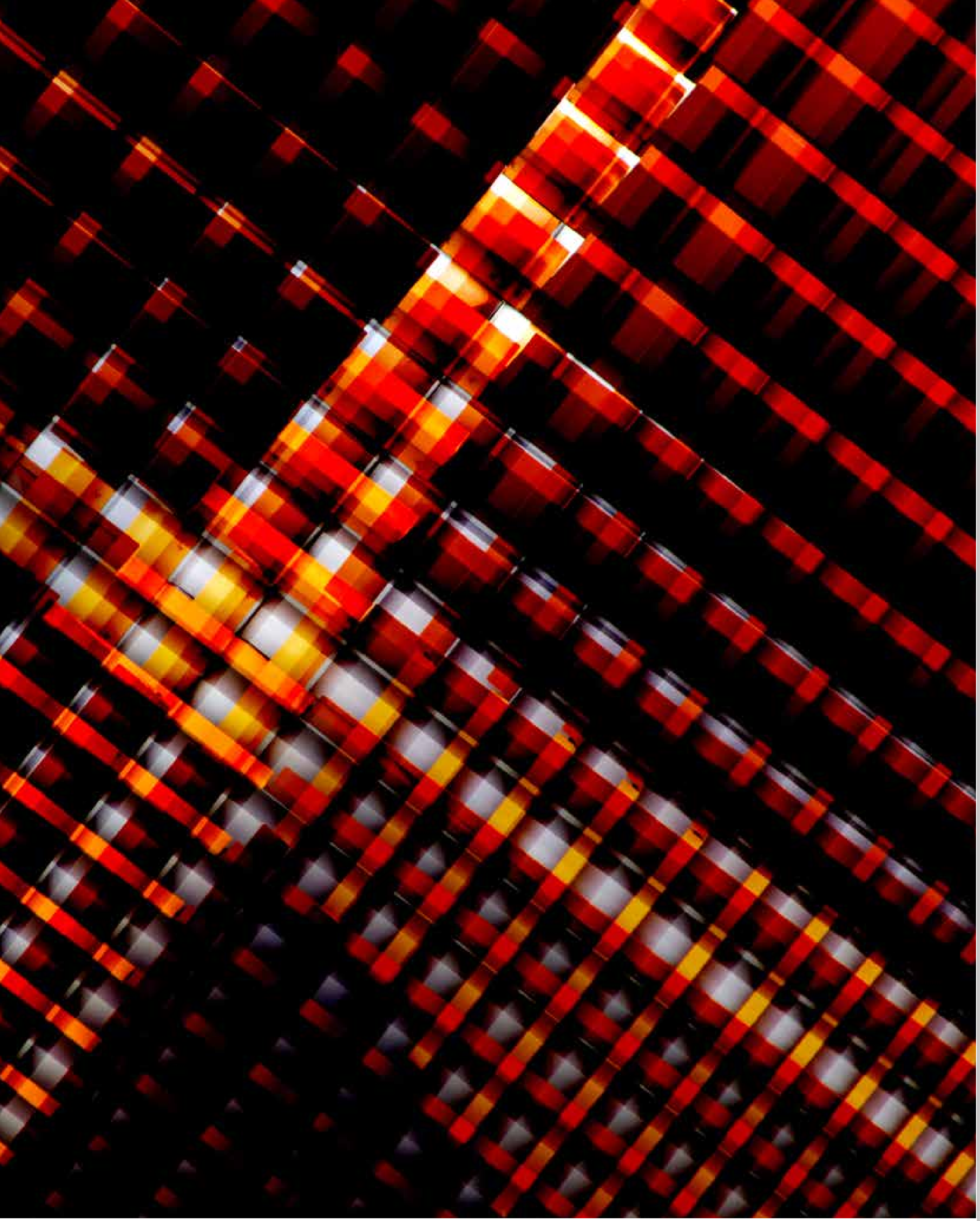
Do	Don't
• Provide indicators of impairments e.g., outcome of judgements, basis for assumptions and sensitivities; • Explain how cash generating units are identified and any year on year changes; • Explain future cash flow selection, quantify assumptions and the sensitivity of those assumptions; • Values should be assigned to sensitivity analysis, along with headroom; • Explain how discount rates have been set; • Give information about impairment losses, the recoverable amount and the reason for the impairment.	Give boilerplate explanations.

Statement of cashflows

An area of significant that may require some companies to restate their cash flow statements. Robust pre-issue reviews by companies could avoid many problems.

Do	Don't

• Provide reporting which is consistent e.g with the strategic report;
• Ensure that cashflow expenses are added back and income deducted;
• Focus on key areas:
  • Dividends received;
  • Net cash paid on acquisitions;
  • Cashflows from acquisitions of NCI (financing);
  • Cashflows from derivatives (operating where operational hedges or investing where net investment hedges).
	• Present non-cash items:
	• Focus on net basis reporting e.g., new borrowings and payments.



Strategic Report and Companies Act	
An area which has improved, but companies were challenged where significant matters were not addressed.	
Do	**Don't**
• Provide a fair, balanced and comprehensive view; • Outline performance and position, including information on all of the primary statements and other key matters e.g debt, tax, etc; • Include both positive and negative matters; • Ensure that matters are comparable on a like for like basis.	• Omit risks e.g climate; • Focus solely on the good, or the future and omit comment on the negative – be consistent.

Provisions and contingencies:	
A frequently raised topic triggered by inconsistent or unclear information.	
• Explain the basis for recognition; • Include judgements about those taken to both recognise and not recognise provisions; • Disclose the nature of provisions, linked uncertainties and potential timing of cashflows; • Say why disclosure is not provided: information is still required about the general nature of the dispute and the reason why the information is not disclosed due to it being seriously prejudicial.	Recognise provisions on a net basis when covered in part by insurance.

Leases	
• Provide the rationale for transactions outside the scope of IFRS 16 and full disclosure for all transactions falling either in or out of scope e.g., sale and leaseback, lease incentives; • Disclose and explain variable payment features; • Provide quantitative and qualitative disclosures about lease extension or termination options and ensure identification of these is disclosed as a significant judgement. • Give a clear maturity analysis;	Give a clear maturity analysis;

Income taxes	
Significant accounting judgements and sources of estimation uncertainty are required.	
• Disclose the amount and expiry date (where relevant) of deferred tax assets (DTA) recognised, and any movement in P&L; • Provide judgements around key sources of estimation uncertainty including carrying amounts impacted and any changes in assumption on the DTAs.	Fail to provide evidence about why the DTA is being recognised. This should pay heed to the current economic environment.

Show your weak side

Changes to going concern disclosures will require more than just a superficial shift, but the transition to a far more transparent mind-set.

Traditionally, the going concern note that forms part of a company's financial statements has been fairly simplistic: either the company is a going concern, or it's not. The Financial Reporting Council (FRC), has thrown a spanner in the works of this customary practice: it wants companies to explain why.

As a result of this, not un-reasonable new requirement, company management teams will now have to explain how they have reached their conclusions and outline why they believe their company is a going concern, or alternatively, why it is not. A vague statement to the effect that management has looked at the cashflow forecasts and it hasn't got any more funding, will no longer be sufficient.

Management will need to give a much more detailed story about the assessment process they have used to reach their conclusions, including why management chose to employ a particular assessment methodology. For example, management will need to explain why they chose to consider three scenarios and not five; outline why the scenarios they chose for their going concern analysis are reasonable; why, based on that analysis, they chose one particular scenario; and how they reached their ultimate conclusions. To this end, the FRC has published guidance to help management navigate the steps it needs to take to reach its going concern conclusions.

Covid-19 crystalised concerns about the usefulness of going concern notes that have been rumbling in the background since the financial crisis in 2008.

The existential nature of the threat the pandemic posed to many businesses came out of the blue and wasn't something about which the vast majority of management teams had given any prior thought. The new requirements are a move to address that lack of disclosure.

There are a great many potential, probable or remotely possible events and developments that could have a dramatic impact on a business, but none are currently being clearly addressed in company going concern disclosures. That's about to change. In future, management will need to answer questions about disaster planning and worst case scenarios as part of their going concern assessment.

Although only guidance at this point, it is encouraged to be followed, and feeds into a bigger picture drive towards greater transparency by the FRC and other regulatory bodies. The guidance gives a clear indication of the FRC's thinking around potential changes to the way auditors will be able to sign-off going concern notes in future; directors' liability, and the need for consistency and coherance across all management statements, at the front and the back end of the financial statements.

As something that is signed-off by both a company's directors and its auditors, the going concern note will be increasingly seen as a serious disclosure and management will need to get it right. The FRC is unhappy with the current levels of going concern note clarity: businesses have failed - with Carillion being the stand-out example, and it feels investors and users of accounts are not getting the full story.

Transparency, like honesty, is the best policy. Management needs to make investors and other users of company accounts, aware of what has happened and could potentially happen to impact the business - the bad as well as the good. Putting mistakes in the public domain will, paradoxically, strengthen management's position if an issue should later threathen a company's ability to continue as a going concern.

This level of transparency is a difficult mind-set transition for management which always wants to put its best face forward to investors. Giving away sensitive information feels risky. While it is true that the more management is open, the more it opens itself up to challenge, it is equally true that investors and users of accounts will have a greater appreciation and understanding of why management made certain decisions and chose particular courses of action.

Highlighting a company's weak points and explaining how management plans to deal with them, should be seen more as a strength from an investor's perspective. The majority of companies already do the analysis and forecasting required by the new guidance, but only share the work they are doing to build sales and grow, for example. Arguably, sharing the work a company is doing to deal with its threats and ensure it remains operational, is even more important. It also makes it more difficult for investors and other users of company accounts, to point a critical finger after the event.

The arrival of Covid-19 may have been the catalyst for recognising the usefulness of the going concern note, but the return to post-pandemic normality and withdrawl of Government support measures will illustrate its importance in practice. Potentially, a great many businesses will face existential difficulties linked to the repayment of government loans and deferrals, increased petrol and gas prices, the impact of high inflation, cross-border supply issues and trading challenges, as well as new Doomsday scenarios linked to war in Europe and climate change catastrophe. Transparency will be key to keeping investors on side.

We are living in interesting times. Notwithstanding the financial crisis, it seems that businesses will need to navigate far more testing, complex and difficult waters than any that companies have faced in recent decades. With that in mind, of all the statements that management is required to make about its business, there is none likely to be more important than a reasoned assessment about whether the company will survive into the following year.

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Working overseas: understand the tax

The lure of a foreign posting can be considerable. However employers must research carefully the impact of tax and social security on both their companies and employees.

Firms that work internationally often attract the brightest candidates, as employees look for an enriching experience, as well as a good salary and working conditions. The opportunity of a secondment can be a real differentiator when looking for a new job.

From an employer's perspective, having an international presence provides access to a bigger talent pool. It means they can take advantage of regions with access to specialist skill sets. They can locate resource in the most appropriate country. This may save money if it's more geographically central, offers location incentives, or if costs of employment are lower and of course, an international presence often opens up new markets.

There is a lot to consider when working overseas. We look at some of the key tax and social security considerations.

Beware the complexities

It is a common misconception that as long as you pay tax somewhere, everything is ok. This could not be further from the truth. When sending someone overseas or employing an individual in an overseas territory, many companies believe they are doing the right thing by keeping them on (or adding them to) a home country payroll and deducting home country taxes. This is a mistake.

Tax systems are different in every single country even within the UK, since Scotland and Wales now have their own variations on the UK tax regime.

Employers and employees need to be aware of the impact of differing tax and social security regimes when working overseas and how this affects tax returns both in the home and destination country.

'Permanent establishment?'

It is important to assess whether an individual working overseas creates a 'Permanent Establishment' for the home country entity in the host country. If it does, the company must weigh up the pros and cons of having a corporate presence overseas and decide what form this presence should take. The structure should reflect the group's commercial operation and ambition. Corporate filing responsibilities may arise in the overseas territory and transfer pricing may be relevant. Even without a Permanent Establishment, there may still be payroll obligations.

The role of Double Tax Treaties

Double Tax Treaties ("DTT") and social security agreements between home and host countries provide a framework for international taxation. Most treaties follow the OECD model but there are nuances in all of them, so companies should always check the relevant DTT before sending an employee overseas, even as a business visitor.

Another misconception is that a person can spend up to 183 days in a country without triggering any tax or social security issues. Day count is one consideration but there are others too. Who bears the cost? Are there recharges? What is the person going to do whilst in the overseas jurisdiction?

A person can be taxed as a non-resident or, if sufficient time is spent in a country, they may find themselves domestically resident in more than one country. It all depends on the local tax rules. The DTT provides the clarity needed in terms of the period the day count is assessed over but local rules determine the initial residency position.

If there's no Tax Treaty?

From an employment tax perspective, it means that there is no agreement between the countries in respect of who has the taxing rights over income.

For example, someone coming to the UK from Bermuda is taxable in the UK from day 1 and should be added to the UK payroll. There is no consideration of taxes due in Bermuda and no relief available. A non-resident taxpayer visiting the UK is not entitled to a UK personal allowance unless they become UK tax resident in the year.

Interestingly, Bermuda does have a social security agreement with the UK. This means a certificate of coverage can be applied for in Bermuda and the individual will be able to remain in the Bermudan social security scheme and not have to pay UK National Insurance for a specified period of time. The same is true in reverse.

The importance of payroll

Payroll can also be complicated. There may be a requirement for the company to run a payroll in both the home and overseas countries. Clearly, if tax is withheld in both countries, there will be very little money left over. So it important to understand what agreements are available to mitigate the double withholding on a real time basis - rather than just through the individual tax return at the end of the year.

Social security: which rules?

It is worth noting that tax and social security are completely separate from one another and have different rules and regulations around determining things such as residency - and whether or not there is a liability.

Broadly, social security rules mean you pay where you work. However, in the international arena this is not necessarily the case. For assignments of less than five years, where there is an agreement in place, it may be possible to remain in the home country social security scheme.

What are assignment letters?

Many individuals who go to work overseas will have an assignment letter so that they remain under their original contract of employment where they will retain all the benefits of their accumulated years of service. The assignment letter outlines the terms and conditions of the assignment overseas.

The assignment letter is important and the wording can affect subsequent tax treatment in the destination country. It should be supported by a well written company policy document which sets out who is responsible for what. The policy acts as a reference document for the HR team and helps should a dispute arise.

Tax rates

The rate of tax in the overseas country, and whether it influences an individual's willingness to go and work in that country, is also pertinent. Unsurprisingly, employees are very willing to go to a country with a zero rate of tax but no one is keen to lose a significant amount of their usual net income in a country with a very high tax rate. One solution is to adjust salary so that take home pay is in line with the rate for the same position in the home country but this can be very difficult to maintain, particularly where there is no in-house global mobility team.

Some companies have a tax equalisation policy which essentially keeps the employee 'whole'. They do this by deducting a hypothetical tax from the individual's payroll, based on their home country income (not including assignment specific payments). The company then pays the tax in the host country, using the hypothetical amount to help offset the cost. However, this is an expensive undertaking, as the fact that the company paying the tax is considered a taxable benefit in itself, and so creates an additional tax liability.

Some companies link equity to performance and this too can have its pitfalls, as each country has its own tax and social security rules as to how equity is treated and what is a tax efficient scheme in one country is unlikely to have the same status in another.

Short-Term Business Visitors

Finally, for the purposes of this article we should also consider individuals who are employed in one country but visit another group entity in a different country in the course of their duties. Many assume this is simply business travel with no tax or social security consequences. Not so.

The UK, for example, has legislation specifically designed to capture business visitors where there is a tax treaty between the UK and their home country. This requires a Short-Term Business Visitors (STBV) agreement with HMRC. Without this, the individual should be added to UK payroll, even if only for one day.

Different legislation applies to countries where there is no tax Treaty with the UK and yet another set of legislation for Statutory Board Members of UK companies who visit the UK for work purposes but who are UK non-resident.

Be proactive

There are mechanisms to help deal with international tax and social security issues, but proactivity is the key. It may be possible to claim treaty residence which supersedes domestic residence; foreign tax credits may be available to offset taxes due in both countries on the same income; there may be the possibility of registering with the tax authorities for special agreements. The important thing is to recognise and understand the position, and the tools available to ensure the best outcome.

As with many things, it takes a lot longer and is much more costly to put things right once they have gone wrong. International travel will always involve at least two countries and what works in the first country is unlikely to follow the same pattern in the second. We recommend you seek professional advice in what is a very dynamic technical space to support your decisions. Our Global Mobility team have extensive experience and are very happy to help you navigate the international tax arena. For more information, please contact Louise Fryer.

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About PKF
Simplifying complexity for our clients

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Our auditor rankings from ARL

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- 1 — Basic materials sector
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PKF UK in numbers	Capital Markets in numbers	PKF International in numbers
9th Largest Audit practice in the UK	**160+** Listed audit clients	**Part of the 14th** Largest global accounting network
35 Offices across the UK	**£2.7bn** Value of transactions advised on in last 10 years	**480** Offices in 150 countries
2,035+ Employees and 180 partners	**100+** Transactions advised on in last 5 years	**$1bn+** In aggregate fee income
£182.5m Fee income and growing rapidly	**26** International businesses brought to the UK in last 10 years	**20,000** Employees

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