Audit Committee Network technical update

19 June 2024

Agenda

Timings	Session	Facilitator
10.00am	Welcome and introductions	Ian Chambers
10.05am	Regulatory and Public Policy matters	Jayne Kerr / Harriet Barker
10.30am	Accounting update	Peter Hogarth
10.50am	Corporate Reporting & Governance update	Mark O’Sullivan / John Patterson
11.15am	**BREAK**	15 mins
11.30am	Tax reminders	Tom Dane
11.55am	Focus on AI	Gary Rapsey
12.25pm	Closing comments, followed by lunch	Ian Chambers

Regulatory and Public Policy matters

Jayne Kerr
Harriet Barker

The Spring Report - One year on

The Spring Report: A combined perspective on enhancing audit quality was issued one year ago. Below we recap the project and follow up plans, one year on.

The Spring Report

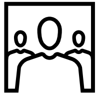
- ACCIF initiative to bring the FRC, Audit Committee Chairs (‘ACCs’) and firms together to discuss audit quality and the role each has to play.
- Final report issued in June 2023. Here is a link to the full report and a link to a summary version
- Participating groups committed to certain actions
- The report emphasises that audit quality needs all parties in the ecosystem to work together.

One year on

- In June 2024, ACCIF are reconvening the participating groups to understand the actions each group has taken, the impact the report has had in the audit ecosystem and what more needs to be done.

ICAEW Audit & Assurance Conference 2024

On 10 June 2024, the ICAEW's Audit & Assurance Facility held its annual conference for 2024 entitles Sustainability Assurance - Embracing the future. The agenda focused on sustainability assurance but also covered sustainability reporting. Key messages we heard during the event are summarised below.



What we heard…

- Companies were encouraged and reassured to make whatever steps forward in sustainability reporting and transition plans that they are able to .
- Interoperability between reporting standards continues to headline discussions, but there is progress in global standards such as ISSA 5000.
- As EU territories transpose the CSRD into law, UK equivalence continues to be an issue and international divergence continues to be observed.
- Heard from Chief of Strategic Affairs and Capacity Building, IFRS Foundation, discussing progress in upskilling reporters and the regulator.
- Rewired Earth shared the progress they were making in global supply chains to enable sustainable data collection.

UK regulatory reform developments

Financial Reporting Council

UK Corporate Governance Code

We continue to regularly present to Audit Committees, Boards and Finance personnel on regulatory developments.

Following direct engagement with the FRC we understand there is no immediate plan for further guidance regarding the company’s or auditor's responsibilities regarding the new declaration under the Code.

Ongoing activities

Assurance of sustainability reporting market study
The first study of its kind for the FRC, aims to 'ensure this rapidly growing market is functioning effectively and providing high quality assurance over companies' sustainability reporting'. Response period closed 13 June 2024.

Stewardship Code
A three-staged review which attempts to encourage better interaction between asset managers and the companies that they invest in. Activities in response will continue throughout 2024, with the revised Code expected in early 2025.

ISA (UK) 250 Section A and B
The FRC’s consultation which included proposals to strengthen auditor requirements to detect and report material misstatement from non compliance with laws and regulations closed earlier this year. Not yet clear what the outcome will be.

UK Government

Business and Trade Select Committee

In March, a Select Committee was held to question stakeholders (including Sir John Kingman, Professional Bodies, audit firms the FRC and the responsible minister) about the Government’s lack of progress with the reform agenda.

Somewhat unfinished business when the general election was called. Not yet clear what will happen to this committee and the report after the election.

International regulatory reform developments

PCAOB - Firm and Engagement Metrics & Firm Reporting

In April, 2024, the PCAOB issued two proposals that would significantly expand public reporting by audit firms about their audits and audit practices - Firm and Engagement Metrics and Firm Reporting.

Proposing metrics in 11 areas are publicly disclosed at both the firm and individual engagement level.

PCAOB - NOCLAR Roundtables

On June 6, 2023, the PCAOB proposed amendments to its auditing standards related to a company's noncompliance with laws and regulations.

On March 6, 2024, the PCAOB held a virtual public roundtable to engage with stakeholders and reopened its comment period.

Will impact audits of UK Foreign Private Issuers

Accounting update

Peter Hogarth

IFRS 18: Presentation and Disclosure in Financial Statements

Major new IFRS Standard issued in response to investor demands for better and more transparent information

- Replaces IAS 1 as the new standard on the presentation of financial statements.
- Effective for annual financial reporting periods beginning on or after 1 January 2027.

Key changes:

1 Structure of the statement of profit or loss

- Introduction of operating, investing and financing categories.
- Mandatory sub–totals, including operating profit.

2 Management–defined performance measures

- Defined subset of APMs.
- Mandatory disclosure requirements, including reconciliations.

3 Aggregation and disaggregation principles

- Judgement based on characteristics of items.

IFRS 18: What is a ‘management-defined performance measure’?

A management-defined performance measure is **a subtotal of income and expenses** that:

(a) an entity uses in public communications outside financial statements;

- Public communications **include** management commentary, press releases and investor presentations.
- Public communications **do not include** oral statements and social media posts
- The requirement relates to measures covering the **same time period** as the financial statements

(b) an entity uses to communicate to users of financial statements management’s view of an aspect of the financial performance of the entity as a whole; and

- **Rebuttable presumption** that a subtotal used in public communications does communicate management’s view.
- To rebut this, need to understand **why** a measure is included if it does not represent management’s view. An example would be if a regulator requires disclosure of a measure.

(c) is not specifically excluded from being an MPM, or specifically required to be presented or disclosed by IFRS Accounting Standards.

Examples of specific exclusions:

- Gross profit or loss
- Operating profit or loss before depreciation, amortisation and impairment
- Operating profit or loss and income and expenses from all investments accounted for using the equity method

Key changes to FRS 102

Revenue

- Five-Step Model
- Model entirely different to current FRS 102 revenue accounting
- May lead to different accounting outcomes

Leases

- On-balance sheet model
- Key challenges - Identification of leases and systems set up
- Decisions to be made on use of practical expedients

Other Changes

- New disclosures for supplier finance arrangements in the cash flow statement *
- Most sections changed to some degree
- Small companies

Effective for years commencing on or after 1 January 2026 (except *)

What else to think about in June 2024 interims

Accounting changes

Sale & leaseback (amendment to IFRS 16)

Disclosures to plan for

Supplier finance

Non-current liabilities with covenants

Pillar II

Now effective in UK.

Disclose:

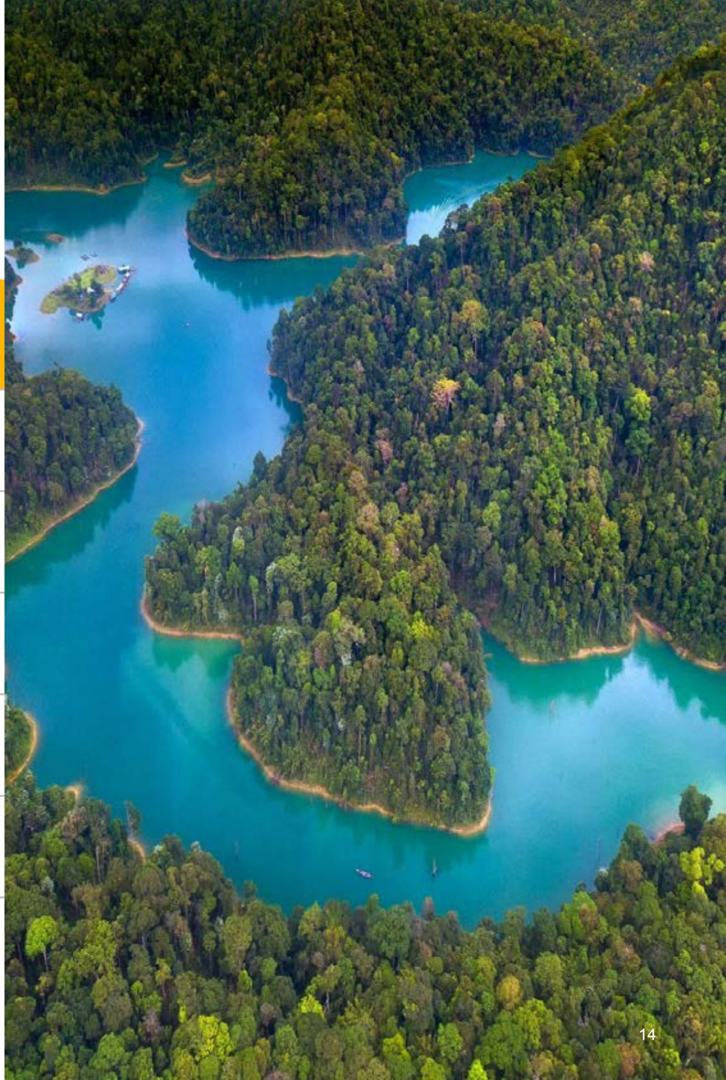
- Current tax expense related to Pillar II
- Use of deferred tax exception

Corporate Reporting & Governance update

Mark O'Sullivan
John Patterson

Agenda

Topics
Global ESG regulatory landscape
UK Sustainability reporting landscape
Climate reporting in the current reporting cycle
Non-financial reporting review: UK Government Proposals
IoD consultation: Code of Conduct for Directors



ESG landscape and headlines

Europe:

- The **Corporate Sustainability Reporting Directive (CSRD)** in the European Union is now effective for the first tranche of reporters, even as Member States work toward the July 2024 transposition.
- Related reporting standards - the European Sustainability Reporting Standards (ESRS) - finalised 2023.
- First wave of reporters in 2025 for Dec 2024 year ends

International:

- In June 2023, the first two IFRS Sustainability Disclosure Standards were issued by the **International Sustainability Standards Board (ISSB)**.
- ISSB to commence research projects on R&Os related to nature and human capital
- As of March 2024 five jurisdictions (incl Turkey, Bangladesh and Brazil) have adopted on a voluntary or mandatory basis while another 11 are planning to adopt in the future (eg Australia, Canada and UK)

United States:

- In October 2023, four landmark sustainability disclosure bills were signed into **California law**, three of which require climate-related disclosures.
- In March 2024, the **Securities and Exchange Commission** adopted final rules designed to enhance public company disclosures related to the risks and impacts of climate-related matters.
- In May 2024, SEC stayed climate disclosure rules to “facilitate the orderly judicial resolution” of pending legal challenges.

A delayed pipeline

Sustainability Disclosure Requirements: Implementation Update 2024

International Sustainability Standards Board (ISSB)

- Make UK-endorsed ISSB standards available in **Q1 2025.**
- Consult on following proposals Q2 2025:
  - FCA introduce requirements for UK-listed companies
  - Requirements for other UK companies
- UK Sustainability Disclosure Technical Advisory Committee (TAC) and Policy and Implementation Committee (PIC) established
- Changes effective no earlier than periods beginning **1 Jan 2026**

Transition plan

- Commitment to introduce transition planning disclosures requirements.
- UK transition plan taskforce disclosure framework published **Oct 2023.**
- Final set of resources, including sector deep dives published **April 2024**
- FCA will consult on strengthening its expectations for transition plan disclosures as part of its ISSB consultation
- Government consult **shortly** on how UK's largest companies can effectively disclose its transition plans

UK green taxonomy

- GTAG established to provide non-binding technical guidance.
- Expects to consult in '**due course**' on the proposed UK Green taxonomy
- Initially expect companies to report voluntarily (at least 2 years).

Taskforce for nature-related financial disclosures (TNFD)

- Final TNFD framework published **Sept 2023.**
- Encourages companies to:
  - engage with TNFD UK National Consultation Group
  - follow with interest ISSBs future priorities

Regulatory focus

Climate themes arising from CRRT review

Since March 2022, the Corporate Reporting Review Team (CRRT) has published the queries it has sent to companies based on their published annual reports. The main themes of these are set out below.

Listing rule compliance

CRRT has challenged all aspects of listing rule compliance including whether there is a clear statement of consistency. Companies are continuing to be challenged about whether stating full consistency is the appropriate conclusion e.g. a number of the reviews queried whether companies had appropriately considered the non-disclosure of all material scope 3 emission categories.

Climate change in the financial statements

CRRT has challenged companies about the connection between the front half disclosures and the financial statement disclosures. In particular challenging how the information disclosed in the front half has been considered in the financial statements. Example of areas they have challenged, segmental reporting, financial impact of transition plans, impairment reviews, forecasting.

Other points raised

01 Streamlining reporting

02 Clearer descriptions of risks and opportunities

03 Describe material movements in Scope 3 emissions

04 Clearer definition of Net Zero

05 Links between material metrics and CRRO's

06 Clearer narrative on carbon reduction targets and related timelines

07 SECR

Climate-related financial disclosures

Reflections from the first year of adoption

Existence & placement

Relevance

Materiality & Balance

NFSIS for group companies

Common issues with climate change reporting

Complexity - but limited value in some areas?

Parent companies

- Where group annual report and accounts not prepared
- Parent (or intermediate parent) entity still needs to consolidate the group that it heads in order to apply the (differing) size thresholds for reporting on:
  - NFSIS
  - SECR
- Reporting is only for the parent entity however

Subsidiaries

- Subsidiaries are generally exempt from preparing a NFSIS or SECR when they are included in a group's report on the same requirements
- But this exemption is not available where there is no UK consolidation
- Groups sometimes need to develop a means to split SECR emissions information between subsidiaries when the information is not collected in this way
- Ultimately - follow the activity

Re-basing

- SECR is largely about demonstrating progress in reducing emissions against a base year
- Companies need to re-base when there are developments in the business, including M&A
- Questions arise in relation to: the year of change the comparatives
- Usually want a full year's emissions in every reported year
- Comparatives only change if misleading to leave the same

Non-financial reporting review: simpler corporate reporting

UK Government plans and consultation

Recap

- Smarter regulation non-financial reporting review, closed Aug 2023
- UK greenhouse gas emissions reporting: Scope 3 emissions, closed Dec 2023.
- March 2024 announced plans (Summer ‘24) to:
- Uplift monetary thresholds
- Exempt certain directors report disclosures

Directors’ report

- Use of financial instruments
- Important events affecting the company since the end of the financial year
- Likely future developments in the business of the company
- R&D activities of the company
- Branches of the company outside the UK
- Employment of disabled persons
- Engagement with employees and engagement with suppliers and customers

Consultation proposals

- Increase the limit to qualify as a medium-sized company from 250 to 500 employees.
- Exempt private medium-sized companies from producing a strategic report.

Institute of Directors

Consultation on a Code of Conduct for Directors

Code structured around six key Principles of Director Conduct, inspired by the Seven Principles of Public Life (or 'the Nolan Principles' published by the Committee on Standards in Public Life in 1995).

IoD Commission chaired by Lord (Iain) McNicol.

Leading by example: Demonstrating exemplary standards of behaviour in personal conduct and decision-making.

Accountability: Taking personal responsibility for actions and their consequences.

Integrity: Acting with honesty, adhering to strong ethical values, and doing the right thing.

Fairness: Treating people equitably, without discrimination or bias.

Transparency: Communicating, acting and making decisions openly, honestly and clearly.

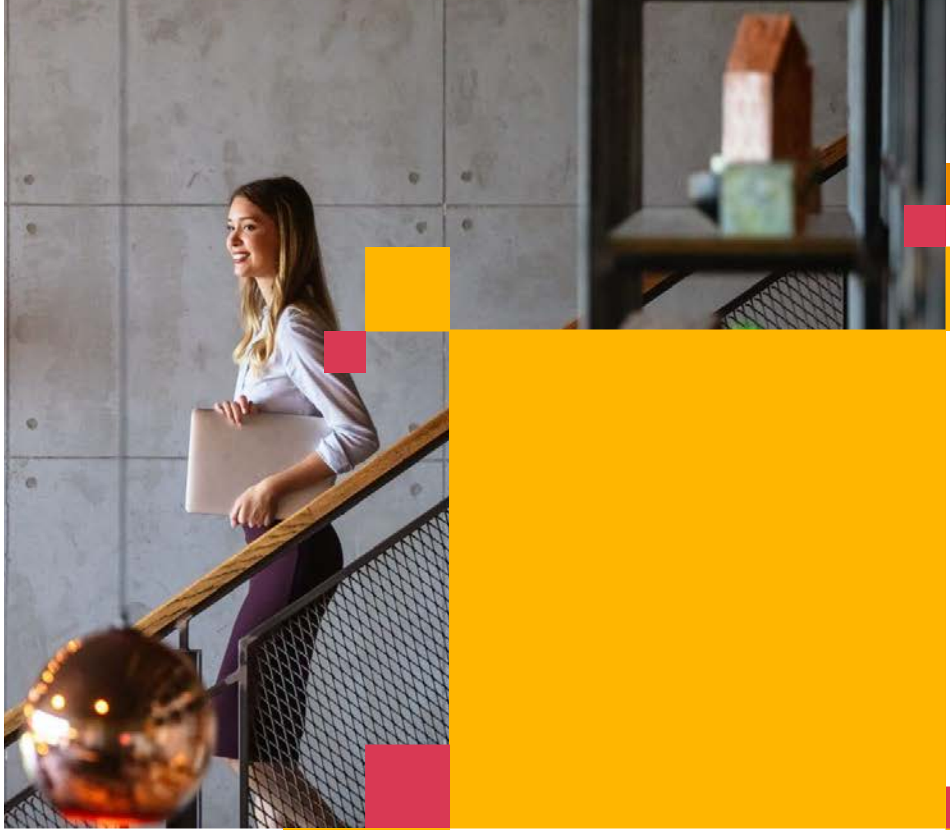
Responsible business: Integrating ethical and sustainable practices into business decisions, taking into account societal and environmental impacts.

Example of Undertakings related to the Transparency Principle:

As a director, I undertake to:

- Be open and transparent to the rest of the board and relevant stakeholders in respect of anything that might be perceived as affecting my objectivity (such as a conflict of interest).
- Promote an open business culture which does not cover up wrong-doing or mistakes.
- Encourage the adoption of 'speak up' mechanisms which enable employees and other relevant stakeholders to report concerns about any misconduct or actions that are not aligned to the organisation's values.
- Communicate with stakeholders in a straightforward and accessible manner, providing proactive, relevant and timely information.
- Be candid with stakeholders about the limits of transparency (such as information of a commercially sensitive nature).

BREAK



Tax reminders

Tom Dane

The wider tax sustainability reporting agenda

Public CbCR is one of a range of established and emerging sustainability reporting regimes that touch on tax. The complexity that arises from the interaction of these regimes pose a number of challenges for taxpayers.

Tax Sustainability Reporting Regimes

- CSRD
- EU Taxonomy
- GRI 207
- (Public) CbCR
- S&P Global Corporate Sustainability Assessment
- World Economic Forum TTC Metric
- OECD Guidelines for Multinational Enterprises
- B Team Responsible Tax Principles

Taxpayer Challenges

- Cross business impact
- Materiality Single or Double
- Scoping is complex
- Interoperability with various reporting requirements
- Data availability & processing
- Assurance
- Ensuring connectivity other reporting
- Value chain

EU Public Country by Country Reporting (‘CbCR’)

Scope

- Multinational companies (MNCs) with a total consolidated revenue of at least EUR 750 million are required under the EU public CbCR Directive to publicly disclose certain tax and financial information on a country by country basis.
- Applies to EU headquartered groups and non-EU headquartered groups with a medium- or large-sized subsidiary or branch in the EU
- Data is to be disaggregated for EU Member States and “black and greylist” countries. Any data on the stateless line need to be allocated to tax jurisdictions.

Audit requirement

- Auditors have to confirm if a company has a requirement to publish a CbCR report and whether it has done so in the required manner (e.g. by the deadline, freely available on a website).

Effective dates

EU Directive: Financial years beginning on or after 22 June 2024 with publication within 12 months of year end. i.e. for December year ends publication of FY25 data in 2026.

Some EU Member States have earlier reporting deadlines, notably **Romania** for financial years beginning on or after 1 January 2023.

Country variations

There are some variations in the way that Member States have implemented the EU pCbCR Directive, but where a group is headquartered in the EU we expect it to be sufficient to follow the rules of the country in which its ultimate parent entity is based.

For more information on country variations, please see our tracker.

Australia Public Country by Country Reporting (‘CbCR’)

Status

- A bill containing a public CbCR requirement was introduced to the Australian parliament on 5th June 2024 and while it still needs to be enacted, further significant changes are not expected. This follows a consultation on an exposure draft in February 2024 and an initial draft bill in 2023.

- More information on the Australian regime is available here.

Scope

- The rules will broadly apply to groups with an Australian presence (an Australian resident entity or an Australian permanent establishment), global consolidated income of more than AUD 1 billion in the prior year, and AUD 10 million or more of aggregated Australian sourced income in the current year.

Effective date

- Once enacted, the rules will apply to years beginning on or after 1 July 2024. For December year-end groups, the 31 December 2025 year will be the first year for which public CbC reporting is required in Australia.

A comparison of CbCR data requirements across different regimes

CbCR data requirements	GRI 207-4	OECD	EU pCbCR	Australia (June 2024 draft bill)
Total Revenue	❌	✅	✅	❌
Revenue from third parties	✅	✅	❌	✅
Revenue from related parties	Between jurisdictions only	✅	❌	✅*
Profit/loss before tax	✅	✅	✅	✅
Cash tax paid	✅	✅	✅	✅
Tax accrued	✅	✅	✅	✅
Tangible assets other than cash and cash equivalents	✅	✅	❌	✅
Number of employees	✅	✅	✅	✅
Total accumulated earnings	❌	✅	✅	❌
Stated Capital	❌	✅	❌	❌
A description of the country by country reporting group's approach to tax	✅	❌	❌	✅*
Explanation as to why income tax accrued (current year) differs from headline tax rate multiplied by profit/loss before tax	✅	❌	❌	✅**

*Per GRI 207
**This does not apply to RoW (aggregated)

10-Step plan for publishing CbCR data

01

Stakeholder Engagement
Action: Form a cross-functional team, develop an internal communication strategy, and secure senior management endorsement.
Outcome: A unified approach to tax reporting and a reinforced commitment to responsible tax practices.

02

Confidence In Your Data
Action: Integrate data verification into the Tax Control Framework and perform regular checks.
Outcome: Reliable and consistent CbCR data that aligns with tax strategy.

03

Reconciling with Financial Statements
Action: Reconcile CbCR data with financial statements and provide clear explanations for discrepancies.
Outcome: Transparent financial narrative and enhanced reporting credibility.

04

Trend Analysis and Outliers
Action: Analyse CbCR data to identify trends and investigate outliers.
Outcome: Economic narrative and preparedness for stakeholder inquiries.

05

Peer Benchmarking Analysis
Action: Execute benchmarking analysis using key financial ratios and metrics.
Outcome: Insights into competitive standing and narrative credibility.

10-Step plan for publishing CbCR data

06

Country Lists Analysis (EU, Australia, etc.)
Action: Analyse transactions with entities in countries covered by applicable lists.
Outcome: Management of reputational risks and compliance with reporting requirements.

07

Jurisdiction Filing Considerations
Action: Assess global reporting requirements and select the most suitable jurisdiction for filing.
Outcome: Streamlined reporting processes and alignment with transparency strategy.

08

Public Disclosure Preparation
Action: Compile analyses into a public disclosure document and prepare an internal Q&A.
Outcome: Clear disclosures and proactive stakeholder engagement.

09

Narrative Alignment
Action: Ensure consistency with other corporate disclosures and comply with international guidelines.
Outcome: Unified corporate message and trustworthy reporting.

10

Voluntary Disclosure Consideration
Action: Evaluate the benefits of additional voluntary disclosures.
Outcome: Leadership in corporate responsibility and enhanced stakeholder trust.

Focus on AI

Gary Rapsey

What is on the minds of CEOs, Boards and investors?

The opportunity/risk dichotomy of AI

PwC's 27th Annual Global CEO Survey

reveals that CEOs overwhelmingly see generative AI as a catalyst for reinvention that will power efficiency, innovation, and transformational change

48%

Over the next year, about half of CEOs expect generative AI to enhance their ability to build trust with stakeholders

PwC's Trust Survey 2024

highlights that there is a wide range of company preparedness when it comes to governance over AI risk and responsible AI usage

3% **have not** yet considered Responsible AI

10% **have** considered Responsible AI **but have not taken any concrete steps** yet

19% are in the process of **developing a strategy** for Responsible AI

30% have a **strategy in place** for Responsible AI in parts of their business

39% have a **company-wide strategy** in place for Responsible AI

PwC Global Investor Survey 2023

highlights that investors feel companies must accelerate the adoption of AI, but there are significant risks:

85% say it's important for companies to **accelerate the adoption** of AI

86% believe **data security and privacy** are a risk for companies as they adopt AI

83% believe **misinformation** is a risk for companies as they adopt AI

84% believe **insufficient governance and controls** are a risk for companies as they adopt AI

79% believe **bias and discrimination** are a risk for companies as they adopt AI

How are regulators responding to AI?

Global legislative oversight activity over AI is increasing at a significant pace

European Union

- EU AI Act expected to come into force July 2024, with first requirements applying within 6 months
- AI Pact – voluntary initiative to accelerate adoption of AI Act rules
- AI Liability Directive – introduces new rules to provide protections to persons harmed by AI systems

United Kingdom

- Originally adopted a ‘pro innovation’ approach now signalling specific regulation over AI will be required
- UK AI Safety Institute established
- DSIT has issued guidance principles to sectoral regulators

China

- Enforcing regulation over content generation technologies
- Personal data protection and security through existing laws
- Providers of systems must uphold user rights
- Algorithmic Registry includes assessment of AI with ‘public opinion attributes or social mobilisation capabilities’

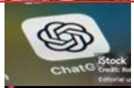
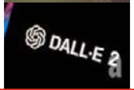
United States

- October 2023 Executive Order – a ‘sprawling’ directive calling for more transparency and standards
- US AI Safety Institute established to execute policies
- NIST’s Risk Management Framework for managing AI risk
- Bill of rights and other voluntary guidance issued

Regulatory update as at May 2024

EU AI Act expected to come into force July 2024

This sweeping legislation will set the benchmark for global AI regulation

Timeframe for compliance – months		**EU AI Act category**	**Examples**		**Organisation requirements**[1]	**Penalties**[2] **for non-compliance**
6	Prohibition on banned AI systems Expected January 2025	**Prohibited AI practices**		• Social scoring • Biometric identification in real time	**Inventory and classify AI systems to determine the nature and type**	€35m or 7% of global annual turnover if higher
12	Requirements on providers of General Purpose AI Expected July 2025	**Providers of General Purpose AI, eg foundation models**	 	• Chat GPT • DALL-E • Claude	**Provide technical documentation to the supervisory authority on request – including the training and testing process, and results evaluation**	€15m or 3% of global annual turnover if higher
24	Act applicable for most provisions including high-risk systems Expected July 2026	**High risk AI systems**	 	• Selecting and evaluating job candidates • Assessing creditworthiness • Access to training • Risk assessment and pricing for life and health insurance • Access to essential public services eg healthcare • Remote biometric identification • Eligibility for benefits	**Conformity assessment per model/ use case** **Implement robust risk and quality management systems** **Implement data governance controls for AI training and testing** **Monitor accuracy, robustness and cyber security of AI systems throughout their lifecycle**	€15m or 3% of global annual turnover if higher
+		**AI systems with additional transparency requirements**		• Synthetically generated content eg deep fakes • Customer service chatbots	**Disclose to user that they are interacting with an AI system** **Label synthetically generated content**	**€7.5m or 1.5% of global annual turnover if higher for supplying incorrect information**

Regulatory update as at May 2024

[1] For a comprehensive list of requirements, please consult the EU AI Act text as the above listed requirements are not exhaustive

[2] For SMEs fines are capped at the lower of the Euro or % of global annual turnover amount

The EU AI Act – how should companies prepare?

The impact of the EU AI Act will be far-reaching

The Act applies to AI systems available in EU markets or where the output of the AI system is used in the EU

It also applies to providers of AI systems who are not based in the EU if they are within the AI ‘supply chain’ of EU-based companies

Deployers of such systems will need to ensure that a non-EU provider has already carried out the appropriate conformity assessment procedure and that the AI system is accompanied by the required documentation and instructions for use

Consider taking these steps

Inventory your AI use – identify all AI usage in your organisation and its status

Conduct a regulatory impact assessment – based on your inventory, determine which AI systems and use cases are within the scope of the Act

Perform a gap analysis – compare your existing controls and processes against the Act’s compliance obligations

Develop a readiness plan – enhance your AI governance model, capabilities to assess and test AI systems and train your staff

Data quality – compare your existing controls and processes against the Act’s obligations to ensure data used to train and operate your AI models is high quality and properly sourced

Companies should understand the potential impacts, identify gaps, and plan accordingly

Framework for trustworthy AI

AI governance

AI governance provides a framework enabling organisations to adopt AI at pace with confidence that it will be able to do so safely and effectively

Where is AI being used within the organisation?

Who at the Board level is responsible for governance over your AI systems and data?

Model trustworthiness

AI models should perform reliably and behave as intended for their use case in line with principles of trustworthiness such as fairness and safety

1. Validity and reliability
2. Explainability and interpretability
3. Fairness – with harmful bias managed
4. Security and resilience
5. Accountability and transparency
6. Enhanced privacy
7. Safety

What steps are you taking to ensure your AI systems are trustworthy and fit for your organisation's purpose?

Data governance

High-quality data enables AI models to make better predictions and produce more reliable outcomes, fostering trust and confidence among users

Quality | Security | Privacy | Transparency | Traceability

What controls are in place to manage data quality in your AI systems?

Thank you

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