Winter **2025**

CapitalQuarter

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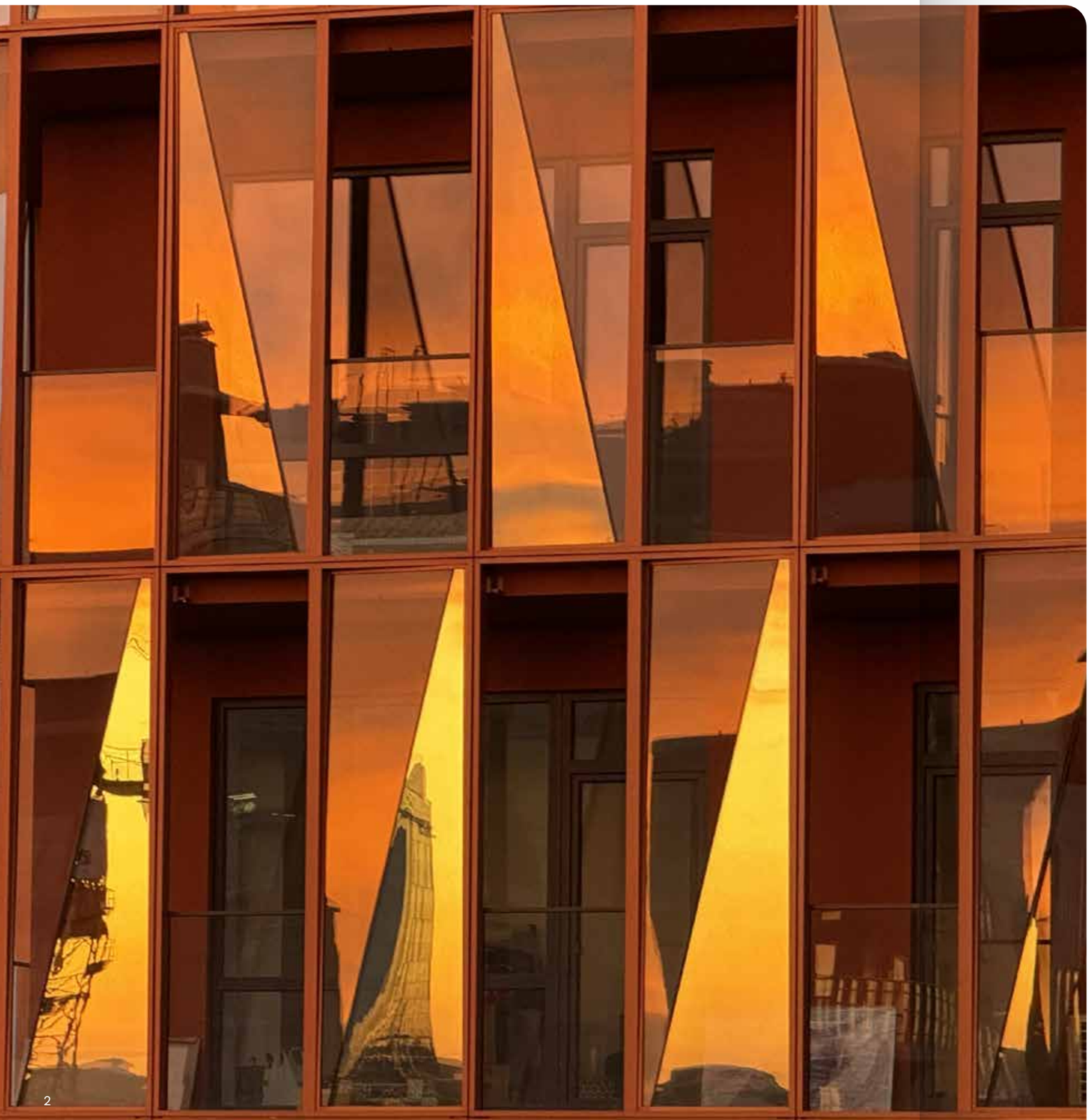

December
In this issue...

Welcome to the Winter issue of **CapitalQuarter...**

In this issue, we explore several important developments shaping financial reporting and governance. The 2018 Corporate Governance Code, updated in January 2024 following a targeted consultation, introduces new expectations for board accountability and transparency. The revised Code will apply to financial years beginning on or after 1 January 2025, signalling a significant shift in governance practices. Here we break down the changes and what they mean for your organisation.

The Financial Reporting Council has updated its 2016 guidance on going concern disclosures. We explain what makes a robust going concern model and outline the key information companies should include when preparing their financial statements.

Onerous contracts can impose significant obligations on businesses, leaving them exposed to unexpected costs, legal disputes, and reputational damage. We discuss how to identify an onerous contract and examine its impact on financial reporting obligations.

Since the change in government, HMRC has intensified its review of VAT returns filed over the past four years. Our VAT specialists share practical advice on how listed businesses can stay ahead and outline the steps to take if there is a risk that HMRC seeks to claw back previous VAT refunds.

And finally, as Jersey implements its multinational corporate income tax regime from 1 January 2025, our tax experts explore the practical implications for in-scope groups and what actions businesses should consider now.

Whilst this is not a Budget edition, the release of this issue of CapitalQuarter falls the week after the Autumn Budget 2025. Please do take a look at our Budget guide if you have not already done so which can be found **here**.

We hope you find this edition insightful and useful. As always, we welcome your feedback and suggestions for future topics—please do get in touch.

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The new UK Corporate Governance Code: what to look out for

The 2024 version brings in updates designed to strengthen governance practices and investor confidence. Here's what you need to know.

The new code replaces the 2018 version and is applicable to all companies listed in the 'equity shares (commercial companies)' and the 'closed-ended investment funds' categories on the UK Official List, regardless of where they are incorporated.

It is applicable for accounting periods beginning on or after 1 January 2025. The exception is a new requirement for internal controls (provision 29) which will take effect from 1 January 2026.

AIM companies and all others on the UK Official List, including those in the 'equity shares (transition)' category, are not required to comply. But many choose to adopt the code voluntarily as a demonstration of good governance.

Like the 2018 version, the 2024 code is in five sections as follows:

1. Board Leadership and Company Purpose
2. Division of Responsibilities
3. Composition, Succession and Evaluation
4. Audit, Risk and Internal Control
5. Remuneration.

Each contains principles and provisions. The principles set out the fundamental expectations for governance, while the provisions offer guidance on how to implement those principles effectively. There is no single way to apply the principles and comply with, or explain against, the provisions. Companies applying the code will differ in size, sector and maturity, and boards should take this into account when they decide their approach to implementation.

As before, the code operates under the 'comply or explain' principle. This allows companies flexibility in how they meet governance expectations, while requiring clear explanations for any deviations.

So what is new?

Section 1 – Board Leadership

Principle C. Boards are expected to report on governance activities by focusing on decisions and their outcomes in the context of the company's strategy and objectives. Where there are departures from the code's provisions, boards should provide clear and meaningful explanations.

Section 4 – Audit, Risk and Internal Control

Provision 29 (effective from 1 January 2026). This revised and expanded provision is the most significant change to the code. It asks boards to monitor and review the company's risk management and internal control framework annually. They must report on how effective these frameworks are and discuss any material weakness in the reporting period. The monitoring and review should cover all material controls – financial, operational, reporting and compliance. It also introduces a formal declaration of internal control for the first time.

This means the annual report must include:

- A description of how the board has monitored and reviewed the framework's effectiveness
- A declaration of effectiveness of material controls as of the balance sheet date
- A description of any material controls that did not operate effectively, actions taken or proposed to improve them, and steps taken to address previously reported issues.

Section 5 – Remuneration

Provision 38. In conjunction with provision 37 which prescribes that directors' contracts should incorporate malus and clawbacks, companies must include in their annual report a description of their malus and clawback provisions, including:

- The circumstances under which these provisions may be applied
- The duration of the provisions and the rationale for the selected period
- Whether the provisions were used during the reporting period – with a clear explanation if so.

What are the priorities?

Boards should already have begun implementing changes ahead of the reporting season. If not, they should be preparing for them now. While most provisions apply from 2025, the delayed implementation of provision 29 buys extra time for companies to strengthen internal control frameworks.

This is also a good opportunity to assess current governance practices, ensure they have robust monitoring and reporting mechanisms, and engage with auditors and advisors to prepare for the new requirements. So how should boards begin?

- Conduct a gap analysis against the new requirements
- Review internal control frameworks to ensure readiness for provision 29
- Update governance reporting to reflect decision-making outcomes
- Revisit remuneration policies to ensure compliance with new disclosure obligations.

Non-executive directors (NEDs) also have an important role in the introduction of the new code. This particularly applies to provision 29, with its requirement for formal declaration of internal control effectiveness which raises the bar for assurance and accountability.

For NEDs this is an opportunity to reinforce their oversight role, challenge management constructively, and ensure the board is equipped to meet evolving expectations.

After all, boards that proactively engage with these changes will be better positioned to meet investor expectations and regulatory requirements.

For further guidance on any issues raised in this article, please contact our experts.

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Disclosure of going concern: managing risk and uncertainty in financial statements

The FRC has updated its 2016 guidance on disclosure of going concern. It aims to help companies increase investor and stakeholder confidence, through clearer demonstration of their assessments.

The revised, non-mandatory guidance – issued in February – reflects changes in accounting and auditing standards, as well as market and economic developments. It clarifies overarching disclosure requirements. Its scope also now includes companies which apply the UK Corporate Governance Code.

The concept of going concern is a core accounting and financial reporting principle. It's significant for capital market entities with its direct implications for investor confidence, regulatory expectations, and disclosure of financial information.

For capital markets, that investor confidence and regulatory compliance are key. Likewise, management's duty to provide clarity to users as to how they reached their conclusions is crucially important.

What is management's role in going concern assessment?

Management is responsible for evaluating the going concern status of an entity. This means reviewing:

- Future cash flows
- Debt obligations and maturities
- Availability of capital
- Market and operating conditions.

They must document their assessment and include explicit disclosures in the financial statements, especially where there are material uncertainties.

What should they be careful to avoid?

Some of the common pitfalls of going concern disclosures are:

- Boilerplate or generic disclosures
- Insufficient disclosure of material uncertainties
- Disregarding events more than 12 months beyond the minimum
- Overly-optimistic or weakly-supported assumptions
- Lack of transparency in relation to Group support
- Deficient disclosure of judgements
- Inadequate scenario analysis
- Misstated growth rates and mathematical errors used in underlying model.

What makes a robust going concern model?

For the going concern model of a UK-listed company to work well, it should align with the latest FRC guidance and detail the following:

1. Clear governance and responsibility

- Board responsibility
- Systematic process
- Risk management integration

2. Forward-looking financial analysis

- Cash flow forecasting
- Liquidity analysis
- Solvency review

3. Stress testing and scenario planning

- Review of plausible worst-case scenarios
- Evaluation of management's mitigating measures in each instance

4. Clear documentation and evidence

- Clear documentation of assumptions underlying forecasts, judgements by management and external evidence

5. Clear disclosures

- Allow users to understand the risks and how the directors are managing the company's financial position

6. Compliance with regulatory expectations

- Ensure compliance with latest regulatory guidance.

What should companies disclose for going concern?

The FRC's updated guidance consolidates and harmonises the various legal, accounting, listing, auditing and governance requirements.

1. Basis of preparation

All financial statements must declare whether they have been prepared on a going concern basis or, if not, show the alternative basis used. Any material uncertainty which gives rise to doubt regarding this assumption requires disclosure.

The level of disclosure must be proportionate to the level of uncertainty, as well as to the financial robustness of the company. Where higher uncertainty exists or limited headroom is available, greater disclosure is expected.

2. Material uncertainties

Where there are material uncertainties these should be disclosed, together with an outline of the key events or conditions that created them and how management are managing the situation. There has been an increase in material uncertainties, driven by a combination of factors:

- Economic uncertainty
- Supply chain disruptions
- Geopolitical risks
- Environmental risks
- Dependence on key contracts or customers
- Timing for ongoing negotiations of funding facilities.

Declaring material uncertainties provides transparency to users and a clear insight into management's actions. A material uncertainty note doesn't mean the company is, or will become, insolvent. It shows that certain key events need to occur for it to remain liquid. For example, the refinance of a loan facility or capital raise.

Unless those are unsuccessful, the uncertainty may not occur. By identifying and disclosing uncertainties, organisations can better prepare for them. It also alerts stakeholders that the organisation is actively addressing its risks and preparing for differing outcomes.

3. Significant judgements, assumptions and other sources of estimation uncertainty

Major judgement disclosures regarding going concern assessment must be company-specific. They should also clarify the major considerations and how these influenced directors' judgements.

Examples of judgemental situations include:

- Potential restructuring or refinancing
- Breach of a covenant
- Planned business restructurings.

Disclosure of assumptions made should also be tailored to the company and be sufficiently detailed to allow the users to grasp the rationale behind the directors' conclusions.

What is best practice for disclosing geopolitical risk?

Geopolitical risk has, sadly, become more prevalent in recent times. This means there is increased focus on those risks and their impacts and how they are disclosed. Key considerations are:

- Identification of geopolitical risks
- Linking risks to financial forecasts
- Assessing material uncertainties
- Presenting reports consistently
- Disclosing company-specific circumstances
- Engaging the board and audit committee, and disclosing the process
- Transparency.

What are the potential challenges for management?

The revision of ISA 570 has increased auditor responsibility in relation to going concern. Among the key questions for management to answer are:

- Reasoning behind their belief that going concern is appropriate
- Whether all material events beyond the minimum 12-month time frame have been considered
- Current cash runway and susceptibility to variability in revenue or costs
- Contingency arrangements
- Arrangements and likelihood for securing further funding
- Near-term debt maturities or covenant tests likely to impact liquidity
- Formal commitments received from lenders, investors or parent entities
- Material uncertainties identified
- Potential triggers that could cause uncertainties to crystallise
- Judgements reached and how assumptions used compare with others used elsewhere in the financial statements eg impairment
- Whether any scenario analysis or stress testing has been carried out, and outcomes.

Preparers should incorporate all these considerations when they make their going concern disclosures and design the supporting models. They must produce a thorough explanation and documentation of every major assumption, important judgement and probable risk factor, in accordance with relevant financial reporting frameworks and supervisory standards.

Comprehensive and concise going concern disclosures are important to the integrity and reliability of financial reporting. They provide stakeholders with valuable information on the financial situation of a business, its exposure to risk, and its management's forward-looking judgements.

In periods of heightened economic uncertainty or operating stress, tailored and clearly worded disclosures enable users to make well-informed decisions and boost confidence in the company's stewardship.

If you would like further advice on the issues raised in this article, please contact our experts.

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Onerous contracts: how to recognise them and why they matter

Could your company be managing an onerous contract? If so, it will have a significant effect on your businesses and financial reporting obligations.

Onerous contracts have significant obligations for businesses and financial reporting. The terms of these contracts can leave a business exposed to unexpected costs, legal disputes and even reputational damage. It remains essential to identify and manage onerous' contracts at an early stage. This will ensure accurate accounting and disclosure, while also allowing the opportunity to convey a positive message to stakeholders.

What is an onerous contract?

According to IAS 37 Provisions, Contingent Liabilities and Contingent Assets, an onerous contract is one in which the unavoidable costs of fulfilling the contractual obligations exceed the economic benefits expected to be derived from it. The standard clarifies these unavoidable costs as the lower of the cost of fulfilling the contract and any compensation or penalties that would arise from failing to fulfil it.

In other words, a contract is considered 'onerous' when a company cannot meet its obligations without incurring a loss.

When can a contract be labelled onerous?

Types of contracts that often become onerous include leases, supply agreements, and revenue/service contracts. A contract may be onerous from the outset due to factors such as unrealistic delivery timelines (where the liability rests with the contracting party), excessive fees, hidden penalties, or ambiguous terms – to name a few. In such cases, the agreement may place the full legal burden on one party and be difficult or costly to terminate.

Sometimes companies enter into revenue-generating contracts during the early stages of market entry or product development, without fully assessing the associated costs. As a result, they may set pricing that fails to cover expenses, let alone generate profit.

Under IAS 37, a contract is only classified as onerous if the costs of meeting its obligations outweigh the benefits. It's important to note that a contract may contain unfavorable terms – such as strict deadlines, high penalties, or ambiguous clauses –, without necessarily being onerous.

Similarly, a contract that underperforms or fails to meet expectations is not automatically considered onerous. The key criterion is whether fulfilling the contract results in a net loss.

Interaction between IAS 37, IFRS 15 and IAS 2

As we've said, a contract may be onerous from the very start or it may become onerous over time due to changing circumstances. These changes can stem from shifts in the company's internal strategy. Alternatively, they may be caused by external factors such as market conditions, regulatory developments, natural disasters, or supply chain disruptions.

In order to determine if a contract is loss-making or onerous, the assessment has to look at the totality of the contract (or the totality of the remaining contract term in the case of an ongoing contract), rather than on a 'loss-making' year within an overall profitable multi-year contract or on a performance-obligation basis.

Similarly, an entity may have a portfolio of similar contracts with different customers (for example, multiple customers are receiving similar goods or services). In this case, an onerous contract a provision should be recognised for loss-making contracts within that portfolio – regardless of the existence of other profitable contracts.

When to combine contracts

It's important to note that IFRS 15 allows companies to combine two or more contracts entered into at (or around) the same time with the same customer, or related parties, and account for them as a single contract. But one or more of these criteria must be met:

1. The contracts are negotiated as a package with a single commercial objective
2. The consideration in one contract depends on the price or performance of the other
3. The goods or services promised in the contracts represent a single performance obligation.

In such cases, the total contract price is determined by combining the contracts, and the assessment of whether the contract is onerous is based on that combined arrangement.

It's also important to consider the value of inventory held in relation to fulfilling a loss-making contract. According to IAS 2, this may need to be written down to reflect its net realisable value.

For example:

Company A has entered into two revenue contracts with Customer B. The first involves the manufacture and delivery of a water-powered car at a sales price of £100m, with an estimated cost of £250m. The second grants Customer B the rights and licensed intellectual property to manufacture the car independently, priced at £400m. Payments under the second contract begin only after the first car has been delivered and has operated for at least a month.

Given that the second contract is contingent on the successful execution of the first, it is reasonable to conclude that both contracts were negotiated as a package with a single commercial objective. This satisfies criterion (a) above, which allows for the combination of contracts for accounting purposes.

So to assess whether the arrangement is onerous, the combined contract price of £500m should be considered. This approach concludes that the overall contract is not onerous.

How can we help?

Although onerous contracts are common, they involve a lot of judgement and can be challenging. It's essential to maintain accurate and timely tracking of contracts, their recognition and their disclosure.

While the accounting standards provide extensive guidance, they strike a balance between prescriptive rules and areas requiring professional interpretation. IFRS, in particular, is clear on certain matters but leaves room for interpretation in others. So sound judgement is critical.

We recognise that some contracts can be complex, and PKF is here to support you in navigating the associated challenges, uncertainties, and assessments with confidence and clarity.

If you would like further guidance on any issues raised in this article, please contact our experts.

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The challenge of VAT refunds: how listed businesses can stay ahead

HMRC is not missing a trick. Historic approval may not let you off the hook. We offer advice on how to protect your business from a nasty shock.

A VAT-registered company that regularly reclaims, and receives, refunds from HMRC for input VAT incurred on its expenditure unchallenged, might assume its historic input VAT refunds are secure. Unfortunately, this is not the case.

Since the change in Government, a reinvigorated HMRC is now reviewing VAT returns filed in the past four years. Many of these inspections arise from a pre-credibility check of the most recent return that claimed a refund of VAT.

Until HMRC's enquiries are resolved, it holds on to the input VAT refund claimed, as well as other input VAT refunds claimed in the meantime. This is to offset any historic monies identified as owed to HMRC, against the most recent claims for input VAT refunds. So, from a cash flow perspective, it's in the interest of the business to resolve HMRC's enquiries as quickly as possible.

The power to review

Let's take a scenario where HMRC issues an assessment to claw back previously made input VAT refunds plus interest (currently 8%) and, potentially, also a 'careless error' penalty of up to 30% of the amount of VAT clawed back. The business may try to argue that HMRC's previous willingness to make VAT refunds without challenge should make a difference. That it should somehow stop it from retrospectively applying its current view on how the business should correctly account for VAT on its transactions. But this is incorrect.

Where HMRC has merely processed filed VAT returns without query, it has no knowledge of how the figures reported have been calculated. But the VAT Act gives HMRC the power to review, and challenge where necessary, the underlying VAT return workings going back up to four years.

Not a full audit

Where a business points out a previous four-year VAT inspection, or a pre-credibility check of one VAT return, on which HMRC did not carry out a VAT assessment in respect of the accounting error that it is currently identifying, the business may try to argue that HMRC approved its VAT accounting during those previous interactions. But be warned: when it concludes a pre-credibility check of a single VAT return, HMRC says the following in the closing communication to the business:

"It is important that you understand that this check is not a full audit of your VAT declarations. If we consider that a more detailed check of the same period is appropriate we may carry out a further review at a later date."

False sense of security

So, input VAT refunds received following a 'successful' pre-credibility check of a single VAT return are, as far as HMRC is concerned, provisional and subject to future enquiries as part of any future in-depth four-year VAT inspection.

Where HMRC has previously carried out a four-year VAT inspection without challenging the business's VAT accounting, the business may feel it has stronger grounds to rebuff any retrospective VAT assessments issued now.

But the courts have confirmed this is not the case on several occasions. The most recent was Realreed Ltd t/a Chelsea Cloisters, where the taxpayer lost its judicial review High Court case against HMRC's retrospective four-year VAT assessment issued – even though several previous VAT inspections had passed without incident.

The Court ruled that a taxpayer can only defend against retrospective VAT assessment action where HMRC has done or said something positively, during a previous inspection, about the taxpayer's VAT accounting. In other words, HMRC clearly states in writing that it agrees with the taxpayer's VAT accounting – rather than just not taking issue with it by issuing a VAT assessment.

What is ‘reasonable care’?

The same taxpayer also lost its argument, in the First-tier Tribunal, that HMRC should not have levied a ‘careless error’ penalty, on top of the retrospective four-year assessment for VAT and interest. HMRC considered that the taxpayer had not taken ‘reasonable care’ in its VAT accounting. The Tribunal provided these reasons for its view:

01 The taxpayer did not take considered professional advice about its VAT accounting from a specialist VAT adviser, nor on whether HMRC’s conduct following previous VAT inspections (when no assessments were issued) gave the taxpayer a ‘legitimate expectation’ that HMRC had effectively approved the taxpayer’s VAT accounting

02 When he arrived at the business, the taxpayer’s current finance director did not investigate (internally or externally) the taxpayer’s VAT accounting – he just accepted that it was correct

03 HMRC offer a VAT ruling service – the taxpayer did not use this to try to obtain positive written confirmation from HMRC that it agreed with its VAT accounting.

How should a business protect itself?

Obtain VAT advice from a specialist VAT adviser. Even if HMRC disagrees with the VAT accounting used, it shouldn’t levy ‘careless error’ penalties on top where a competent adviser has provided an arguable view that the taxpayer’s accounting is correct, based on full knowledge of all of the relevant facts. Where there is a risk that HMRC may seek to claw back previous VAT refunds (plus interest), then consider one or more of the following actions:

- Earmark funds to cover any potential future VAT assessments
- Where the total potential amount at stake is greater than £1m, consider taking out tax exposure insurance
- Where possible, follow the advice given by the specialist VAT adviser and change contractual and commercial arrangements to support the VAT accounting method currently used.

For further guidance on any issues raised in this article, please contact our expert.

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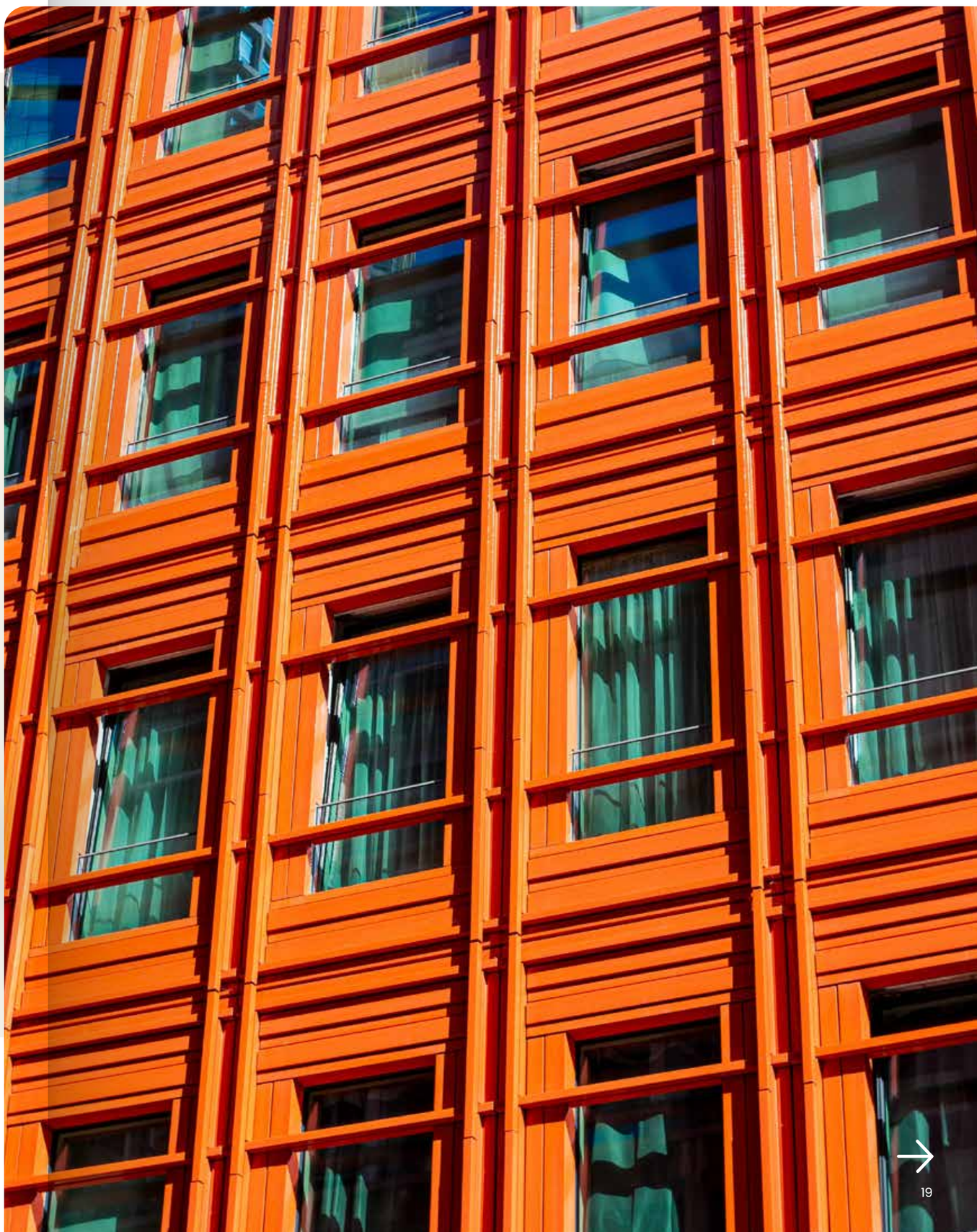

Global tax reform: how will it affect Jersey's multinational companies?

As Jersey implements its multinational corporate income tax regime from 1 January 2025, our tax experts Mimi Chan and Anthony Chandlen explore the practical implications for in-scope groups.

Drawing on our work on joint projects, latest guidance and legislative developments, we aim to help you navigate the new compliance landscape and highlight key considerations for Jersey-based entities.

Among other considerations, multinationals need to focus on registration requirements, reporting obligations, and the interaction with OECD Pillar Two rules.

Pillar Two represents a landmark shift in international taxation. Its purpose is to curb base erosion and profit shifting (BEPS) by ensuring that large multinational enterprises (MNEs) pay a minimum level of tax — 15% — in every jurisdiction where they operate. This initiative, part of the broader OECD/G20 Inclusive Framework, has been embraced by over 140 jurisdictions. It's designed to address the tax challenges caused by the digitalisation and globalisation of the economy.

Multinational corporate income tax: what it means

Jersey, a leading international financial centre, has responded to Pillar Two by introducing a multinational corporate income tax (MCIT) regime. Effective for accounting periods beginning on or after 1 January 2025, MCIT applies a 15% effective tax rate (ETR) to in-scope MNE groups with consolidated revenues of at least €750 million.

This regime operates alongside Jersey's existing 0/10/20 corporate tax introduced in 2009. That means Jersey can maintain its traditional tax model for the majority of companies ultimately owned by non-Jersey residents while ensuring that large MNEs are taxed in line with global standards.

	Traditional Jersey regime	MCIT regime
In-scope entities	All Jersey companies that are not part of a Pillar Two group	Only MNE groups within Pillar Two
Tax rate	0%, 10% or 20% depending on activities	15% ETR
Tax basis	Domestic tax law	OECD Pillar Two-aligned model
Compliance	Annual tax return	Additional MCIT registration and reporting
Impact	Most companies pay 0% tax	Up to 5% of Jersey companies affected

Although MCIT allows Jersey to collect taxes domestically, it is not a qualified domestic minimum top-up tax (QDMTT) under the Pillar Two framework. Instead, it's treated as a 'covered tax' for Pillar Two purposes. This means:

- Jersey's MCIT contributes to the calculation of an MNE's ETR in Jersey under the GloBE (global anti-base erosion model) rules
- It does not, however, prevent other jurisdictions from applying top-up taxes under the income inclusion rule (IIR) or undertaxed profits rule (UTPR) if the ETR in Jersey is below the 15% minimum.

In terms of Jersey's own adoption of these broader Pillar Two rules:

- It **has implemented the IIR**, allowing it to apply top-up taxes to the low-taxed profits of foreign subsidiaries of in-scope MNE groups
- It **has not adopted the UTPR**, which would allow it to collect top-up taxes on other low-taxed profits within the group (that are not otherwise captured by a QDMTT or IIR).

What are the implications for administration and compliance?

Jersey has launched a registration portal for in-scope MNE groups, requiring them to register before the end of their first fiscal period under the MCIT regime. This must be done by the group's designated reporting entity or an appointed tax agent. The reporting entity could be:

- The Jersey-based ultimate parent entity (UPE)
- A Jersey-based intermediate parent entity (IPE)
- A nominated Jersey entity, subject to approval by Revenue Jersey.

Entities must also submit an MCIT return by the due date. The return includes detailed financial data aligned with GloBE standards.

	For in scope Jersey companies with a year-end 31 Dec 2025
MCIT registration deadline	31 Dec 2025
MCIT return filing deadline	31 Dec 2026
MCIT liability payment deadline for: Instalment (50% of estimated MCIT due) Balance	31 May 2026 31 December 2026

MCIT: what to focus on

- Consider the exemptions available:
  - Certain entities are excluded from the scope of MCIT. These include investment funds and pension funds
  - There is also an exemption from MCIT where the average GloBE revenue for Jersey is less than €10m and the average GloBE income for Jersey is either a loss or a profit of less than €1m
- With the introduction of MCIT, Jersey companies' financial statements, which may have previously received limited tax scrutiny, are now central to compliance and the calculation of MCIT
- There are various elections available that can affect the amount of MCIT payable. But these should be considered carefully, particularly the interaction of these with Pillar Two.

What is our advice?

Jersey's adoption of the MCIT regime is a significant change in the tax regime for in-scope Jersey entities.

While there is ongoing global debate about **the future of Pillar Two** — particularly in light of proposed special arrangements exempting US parented groups from certain Pillar Two rules and the non-participation of major economies like India and China — Jersey's MCIT regime has already been legislated and Jersey remains committed to Pillar Two.

As the first MCIT filing deadlines approach, in-scope companies should proactively assess their readiness and consider key compliance requirements well in advance.

If you would like further information or advice relating to the issues covered by this article, please contact our experts.

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