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PKF

CapitalQuarter

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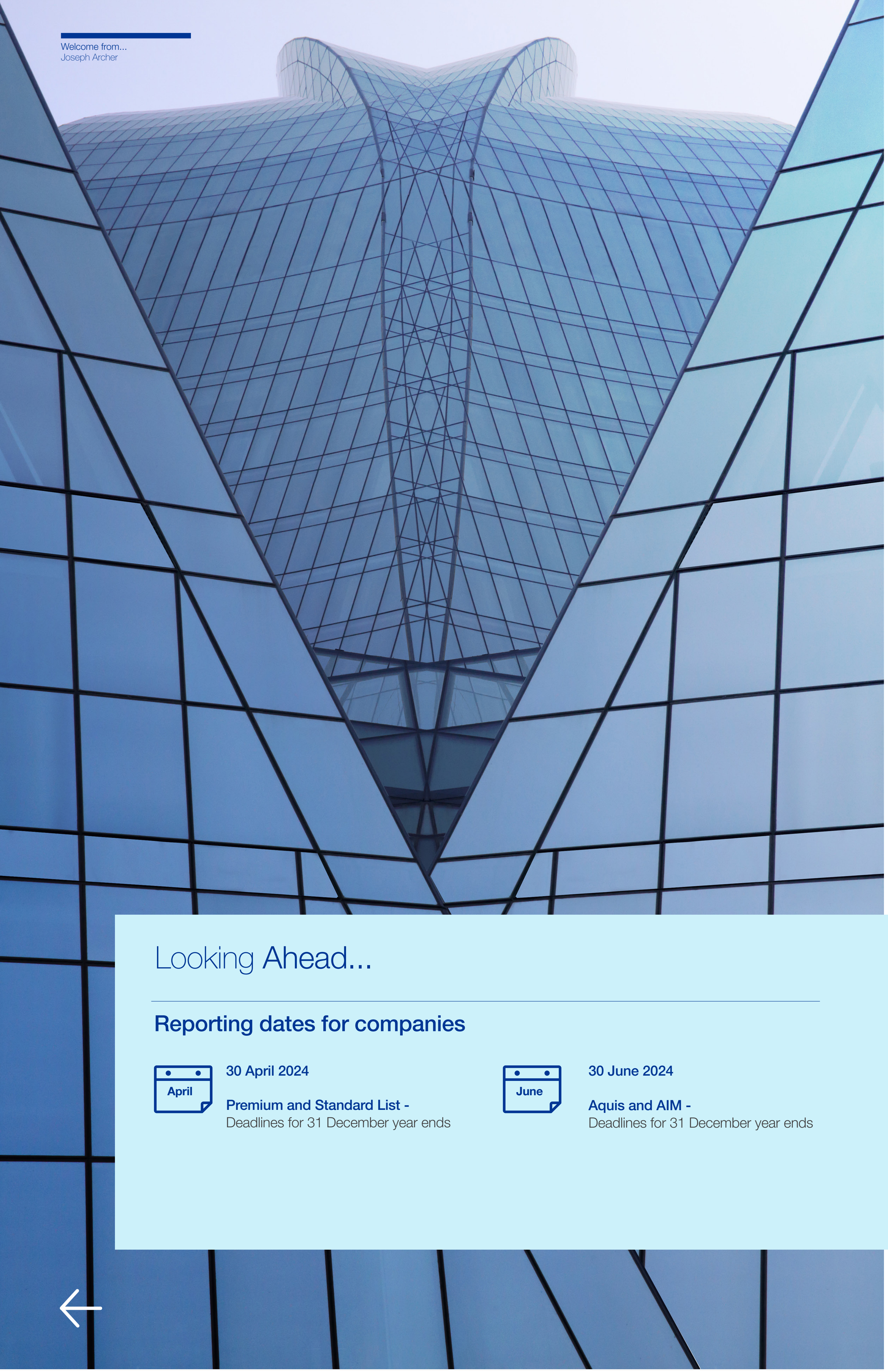

Looking Ahead...

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 the March issue of CapitalQuarter...

The Financial Reporting Council (FRC) has recently published its Annual Review of Corporate Reporting 2022/23. The review sets out the top 10 issues on which the FRC has raised questions, as well as its findings from thematic and other specific reviews, and future expectations which are likely to present reporting challenges for companies. Wendy Liang, Audit Director, breaks down the report and provides guidance for your 2023/24 reporting season.

The Quoted Companies Alliance (QCA) has published a revised UK Corporate Governance Code, following its first review for five years. This 2023 version of the code will apply for financial years beginning on or after 1 April 2024. The updated code places emphasis on emerging areas of investor interest, such as ESG-related disclosures, and wider stakeholder considerations. Calum McChrystal highlights the key changes and implementation deadlines.

The effects of climate change are increasingly visible and have the potential to impact entities of every shape and size. As such, the requirements surrounding climate-related disclosures are ever evolving. To explain the latest requirements Audit Director, Ryan Davies examines the latest regulations and their complexities – including the Climate-Related Financial Disclosure Regulations 2022.

We hope you find this edition useful. We are always keen to hear your comments and suggestions for future articles so do please get in touch.

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Corporate reporting: what the FRC says

The FRC has recently published its Annual Review of Corporate Reporting 2022/23. We look back at the key points and also forward to the 2023/24 review to guide companies in their approach.

This review sets out the top 10 issues on which the FRC has raised questions with companies, as well as its findings from thematic and other specific reviews. There's also a focus on its overall expectations for 2023/2024 and on aspects that are likely to present reporting challenges for companies.

The top 10 issues

The FRC's Annual Review found that the general quality of corporate reporting among FTSE350 companies has been maintained. The number of substantive questions was similar to previous years and these were resolved through open and constructive engagement - a positive outcome in a challenging trading and reporting environment.

There were a few improvements, with alternative performance measures (APMs) dropping out of the top 10 for the first time in several years.

Impairments

The issues most frequently raised in the latest Annual Review were related to impairments, including the disclosure of judgements and estimates. This may reflect the heightened economic uncertainties companies have had to factor into their financial reporting.

Reduced headroom in impairment tests may trigger additional disclosure requirements for assumptions and sensitivities. Estimates, such as discount rates, may need to reflect a wider range of possible outcomes than in previous reporting periods. Reasonably possible changes in assumptions that would result in a recoverable amount below the carrying amount are required to be disclosed. Quantitative disclosures about the amount of headroom in the recoverable amount over the carrying amount, the key assumptions, or the sensitivity of the headroom to changes in the key assumptions are required to be disclosed if change in assumptions would result in impairment. Companies have not always provided sufficiently transparent disclosures for users to understand the view taken by management on these points, and the FRC believes these will remain areas of risk for the coming reporting season.

Cash flow statements

As for cash flow statements, there were fewer major errors than previously noted, but there were still many issues arising from basic consistency checks, comparing the cash flow statement to other information in the financial statements. Other common errors related to classification, netting off and reporting on non-cash movements in the cash flow statements.

Further challenges included:

- Strategic reporting requirements and other issues relating to requirements of the Companies Act 2006
- Financial instruments
- Income tax
- Revenue recognition
- Provisions and contingencies
- Presentation of financial statements
- Fair value measurement.

What to beware of for 2023/24 annual reports and accounts

The FRC also highlighted the main obstacles in the current trading or reporting environment likely to present reporting challenges for companies.

One is high inflation and rising interest rates that may drive significant changes to discount rates. These, in turn, could result in additional impairments or a reduction in pension scheme liabilities and potential recognition of a surplus.

The range of estimation uncertainty over a number of economic factors, including inflation, has increased. This may mean more judgement calls by management to determine inputs to the financial statements, and disclosure of sensitivities to a wider range of reasonably possible outcomes.

Companies should consider the effect of uncertainty and high inflation on the recognition and measurement of assets and liabilities, and related disclosures, and to ensure that the key assumptions and range of sensitivity disclosures remain appropriate.

Changes to IFRS accounting standards for the coming reporting season are relatively minor, except for the implementation of IFRS 17.

What does the FRC expect of companies?

The FRC set out its key disclosure expectations for 2023/24:

- Ensure disclosures about uncertainty meet the relevant requirements and are sufficient for users to understand the positions taken in the financial statements.
- Give a clear description in the strategic report of risks facing the business, their impact on strategy, business model, and going concern, cross-referenced with relevant detail in the reports and accounts.
- Provide transparent disclosure of the nature and extent of material risks arising from financial instruments, including: changes in investing, financing and hedging arrangements; the use of factoring and reverse factoring in working capital financing; the approach to, and significant assumptions made in, the measurement of expected credit losses; and concentrations of risks and information about covenants (where relevant).
- Provide a clear statement of consistency with Task Force on Climate-related Financial Disclosures (TCFD) (where required by the stock market listing rules), or an explanation of the reasons for not doing so, which explains clearly whether management believes it has given sufficient information to comply with the framework in the current year.
- Carry out a sufficiently critical review of the annual report and accounts.

What are the thematic focuses for 2023/24?

The FRC has started its next review cycle and is carrying out four thematic reviews:

- Fair value measurement
- TCFD – metrics and targets
- Large private companies
- Insurance contracts.

Fair value measurement is required or permitted by many IFRSs. Companies are facing greater estimation uncertainty and a high level of judgement in this area, given the risks posed by the challenging economic environment and by climate change. This means clear and transparent disclosures of fair value measurements will become increasingly important.

Another thematic review focused on the quality of companies' disclosures of TCFD metrics and targets. There has been a gradual improvement in this aspect of reporting since the 2022 review. Most companies have set net zero or other climate-related targets and interim emissions targets, but these have not always been well explained. Likewise, the review found there has been some commonality between companies in the same sectors, but different methodologies have made direct comparison difficult and challenging.

The FRC published its review of reporting by the UK's largest private companies in January 2024. The reporting quality was mixed in terms of how clearly companies explained material matters that were complex or judgemental. All companies included in the review were substantial entities in respect of revenues and employees, many of which have complex structures, business models and operations.

Key findings that companies should take into account for future annual reports include:

- The strategic report should explain the key matters in a clear, concise and understandable way that is consistent with other disclosures in the financial statements
- Details of the specific judgment involved and rationale for the conclusion must be explained clearly
- Quantitative disclosures should be included to provide clarity on the significance of estimation uncertainty
- Accounting policies for complex transactions and balances should be entity specific.

The thematic review was based on the disclosures regarding the impact of the new standard IFRS 17 Insurance contracts on a sample of companies for the June 2023 interim reports. Overall, the FRC was pleased with the quality of IFRS 17 disclosures in the sample interim accounts. But it also identified areas for improvement:

- Companies must provide high quality disclosures about complex or subjective areas
- Accounting policies should be company-specific
- Disclosures of significant judgements and estimates must be sufficiently detailed
- Companies should explain the transition approach they adopt.

The 2022/23 FRC Annual Review can be found here. For further information or guidance, please contact Wendy Liang.

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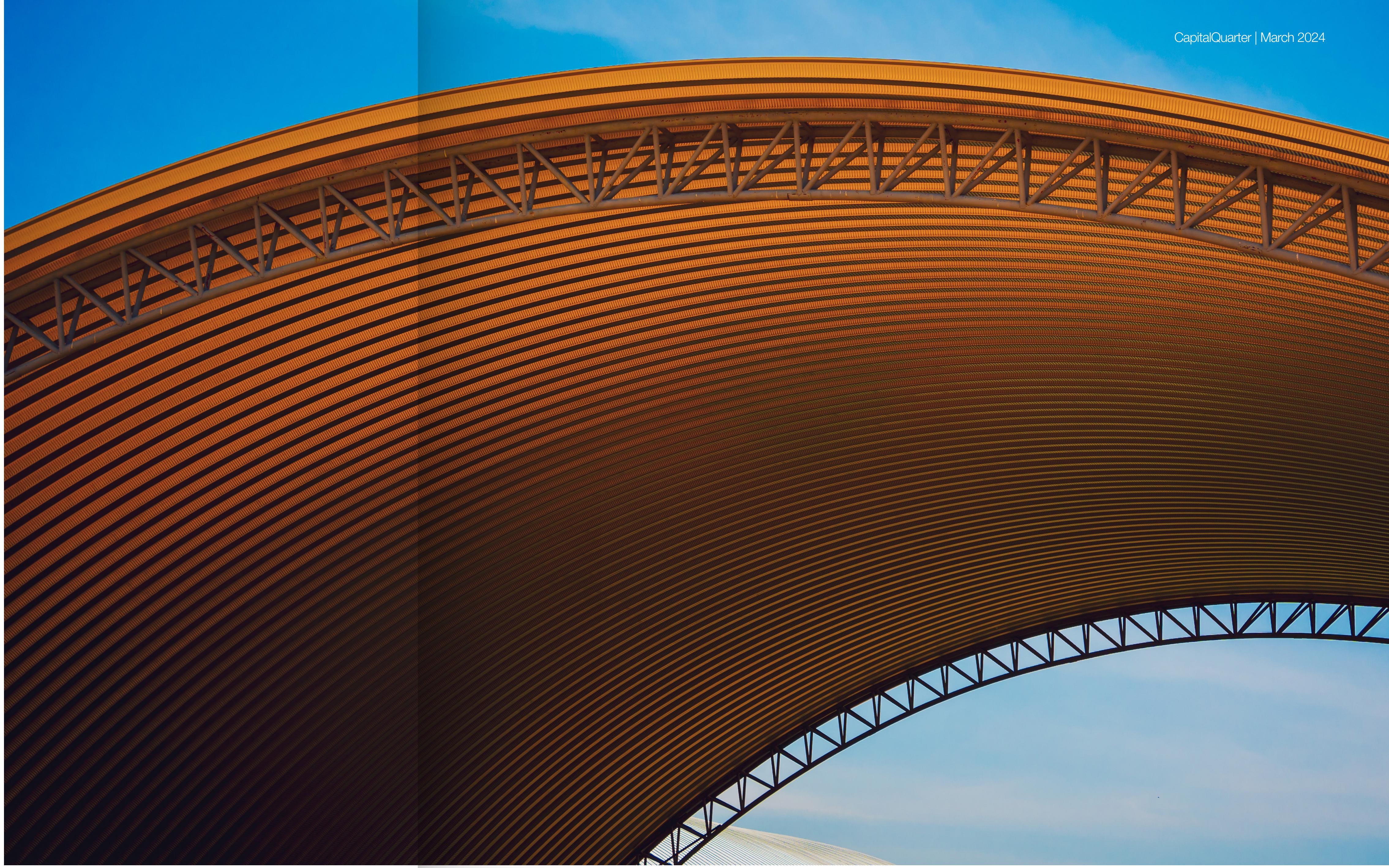
QCA Code refresh



In its first review for five years, the Quoted Companies Alliance (QCA) has published a revised corporate governance code. Here's a guide to the key changes.

This 2023 version of the code will apply for financial years beginning on or after 1 April 2024. Although it has been re-worked and re-organised, it maintains its principles-based approach to corporate governance. There is additional emphasis on emerging areas of investor interest and expectation, such as environmental and social governance (ESG)-related disclosures, compositions of the board and wider stakeholder considerations.

What is the QCA Code?

First introduced in 2013, the QCA Code is a practical governance framework which offers flexibility and helps companies of different sizes and backgrounds to adopt an approach to corporate governance that is based on certain principles. Where a company chooses not to, or is unable to, apply a particular principle, it can provide an explanation for not doing so through disclosures in its annual report or via its website.

The QCA Code is constructed around 10 broad principles and a set of disclosures. Principles 1-9 are designed to ensure that good governance practices are followed. Principle 10 deals with how this good governance is communicated and reported to shareholders and other stakeholders.

The Code's pragmatic approach means it has been widely adopted. There are some 900 companies currently applying it. These include around 93% of AIM-listed entities, many on the Main Market of the London Stock Exchange and three-quarters of those quoted on the Aquis Stock Exchange.

What are the key changes this time?

Below are some of the notable developments for the 2023 code.

Wider stakeholder interests and ESG responsibilities (Principle 4)

Previously Principle 3 in the 2023 code, Principle 3 is now: Seek to understand and meet shareholder expectations. The revised code, now Principle 4, increases the focus on the workforce as a key stakeholder and asks that practices towards employees be consistent with the company's values.

The new code has explicit references to ESG issues, including those relating to climate change.

It recommends that ESG issues be incorporated into the company's strategy, risk management and business models. Companies should provide both qualitative and quantitative disclosures in their annual report, including a description of ESG issues that the board has identified as being material.

Board independence and composition (Principles 6 & 7)

Board independence was previously included in the guidance section of the 2018 QCA Code, but this focus has been moved forward to be part of Principle 6 in the revised corporate governance tool.

It recommends the following:

- All directors should submit themselves for election or re-election on an annual basis;
- At least half of the board should be comprised of independent non-executive directors (NEDs). Boards are still expected to contain a minimum of two independent non-executives; and
- Certain committees, such as the audit and remuneration committee, should have at least a majority of independent NEDs and, "ideally should aim for full independence".

The 2018 iteration of the QCA Code allowed independence to be determined by the board. The revised 2023 publication is more dictatorial, requiring the board to consider a list of factors which may be considered to impair independence, including:

- The length and tenure of the board;
- Sizes of shareholdings;
- Prior and/or current commercial or contractual relationships with the company or executive directors; and
- Significant pay arrangements beyond a director's fee.

Succession and contingency planning (Principle 8)

Succession planning for both executive and non-executive directors, senior management and key staff, is now a vital task for the board (with assistance from its nomination committee). No member of the board should become indispensable and board membership should be periodically refreshed.

The skills, experience, capabilities and background required for directors and senior management to support the next stage of a company's development should be identified and factored into succession planning.

Companies should disclose their succession planning processes in their annual report and accounts, including any indicative timelines for expected appointments.

Remuneration (Principle 9)

This broadly aligns with the previous guidance on remuneration, but also recommends that:

- companies devise and implement an effective remuneration policy;
- pay structures for senior management be easy to understand and align with shareholder values;
- shareholder votes be required for the annual remuneration report, remuneration policies and any amendments to existing employee share schemes or long-term incentive plans.

What are the deadlines?

A 12-month transition period will be implemented from 1 April 2024. The aim is to give companies long enough to adjust to the new Code and to build in the necessary operational and strategic capabilities to apply the principles in full. Initial disclosures against the 2023 Code are expected in 2025.

For further guidance on the new QCA Code, please contact Calum McChrystal.

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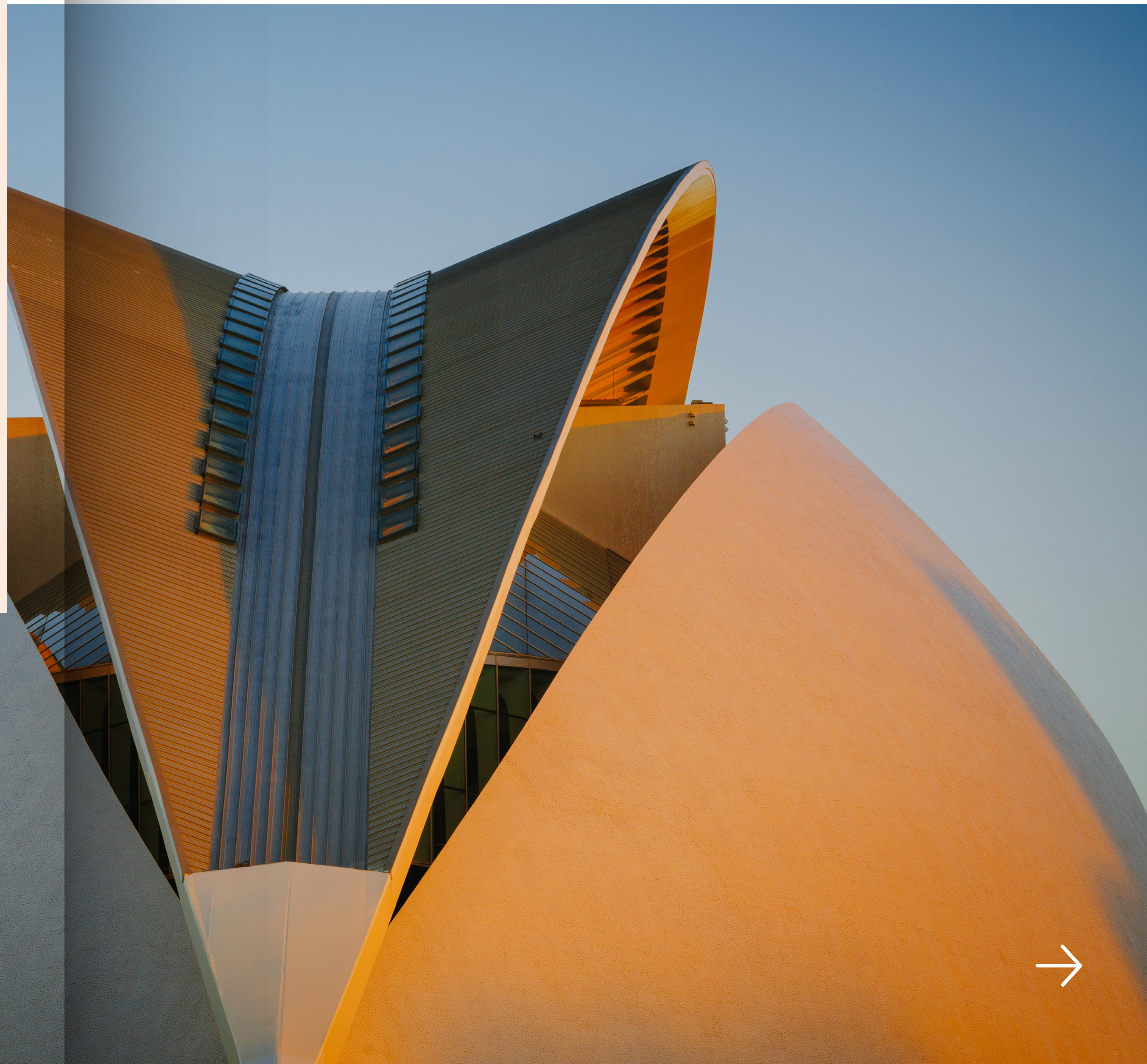
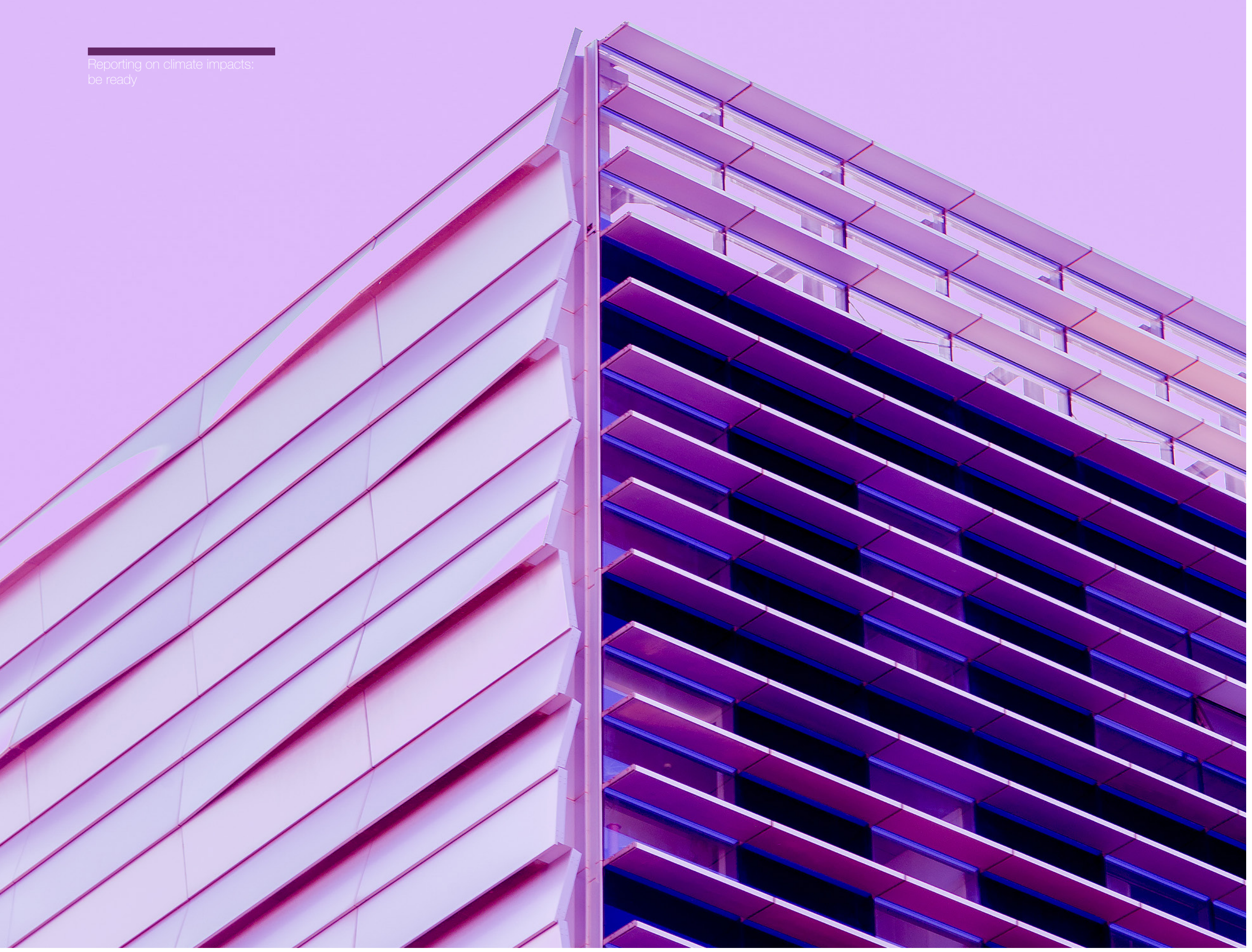




Reporting on climate impacts: be ready

Climate-related disclosures are not just a compliance exercise. The analysis involved may help you to protect your business. Here's a guide to the requirements and complexities.

Since 1 January 2021, the Listing Rules have required premium listed companies to follow the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), on a 'comply or explain' basis. These rules were extended to certain standard listed companies for accounting periods beginning on or after 1 January 2022.

The effects of climate change are ever more visible and have the potential to impact an increasing number of entities of every nature and size. In response, the Climate-Related Financial Disclosure Regulations 2022 were introduced in the UK to help investors make informed decisions as the UK progresses towards a low-carbon economy.

For periods starting on or after 6 April 2022, certain UK companies must disclose relevant information in their annual reports, as set out in the Regulations. This applies to:

- public interest entities (PIEs) with more than 500 employees
- UK-registered companies with securities admitted to the AIM with more than 500 employees
- UK-registered companies not included in the categories above, with more than 500 employees and a turnover of more than £500m.

Certain LLPs will also be captured by the Regulations but the requirements are complex and should be assessed case by case.

What are the Regulations?

Companies within scope must disclose, under the four pillars (see below) in the non-financial and sustainability information (NFSI) statement of their strategic report, or in their energy and carbon report if they don't produce a strategic report. These requirements are based on the Task Force on Climate-Related Financial Disclosures recommendations, but are not identical. Minor adaptations ensure the language and format of the content is suitable for UK legislation.

What are the four pillars?

The four pillars of governance, risk management, strategy, and metrics & targets are the overarching areas in which climate-related disclosures sit. Under the pillar headings are eight further specific requirements:

Governance and Risk Management (Pillars 1 & 2)

1. A description of the governance arrangements of the company in relation to assessing and managing climate-related risks and opportunities
2. A description of how the company identifies, assesses, and manages climate-related risks and opportunities
3. A description of how processes for identifying, assessing, and managing climate-related risks are integrated into the overall risk management process in the company.

Strategy (Pillar 3)

4. A description of the principal climate-related risks and opportunities arising in connection with the operations of the company and a description of the time periods by reference to which those risks and opportunities are assessed
5. A description of the actual and potential impacts of the principal climate-related risks and opportunities on the business model and strategy of the company
6. An analysis of the resilience of the business model and strategy of the company, taking into consideration different climate-related scenarios.

Metrics & Targets (Pillar 4)

7. A description of the targets used by the company to manage climate-related risks and to realise climate-related opportunities, and of performance against those targets
8. The key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities, and a description of the calculations on which those key performance indicators are based.

Are the Regulations mandatory?

Unlike the Listing Rules, the Regulations are mandatory rather than 'comply or explain'. But the duty to make disclosures under the Regulations includes discretion to omit some of them where they are not considered necessary for an understanding of the business. However, directors must provide a clear explanation as to why they believe it is appropriate to omit the information.

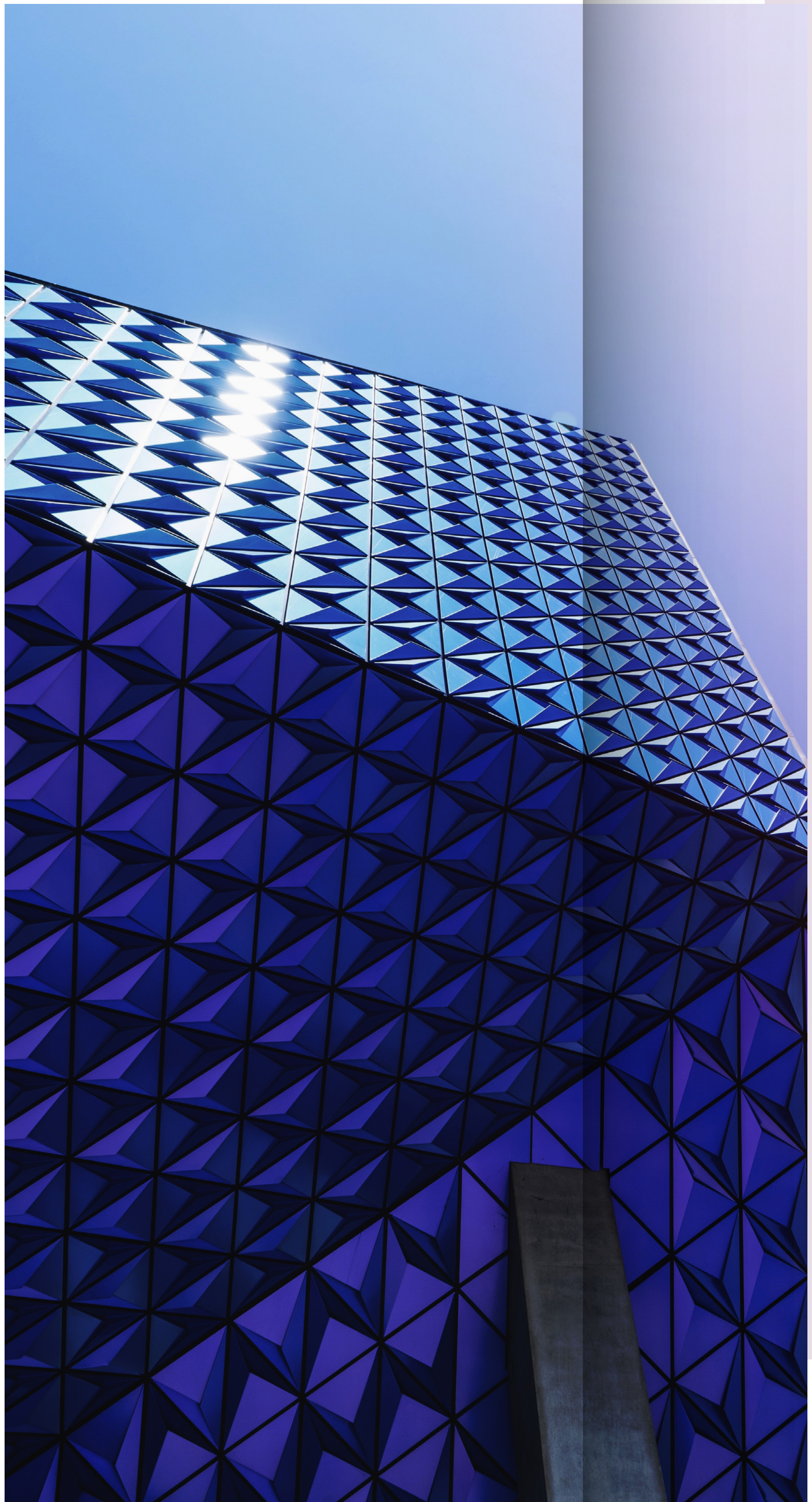
Group considerations

Companies are expected to report at group level, or at company level if not included in consolidated group reporting. This is particularly relevant to AIM-listed companies in the natural resources sector. These quite often find themselves with a small UK headcount but a large worldwide workforce owing to the labour-intensive nature of the industry. UK subsidiaries whose activities are included in the consolidated group report of a UK parent that complies with the climate-related financial disclosures requirements are not required to report separately.

But UK companies with an overseas parent that reports on a consolidated basis, with all the relevant Regulation disclosures, cannot take advantage of this exemption. Neither can UK companies which are included in an LLP set of financial statements.

Where a parent company does not produce consolidated accounts, the scope criteria should be applied to the aggregated turnover and employee figures of the group headed by that parent. In these cases, the climate-related financial disclosures must relate to the parent company, including how climate-related risks and opportunities may affect the value of the investment in the subsidiaries. A subsidiary of a parent company that does not produce consolidated accounts, and that is within scope on an individual basis, must also make climate-related financial disclosures in its individual accounts.

When a UK group is in scope, the top UK parent is expected to include in its annual report the global operations of the UK group, regardless of whether activities are conducted through a UK or overseas subsidiary.



IFRS S1 and S2

On 26 June 2023, the International Sustainability Standards Board (ISSB) released its first two International Sustainability Disclosure Standards (IFRS SDS or 'the Standards') that became effective for periods beginning on or after 1 January 2024.

Although the ISSB has built upon work of several pre-existing frameworks, it is the Task Force on Climate-related Financial Disclosures (TCFD) framework that forms the bedrock of the first two standards that have been issued by the ISSB.

IFRS S1 provides a set of disclosure requirements designed to enable companies to communicate to investors about the sustainability-related risks and opportunities they face over the short, medium, and long term.

IFRS S2 sets out specific climate-related disclosures and is designed to be used in conjunction with IFRS S1. For IFRS S1 and S2 to be available for use in the UK, they must first be endorsed. The UK government is currently consulting on their endorsement, and aims to make decisions on the first two Standards by July 2024. However, this does not mean that accounts preparers can disregard climate-related risks and disclosures.

While accounting standards do not currently refer to 'climate change', the potential implications from climate-related risks could impact:

- asset impairment, changes in the useful life of assets, or the fair value of assets;
- increased costs and / or reduced demand for products and services affecting impairment calculations;
- potential provisions and contingent liabilities arising from fines and penalties; and
- changes in expected credit losses for loans and other financial assets.

It is important the preparers of financial statements familiarise themselves with the Standards as the UK government has been a strong supporter of the ISSB since its launch and it is a case of when, not if, the Standards will be endorsed. Companies who understand these requirements sooner will be better prepared to implement them later, especially as these will be reported at the same time as year end financial reporting and will cause additional reporting pressures to the finance team. Additionally, a good understanding of the standards will allow companies the opportunity to gather good quality data and assess whether their policies and procedures for gathering such data, not just within the finance team but the wider organisation, are adequate.

If you would like further information or guidance on issues raised in this article, please contact Ryan Davies.

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About PKF
Simplifying complexity for our clients

PKF is one of the UK's largest and most successful accountancy brands.

We have a strong reputation with publicly listed companies, and understanding these highly regulated, technically complex businesses has become a specialism of ours. We focus on delivering consistent quality and making all our clients feel valued.

Our specialist capital markets team has vast experience working with companies listed, or looking to list, on a range of international markets including the London Stock Exchange Main Market (Premium and Standard), AIM, AQUIS, NASDAQ & OTC, ASX and TSX & TSX-V.

PKF in the UK...

Ranked 12th largest Audit practice in the UK in the latest Accountancy Daily rankings

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1,450+ staff

5th ranked auditor of listed companies in the UK

Our Capital Markets credentials

Our auditor rankings from ARL

- 6 Technology sector
- 2 Total AIM listed clients
- 1 Energy sector
- 5 Total UK stock market clients
- 1 Basic materials sector
- 6 Financials and Real Estate sector

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PKF UK in numbers

12th
Largest Audit practice in the UK

17
Offices across the UK

1,450+
Employees and 180 partners

£153m
Fee income and growing rapidly

Capital Markets in numbers

180+
Listed audit clients

£2.7bn
Value of transactions advised on in last 10 years

100+
Transactions advised on in last 5 years

26
International businesses brought to the UK in last 10 years

PKF Global In numbers

Part of the 14th
Largest global accounting network

480
Offices in 150 countries

$1.4bn+
In aggregate fee income

21,000
Employees

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