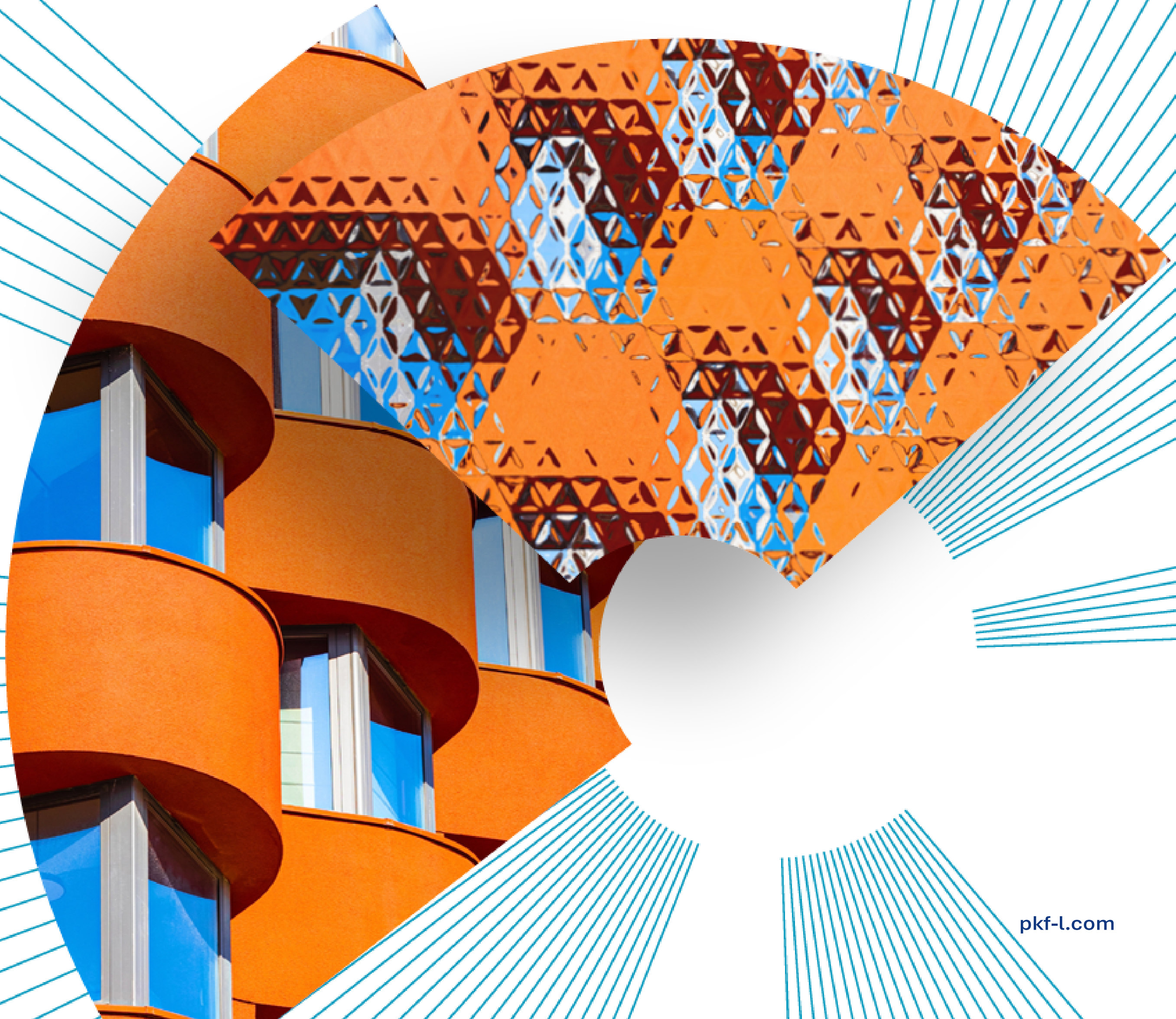
04 December 2024

Preparing for the 2024/25 financial reporting season

Capital Markets
Webinar



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Agenda

Today's speakers

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Common disclosures and accounting errors picked up by the FRC

FRC Publications – 2024

During 2024, the FRC have released their suite of reviews of corporate reporting.

Annual Review of Corporate Reporting:

- Thematic review of offsetting in the financial statements
- Thematic review of IFRS 17 *Insurance Contracts*

Annual Review of Corporate Reporting 2023/24

Executive summary:

- Continued need for improvement in relation to impairments and cash flow statements
- Widening gap between quality of reporting in FTSE 350 and other companies
- Climate-related reporting has become a top 10 issue for the first time, with restatements noted in climate related information
- Restatements (outside FTSE 350) in relation to impairment of assets rose. Primarily resulted in additional impairments in parent company financial statements – potentially impacting the ability of the company to distribute profits
- Improvements in reporting on provisions and contingencies, with these areas falling outside of the top 10 issues for the first time in five years

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Annual Review of Corporate Reporting 2023/24

The FRC provided detailed feedback on the top 10 areas of concern and where cases were opened, comparing this to the results in their review for 2022/23.

Ranking		Topic	Percentage of cases opened	
23/24	22/23		23/24	22/23
1 =	1	Impairment of assets (Retail sector focus)	12%	10%
2 ▲	3	Cash flow statements (± !)	11%	8%
3 ▲	5	Financial instruments (±)	10%	8%
4 ▲	6=	Revenue	9%	6%
5 ▲	9	Presentation of financial statements (± !)	6%	4%
6 ▼	4	Strategic report and Companies Act 2006	5%	8%
7= ▼	2	Judgements and estimates (Retail sector focus)	5%	9%
7= ▼	6=	Income taxes (!)	5%	6%
9= ▲	10	Fair value measurement	4%	3%
9= ▲	-	TCFD and climate-related narrative reporting	4%	2%

Retail sector focus

± Also included in offsetting thematic review

! Led to restatement of company's financial statements

Impairments of assets

Top issue with most substantive enquiries for the second consecutive year, resulting in a number of restatements.

Key findings:

- Inconsistency of assumptions across financial statements / other sources
- Uncertainties in relation to climate change not provided
- Inclusion of asset enhancements in cash flows used to calculate value in use
- Periods of assessment in excess of five years with no explanation
- Omission of sensitivity disclosures and ineffective explanation of estimates / assumptions

Ensure that per IAS 36...

Adequate disclosures about key inputs and assumptions used in ‘value in use’ models are provided, and that these are consistent with other information.

Cash flow statements

The FRC was disappointed in the ongoing frequency of questions in relation to the cash flow statement, with a significant number of internally and externally identified prior year restatements.

Key findings:

- Classification of items in the cash flow statement
  - Non-controlling interests
  - Settlement of debt on acquisition
  - Repayment of a loan from group undertaking
- Offsetting of cash flow items without explanation
- Inclusion of non-cash transactions

Ensure that per IAS 7…

The classification of items in the cash flow statement is carefully thought through and in line with the relevant criteria and definitions of operating, investing and financing cash flows.

Financial Instruments

The completeness and specificity of disclosures in relation to financial instruments, especially Expected Credit Losses (ECLs) and explicit Parent Company disclosures continued to dominate queries on financial instruments.

Key findings:

- Boilerplate accounting policies which did not allow the user to gain an understanding of material financial instruments
- Material risks relating to financial instruments not provided
- Risk management procedures taken by Directors omitted
- IFRS 9 ECLs
  - Percentages used in ECL models
  - Intercompany transactions
  - Credit risk disclosures

Ensure that per IAS 1…

Adequate explanation is provided for all material financial instruments, such that the user can understand them.

Revenue

The regulators' queries increased period on period. The adequacy of accounting policies and significant judgement disclosures required by IAS 1 and IFRS 15 continue to persist.

Key findings:

- Poorly written accounting policies
  - Inconsistency of timing of performance obligations
  - Method of measurement of accrued income unclear
  - Principal vs agent considerations ineffective
- Revenue by business class and / or geographical information not provided

Ensure that per IAS 1…

For each material revenue stream, specific accounting policies are provided which include the timing of revenue recognition and its basis as over time / point in time.

Ensure that per IFRS 15…

Significant estimates and judgements are provided for each material revenue stream.

Presentation of the financial statements

The consistency of presentation across the financial statements was queried, resulting in the restatement of a selection of primary statements.

Key findings:

- Inconsistency of current vs non-current presentation across the financial statements
- Material impairment losses not presented separately in the income statement
- Accounting policies for material classes of transactions not sufficiently disclosed
- Material balances not separately presented in the financial statements
- Disclosures in respect of going concern assumption inconsistent with other areas of the annual report

Ensure that per IAS 1…

That material accounting policies are provided and that these are tailored for the company and not boilerplate.

Strategic reports and other Companies Act 2006 matters

The FRC continued to emphasise the requirement for the Strategic Report to be 'fair and balanced,' and consistent with other information / external sources of information about the Company.

Some examples include:

- Material items not discussed in sufficient detail
- Lack of alignment with other information published by the company – ie, on their website
- Use of Alternative Performance Measures (APMs) outweighed the use of IFRS measures
- Dividend payments that appeared unlawfully not adequately explained

Ensure that per the Companies Act...

That the strategic report is fair and balanced, and a comprehensive review of the business.

Judgements and Estimates

Improved disclosure was noted in this area. However, given ongoing economic and geopolitical uncertainty, quality disclosure of estimates and judgements is essential.

A number of inconsistencies were noted where financial statements were not fully compliant with IAS 1 in this area:

- Estimation uncertainty – lack of sufficient detail about key assumptions and sensitivities
- Significant vs other estimates not clearly distinguished
- Link to principal risks involving estimation uncertainty not provided

Ensure that per IAS 1…

Sufficient detail, including explanations of uncertainties, are provided for material estimates and judgements.

Ensure that per IAS 1…

Significant estimates are disclosed separately from other estimates.

Income taxes

Although substantive queries in this area reduced, clarification of reconciling items in the effective tax rate reconciliations and the recoverability of deferred tax assets were questioned.

Key findings:

- Deferred tax assets recognised in companies with recent losses were not accompanied with convincing evidence of their recognition, as required by IAS 12
- Deferred tax liabilities were not recognised in relation to intangible assets in a business combination
- Information in the tax reconciliation was inconsistent with information presented elsewhere in the financial statements
- Pillar Two – lack of disclosure as to the applicability of the new regime

Ensure that per IAS 12…

Detailed and convincing evidence is provided for the recognition and recoverability of deferred tax assets.

Fair Value Measurement

Alongside missing disclosures, the focus in the findings relates to the lack of clear explanation as to how companies had applied the requirements of the standard to fair value measurements and techniques in the disclosures provided.

The FRC investigated financial statements further when:

- It was unclear that the market participant assumptions had been used in the determination of fair values
- Explanations of valuation techniques and key inputs were unclear
- When other areas of the financial statements appeared to contradict the categorisation used within the fair value hierarchy

Ensure that per IFRS 13.93...

Explanations of valuation techniques and the assumptions used are clear, specific and fit with the facts of circumstances of the company.

TCFD and climate-related narrative reporting

The second year of reporting for premium-listed companies resulted in enquiries into statements of consistency with the framework and a need to more company-specific disclosures.

Varying levels of compliant disclosures were noted, with key areas investigated further by the FRC being:

- Where companies did not appear to report against the TCFD requirements, despite falling within its scope per the Listing Rules
- When companies provided disclosures which only part satisfied the requirements and did not clearly identify areas of non-compliance
- When companies declared non-compliance with certain areas but provided no overview of the plans in place to address this or the timelines

Ensure...

Any material impact of climate change on the company is disclosed and all disclosures are company-specific.

Per the Listing Rules, any areas of non-compliance are explained along with actions and timelines for remediation.

Other more basic errors noted in the Annual Review of Corporate Reporting

Executive summary:

- The FRC's review also took time to discuss more basic errors in corporate reporting during 2023/24, including:
  - Tailoring of accounting policies
  - Typographical errors
  - Casting errors
  - Incorrect amounts presented in notes
- Amalgamation of immaterial issues can create negative impression for users on the financial statements

2024 Thematic Review: offsetting in the financial statements

Thematic Review: Summary

- Offsetting ("netting") is the classification of dissimilar items as a single net amount
- Challenging area as requirements are complex and located in various areas in the IFRS's
- Some IFRS's contain explicit guidance on offsetting whilst others rely on the offsetting principals in IAS1, Presentation of financial statements
- Application of the requirements may require management to make significant judgements especially when they involve complex financial arrangements
- This is an area FRC continually identified material errors through their routine monitoring work
- In appropriate application of the offsetting requirements mask the full extent of the risks relating to a company's income and expense, assets and liabilities or cashflows
- When done correctly and disclosed adequately, it can enhance comparability, completeness and clear presentation of income and expenses, assets and liabilities and cashflows and outflows

Common areas where issues were identified

Thematic review concentrated on areas where frequent issues have been noted as below:

- A - Cash flow statement
- B - Financial instruments
- C - Provisions
- D - Income taxes
- E - Presentation of financial statements
- F - Other

Key observations

Quality disclosures are important

- IAS 1 prohibitions from offsetting of assets and liabilities or income and expenses unless required or permitted by an IFRS

- Exceptions
  - Offsetting is required in all instances below
    - Cashflow on a business acquisition/disposal net of cash acquired/disposed,
    - Consideration received on disposal of a non-current asset net of the carrying amount and selling expenses

  - Offsetting is required if conditions are satisfied, ie –
    - Financial instrument balances (trade receivables and payables)
    - Income tax balances (netting of deferred tax assets and liabilities)
    - Defined benefit deficits and surplus
    - When it reflects substance or arises from a group of similar transactions

  - Offsetting is permitted for example as a policy choice
    - Provision expense and reimbursement income
    - Government grants
    - Income and expenses from a group of reinsurance contracts

  - If conditions are satisfied – ie, cashflow from operating, investing and financing
    - Activities and net interest of a segment

Key takeaways

- Disclosure of material accounting policy information relating to offsetting including all aspects relating to any offsetting condition are met

- Significant judgements made in applying the policies should be disclosed

- Disclosures important where financial instruments are subject to a master netting arrangement or similar agreement

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Key observations

Presentation of cashflows should be gross unless otherwise permitted

- Cash inflows and outflows within investing or financing activities to be presented gross in cashflow statement except in limited cases where netting is either required or permitted – For example:
    - Cash receipts and payments on behalf of customer usually in Agent vs Principal arrangements
    - Cash receipts and payments for items in which the turnover is quick, the amounts are large and maturities are short
- Consideration of whether to exclude overdrafts from cash and cash equivalents in the cashflow statement especially when they remain overdrawn for several reporting periods
- Accounting requirements for including overdrafts within Cash and cash equivalents in the cashflow statements differ from those to offset of overdrafts and cash and cash equivalents in the financial position – For example:
    - Bank overdrafts are included in the cash and cash equivalents when; (a) repayable on demand and (b) form an integral part of the entity's cash management and the bank balance often fluctuates from being positive to being overdrawn
    - Bank overdrafts that meet the cash and cash equivalents for purposes of the cashflow statements can only be offset in the statement of financial position if the criteria for offsetting in IAS 32 are met

Key observations

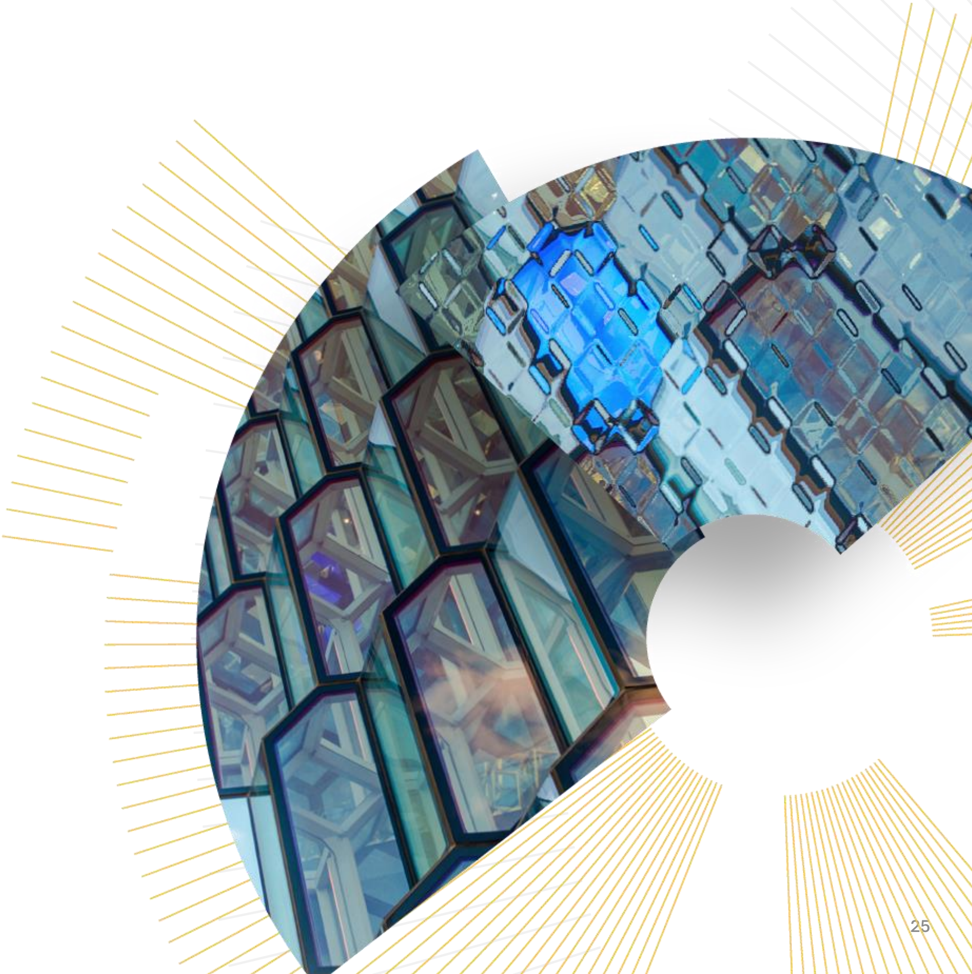
Terms of a cash pooling arrangement and an intention to settle on a net basis are key

- Notional cash pooling arrangement do not generally satisfy the criteria to offset positive bank balances and overdrafts in the balance sheet – ie, they don’t involve physical transfers of individual bank balances to one bank account
- Increased complexity of determining whether to offset positive bank balances and overdrafts in the statement of financial position for zero balancing CPAs when regularity of the cash sweeps and their timing in relation to period-end balances differ between arrangements – ie, judgements maybe required in determining whether zero balancing CPA satisfied the Offsetting criteria when period-end balances are not settled soon after the reporting date
- Demonstration of an intention to physically transfer period end balances to one account to satisfy criterion (b) of offsetting in IAS 32 (42b)
- Offsetting receivables and payables is only permissible when the criteria in IAS 32 (42b) is met

Key observations

Accounting treatment applied to reimbursement rights should be clearly explained

- Reimbursement asset has to be separately presented from the associated provision (ie, it should be recognised when it is virtually certain that it will be received if the entity settles the obligation)
- In the statement of comprehensive income, the expense relating to a provision maybe presented net of the reimbursement income
- Reimbursement rights that satisfy the contingent asset requirements of IAS 37 should appropriately disclosed



Updates on new standards, amendments to existing standards and legislative changes

New and amended IFRS

New or amended?	IFRS Standards	Dates of effect
New standards	**IFRS 18** Presentation and disclosure in the financial statements **IFRS 19** Subsidiaries without public accountability: disclosures **IFRS S1** General requirements for disclosure of sustainability-related financial information **IFRS S2** Climate-related disclosures	1 January 2027 1 January 2027 1 January 2024 1 January 2024
Amended standards	**Amendments to IAS 1** Presentation of financial statements: classification of liabilities as current or non-current liabilities with covenants **Amendments to IFRS 16** Leases: Lease liability in a sale and leaseback **Amendments to IAS 7** Statement of cash flows and **IFRS 7** Financial instruments: disclosures: supplier finance arrangements **Amendments to IAS 21** The effects of changes in foreign exchange rate: Lack of exchangeability **Amendments to IFRS 9** Financial Instruments and IFRS 7 Financial Instruments: Disclosures: classification and measurement of financial instruments	1 January 2024 1 January 2024 1 January 2024 1 January 2025 1 January 2026

Accounting developments: UK GAAP

Changes to	Developments	Dates of effect
Periodic review amendments	Numerous amendments to **FRS 102** and **other** UK GAAP standards The most significant amendments relate to accounting for **revenue** and **leases**	1 January 2026
Annual review cycle	Minor amendments to **FRS 101** *Reduced Disclosure Framework* following the 2023/24 **annual review cycle**	1 January 2024 / 1 January 2025, depending on the specific amendments
LLP SORP	Minor amendments to the Limited Liability Partnership' (LLP) Statement of Recommended Practice (SORP)	1 July 2024

International Standards on Auditing (UK)

Developments	Dates of effect
ISA (UK) 600 [Revised September 2022] *Special Considerations – Audits of Group Financial Statements (including the Work of Component Auditors)*	Effective for audits of financial statements for periods commencing on or after 15 December 2023

IFRS

Classification of liabilities: Current or non-current

Amendments to IAS 1

Mandated for p.c. on or after 1 January 2024

- Amendments clarify that the **classification** of liabilities as current or non-current should be based on **rights** that exist at the **end of the reporting period**
  - **Expectations** about whether an entity will exercise a right to defer settlement of a liability **do not affect its classification**
  - To conclude a liability is **non-current**, the right to defer settlement of a liability for at least **12 months** after the reporting date **must exist** as at the end of the reporting period

Non-current liabilities with covenants

Amendments to IAS 1

Mandated for p.c. on or after 1 January 2024

- In some cases, the **right to defer settlement** will be subject to the entity complying with certain **conditions** (ie, covenants) specified in the loan agreement
    - Only those covenants with which an entity **must comply on or before the end of the reporting period** affect the classification of a liability as current or non-current
    - This is the case even if the **assessment of compliance** with the covenant occurs **after the reporting period**
    - When an entity is required to comply with the covenant **only after the reporting date** it does not affect whether the right to defer exists at the end of the reporting period and therefore **does not impact** the classification of the liability as current or non-current

Lease liability in a sale and leaseback

Amendments to IFRS 16

Mandated for p.c. on or after 1 January 2024

- The amendments add **new requirements, guidance and examples** on sale and leaseback transactions that should be applied by a **seller-lessee** to subsequently measure **lease liabilities** arising from a lease back
    - The seller-lessee **cannot recognise** any amount of the gain or loss that relates to the **right-of-use it retains**
    - Specifically relates to instances where the leaseback contains **variable lease payments** (eg, turnover rentals, that do not depend on an index or rate)

Supplier finance arrangements

Amendments to IAS 7 and IFRS 7

Mandated for p.c. on or after 1 January 2024

- Implemented to **address investor demand** for more detailed information about supplier finance arrangements (ie, supply chain finance, payables finance, reverse factoring)
- Entity **must disclose** information about their supplier finance arrangement (SFA) to enable users to access the effects of those arrangements on the entity’s **liabilities, cash flows** and **exposure to liquidity risk**

Sustainability standards: IFRS S1 and IFRS S2

Must be endorsed for use in the UK

The endorsed standards are expected in the first quarter of 2025

IFRS S1

- Sets out the general disclosure requirements for companies to communicate to primary users of financial information about the sustainability-related risks and opportunities they face over the short, medium and long term
- Builds on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, which require governance, strategy, risk management as well as metrics and targets disclosures

IFRS S2

- Sets out specific climate-related disclosures and is designed to be used in conjunction with IFRS S1
- Requires disclosures of climate-related risks and opportunities

UK GAAP

Periodic review 2024

The periodic review amendments will introduce significant changes for UK GAAP reporters

The FRC undertakes a review of UK GAAP at least every 5 years

- The second periodic review has been **finalised**, with most of the amendments in FRS 102 becoming effective for p.c. on or after **1 January 2026**
- The **most significant** amendments relate to accounting for revenue and leases
    - This will align UK GAAP requirements more closely with IFRS, albeit with some considerable differences
    - The key areas of change are in respect of FRS 102 and FRS 105
    - Only **minor amendments** have been made to the other standards

Revenue recognition

Current recognition model

- Under **FRS 102** and **FRS 105**, revenue may arise from the sale of goods, the rendering of services, construction contracts, or the use of an entity's assets by others (eg, interest, royalties or dividends)
- An entity must measure revenue at the fair value of the **consideration received or receivable**
- The recognition of revenue is based on a **risks and rewards approach**

Revised model

- The revised revenue recognition model is based on **IFRS 15** *Revenue from contracts with customers*
- Revenue recognition is based on a **control approach** (ie, revenue is generally recognised when the entity **transfers control** of a good or services to a customer)
- The revisions also introduce a **five-step model**, similar to that in IFRS 15, but with certain **simplifications** to make the requirements 'proportionate' for FRS 102 and FRS 105 preparers

Lease accounting

Current recognition model

- Under **FRS 102** and **FRS 105**, an entity must determine whether an arrangement is, or contains, a lease based on the substance of the arrangement rather than the legal form
- Leases are categorised into **finance** and **operating** leases by both lessees and lessors
- A lease is classified as a **finance lease** if substantially all of the **risks and rewards** incidental to ownership of the asset are transferred from the lessor to the lessee
- A lease is classified as an **operating lease** if it does not transfer substantially all the risks and rewards incidental to ownership

Revised model

- The revised lease accounting model is based on IFRS 16 *Leases* and will bring a large majority of leases **onto the balance sheet**
- **Exemptions** will be available for **short-term leases** (ie, lease term of 12 months or less and those where underlying asset is of **low value**
- Entities must determine whether an arrangement is, or contains, a lease based on whether the contract conveys the **right to control** the use of an identified asset for a period of time in exchange for consideration

Fair Value Measurement

Revisions

- The appendix to FRS 102 Section 2 Fair value measurement has been **replaced** with a new **Section 2A**, which is more aligned with the fair value principles of IFRS 13 Fair Value Measurement
- Section 2A applies when another FRS 102 section **requires or permits** fair value measurements or disclosures about fair value measurement, **except** shared-based payment transactions and leasing arrangements

Revised definition of 'fair value'

- The key change from the replacement of the Section 2 appendix with Section 2A is the **revised definition of 'fair value'**

From:

- The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction

To:

- The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date

International Standards on Auditing (UK)

ISA (UK) 600 Audits of Group Financial Statements

Overview

- What is ISA (UK) 600?
- What does it require group auditors to do?
- What does it involve?

Changes

- Proactive risk-based approach
- Components
- Materiality

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Any questions?

04 December 2024

Thank you

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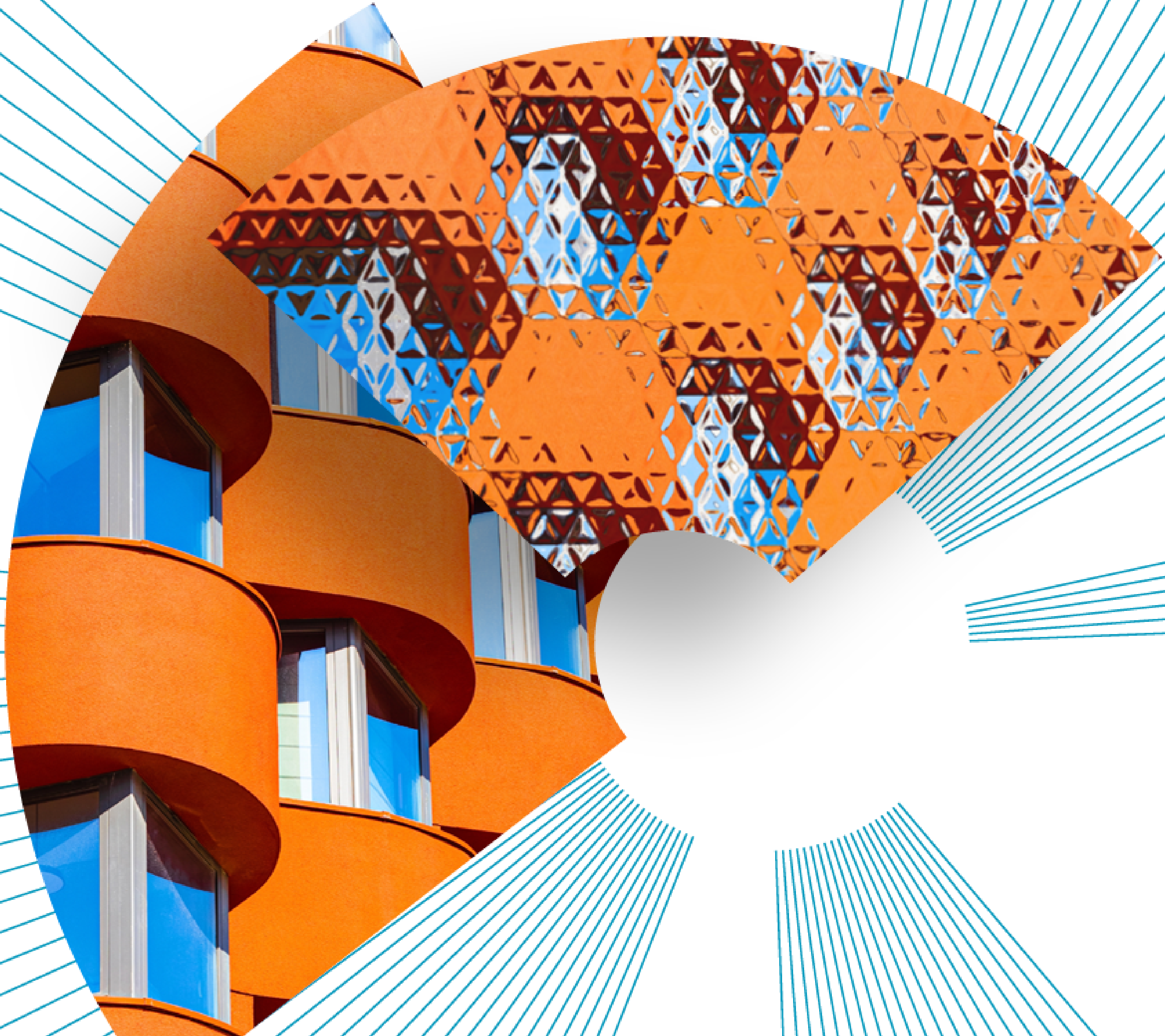

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