The publication for listed businesses and their advisors.

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PKF

CapitalQuarter

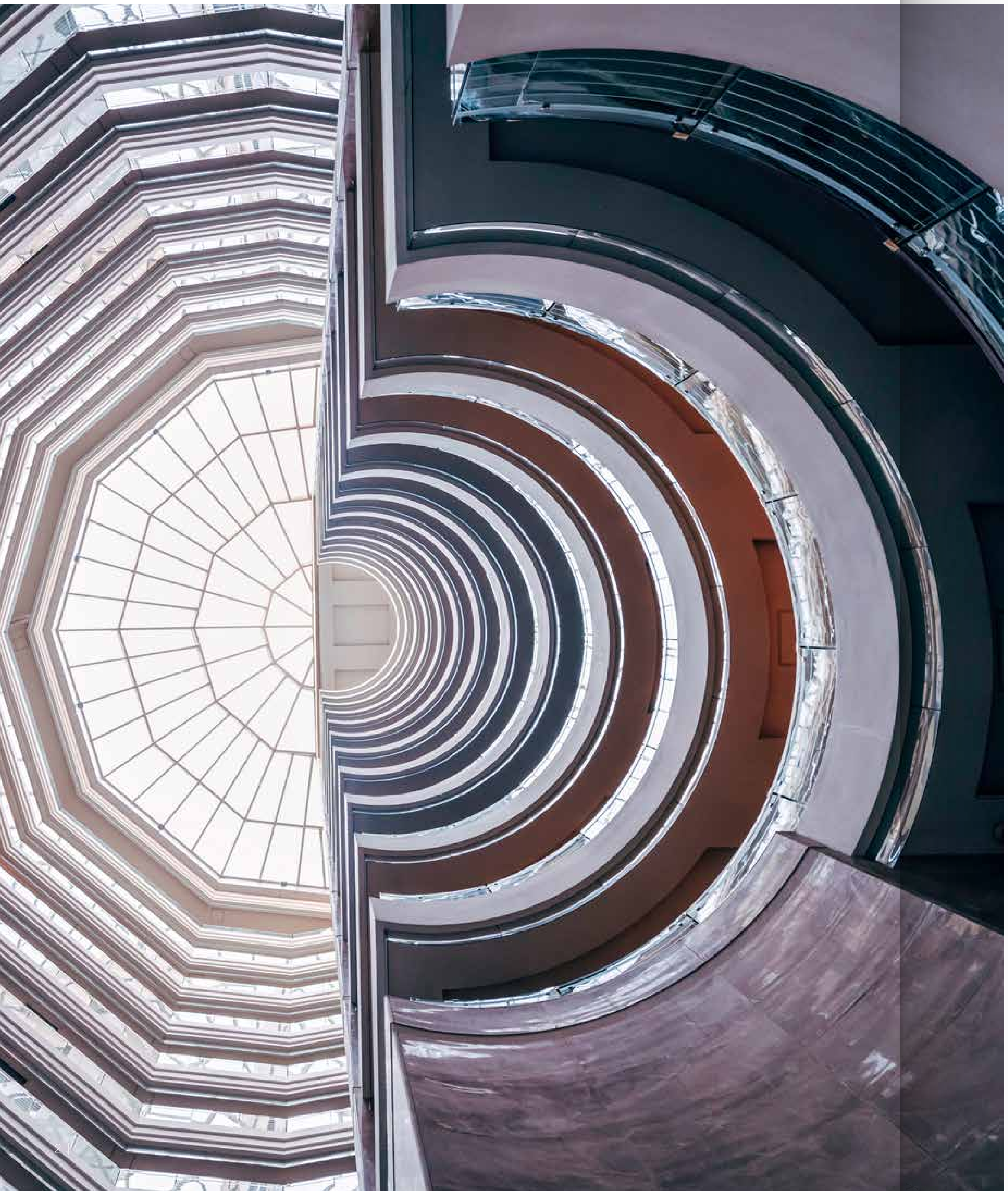
In this issue

Page—12

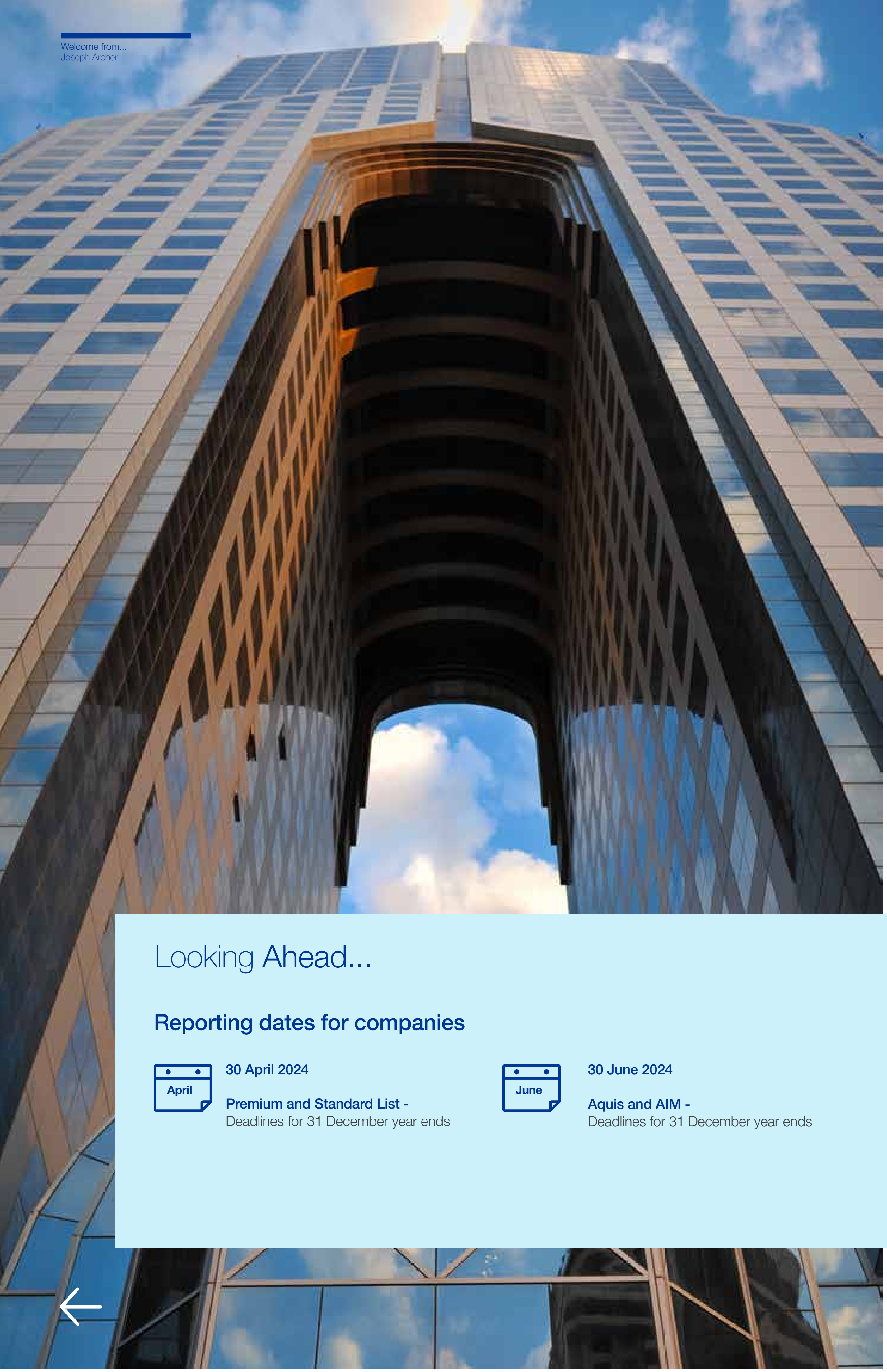
Cryptoassets: an overview of consumer protection

Until recently, cryptoasset markets have been fairly under-regulated, leaving consumers vulnerable. But measures brought in by the FCA and the Government will bring more oversight.

Contents



September in this issue...



Looking Ahead...

Reporting dates for companies

April
30 April 2024

Premium and Standard List -
Deadlines for 31 December year ends

June
30 June 2024

Aquis and AIM -
Deadlines for 31 December year ends

Welcome to September's issue of CapitalQuarter...

The Finance Act 2023 received royal assent in July. It introduces to UK tax legislation the first elements of the OECD Global Anti-Base Erosion (GloBE) rules: a minimum Corporation Tax rate of 15% for large multinational groups. Chris Riley, Head of our Tax team, identifies the implications and requirements ahead of 1 January 2024.

Cryptoassets have seen a meteoric rise is the past decade. Although the fundamental pillar of most cryptoassets is their decentralised nature, regulators across the globe have had to step in to ensure transparency and fairness where possible. In this edition, James Savage, Audit Director outlines these new measures.

The Government consultation on restoring trust in audit and corporate governance means stakeholders are focusing more on the make-up and oversight of audit committees. The FRC is consulting on this, and although initially directed at the FTSE350, it is likely to be extended to other entities in the future. Nick Joel a Director in our Capital Markets team, explains the key points and other areas of good practice. Governance, Risk and Control Assurance Partner, Jessica Wills highlights the proposed changes and potential implications for firms following the FRC's consultation document focusing on areas of internal control, assurance and resilience.

The International Sustainability Standards Board (ISSB) issued its inaugural standards — IFRS S1 and IFRS S2 — on 26 June. Lauren Haslam, Senior Manager in our Transaction Services team explains the new rules for sustainability disclosures and what they mean for you.

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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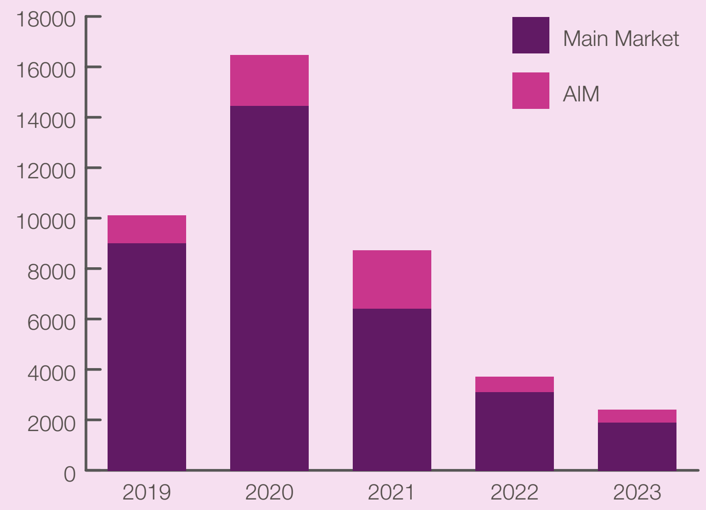
Cautious optimism for Q3 and Q4

Market analysis

The UK capital markets continue to struggle after the macroeconomic landscape caused investor appetite to plummet in 2022. Over the six months to June 2023, interest rate hikes persisted and inflation showed only marginal movements back to the levels seen between 2015 and 2021. Owing largely to political uncertainty in the UK and the ongoing conflict in Ukraine these factors, among others, have maintained a lack of confidence across the London markets. Notwithstanding this, the quantity of UK-based new issues in 2023 Q2 climbed to 17, more than the previous two quarters combined. This suggests that improvements may be just around the corner.

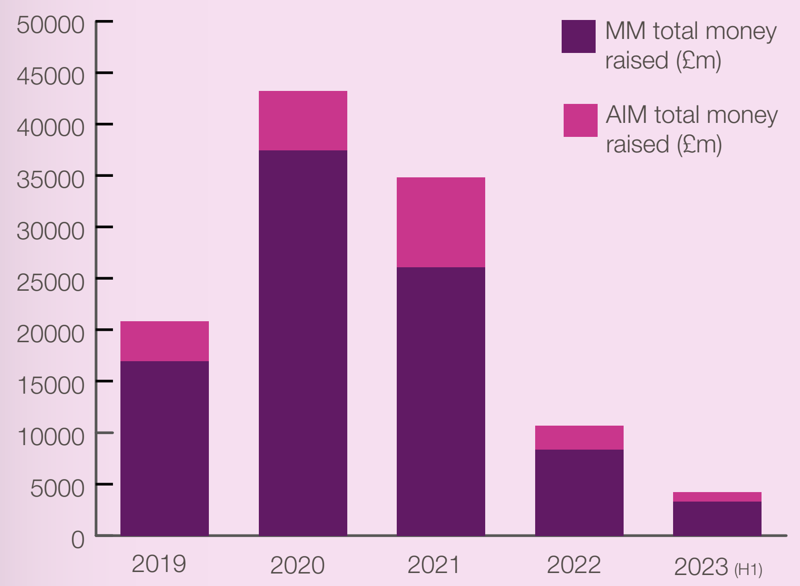
Total Raises in Q2 by year (£m)



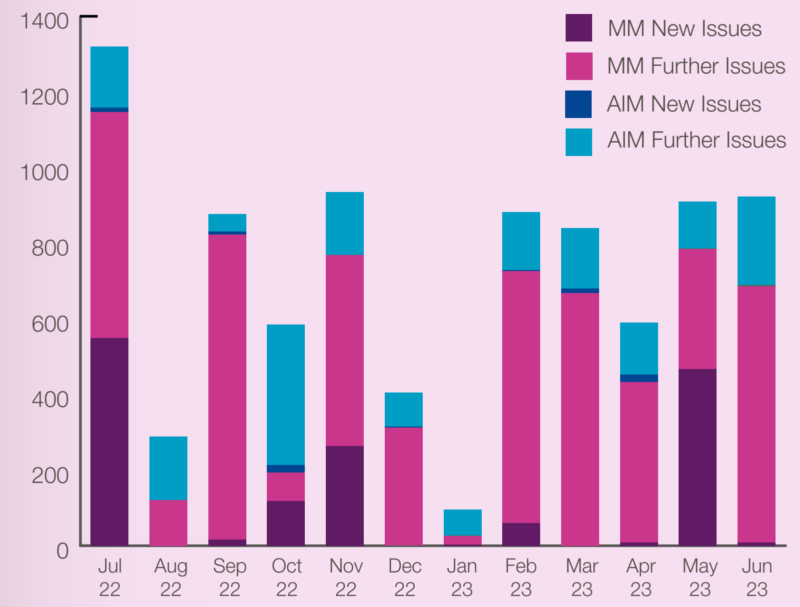
In the second quarter of 2023, total amounts raised were down again on the previous year. Q2 saw five-year lows in both AIM and the Main Market of £1.9bn and £0.5bn respectively. This is a reduction of 35% on the same period in 2022, and 85% going back to 2020.

Looking back over the first half of 2023, total funds raised also tracked at a lower rate than the previous year, and the majority of raises were comprised of further issues, rather than new entrants to the markets. These trends highlight the current stagnant nature of capital markets in the UK.

Total annual funds raised on AIM and the Main Market (£m)



Total monthly funds raised on AIM and the Main Market (£m)



Whilst down on the same quarter in 2022 in terms of total money raised, the number of new issues climbed over the last period, as we've said, with a total of 17 in the UK. Of these new issues, 12 joined the Main Market and five joined AIM.

Recent transactions

Acting as reporting accountants on six transactions across both markets, PKF is pleased to have been involved in the listing of World Chess Plc, Altona Rare Earths Plc and Kanabo Group Plc on the Main Market and Fox Marble Holdings Plc, Drumz Plc and Golden Metal Resources Plc on AIM.

World Chess Plc debuted on the Main Market in April with an approximate market capitalisation on admission of £41.7m, raising gross proceeds of £3.04m. World Chess Plc is a leading organisation in the chess industry, looking to capture public interest and generate wider market appeal through new formats and tournaments.

In the manufacturing sector, Fox Marble Holdings Plc successfully completed the reverse takeover acquisition of Eco Buildings Group Limited in May. Raising gross proceeds of £2.7m, the renamed Eco Buildings Group Plc aims to provide a range of environmentally friendly, prefabricated modular housing products in Albania and Kosovo.

Amid high global political tensions and economic uncertainty, the UK IPO market has struggled to recover from the turmoil in 2022 and the risk of recession persisted into the summer months of 2023.

Looking ahead

Despite this, the many factors which provide the foundations for the UK's macroeconomic landscape are still largely unknown, and the latest increase in new issue numbers is a hint of light at the end of the tunnel. Recent declines in inflation rates also deliver some hope for increased IPO activity, giving a somewhat positive outlook for the rest of the year.

Preparations continue for a boost in the number of prospective issuers looking to capitalise on potential investors in the post-summer holiday period. This means expectations for a productive final two quarters are high, with aspirations for a strong rebound in the UK capital markets.

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Corporation Tax: Be prepared for the new OECD rules

Find out how the introduction of the minimum Corporation Tax rate will affect multinational groups.

The Finance Act 2023 received royal assent in July. It introduces to UK tax legislation the first elements of the OECD Global Anti-Base Erosion (GloBE) rules: a minimum Corporation Tax rate of 15% for large multinational groups.

In 2021, 136 of the 140 countries in the OECD Inclusion Framework agreed to implement the GloBE models that aimed to achieve a 'floor' for the level of tax competition between jurisdictions. Also known as Pillar 2, the initial plan was to bring in the rules worldwide from 2023. The primary measure of Pillar 2 is the income inclusion rule (IIR) – introduced in the Finance Act as the multinational top-up tax (MTT).

Although the framework for the regime globally has been internationally agreed by OECD member countries, each needs to incorporate the rules into domestic tax legislation. The UK is one of the first to do so through the Finance Act. EU jurisdictions are also required to implement the rules from 1 January 2024. But many other countries (notably the US) are much further behind and, in some cases, it is doubtful whether the rules will be implemented at all, let alone to the planned timeline.

A secondary Pillar 2 measure (the undertaxed profits rule) will act as a backup to prevent profit shifting to low tax jurisdictions where not captured by the IIR. These rules will be introduced later in most jurisdictions, and the UK is currently consulting on draft legislation for them to apply from 2025.

What are the principles of the MTT?

UK parent companies within the scope of the regime will need to consider, for each jurisdiction in which they operate, the accounting profits for each subsidiary against the current tax charge applied to those profits. Where a jurisdiction has an effective tax rate of less than 15%, the UK parent will pay the new tax to make up the difference.

It's important that each jurisdiction is considered separately. Where the combined entities in one jurisdiction pay more than a 15% effective tax rate, these 'overpayments' cannot be offset to reduce the exposure from subsidiaries in other jurisdictions paying less than 15%.

UK groups will have to make a number of adjustments to both the profits and tax base for each jurisdiction to determine the scale of any potential charge. The chief aim is to remove the effect of intra-group dividends, equity sales or qualifying tax reliefs (such as R&D). The calculations will be complex, although not quite so challenging as under the existing UK CFC regime, where overseas profits need to be rebased to UK Corporation Tax principles.

What are the implications of a domestic top-up tax (DTT)?

The GloBE rules also state that where local legislation for an overseas subsidiary provides for a qualifying domestic minimum top-up tax, where the combined local mainstream Corporation Tax and top-up tax meet (or exceed) the 15% minimum rate, this should prevent further exposure to a global minimum tax charge for that subsidiary in the ultimate parent jurisdiction.

So it's no surprise that most jurisdictions on the path to implementing the IIR locally are also introducing a top-up tax for subsidiaries based in their own jurisdiction. If a local subsidiary is undertaxed, leading to a charge from the parent jurisdiction, it is preferable to increase the tax base to the benefit of the local tax authority. The UK is no exception, and a 15% DTT will apply to UK subsidiaries of groups with over €750m income from 31 December 2023, wherever they are headquartered.

Which groups will be affected?

The MTT will apply to UK parented groups with global annual revenues over €750m in at least two of the previous four years, where there is any form of overseas presence in the group.

The DTT will apply to all UK subsidiaries and permanent establishments of groups that meet the same annual revenue criteria but do not fall within the scope of MTT, because either they are non-UK headquartered, or they do not have an overseas presence.

Implementation and requirements

The UK legislation will take effect for in-scope entities for year ends that begin after 31 December 2023. So, for many groups, the first period covered by the new taxes will be the year ending 31 December 2024.

There will be a one-time requirement for companies to register with HMRC when they first come into the regime. After that, groups will have 15 months from the accounting period end to report their top-up tax liabilities. It will also be the payment date for any associated top-up taxes. For the first year a group is in the regime, the 15-month window is extended to 18 months.

This means that affected groups running to a calendar year end should note that the first submission of the additional UK returns is due 30 June 2026, as is payment of associated top-up tax liabilities.

There are transitional safe harbour simplifications until 31 December 2026. These allow companies to apply data from CbCR reports (MTT) or financial statements (DTT) as an initial test to exclude groups from the requirement to carry out the more complex calculation and reporting considerations for some or all entities in a group.

If those reports clearly demonstrate that the group suffers an effective tax rate of 15% (rising by 1% per annum to 17%) in a jurisdiction (or the UK as a whole) the safe harbour election can be made to exclude the jurisdiction from full calculations.

What's more, 'small' overseas subsidiaries can be excluded from the calculation for companies within the scope of the rules, where average revenue in the given jurisdiction is less than €10m and average profits lower than €1m.

What is the impact for large groups?

Whilst there may be commercial and non-tax benefits of operating in low-tax jurisdictions (which are secondary to the wider regulatory, commercial and operational benefits for the group) there is no 'motive' test to override such benefits under the Pillar 2 rules globally. Neither is there such an override in UK domestic legislation, and the application of the charge can be based solely on financial data. This means all large groups will need to consider their potential exposure to top-up taxes, both in the UK and overseas.

The formal introduction of the UK measures will enable UK groups and companies to determine their potential exposures to the new top-up charges arising in the UK from 2024. They will also be able to consider the accounting impacts in the first year that the charges apply. But the situation in other jurisdictions is inconsistent, with introduction of the rules and domestic changes to legislation running on differing timelines. So multinational groups will need to keep abreast of changes in the countries in which they operate, together with their forecasts, to establish exactly where the potential increased tax charges may arise.

The 'per-jurisdiction' (and non-consolidated) nature of the IIR applied globally will also encourage groups to review their structures and transfer pricing policies alongside the new rules. This will ensure that they don't create unforeseen exposures. The risk arises that a group has a greater than 15% effective tax rate globally, but is exposed to additional tax charges in profitable low-tax jurisdictions.

If you would like more information or support on any of the issues raised in this article, please contact Chris Riley.

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Cryptoassets: an overview of consumer protection

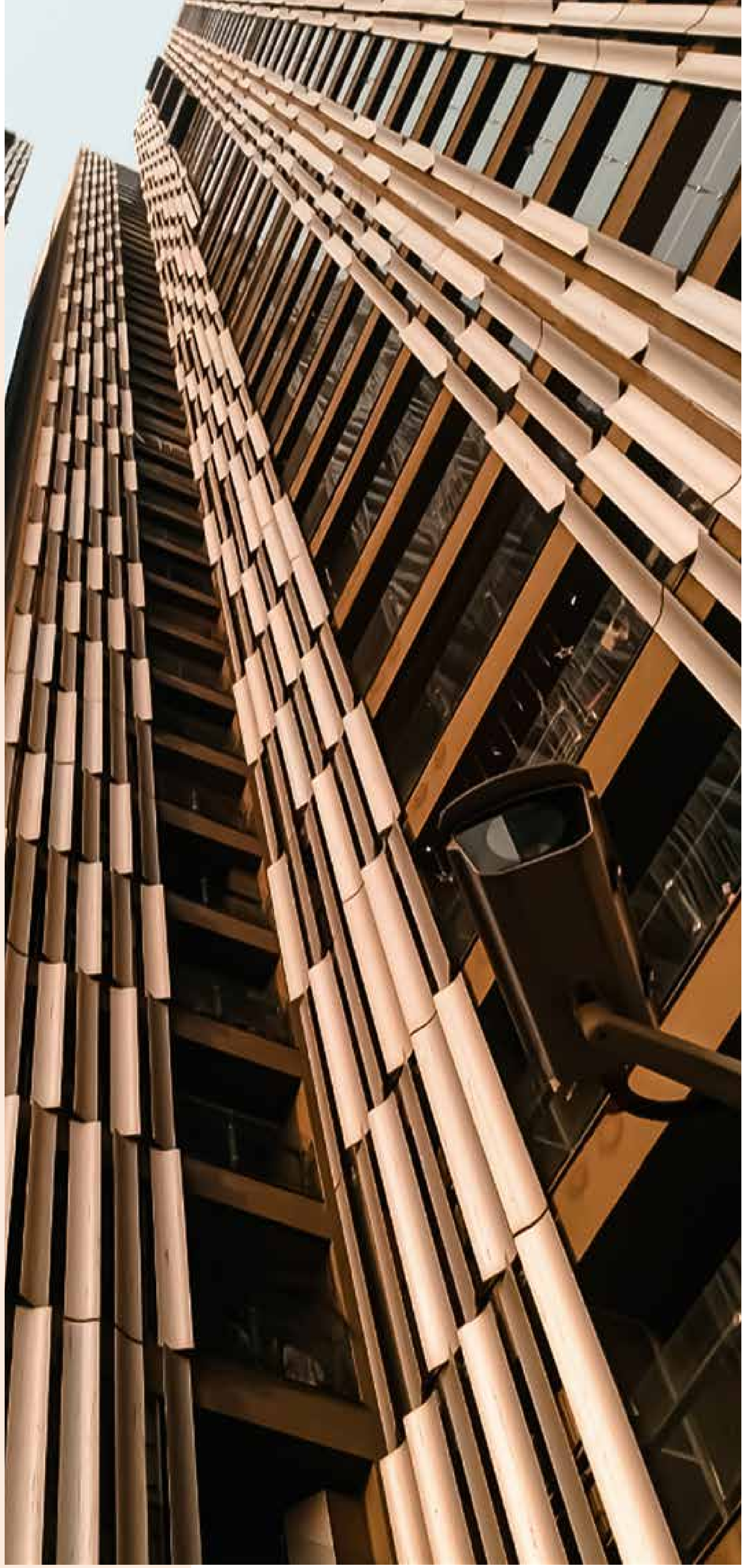
Until recently, cryptoasset markets have been fairly under-regulated, leaving consumers vulnerable. But measures brought in by the FCA and the Government will bring more oversight.

Cryptoassets have seen a meteoric rise is the past decade. Beginning as a low-volume speculative asset class, they have become part of modern culture and everyday life. This surge in popularity has brought extreme price volatility, thousands of alternative cryptoassets, decentralised finance and new technologies. Unfortunately, this ever-changing landscape has tempted unscrupulous individuals to take advantage of imperfect information to conduct financial crime. Although the fundamental pillar of most cryptoassets is their decentralised nature, regulators across the globe have had to step in to ensure transparency and fairness where possible.

The role of banks

Financial products, such as savings and investments, are regulated in the UK and protected under the Financial Services Compensation Scheme. Complaints and concerns can be reported directly to the Financial Ombudsman Service. Under this scheme, up to £85,000 of a consumer's money can be protected.

But this protection does not exist for cryptoasset transactions. Instead, the onus is largely put on banks to ensure that their customers are aware of the risks of fraud when making a payment. Banks are also expected to monitor accounts for unusual transactions. Some have imposed daily and monthly restrictions on payments to cryptocurrency exchanges.



FCA registration

Since January 2020, companies carrying out specified cryptoasset activities (largely surrounding exchanges) in the UK must register with the FCA. These companies are required to comply with the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. The FCA supervises and enforces the regulations for companies for anti-money laundering and counter terrorist financing purposes. Details of UK registered cryptoassets firms can be found on www.fca.org.uk.

Treasury plans for regulation

In February, the UK Government announced ambitious plans to robustly regulate cryptoasset activities in order to provide confidence and clarity to consumers and businesses. It plans to strengthen the rules on crypto trading and to create a world-first regime for crypto lending.

The Economic Secretary to the Treasury, Andrew Griffith, said "We remain steadfast in our commitment to grow the economy and enable technological change and innovation – and this includes cryptoasset technology. But we must also protect consumers who are embracing this new technology - ensuring robust, transparent, and fair standards".

The proposals bring added regulation and responsibility to crypto trading/lending venues, intermediaries and custodians. This includes:

- content requirements for admission and disclosure documents, to ensure that crypto exchanges have fair and robust standards
- regulations which govern the safe facilitation of crypto transactions and storage of customer assets, to enhance consumer protection and the resilience of crypto firms
- setting out a crypto market abuse regime to ensure customer protection and market integrity.

Marketing rules tightened

In June, the FCA released a policy statement (PS23/6) regarding financial promotion rules for cryptoassets. This applies to all firms marketing cryptoassets to UK consumers, regardless of geographical location or medium of advertising. This policy aims to ensure that cryptoasset promotions are fair, clear and not misleading. It means consumers have more information before investing, so that they understand the risks involved and know they can afford to absorb the potential losses.

After a consultation period, the FCA's policy statement has reached a set of near-final rules which cover:

- Inclusion of risk warnings and risk summaries
- A ban on incentives to invest
- A 24-hour cooling-off period for new investors
- Client categorisation and appropriateness assessments

Consequences of non-compliance include the taking down of websites and placement on an FCA warning list. Where communications are seen to be illegal, this is deemed to be a criminal offence and is punishable by an unlimited fine and/or two years in jail.

So the UK is embracing the innovation and technology of cryptoassets while at the same time seeking to protect consumers. It is doing so by enforcing regulation akin to that seen in traditional financial markets and high-risk investments. And that is reassuring.

For more information about issues raised in this article, please contact James Savage.

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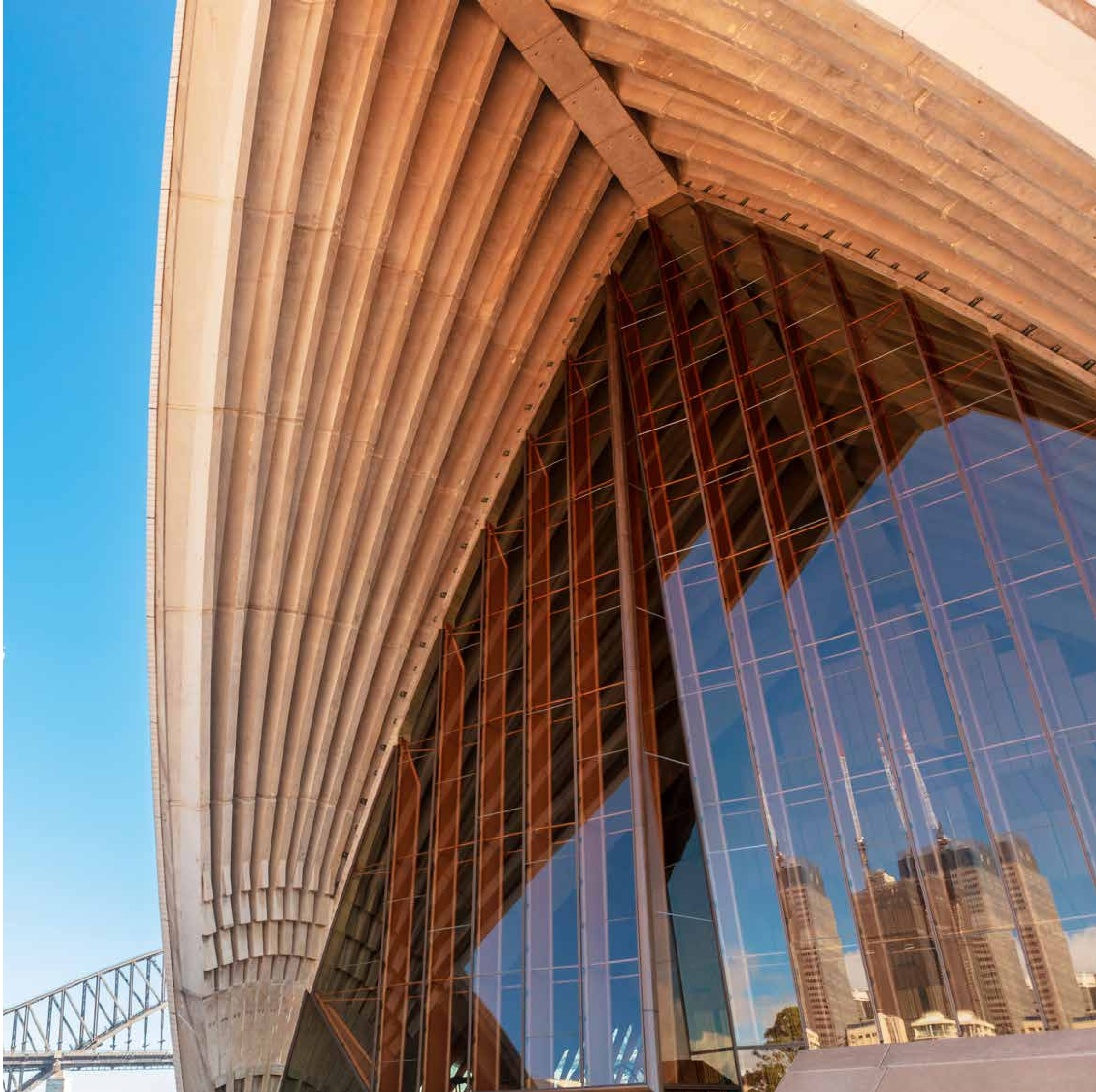


Guidance for audit committees

The Government consultation on restoring trust in audit and corporate governance means stakeholders are focusing more on the make-up and oversight of audit committees. How should you prepare?

The structure and oversight of audit committees differ between entities. This may depend on size, industry and the specific market on which the entity trades, among other factors.

As a direct result of the Government's intervention, the FRC has held consultations on how best to implement minimum standards for audit committees in their role on external audits.

Their purpose is both to enhance performance and to ensure a consistent approach across the committees. Although initially directed at FTSE350 companies, it's likely to be extended to other entities in the future. So we would advise taking action in your business ahead of time.

We summarise the key areas for consideration, and suggest other areas of good practice:

Oversight of auditors and audit

It is the responsibility of the audit committee to oversee and assess the entity's audit and its auditors. The committee should not only aim to work with and challenge the auditors, but also create an open environment for the auditors to appropriately challenge management. What's more, it should review the effectiveness of the audit process regularly.

This review can be undertaken by focusing on four key areas:

- Audit quality (with particular emphasis on auditor's mind-set and culture)
- Skills, character and knowledge
- Quality control
- Auditor robustness on key areas of management judgement and estimation uncertainty, and the ability to respond to questions from the committee.

In this assessment of the effectiveness of the auditor, the audit committee should:

- ensure the auditor explains the risks to audit quality they've identified, and how these have been addressed.
- discuss the controls the auditor is using to address risks to audit quality and check their findings from internal and external inspections of the audited firm.
- discuss any reasons why the auditor has not met the original audit plan, including any changes in assessed risks.
- hold discussions with key people internally (such as the finance director) for feedback regarding the audit team.
- review formal communications from the auditor to assess their understanding of the business and whether their recommendations are appropriate and have been acted upon.

This review process will help the audit committee to satisfy itself that the quality of the audit is of a sufficiently high standard. But regular open communication with the auditor and with the management is also vital.

Internal assessment and quality

The audit committee receives at least two separate reports from the external auditors each year. These provide an overview of the audit plan and the findings from the audit.

As mentioned, the committee reviews the audit plan and the findings to judge the auditor and audit. But it is equally important to use this information to assess the effectiveness of internal controls and quality assurance.

Examples of this assessment include:

- the number and size of both adjusted and unadjusted misstatements, which provide a good overview of the quality of financial reporting. This not only affects the audit and year-end statutory financial statements but also internal reporting.
- a review of the number and significance of deficiencies in internal control briefed by the auditor, management's response to these deficiencies, and a post-audit check on whether a solution has been implemented.
- getting regular updates from the auditor throughout the audit process.
- requesting an 'off camera' session between the audit committee and the auditor, without management or the finance team present, for open questioning and feedback.

Audit committees and the annual report

The annual report should include a description of the roles and responsibilities of the audit committee and its work (including any relevant corporate governance code requirements).

Where relevant, these disclosures can be enhanced to provide the stakeholders with a greater understanding of the business and the committee's role.

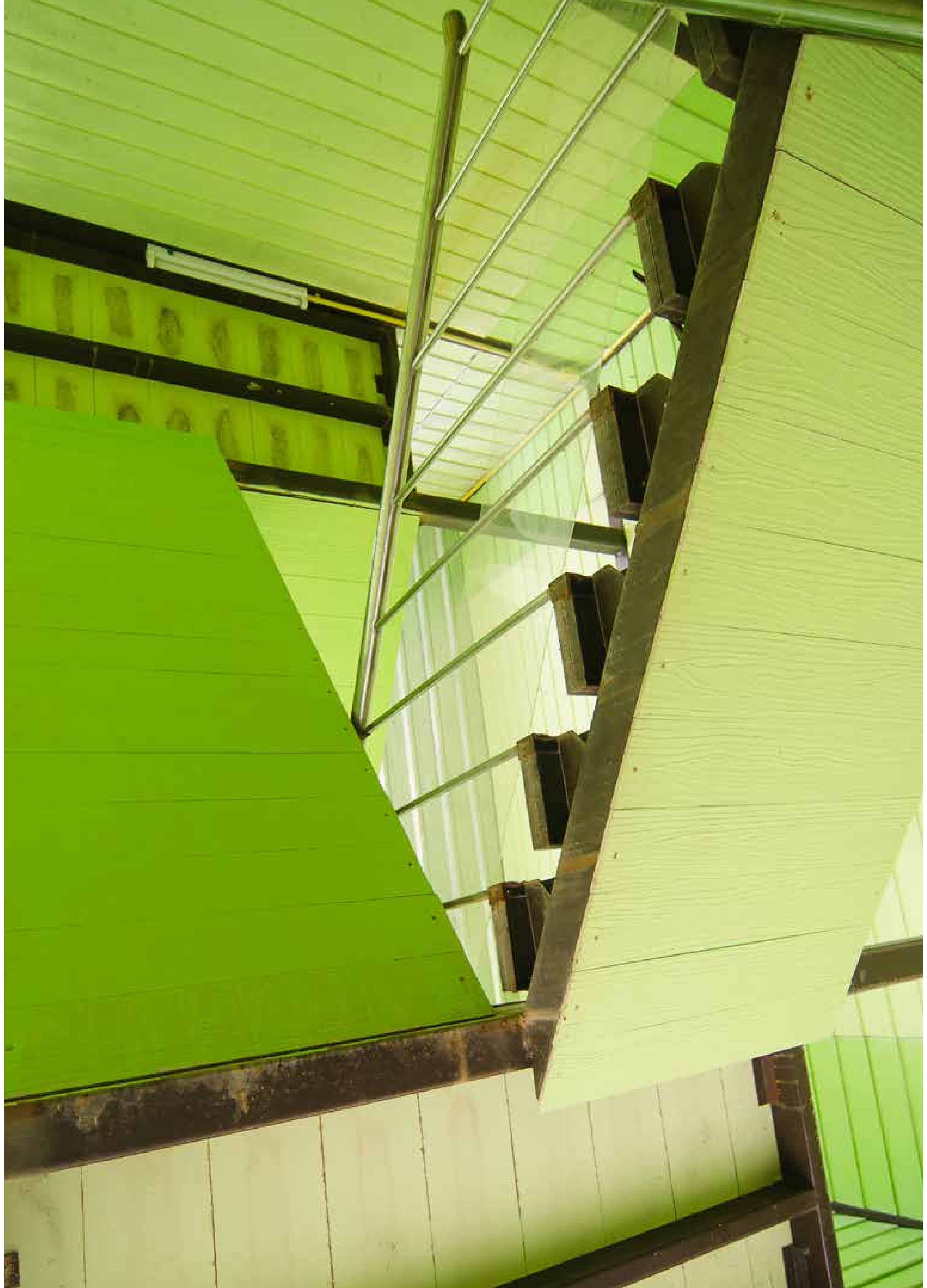
Disclosure examples include:

- any significant issues the audit committee considered and how they were addressed
- explanation of why certain matters requested for inclusion by shareholders were rejected
- explanation of how the committee assessed the independence and effectiveness of the external audit process
- explanation of how auditor independence and objectivity are safeguarded, if the external auditor provides non-audit services
- details of the criteria for selection and process followed for any tender process undertaken during the year.

The audit committee should also report on the activities it has undertaken to meet the expectations of their role.

The audit tendering process

The audit committee, rather than the entity's executive management, should lead the tendering process. This includes initiating the process, influencing the appointment of an engagement partner, negotiating the fee and scope of the audit, and making formal recommendations to the board on the appointment, reappointment and removal of the external auditors.



The committee should take the following into consideration during the tendering process:

- The selection criteria should be transparent and non-discriminatory.
- All tendering firms must have the necessary access to information and all tenders must be given fair and objective consideration.
- The decision should be made on quality, independence, ability to challenge and technical competence, and not on the quoted fee nor the cultural fit (the committee should also consider running a 'blind tender'.
- All members of the committee should be involved throughout the tendering process.
- The committee should submit two possible audit firms for the engagement to the board, with a justified preference for one of them.

A typical tendering process may involve three or four audit firms. But in some industries there may be a limited number with the necessary expertise that makes it difficult to identify more than two. Companies should manage their relationships with audit firms to allow them sufficient choice in a future tender, and to take account of the need to expand market diversity and follow any 'market opening' measures that may be introduced.

If some eligible audit firms are unwilling to tender for an audit, the committee should communicate with them to understand why they are unwilling and whether there is anything that could be done to change that.

The committee should also consider asking those firms how such action is in the public interest, and ensure that it has not excluded other firms from tendering without good reason to believe they would not be able to perform a high-quality audit.

If you would like more information about issues raised in this article, please contact Nicholas Joel.

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How companies should be governed: the FRC's latest proposals

The FRC launched a consultation document on the UK Corporate Governance Code in May. The proposed changes to the Code address the policy issues raised by the Government. They focus on the areas of internal control, assurance and resilience.

Here's a summary of the proposed changes and potential implications for firms.

Code section	Summary of proposed changes	Implications for firms
Section 1 – Board leadership and company purpose	Proposed changes to this section are limited but include: • New principle setting expectation that, when reporting on governance activities, there is focus on outcomes to demonstrate impact of governance practices. • Amendments to provisions to: - describe how ESG matters are taken into account in the delivery of company strategy, including climate ambitions and transition planning. - not only assess and monitor culture, but also report on how effectively the desired culture has been embedded. - report on the outcomes of shareholder engagement during the reporting period.	Governance outcomes Firms should carefully consider how they can demonstrate, and report on, governance outcomes. Although it is relatively easy for firms to describe their governance process and practices, it is harder to demonstrate their impact. One way is to report on some case studies or key topics considered by the Board during the year, how they have been dealt with through governance process, the decisions taken and outcomes / impact on company objectives and stakeholders. To simplify this reporting, Boards could keep a log of key topics discussed and their outcomes so there is a clear record to refer to. ESG Firms need to focus more on ESG in their reporting. This requires a clear explanation and understanding of how ESG supports the overall company strategy, a definition of climate ambitions, and a transition roadmap. Whilst most firms are considering ESG, the Code changes may require firms to be more definitive in their ESG strategy and the public commitments they make in this area. It will also increase accountability, as stakeholders will want to see progress year-on-year. Culture Firms need to introduce mechanisms and metrics to be able to assess and report on the effectiveness of embedding the desired culture. For example, the use of staff culture surveys or HR data / metrics to show how behaviours and culture are achieved at the firm. Shareholder engagement The chair will need to report, in greater detail, on shareholder engagement and outcomes. This may mean increasing the formality of the shareholder engagement process, so that shareholder views are captured and fed back into the governance process and decision-making. The outcomes will need to be tracked and monitored so they can be readily reported in the annual report.
Section 2 – Division of responsibilities	In response to investor concerns over the number of Board positions held by directors and their time commitment, there is a new requirement proposed to list all significant director appointments in the annual report and describe how each director has sufficient time to undertake their role effectively.	Most firms have a process to identify and record other directorships, but it may need improving in response to the proposed Code changes. For example, through a better understanding and record of the time commitment of other directorships and their impact. It may also be necessary to (re)define time commitment expectations for each director and monitor more closely expected versus actual time to improve reporting in his area.

Section 3 – Composition, succession and evaluation	Proposed changes to this section aim for a more joined-up approach to diversity and inclusion. Among them are amendments to principles to set the expectation that appointments and succession plans will promote equal opportunity and diversity, and inclusion of protected and non-protected characteristics. In support, provisions would state that diversity and inclusion initiatives and any targets set should contribute to succession plans. There are also additional reporting requirements for nomination committees e.g. on succession planning, Board and senior management appointments and the effectiveness of the diversity and inclusion policy. Another amendment suggests that annual performance reviews should consider each director's commitments to other organisations and ability to discharge responsibilities.	**Succession plans** As set out in the consultation document, the FRC continually sees poor reporting on approaches to succession planning, so firms must improve in this area. The Code changes require a clear link between succession plans and diversity and inclusion, which means consideration beyond gender, social and ethic backgrounds. Depending on the maturity of firms' diversity and inclusion policies, this may require a lot of proactivity in development of succession plans and greater clarity in how they support diversity and inclusions initiatives / targets. **Nominations committee reporting** The proposed changes to nominations committee reporting are likely to require greater oversight of the development of succession plans, how diversity and inclusion is promoted in the appointments process, and the overall effectiveness of diversity and inclusion policies. This may need more scope and time commitment for the nominations committee, and additional MI to achieve effective oversight. In particular, this could mean extra metrics / MI so that the nominations committee can assess progress towards diversity and inclusion objectives, targets and initiatives. **Annual performance reviews** The scope and rigour of annual performance reviews will require more time commitment from each director. This could ultimately lead to changes in Board composition or size.

Section 4 – Audit, risk and internal control	Proposed changes to this section are largely in response to the Government's consultation Restoring Trust in Audit and Corporate Governance. For example: • Additional roles and responsibilities of the audit committee, such as: - monitoring integrity of narrative reporting, including sustainability matters, and reviewing significant reporting judgements. - developing, implementing and maintaining an audit and assurance policy (AAP) (currently in draft legislation). - following the Audit Committees and the External Audit: Minimum Standard. • Additional audit committee reporting e.g. in respect of the Audit Committees and the External Audit: Minimum Standard, any assurance of ESG metrics and sustainability matters and the AAP. On risk management and internal controls, there are proposed changes to provisions for the Board to: • explain the procedures in place to identify and manage emerging risks, and describe these. • declare in the annual report whether risk management and internal control systems have been effective throughout the reporting period and up to the date of the annual report. They should provide the basis for this declaration, including how the Board has monitored and reviewed the effectiveness of these systems. Also included should be any material weaknesses or failures and remedial actions, and their timeframe.	**Audit committee role, responsibilities and reporting** Most critically, firms reporting against the Code will need to develop and implement a triennial AAP and report on this annually. This will require significant involvement from the audit committee, and engagement with other Board committees and stakeholders. Also needed will be ongoing compliance and monitoring against the AAP, as well as the Audit Committees and the External Audit: Minimum Standard. With the additional responsibility for narrative reporting, including on sustainability matters, firms will see increased scrutiny from audit committees. This means greater audit committee oversight of ESG disclosures, controls and processes, and of assurance obtained from third parties. **Risk management and internal controls** Not only may the Board need to tighten risk management processes around emerging risk, but it will also need to implement mechanisms to declare the effectiveness of risk management and internal controls. This is likely to include the results of first-line risk/ control self assessments, results of second-line reviews, consideration of risk events/ control breaches, and results of internal audit reviews or obtained external assurances. Critically, the requirement to report on material weaknesses or failures will require careful consideration to include sufficient detail of remedial actions / timeframe to demonstrate effective management.

Section 5 – Remuneration	Overall, proposed changes to this section are designed to strengthen the links between remuneration policies and outcomes and corporate performance, including ESG objectives. Other proposed changes include: • additional reporting requirements on malus and clawback provisions. This aims to increase the accountability of directors by adhering to their statutory duties in corporate reporting and audit, and also increase transparency for investors. • additional emphasis on workforce pay and conditions when determining executive director remuneration. The annual report will also need to describe the remuneration committee's engagement with shareholders and the workforce and its impact, including alignment with executive remuneration and the overall company pay policy.	The main challenge for firms is to set clear ESG objectives and show how they drive director and senior management remuneration. Firms should consider how they incorporate ESG into remuneration assessments and decisions. They must also identify and report on malus and clawback provisions (whether set out in director contracts and/or other remuneration agreements/documents). Firms should maintain a central register of these, that includes all details they will need to disclose following proposed changes to the Code.

The proposed changes to the Code will apply to accounting years that start on or after 1 January 2025, so that firms have time to prepare. If you would like to talk to us about the potential impact of the Code changes on your listed business, or would like assurance on the effectiveness of your current governance arrangements, please contact Jess Wills, Partner and Head of Governance, Risk & Control Assurance.

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What the new sustainability standards IFRS S1 and IFRS S2 mean for companies

The International Sustainability Standards Board (ISSB) issued its inaugural standards — IFRS S1 and IFRS S2 — on 26 June. What should you do to prepare and how do they interact with other frameworks?

The launch marks the start of an exciting new era for sustainability-related financial disclosures. The standards will help to improve trust and confidence in company disclosures. This in turn should support capital market allocations towards more resilient economic models for companies.

The ISSB's main objective is to provide investors globally with more consistent, complete, comparable and verifiable sustainability-related financial information. The new requirements should also help companies reduce the risk of greenwashing.

It was investor demand for a common language across sustainability reporting worldwide that drove the creation of the new standards. They wanted to be able to compare portfolios more easily. A key consideration for investors is long term value creation, in which sustainability plays an increasingly vital role.
IFRS S1 and S2 used concepts and recommendations from a number of existing frameworks, to set the global baseline for sustainability-related disclosure. This can only be good news for companies. The new global baseline is intended to reduce the so-called 'alphabet soup' of reporting that companies face today, particularly those that span many jurisdictions.

The two standards cover general sustainability-related disclosures (S1) and climate-related disclosures (S2). Although it is up to each jurisdiction to adopt these standards, they are effective for reporting periods starting on or after 1 January 2024. This means, in jurisdictions where the standards are adopted, companies will make their first disclosures in 2025.

What do the two standards require?

S1 sets the scene asking for disclosures on all material sustainability-related risks and opportunities that could affect a company's prospects (cash flow, cost of capital and access to finance).

What are its key concepts?

Materiality: Information is material where its disclosure is so important that by omitting, misstating, or obscuring it, it could reasonably be expected to alter the investment decision.

Stakeholder view: Companies need to consider their interactions with stakeholders, society, the economy and the natural environment through their whole value chain.

Industry-specific disclosures: are required. As a source of inspiration, there are examples to help companies understand the kind of information they should provide related to their industry and S1 refers users to the SASB standards. The SASB standards, under stewardship of the ISSB, enable organisations to provide industry-based disclosures about sustainability-related risks and opportunities.

The standard requires companies to report under S1 as part of their general reporting package, and emphasises the need for consistency and connectivity with financial reporting. There should be uniformity of assumptions for accounting, where relevant, between sustainability reporting and financial statements.

S2, sets out the disclosures needed for material climate-related physical risks, transition risks and opportunities.

S2 is built on the same four pillars as the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. Here are the key points relating to each:

Governance Information that enables investors to understand the governance processes, controls and procedures a company uses to monitor, manage and oversee sustainability-related risks and opportunities.	**Strategy** Information that enables investors to understand a company's strategy for managing sustainability-related risks and opportunities.
Risk management Information around a company's processes to identify, assess, prioritise and monitor sustainability-related risks and opportunities.	**Metrics and targets** Information on a company's performance in relation to sustainability-related risks and opportunities, including progress towards any targets the company has set, or any targets it is required to meet by law or regulation.

Global implementation

The ISSB's goal is to encourage companies around the world to implement the new standards either through compliance or by voluntary adoption. On 25 July, IOSCO (the International Organization of Securities Commissions) announced its endorsement of the ISSB standards. In doing so, it called on the 130 IOSCO member jurisdictions, that regulate more than 95% of the world's financial markets, to consider how they might apply or be informed by the standards. This is clearly a significant step towards a common language for global sustainability reporting.

The UK (and many other countries including Canada, Japan and Singapore) is considering adopting the ISSB standards. In turn, the ISSB is actively discussing global uptake of the new framework with various regulators. The UK Government has shown support for the ISSB and will be establishing a mechanism for UK endorsement and adoption of the standards as part of the Sustainability Disclosure Requirements regime, with a timeline for implementation expected imminently.

Once available for use in the UK, it is the FCA's intention to update its climate-related disclosure rules to reflect the ISSB standards.

Interaction with other frameworks

Our clients often ask how the various standards overlap, or where they can save time in the reporting process. When adopting the ISSB's standards, companies will need to consider other requirements based on jurisdiction and size. There may be differences between frameworks, but there will also be vast overlaps which should reduce the reporting burden and facilitate far more useful information for key stakeholders.

In creating these standards, the ISSB has consolidated many existing frameworks including the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation (Integrated Reporting Framework and SASB Standards).

The standards build on the existing TCFD framework, with which we are already familiar. Companies will be pleased to know that in adopting S1 and S2, they will already meet the requirements of TCFD, so reducing the reporting 'alphabet soup'. The ISSB will now be responsible for monitoring the TCFD.

The ISSB also works closely with the Global Reporting Initiative (GRI) in developing these standards.

The collaboration aims to ensure compatibility and interconnectedness between the ISSB's investor-focused sustainability information that meets the needs of the capital markets, and the GRI's information that serves a broader range of stakeholders. This work will not only lessen reporting requirements for companies but also harmonise sustainability reporting at an international level.

The standards also work well with other accounting frameworks like US GAAP and UK GAAP, so are truly considered to be a global baseline that's easy to adopt regardless of your existing reporting framework.

Challenges remain

But companies (especially large multinationals operating cross-border) will still face the challenge of navigating overlapping but non-identical disclosure regimes. The EU, for example, has adopted the Corporate Sustainability Reporting Directive requiring in-scope EU-based entities, and non-EU entities operating in the EU, to make extensive sustainability disclosures aligned with the European Sustainability Reporting Standards (ESRS). It's expected that the ESRS will apply in a phased manner from January 2024.

The ISSB has said it is working closely with EU authorities to align its own and the ESRS's disclosure requirements to make them as interoperable as possible. Despite this, differences like 'double materiality' remain. The ISSB will publish a comparison between ISSB and ESRS following the finalisation of ESRS and, we understand, the ISSB and the EU will also issue guidance on avoiding duplication.

Under the current UK regime, including Streamlined Energy and Carbon Reporting (SECR) and UK climate-related financial disclosures regulation, certain in-scope companies must already include environmental and social information in their annual reports. Requirements vary depending on size, jurisdiction and listed status, but common elements include disclosing greenhouse gas emissions, energy consumption, water usage and waste management. Companies are encouraged to report on social issues including workforce diversity and community engagement.

How to prepare during the remainder of 2023

- Evaluate existing internal systems and processes and identify gaps.
- Consider the sustainability risks and opportunities that most affect your business' long-term prospects.
- Review ISSB standards and supporting materials as well as the SASB standards, CDSB framework and the TCFD recommendations.
- Research sustainability matters that affect the whole value chain. This is essential in terms of both risks and opportunities, as sustainability matters are by nature complex and systemic.
- Take advantage of the temporary relief from the ISSB's decision that entities need not disclose their Scope 3 GHG emissions in the first year. Do this by working with your supply chain to identify their Scope 3 emissions in advance of this disclosure becoming compulsory.
- Upskill your personnel and link your sustainability and finance functions (if they are currently separate).
- Phase in capacity and skill sets to meet these new requirements.

For more guidance on any issues raised in this article, please contact Lauren Haslam.

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Get in touch today
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