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On the board agenda 2023

Autumn Regulatory Update

September 2023

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Foreword

Dear Board Member,

In the current environment, effective decision making requires constant attention to stakeholder issues and continuous reappraisal. Many companies are grappling with forecasting demand and pricing, supply chain disruption, other input cost pressures and challenges in attracting and retaining talent. The pace of technological change shows no sign of relenting and boards have to work hard to keep pace in order to remain ahead of the threats and opportunities such as the rapid developments in Generative AI.

There are a number of areas that boards can be getting on with to get ahead of the regulatory agenda, allowing more time for consideration of choices. In this Autumn Regulatory Update, at a time when there continue to be so many moving parts in the governance and reform agenda, we have two objectives:

- to provide a current status update on the regulatory landscape for boards; and
- to help you set the agenda for the year ahead.

It is with these issues and challenges in mind that we have constructed the content of this publication. We have drawn together, in one place, an overview of some of the key regulatory and governance boardroom topics, explained the latest position and directed you to where further resources are available.

We hope you find this publication a helpful and interesting read. We look forward to welcoming you at our discussions in the Deloitte Academy over the coming months to debate these topics in more detail.

Claire Faulkner
Deloitte Academy Governance Chair
September 2023

The regulatory agenda

The regulatory agenda

Through our series of 'On the board agenda' publications, we have been providing updates on the latest position in relation to the corporate governance reform agenda. In this article we explain the current status and expectations for the rest of this year. There remain a number of moving parts so this is mainly to ensure you have access to the latest insights but also a reminder of some calls to action for boards to prepare effectively for what is to come.

'Restoring trust in audit and corporate governance' – an update

It is now over a year since the Government published its response to the 'Restoring trust in audit and corporate governance' White Paper. Over the last few months there have been a number of steps forward towards implementation of the reform proposals.

Proposals where action has been taken

Audit Committees and the External Audit – the FRC has now published 'Audit Committees and the External Audit: Minimum Standard'. This is being introduced for adoption on a voluntary basis at present. The intention is that once the Audit, Reporting and Governance Authority (ARGA) is established, it will be given powers to enforce the Minimum Standard for the audit committees of FTSE 350 companies as recommended by the Competition & Markets Authority. See our newsflash for further details.

Changes to the UK Corporate Governance Code – the FRC issued a consultation on proposed changes to the UK Corporate Governance Code in May. This consultation included the two areas of the reform package to be implemented through the Code: the new board declaration on the effectiveness of risk management and internal control systems and enhanced transparency on malus and clawback arrangements.

Other changes to the Code are being consulted on at the same time, including changes to diversity reporting and wider responsibilities for the board, audit committee and remuneration committee in relation to sustainability matters, but these were not part of the reform package. See our newsflash for further details.

New reporting requirements – in July a Statutory Instrument was laid before Parliament setting out requirements for the Audit & Assurance Policy, the Resilience Statement, a statement on activities to prevent and detect material fraud and enhanced disclosures around distributions.

These amendments to the Companies Act are expected to apply to UK incorporated entities with 750 or more employees and annual turnover of more than £750m. For listed UK incorporated entities of that size the likely implementation date is periods commencing on or after 1 January 2025 and for unlisted UK incorporated entities of that size, one year later, for periods commencing on or after 1 January 2026. The draft regulations will be subject to debate in both Houses following the summer recess. See our newsflash for further details.

The regulatory agenda continued

Consultation on the Ethical Standard for Auditors – in August the FRC issued a consultation on revisions to the Ethical Standard. The proposed revisions enhance prohibitions where an audit firm's independence could be threatened by an economic over reliance on fees from specific entities that are connected and reflect relevant findings from audit inspections and enforcement cases. There are also changes to reflect significant developments in the International Ethics Standards Board for Accountants Code (see below) to ensure that the UK's Ethical Standard is no less stringent than the international code. The new standard has also been revised to ensure breaches of ethical standards are reported to the FRC on a more timely basis. Finally, the FRC is also consulting on the withdrawal of the Other Entities of Public Interest category introduced in 2019. This is in light of the government's proposed changes to the statutory 'public interest entity' definition (see below). The full consultation paper is available here and the deadline for comment is 31 October 2023.

Proposals where next steps currently uncertain

Establishment of ARGA and changes to the definition of 'public interest entity' – in May 2022, we saw the draft audit reform bill in the Queen's Speech demonstrating some commitment from the Government to move forward with those elements of the reform package requiring primary legislation. The draft bill has not moved through to consideration by the Houses during this Parliamentary session so we are now waiting to see whether the audit reform bill is included within the Autumn's King's Speech scheduled for 7 November. At the time of issuing this publication, there is speculation that this may not happen until a future date. In March 2023, the FRC published its three-year plan for 2023-2026, outlining its plans for the establishment of ARGA but acknowledging the lack of certainty on timing. Referencing their inclusion of an April 2024 date for commencement of ARGA, the plan included the following statement: "After considering the alternatives, we have opted to retain the 2024 assumption for the purposes of this Plan, whilst acknowledging the continued uncertainty around timing of legislation".

As a result of these updates, we repeat our previous calls for action for boards:

SCOPE – establish a clear understanding of how the new requirements will impact your organisation and consider getting ahead in the following areas if applicable to you

CONTROLS - continue the focus on your definition of, and monitoring and review of the effectiveness of internal controls (financial, operational and compliance controls as defined in the UK Corporate Governance Code, not just internal controls over financial reporting)

RESILIENCE - start to incorporate consideration of material resilience matters into your annual process and build capability in reverse stress testing

FRAUD - assess the quality of your fraud prevention and detection activities and consider how well it will stand up to public scrutiny

ASSURANCE - map out current assurance landscape on all key aspects of corporate reporting (including what will be reported on the effectiveness of internal controls) and build a clear understanding of different assurance offerings; consider developing your Audit & Assurance Policy for discussion at the Audit Committee and Board

DISTRIBUTIONS - ask for a review of distributable reserves across your group so that you can have a clear picture of the areas of the group where gaps in knowledge may exist and ensure that robust procedures exist around approval of proposed dividends

The regulatory agenda continued

IESBA Code changes

Changes to the International Ethics Standards Board for Accountants (IESBA) Ethics and Independence Code (the IESBA Code) took effect for periods commencing on or after 15 December 2022.

The changes impact all public interest entities as defined under the IESBA Code – this currently includes all listed entities, including entities quoted on the AIM market and on overseas markets (IESBA PIEs). It also includes banks, building societies and Solvency II insurers as they are defined as PIEs by UK legislation.

Key areas to be aware of in the updated IESBA Code include:

- An important **new requirement** for the audit committee to concur with their auditor's conclusion regarding the provision of any non-audit service with an eye to independence, including in respect of subsidiaries and parent companies.
- Some additional **non-audit services restrictions** for those IESBA PIEs that do not currently follow the FRC's list of permitted and prohibited services.
- **Requirements for disclosure** regarding non-audit services – this affects IESBA PIEs that are not captured by existing disclosure requirements, mainly overseas entities listed in the UK, listed universities and small or medium-sized entities listed elsewhere than the LSE.

Our publication Governance in Brief: New IESBA Code – what audit committees need to know is available here.

FCA proposals to replace premium and standard listing categories with a single listing category CP23/10 – Comment period ended – 28 June 2023

Another regulatory development to be aware of is this consultation paper from the FCA looking to strengthen the UK's position in global wholesale markets. The plans propose replacing the existing standard and premium listing share categories with a single listing category for commercial company issuers of equity shares (to be known as 'Equity shares in commercial companies' (ESCC)).

From the perspective of good corporate governance, the focus is on ensuring that investors continue to have the information they need to make initial and ongoing investment decisions. This would be supported by retaining the annual reporting requirements in relation to the UK Corporate Governance Code that exists for premium listed companies for this new ESCC listing category. If this were to go ahead, existing standard listed commercial companies would need to ready themselves for reporting against the UK Corporate Governance Code (both in terms of their appliance of the Code principles and their level of compliance with the Code's provisions).

This consultation was undertaken in advance of specific rule-making so there will be a second, more detailed, consultation which the FCA says will run on an accelerated timetable aiming to be complete by the end of 2023. At this stage the implementation timetable and any transition arrangements are not specified. See our newsflash for further details.

Generative AI – a developing landscape

Generative AI – a developing landscape

Deloitte's Digital Consumer Trends research paints an interesting picture. Everyone reading this article will have heard of – and put thought to the possibilities for – Generative AI. However, almost half of over 4,000 adults we surveyed in the UK between May and June (48%) had not heard of the technology, and of those who had used it, 43% mistakenly assumed that Generative AI always produces factually accurate answers.

Over four million people in the UK reported having used Generative AI tools for work purposes. Much of that activity will not have been sanctioned by companies, which are playing catch-up establishing policies and limitations on the use of these tools by employees while training can be developed and rolled out – and of course, planning for how to embrace the opportunities AI affords.

In this article we set out some of the initial considerations facing boards and the C-suite as they grapple with the challenge posed to future business and risk models by generative artificial intelligence capability – AI that creates original content that would previously have taken human skill and expertise to create.

There is far more to say about this area than can be covered in a short regulatory update, and so we recommend the Deloitte reports referenced here to you for further exploration and inspiration.

Generative AI is a rapidly-developing technology and proposals to regulate AI are developing no less rapidly. Government announced in late August that the UK will host a global AI Safety Summit in November 2023. Earlier in the year the White Paper A pro-innovation approach to AI regulation proposed statutory reporting requirements for large language models (LLMs) over a certain size and announced imminent research on best practice in measuring and reporting on AI-related risks.

Indeed, the final question of the FRC's consultation on the UK Corporate Governance Code asks whether there are any areas of the Code that respondents consider require amendment or additional guidance with regard to AI.

Generative AI applications

In Deloitte's publication A new frontier in artificial intelligence: implications of Generative AI for businesses, we predict that the market will unfold in six ways:

1. Although general purpose applications that can be used across industries or functions will likely be the first to deliver value, industry-specific applications will command a premium due to the dependence on proprietary data. As such, data will be a currency, creating new economies for access to proprietary and synthetic data.
2. All industries can benefit from Generative AI. However, data-rich sectors (such as banking, retail, hospitality) or those whose products leverage data (information services) may move —and should move—faster.
3. Costs will increase along with market interest rates, encouraging investment in applications with clear return on investment. As such, applications that reduce costs (e.g. chatbots), increase productivity or revenue (e.g. marketing copy) are likely to be adopted more rapidly and broadly than those that don't require human input.

Generative AI – a developing landscape continued

4 Text-based applications will be commercialised first, but the potential cost and productivity gains may be greater for higher-order tasks as these skills can be more expensive to recruit, take longer to train, and are creative rather than logical, making success subjective.

5 Regulatory actions will vary in speed, reach, oversight, and reporting requirements across major markets. As a result, companies will need to take the lead in establishing practices that ensure data quality, transparency, fairness, safety, and robustness.

6 Today, there are ethical concerns with Generative AI, including its potential to displace the workforce. However, like previous generations of AI, this technology will likely primarily augment human performance.

Driven by these predictions, there are a number of "no-regrets" actions that boards and C-suite can consider at this stage, if not already completed:

- **Education:** Educate the executive leadership team on the potential and risks of Generative AI to ensure a shared understanding and alignment on a path forward
- **Prioritisation:** Identify and prioritise a set of applications that could prove worthwhile for the business, especially in areas that have not yet been automated
- **Strategy:** Update or establish a clear technology strategy, including AI-ready talent (also see our article "Digital transformation: the board's role in leading change" in On the board agenda 2023)
- **Exploration:** Determine sources of competitive advantage, especially proprietary data, and begin curating these for the next wave of Generative AI applications
- **Engagement**: Proactively engage your ecosystem of advisors and partners to create a first-mover advantage, gain favourable pricing, and experiment with new solutions

Generative AI risks

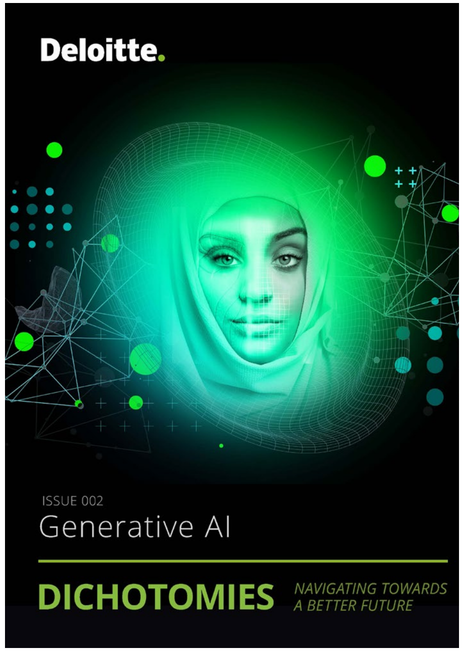
Generative AI can accelerate the pace of creative output across the business, but care needs to be taken to build in systems of checks and balances. Some key risks that boards should consider and manage, along with the usual risks inherent in technology development and digital platforms, include:

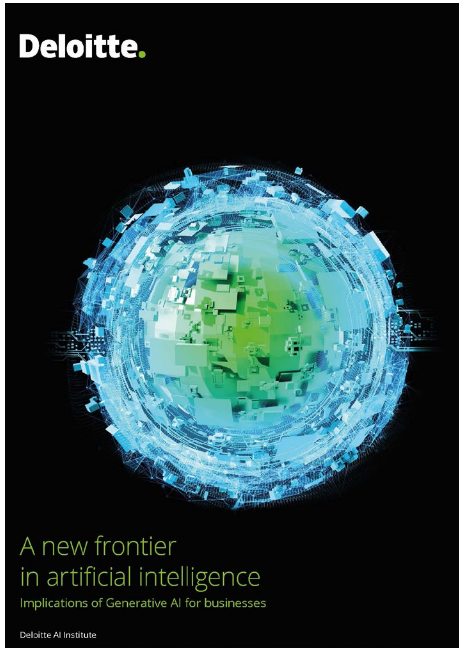
Security and risk Companies need to stay ahead of a rapidly evolving regulatory landscape while maintaining confidentiality of data	**Bias and discrimination** As the saying goes, "garbage in, garbage out": Generative AI is prone to mimicking biases and propagating discriminatory behaviour if implemented without guardrails and continuous monitoring	**Data privacy and IP protection** Models will be trained on a corpus of proprietary, often private data, requiring regulatory compliance and source traceability. Deloitte's Generative AI: A guide for corporate legal departments explores these issues and the associated legal challenges in more detail.
Trust Malicious actors using deepfakes, phishing and other attack methods, without citing data sources, will erode consumer trust.	**Costs** The cost of a query using Generative AI can cost up to ten times that of an index-based query. Although this will likely reduce over time, internal business cases and customer pricing should bear this in mind.	**The workforce** Today, the highest return on investment will come from augmenting human performance and improving productivity, however companies should plan for upskilling the workforce to mitigate the risk of job displacement.

Generative AI – a developing landscape continued

Deloitte's publication Generative AI Dichotomies: Navigating towards a better future explores case studies and considerations around some of the applications and risks of the technology on an industry by industry basis.

For many industries, Generative AI will not only be an opportunity, but a risk that should be considered and reflected in the emerging or principal risk disclosures in the annual report. We have already seen several companies refer to the opportunities of Generative AI – and in their half-yearly reports, a handful of companies have added reference to Generative AI as a principal risk that will be reflected in the 2023 annual report.





FRC Lab insight report: AI, Emerging Tech and Governance

In March the FRC Lab convened a round table including companies, academics, accounting bodies, investors and others.

The key findings included:

Governance: existing aspects of the UK Corporate Governance Code and the s172 regulations provide the framework to consider the implications of new technologies, including AI. The goal remains to effectively manage risks and opportunities to benefit the company and its stakeholders. The skills and training of boards are important considerations.

Response: has to be collaborative with a need to build and develop skills at all levels. The board does not need to be seen as experts. Rather, they can seek to enhance their understanding of the topic and to challenge management and external experts through use of considered questions and follow-ups.

Research: there is a lack of available, quality data and the academic community will be crucial in providing skills and equipping the workforce with practical AI and tech knowledge.

Sustainability reporting – focusing your attention

Sustainability reporting – focusing your attention

One of the key challenges faced by boards when evaluating how to respond to the regulatory calls for more sustainability and climate information is understanding which regulations apply to them.

In this article we set out some key areas in the shifting climate-related reporting landscape and explore scoping considerations to help boards decide where to focus attention in the closing months of 2023.

The shifting sustainability reporting landscape

This section covers the current status and activity relating to the main reporting frameworks that affect reporters in the UK. In addition, companies will often be expected to provide reporting meeting the needs of ratings agencies, lenders and sustainability reporting initiatives that provide either paid-for or publicly available data.

Existing reporting commitments	In the UK, there are a range of existing climate-related reporting obligations, including: • Strategic report: Non-Financial Reporting Information Statement; Section 172(1) Statement ; Streamlined Energy and Carbon Reporting (SECR) • TCFD: FCA and Government mandate UK climate reporting under TCFD recommendations or similar (already in effect for large or listed companies)
Recent activity by standard setters	• International Sustainability Standards Board (ISSB) under IFRS Foundation – IFRS S1 (general requirements) and IFRS S2 (climate) were published in June to be effective for annual periods beginning on or after 1 January 2024 • Exploration of nature and biodiversity – Task Force on Nature-related Financial Disclosures (TNFD) – next version due to be released in September
Regulatory adoption	Regulators are moving rapidly to adopt new standards and expectations from investors and other stakeholders: • EU rulemaking agenda: Corporate Sustainability Reporting Directive (CSRD), introduces mandatory disclosure for entities, with limited assurance, with notable extraterritorial effect • FRC proposes amending the UK Corporate Governance Code to incorporate sustainability, recognising the importance of the board in assessing sustainability-related risks, opportunities and impacts, setting targets, using appropriate internal controls and commissioning assurance • SEC proposed rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors
Investor driven initiatives	Accelerating action and requests for transparency on the financial impacts of climate-related and other sustainability matters, for example: • Climate Action 100+, an investor initiative driven by over 100 asset managers and owners to ensure the largest greenhouse gas producers take action

This is not an exhaustive summary given the breadth of the sustainability reporting landscape across different jurisdictions. Highly regulated industries will have more and different reporting obligations and companies in all industries need to consider other guidance issued to support the TCFD recommendations and the SASB metrics.

Sustainability reporting – focusing your attention continued

Scoping considerations – deciding where to focus your attention

So what needs to be on your radar as a director of a UK business? There are a range of UK Government, FCA and EU rules that already apply or will apply to many UK businesses, listed and otherwise. If your business is dual listed in the US or has significant subsidiaries there it will also be worth paying attention to the status of the SEC's Climate Rule.

In addition, if your business has a listing on a regulated market in the EU, the CSRD comes into effect very soon.

Requirement	Scope	Timing
FCA Listing Rules mandate reporting in line with the TCFD recommendations *	All premium listed commercial companies (LR 9.8.6R(8)) All standard listed commercial companies The largest asset managers and owners, life and personal pension providers	Already in effect
UK Government's mandatory climate-related financial disclosures (CFD)	UK public interest entities (thus capturing premium listed – debt or equity – and regulated banks or insurers) AIM companies – if they have over 500 employees Other UK companies and LLPs with more than £500m turnover and 500 employees.	Already in effect for periods commencing on or after 6 April 2022 (for December year end reporters, the 2023 report) (Note: there are differences to TCFD / Listing Rules requirements. For more analysis, see Deloitte's Need to know)

* The FCA Listing Rules require companies to take into account a range of TCFD supporting guidance which is updated regularly, including the Guidance for All Sectors and likely to include the TPT Disclosure Framework and Implementation Guidance once that is published in October. The Listing Rules currently require a "comply or explain" approach to disclosure in line with the TCFD recommendations; once the ISSB standards have been adopted for use in the UK (see below) the FCA intends to move to mandatory disclosure.

Requirement	Scope	Timing
EU regulations: Corporate Sustainability Reporting Directive (CSRD) driving adoption of European Sustainability Reporting Standards (ESRSs) –12 standards across a range of sustainability topics	All large companies listed on a regulated EU market	Periods starting on or after: 1 January 2024 if >500 employees; 1 January 2025 if <500 employees
	All large EU companies including subsidiaries of overseas parents (Large companies meet two or more of >250 employees, >€40m revenue, >€20m total assets)	1 January 2025
	Followed by smaller EU entities	1 January 2026
	Companies or groups **outside the EU** with >€150m revenue in the EU and at least one branch with >€40m revenue OR one large or listed EU subsidiary **	1 January 2028

** Discussions about interoperability with reporting required in other jurisdictions are ongoing. EFRAG publishes a mapping table and assessment of interoperability between ESRSs and ISSB standards. The EU intends in due course to publish a standard regarding the requirements for reporting by overseas businesses that will need to report for periods commencing on or after 1 January 2028 which is unlikely to align with ISSB standards.

Sustainability reporting – focusing your attention continued

Requirement	Scope	Timing
EU Green Taxonomy	All companies within scope of the Non-Financial Reporting Directive (NFRD), and within scope of the CSRD once in effect for those entities Non-EU companies offering financial products in the EU Non-EU subsidiaries of EU parent companies that may need to provide required information to their parent – reporting on proportion of activities that are environmentally sustainable	Currently applicable; for those entities that will become in scope for the CSRD as above, the timing for the EU Green Taxonomy will be identical
US Climate Rule	All accelerated, non-accelerated and large accelerated filers, emerging growth companies, some smaller reporters, and foreign private issuers (FPIs)	No date yet available

UK adoption of ISSB standards

The ISSB operates under the auspices of the IFRS Foundation. It was set up in November 2021 to develop high-quality sustainability disclosure standards that meet investors' information needs with the objective to create a comprehensive global baseline of sustainability-related disclosures. IFRS S1 (General requirements) and S2 (Climate) integrate the TCFD recommendations – indeed the ISSB will take over the monitoring activity currently undertaken by the TCFD from 2024.

Adoption of the same standards worldwide is needed to help achieve true harmonisation and avoid the risk of a fragmented approach to regulation. At present the EU's CSRD and mandatory ESRSs and the proposed US rule regarding climate disclosure diverge from IFRS S1 and S1.

Following the publication of the final IFRS S1 and S2 in June, during August both the Government and the FCA published their plans to evaluate and adopt the standards.

Sustainability reporting – focusing your attention continued

Government

The Government's UK Sustainability Disclosure Standards includes information on its framework to create UK Sustainability Disclosure Standards (UK SDS) by assessing and endorsing the global corporate reporting baseline of ISSB standards. The Department for Business and Trade (DBT) is responsible and aims to endorse the standards and create UK SDS by July 2024.

DBT has formed the UK Sustainability Disclosure Technical Advisory Committee (TAC) which has published a call for evidence on IFRS S1 and IFRS S2, which closes on **11 October 2023**.

FCA

The FCA has published Primary Market Bulletin 45: IFRS Sustainability Disclosure Standards.

FCA expects to consult in the **first half of 2024** on proposals to implement disclosure rules referencing UK-endorsed IFRS S1 and IFRS S2 for listed companies. Assuming the Government's endorsement process is completed in the timeframe envisaged, their aim is to bring new requirements into force for **accounting periods beginning on or after 1 January 2025.**

FCA also says it will continue to use thematic reviews in 2023/24 to consider TCFD-aligned disclosures, noting that standard listed companies are reporting for the first time.

Resources to help you get ahead

iGAAP in Focus – Sustainability reporting: ISSB publishes first IFRS Sustainability Disclosure Standards

Need to know: The UK climate-related financial disclosure regulations

Blog post: CFD vs TCFD – spot the difference

Need to know: European Commission consults on delegated regulation for European Sustainability Reporting Standards

iGAAP in Focus: EU Taxonomy – corporate reporting requirements

Corporate Reporting Insights: Climate transition plan disclosures, now and future

Keep up to date with the Academy's autumn series

Please scan the QR code below to view and register for our autumn series of climate and sustainability events.

Corporate reporting – areas of focus

Corporate reporting – areas of focus

This section is a reminder of some of the key matters to consider when preparing your annual report in the current environment.

Investors will be expecting clear disclosures around the effect of the global political environment on businesses and supply chains, as well as activity being undertaken to manage the current economic environment and inflationary pressure from cost inputs and wages. Sustainability and climate continue to be key areas of focus with investors looking for consistent, comparable, and timely information.

Reporting in the current environment

Uncertainty continues to permeate reporting considerations. In an interconnected world it is not always possible to isolate the wider economic effects of, for example, Russia's invasion of Ukraine from the increase in energy prices, increase in the general cost of living, or a myriad of other national or regional factors. However, many parts of the world are experiencing similar effects. We outline key considerations for financial reporting below. For further exploration of these topics, Deloitte has recently published Need to Know: Areas of Focus for Corporate Reporting (July 2023).

Topic	Reporting effects to consider
General inflation and interest rate rises	• Impairment of non-financial assets: an increase in market interest rates is an indicator to be assessed in determining whether an asset may be impaired • Measurement of longer-term provisions: inflation can impact the measurement, as its effects on future outflows of economic resources should be reflected either in the forecast cash flows or in the discount rate • Inventory: inflation may lead to products becoming less affordable and this could lead to write-downs to net realisable value and recognition of onerous contract liabilities in respect of purchase commitments • Pensions: inflation in salaries can be an important actuarial assumption for defined benefit obligations • Sensitivity analysis: where inflation is a major source of estimation uncertainty, consider presenting a sensitivity analysis as required by IAS 1 • Measurement of lease liabilities and right of use assets • Increase in expected credit losses • Increased importance of consistency of assumptions for discount rates and forecast cash flows

Corporate reporting – areas of focus continued

Topic	Reporting effects to consider
Increases in energy prices	The increase in energy prices and possibility of energy shortages due to the depletion of gas reserves could result in disruption to production, higher costs (particularly in energy intensive industries), higher revenues for energy producers and lower revenues elsewhere. This would all be relevant to an impairment review in ensuring that forecasts are properly updated and determining the appropriate disclosures. For example, a forecast of future energy prices might become a key assumption for the first time. Other effects could include changes in the value of energy derivatives, impacting hedge accounting or disclosures of market risks.
Government interventions	It is important to characterise these correctly either as a government grant in the scope of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, a tax benefit in the scope of IAS 12 Income Taxes, a below-market loan or potentially simply a lower cost than might otherwise be the case.

New areas to consider for this year's reporting: IFRS 17 for non-insurers

The key new financial reporting area to consider relates to the new IFRS 17: Insurance Contracts which has come into effect for periods commencing on or after 1 January 2023.

Insurance entities may wish to consider consulting Deloitte's publication Insurance disclosures for insurers applying IFRS 17, which covers illustrative presentation and disclosures under the new standard, however most insurers will have been preparing for IFRS 17 for some time.

The implications for non-insurers can also be substantial. Non-insurers will have to consider whether they have entered into contracts which may fall within the scope of IFRS 17 as transferring significant insurance risk.

IFRS 17 defines insurance risk as any risk other than financial risk transferred from the holder (policyholder) of the contract to the issuer. A good starting point is therefore to understand what risks are being transferred by a contract and then whether those risks are 'financial risks' or not using the definitions and examples in IFRS 17. This is an area where boards will wish to focus and to make enquiries of management as applying the accounting standard is challenging and some historical contracts and arrangements may require revisiting and analysis.

A Closer Look: IFRS for non-insurers includes a helpful flowchart to determine whether or not a contract may be in scope, case studies about particular types of contract and details about other accounting policy choices and the restrictions on those.

It highlights that there are multiple types of contract that can transfer significant insurance risk which may not previously have fallen to be accounted for under a specific insurance standard, including product / service warranties issued by a party who is not the manufacturer, dealer or retailer, fixed fee service or maintenance contracts that happen to transfer significant insurance risk, and insurance against product liability.

Corporate reporting – areas of focus continued

In our experience so far, performance guarantee contracts and fixed fee service contracts are areas where there can be substantial work to do, and in some cases accounting treatment will need to be determined on a contract-by-contract basis.

Disclosure of accounting policies

Under IFRS entities are now required to disclose "material accounting policy information" for periods commencing on or after 1 January 2023 – previously this was "significant accounting policies". This has been driven by recent amendments to IAS 1 and IFRS Practice Statement 2 Disclosure of Accounting Policies.

Critically, the amendments also highlight that immaterial accounting policy information should not obscure material accounting policy information, which is an area audit committees may wish to discuss with management and with the external auditor.

The FRC's Financial Reporting Lab is due to publish a project on materiality later in 2023.

SEC Rule: Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure

In July 2023, the SEC adopted its finalised Rule intended to enhance and standardise disclosures around cybersecurity. This will need to be adopted by domestic and foreign private issuers for annual reports for periods ending on or after 15 December 2023.

Key annual report disclosure requirements span risk management and strategy and governance components.

Risk management and strategy

- Describe the processes, if any, for assessing, identifying, and managing material risks from cybersecurity threats in sufficient detail for a reasonable investor to understand those processes.
- Describe whether any risks from cybersecurity threats, including as a result of any previous cybersecurity incidents, have materially affected or are reasonably likely to materially affect the business, including the business strategy, results of operations, or financial condition and if so, how.

Governance

- Describe the board of directors' oversight of risks from cybersecurity threats. If applicable, identify any board committee or subcommittee responsible for the oversight of risks from cybersecurity threats and describe the processes by which the board or such committee is informed about such risks.
- Describe management's role in assessing and managing the registrant's material risks from cybersecurity threats.

Taxation

Taxation

2023 has continued to be a year of change in taxation approach for individual countries and globally. In this article we flag some key changes that already have taken effect or are soon to do so in the UK, including from the Spring Budget. We also highlight major changes resulting from collective international action.

The UK environment: the Spring Budget

The Chancellor of the Exchequer, Jeremy Hunt, delivered the UK's 2023 Spring Budget on 15 March 2023. Policy announcements were aligned to the Government's four growth pillars of employment, education, enterprise and everywhere. A package of measures was released to boost the UK labour supply, with incentives targeted at high-growth sectors and encouraging capital investment. The key measures announced were as follows:

- The Chancellor resisted calls to cancel the increase in the main corporation tax rate from 19% to 25%, which has taken effect as planned from 1 April 2023, as enacted in June 2021 and reaffirmed in the Autumn Statement 2022. The 25% rate confirmed in the Spring Budget 2023 is already applicable for the purposes of calculating deferred tax under IFRS, UK GAAP and US GAAP.
- The Government re-affirmed the commitment made in the Autumn Statement 2022 to implement the G20-OECD's Pillar 2 framework in the UK, starting with accounting periods commencing after 31 December 2023. The Finance Bill was substantively enacted in the UK on 20 June 2023.
  - The Finance Bill has introduced a multinational top-up tax (aligned to the 'Income Inclusion Rule' under the OECD's model rules) which will require large UK headquartered multinational groups to pay a top-up tax where their foreign operations have an effective tax rate of less than 15%.
  - These rules can also apply to UK subsidiaries of foreign groups, in relation to the foreign operations held by those UK subsidiaries.
  - The Finance Bill also includes legislation for a domestic top-up tax, expected to represent a 'Qualifying Domestic Minimum Top-up Tax' under the OECD framework, which will apply where the UK operations of large businesses have an effective tax rate of less than 15%.
- As part of the Government's intention to encourage capital investment, the Chancellor has announced a 100% first-year capital allowance for qualifying plant and machinery expenditure, known as full expensing, and a 50% first-year allowance for qualifying special rate assets. The amount of expenditure that can qualify for these reliefs is uncapped.
  - The measure effectively replaces the super-deduction regime, whereby companies could claim a 130% tax deduction on qualifying capital expenditure based on the 19% corporation tax rate. The super-deduction regime ended, as planned, on 31 March 2023.
  - Full expensing will apply to capital expenditure incurred on plant and machinery assets, subject to eligibility criteria, including the requirement that the expenditure is not incurred on second-hand assets, cars, or assets purchased for leasing to another party.
  - The measure came into effect on 1 April 2023 and will apply to expenditure incurred on or after 1 April 2023 but before 1 April 2026.
- As announced in the Autumn Statement 2022, the Government will proceed with reforming the R&D Expenditure Credit (RDEC) regime for both large companies and SMEs. This includes an extension of the relief available to large companies from 13% to 20% for expenditure from 1 April 2023 (giving effective relief of 15%, as RDEC is a taxable credit), alongside a reduction in the scope of the SME regime. The proposed exclusion of overseas expenditure from R&D claims under both schemes has been delayed, and will now take effect from 1 April 2024. However, additional information requirements relating to supporting documentation have been brought forward and apply to all R&D claims made on or after 1 August 2023.

Taxation continued

Global tax reform: significantly increased compliance requirements

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting reached political agreement on the key components of the two-pillar approach to international tax reform in 2021. 2023 has seen a move into the implementation phases, particularly for Pillar Two, and most global businesses of any scale are likely to be affected both by the tax rate implications and by the compliance requirements.

> It is important for boards to be aware of the issues as action is required in 2023 ahead of a scheduled implementation of the Pillar Two rules starting from January 2024. Boards should note the potential implications on the group's effective tax rate and take care not to underestimate the significantly increased compliance requirements – where tax affairs are complex and cross-border, the requirements can be burdensome to implement.
>
> The tax affairs of large groups have become much more complex: groups should also monitor the timetable for legislative enactment in individual jurisdictions (see below for the UK) and consider the extent to which disclosures on the future impact of these rules should be included in the financial statements.

- **Pillar One: Nexus and profit allocation rules**
  Amount A (a new taxing right allocating a share of global residual profit to market countries) targets the largest multinational groups focusing initially on those with at least EUR 20 billion of consolidated revenue and net profits of over 10% (i.e. profits before tax to revenue). Exclusions apply for the extractive sector and regulated financial services. A formulaic approach will be used to allocate a percentage of global profits to market jurisdictions for tax purposes, i.e. countries where customers and users are located. The Amount A rules will take effect in 2024 if agreed by a 'critical mass' of countries, including the US.

  Amount B is a fixed return for defined 'baseline marketing and distribution functions'. On 17 July 2023, the OECD/G20 Inclusive Framework on BEPS ("OECD inclusive framework") published a public consultation document containing updated design elements of Amount B of Pillar One and outlining a new process for pricing baseline marketing and distribution activities in accordance with the arm's length principle. This update follows a consultation on the main design elements of Amount B in December 2022. Comments on the pricing framework are invited by 1 September 2023. Amount B rules will be incorporated into the OECD transfer pricing guidelines by January 2024. Further work will be undertaken by the OECD inclusive framework in respect of implementation, including whether Amount B should be a "safe harbor." The implementation timetable will take account of the time businesses need to prepare.

- **Pillar Two: Global minimum tax**
  Pillar Two introduces a minimum effective tax rate of at least 15% in each jurisdiction, calculated based on a specific accounting-based ruleset. Groups with an effective tax rate below the minimum in any particular jurisdiction would be required to pay top-up tax in their head office location or in the location of other affiliates. The tax would be applied to groups with revenue of at least €750 million, making it far more widely applicable than Amount A under Pillar One. Countries are also able to introduce domestic rules to tax local businesses including wholly domestic businesses.

Taxation continued

Reporting implications

The Finance Bill No2 2023, which includes the UK's implementation of the OECD Pillar Two tax rules, was substantively enacted on 20 June 2023.

Amendments to IAS 12 Income Taxes were published in May to introduce a temporary exception for accounting for deferred taxes arising from the implementation of the Pillar Two model rules, together with targeted disclosure requirements for affected entities. This was endorsed for use in the UK on 19 July 2023.

UK entities must therefore apply the temporary exception introduced by the amendments, and disclose that this has been applied, for full-year accounting periods beginning on or after 1 January 2023.

Resources to help you get ahead

Tax At Hand is our website providing regular tax news updates

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Audit committees and external audit

Audit committees and the external audit

In May, the FRC issued 'Audit committees and the external audit: Minimum Standard' setting expectations for audit committees in their oversight role of external audits. Also connected to audit committee responsibility, at the start of June, the Audit Committee Chairs' Independent Forum issued the 'Spring Report: a combined perspective on enhancing audit quality' reflecting a collaboration between audit committee chairs, the audit firms and the FRC. In this article we highlight the key matters for members of audit committees to consider in shaping their agendas.

Audit Committees and the External Audit: Minimum Standard

This new Standard has been launched by the FRC as a direct response to the Government's consultation on Restoring Trust in Audit and Corporate Governance, which expressed the intention to grant statutory powers to ARGA (the Audit, Reporting and Governance Authority) for mandating minimum standards for audit committees in their role on external audits.

The primary objective of the Standard is to enhance performance and ensure a consistent approach across audit committees within the FTSE 350. By setting clear expectations and guidelines, the FRC aims to support the delivery of high-quality audits and reinforce public trust in the financial reporting process.

There are a number of other matters to be aware of:

- Until the establishment of ARGA, the FRC does not have powers to enforce the Standard and so until that time, the intention is that the Standard is adopted on a 'comply or explain' basis and companies are encouraged to begin to apply the Standard as soon as they are able;
- The FRC states that the majority of the text in the Standard is taken from existing publications including the UK Corporate Governance Code, Guidance on Audit Committees and Audit Tenders: Notes on Best Practice. The key new aspect is primarily to reflect the Government's focus on diversity in the audit market; and
- The Standard was intended to be applicable to the FTSE 350 only and it is likely to remain the case that, when ARGA receives the necessary powers, enforcement will only apply to those audit committees. However, the recent consultation on changes to the UK Corporate Governance Code proposes that following the Standard is a responsibility for all audit committees of premium listed companies through the 'comply or explain' provisions of the Code.

The content of the new Standard

In addition to an initial section on 'Scope & Authority', the Standard comprises the following sections:

Responsibilities

This section reflects the audit committee responsibilities set out in the UK Corporate Governance Code in relation to the external audit but also includes some additional responsibilities:

- requiring that the company manages its non-audit relationships with audit firms to ensure that it has a fair choice of suitable external auditors at the next tender and in light of the need for greater market diversity and any market opening measures which may be introduced;
- engaging with shareholders on the scope of the external audit (where appropriate); and
- inviting challenge by the external auditor, giving due consideration to points raised and making changes to financial statements in response where appropriate.

Audit committees and the external audit continued

Tendering

This section of the Standard includes the recommendations from the FRC's 'Audit Tenders: Notes on Best Practice' but also incorporates considerations of the need to expand audit market diversity and challenges to those firms eligible to participate in a tender process but who choose not to and how that is in the public interest. In particular, the Standard states "The Audit Committee should remind eligible firms that refuse to tender that they may as a result be ineligible to bid for non-audit services work."

Oversight of auditors and audit

This section emphasises the need for the audit committee to create a culture which recognises the work of and encourages challenge by the auditor. The Standard also notes that engagement level Audit Quality Indicators can be used as evidence of the effectiveness of the external audit and the auditor.

Reporting

The audit committee will be required to report on the activities it has undertaken to meet the requirements of the Standard. Where, in line with the new responsibility to engage with shareholders on the scope of the audit, shareholders have requested that certain matters be covered in an audit and that request has been rejected, an explanation of the reasons why should be provided.

Audit tendering: reporting under the new Minimum Standard

We have surveyed 25 of the most recent FTSE 350 companies that have both undertaken an external audit tender and published their subsequent annual report to assess how they measure up to the expectations in Minimum Standard Provision 25.

You can access the full survey here.

Key takeaways

- 68% of audit committees described their auditor selection criteria. All but one described at least one audit quality measure
- Of those that described selection criteria, 41% considered price or cultural fit, which the Minimum Standard indicates should not influence the choice of auditor
- Only 40% described an audit tendering process that was clearly led by the audit committee
- 28% of audit committees reported that public reports published by the FRC or other regulators had been used in the selection process
- 64% of our sample were conducting a tender at the ten-year mark where they could reappoint the incumbent. Of these, half chose to change auditor

Audit committees and the external audit continued

The Spring Report: a combined perspective on enhancing audit quality

At the end of 2022 the Audit Committee Chairs' Independent Forum (ACCIF) formed a working group of experienced audit committee chairs, auditors and FRC executives to discuss how they could further advance their common objective to enhance audit quality. The Spring Report sets out a summary of the outcomes of the discussions held. The first three sections of the report summarise the learnings identified for each phase of the audit (planning, execution, and completion & reporting). Section 4 addresses a specific question discussed by the group in relation to how a good audit can be conducted of a more challenging company and the final section sets out the next steps that each stakeholder group have agreed to consider in response to the project.

As well as emphasising the fundamental importance of planning and risk assessment in a successful audit, another key message is that delivering a high-quality audit relies on the auditor, management and boards and their audit committees working effectively together. The Spring Report is a public call to action to companies, auditors and the FRC. The FRC have said they will use their report in their revision of the Audit Quality Review process.

You can access the full report here.

Other relevant materials for audit committees:

- The FRC's Audit Quality Review reports on each of the audit firms – issued on 6 July 2023, the reports on the Tier 1 Audit Firms are available here.
- A consultation on the FRC's Ethical Standard (see page 7 for more detail)

Contacts

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The Deloitte Academy

The Deloitte Academy provides support and guidance to boards, committees and individual directors, principally of the FTSE 350, through briefings on relevant board topics.

Members receive copies of our regular publications on Corporate Governance and a newsletter highlighting upcoming briefings and recently published insights. Also a dedicated members' website www.deloitteacademy.co.uk is made available so members can register for briefings and access additional relevant resources.

For further details about the Deloitte Academy, including referring colleagues for membership, please email enquiries@deloitteacademy.co.uk.

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