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Closing Out 2022

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In Closing Out 2022, we discuss the principal issues affecting 31 December 2022 annual reports, including:

- Issues arising from the current uncertain economic environment including the ongoing impacts of climate change, rising commodity prices and inflation, global supply chain disruption and labour shortages, with many issues exacerbated by the conflict between Russia and Ukraine.
- Areas of regulatory focus identified in the Financial Reporting Council's (FRC's) Annual Review of Corporate Reporting 2021/2022 ('the FRC annual review') and its publication Key Matters for 2022/23 reports and accounts ('the key matters publication').
- The FRC's thematic reviews on:
  - TCFD disclosures and climate in the financial statements;
  - judgements and estimates;
  - discount rates;
  - business combinations;
  - deferred tax assets; and
  - earnings per share (EPS).
- Other key aspects of the annual report including corporate governance, the longer-term viability statement and the strategic report.

As in previous years, the FRC annual review provides an assessment of UK corporate reporting based on reviews of listed, AIM quoted and large private companies by the FRC's Corporate Reporting Review team whilst the key matters publication highlights issues relevant to the upcoming reporting season. Although this publication discusses financial reporting in terms of IFRS Accounting Standards, the principal considerations raised generally also apply to those preparing accounts under FRS 101 and FRS 102. However, there are significant differences between the requirements of IFRS Accounting Standards and FRS 102 in respect of the following areas discussed in this publication: financial instruments, revenue recognition, business combinations and lease accounting by lessees.

The UK regulatory environment

The FRC annual review draws largely on the FRC Corporate Reporting Review (CRR) team's reviews of the annual and interim reports of listed, AIM quoted and large private companies, which are designed to ensure compliance with legal and regulatory reporting requirements. The review is accompanied by a highlights summary document and the FRC's Key Matters for 2022/23 reports and accounts, which provides a summary of FRC findings and corporate reporting developments, with links to the related underlying reports, rather than setting out particular expectations. Although the FRC's financial reporting messages derive from their review of annual reports prepared under IFRS Accounting Standards, the considerations apply equally to those preparing accounts under FRS 101 and FRS 102.

Although the CRR team directs its resources primarily towards the reports of the UK's largest listed companies, in recent years it has extended its assessment to large private companies, a practice which it will continue in the current uncertain economic climate. If the CRR team's reviews identify potential substantive issues, the FRC will write to the company to discuss and resolve the issues and agree any action needed to improve the company's reporting. The CRR team will also write to companies when their reports have been reviewed but no substantive queries have arisen – either with an appendix of less significant matters for the company to address or simply to inform them that a review has been performed but no points have been raised.

The FRC has also continued its programme of thematic reviews. This year, the FRC has reviewed disclosures around TCFD and climate, judgements and estimates, discount rates, business combinations, deferred tax assets and EPS. In December 2022 the FRC has also published a guide entitled 'What makes a good annual report and accounts' which provides further guidance and recommendations.

Overall, the FRC was pleased to see that despite the continuing challenging reporting environment amid economic uncertainty and the effects of the Russia-Ukraine conflict, the quality of corporate reporting continues to be maintained and overall fewer substantive questions were raised in relation to the top ten areas of challenge compared with the previous year. In particular, the FRC observed improvements in the reporting of alternative performance measures (APMs), judgements and estimates, revenue and impairment of non-financial assets. However, it noted that scope for improvement remains, particularly in the areas of cash flow statements, financial instruments and deferred tax. It also expressed disappointment that the number of restatements required as a result of its reviews nearly doubled in 2021/22 compared to the previous year.

The FRC's upcoming monitoring of annual reports in 2022/23 will focus on disclosures that address risks and uncertainty in the challenging economic environment, including those relating to rising inflation, slowing economic growth, increasing interest rates, stresses in supply chains, constraints in the labour market, changing consumer behaviour and climate change. It expects companies to assess and clearly explain the impact of these risks on their strategy, business model, viability and going concern assessments. Companies should also ensure that their disclosures are consistent across the whole of the annual report, with matters that are discussed at length in the narrative reporting also reflected appropriately in the financial statements.

Disclosure of interactions with the CRR team

Review by the CRR team can, on an exceptional basis, result in an entity-specific Press Notice where the company makes a significant change as a result of the review; no Press Notices were issued in 2021/22 or in the previous year.

When the company makes a change to a significant aspect of its report and accounts in response to a review, the company may be asked to refer to its exchanges with the CRR team in the next annual report. In 2021/22, 27 such references were required. This represents a sharp increase on 15 in 2020/21 and the majority of these related to the cash flow statement.

The FRC saw an increased number of complaints received in relation to company annual reports – 32 in 2021/2022 compared to 21 in 2019/20. However, only in 13 cases did the complaint result in an approach being made to the company to resolve the issue.

The FRC's Guidance on Audit Committees sets out the expectation that, following an interaction with the FRC, the subsequent audit committee report will explain the nature and extent of that interaction, including details of the questions raised, any corrections or improvements resulting from the enquiry and the inherent limitations of the CRR's review. The FRC annual review observes that most companies do include such a reference, but that the quality and comprehensiveness of this reporting continues to be mixed.

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FRC key expectations for 2022/2023

Driven by its top ten findings and the current economic uncertainty, the FRC has stated that it expects to see the following for 2022/23 reporting:

- Descriptions in the strategic report of risks facing the business and their impact on strategy, business model, going concern and viability should be clear, unambiguous and balanced, with cross-references to relevant disclosures in the financial statements and elsewhere in the annual report.
- Discussion of the impact of climate change on the company in the narrative reporting should be specific to the company, balanced in its approach and well-integrated with the rest of the annual report. Material climate-related commitments, risks and uncertainties should be reflected appropriately in the financial statements. The relationship between assumptions and sensitivities considered in any TCFD scenarios (including any Paris-aligned scenarios) and those applied in the financial statements should be clear; users should be able to understand how sensitivities affect scenarios and whether those sensitivities could affect the numbers in the financial statements.
- Impairment disclosures should assign values to, and explain how, the key assumptions used have been determined, with reference to future expectations regarding external conditions and the company's own strategy.
- Significant management judgements and key assumptions underlying major sources of estimation uncertainty should be disclosed clearly, including information about the sensitivity of reported amounts to changes in assumptions.
- The nature and extent of material risks arising from financial instruments should be discussed in a transparent manner, including:
  - changes in investing, financing and hedging arrangements;
  - the use of factoring and reverse factoring in working capital financing;
  - the approach to and significant assumptions made in the measurement of expected credit losses; and
  - where material, concentrations of risks and information about covenants.
- Companies should ensure that they are giving information that meets the disclosure objectives of the relevant accounting standards rather than simply marking off the specific disclosure requirements. Additional information should be given where necessary for users to understand the impact of particular transactions, events or circumstances.
- The nature of significant inflationary features in revenue, supply, leasing and other financing contracts should be explained, together with their effect on the financial statements.

The FRC also reiterates its general expectation that companies should make disclosures that are clear, concise and understandable and which do not address information that is immaterial.

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Topical issues – reporting on the year to 31 December 2022

Economic uncertainty

Global economic uncertainty and the challenges for corporate reporting

Companies are facing an ever-expanding range of challenges due to climate change, ongoing effects of the COVID-19 pandemic, rising commodity prices, inflation, currency fluctuations, global supply chain disruption and labour shortages, with many issues exacerbated by the conflict between Russia and Ukraine. For those companies directly impacted by the conflict between Russia and Ukraine, uncertainty remains over future operations in and trade with affected and neighbouring regions and the impact of sanctions. The European Securities and Markets Authority (ESMA) released a public statement on the implications of Russia's invasion of Ukraine on half-yearly financial reports. In its European common enforcement priorities for 2022 annual financial reports, ESMA considers that most of these messages are also relevant in the context of annual financial statements.

In an interconnected world it is not always possible to isolate the wider economics effects of, for example, sanctions imposed on Russia and Belarus from the increase in energy prices, increase in the general cost of living or myriad of national or regional factors. These effects are not only interconnected but generally also pervasive:

- **High energy costs** are likely to impact the value chain (i.e. suppliers, operations and customers) including risk of supply of energy (shortages). This will also have a direct impact on inflation and the cost of living.
- **Rising interest rates** have various operational and accounting consequences, including declining fixed-rate financial asset values, changes to entities' investment strategies, increased expected credit losses, and revision of discount rates used to measure pension liabilities.
- **Higher levels of inflation** are affecting both businesses and consumers, with the fast-rising cost of living reducing household savings and disposable income.
- **Foreign exchange volatility** is impacting international operations and outlook, with a knock-on effect on inflation and interest rates.
- **Supply chain disruptions** to transportation, distribution and warehousing are increasingly likely, arising from scarcity of resources, delays and cost increases through shipping, port operations and distribution by HGV lorries.
- **Commodity availability and pricing changes** are causing elevated market volatility and impacting costs of raw materials, components and finished products for businesses.
- **Continued labour supply and wage cost issues** exist, particularly for lower-skilled workers, with structural changes to labour markets.
- **Changing cost structures** with higher inventory, freight, insurance and labour costs may impact profitability if pricing cannot be adjusted.

Companies therefore need to consider how to assess and address these sources of uncertainty when preparing their 2022 annual reports. Whilst companies may by now be familiar with the challenges of reporting in times of uncertainty, timely and high-quality annual reporting that reflects the ongoing uncertainties companies face and their response to those uncertainties remains as important to investors, creditors, and broader stakeholders as ever.

We discuss the key impacts of some of these uncertainties on corporate reporting below, and issues specific to particular aspects of corporate reporting are also highlighted throughout this publication.

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Increases in energy prices

The increase in energy prices and the possibility of energy shortages due to the depletion of gas reserves could have a significant effect on a wide range of entities and several aspects of financial reporting.

This could result in, amongst other things, disruption to production, higher costs (particularly in energy intensive industries), higher revenues for energy producers and lower revenues (for example, in industries sensitive to levels of disposable income in a market where higher energy costs might limit consumers' spending power).

Such effects are clearly relevant to an impairment review conducted under IAS 36 *Impairment of Assets*, both in ensuring that forecasts are properly updated to reflect events and expectations as at the reporting date and in determining the appropriate disclosures to accompany that exercise. For example, a forecast of future energy prices might become a key assumption to be disclosed for the first time.

For some entities, as discussed in more detail below, the effect of energy prices might be severe and form a major part of disclosures explaining doubts over the entity's ability to continue as a going concern.

Less direct effects could also include changes in the value of energy derivatives (for example, forward contracts to purchase or sell gas or electricity), with resultant impacts on hedge accounting or disclosures of market risks under IFRS 7 *Financial Instruments: Disclosure.*

General inflation and rising interest rates

Increases in energy prices have contributed to the increase in general inflation levels. This has been accompanied by increases in interest rates reflecting lenders' perception of increased credit risk and interventions by central banks seeking to control inflation. Growing inflation and market interest rates affect multiple aspects of financial reporting which depend on forecasts of future cash flows and present value calculations.

In respect of impairment of non-financial assets, IAS 36 identifies an increase in market interest rates as an indicator to be assessed in determining whether an asset may be impaired and may lead to a full impairment review, unless the increase in market interest rate does not indicate the existence of a material impairment. This may be the case where an increase in market interest rates does not affect the appropriate discount rate for the asset in question (for example, if short-term interest fluctuations would not affect the rate of return demanded of a longer-life asset) or if the entity expects to recover higher interest charges through prices charged to its customers, or the increased rate is too small to raise concerns over the headroom of an asset's recoverable amount over its carrying amount. However, the possibility of an impairment loss should not be overlooked and a general increase in interest rates should lead to a proper consideration whether a full impairment review is required.

Inflation can have an impact on the measurement of longer-term provisions such as decommissioning obligations, as its effects on future outflows of economic resources should be reflected in either the forecast cash flows or the discount rate applied to longer-term liabilities. Entities should ensure that the inputs used in measuring provisions follow a consistent approach in incorporating the effects of inflation. Nominal cash flows, which include the effect of inflation, should be discounted at a nominal rate and real cash flows, which exclude the effect of inflation, should be discounted at a real rate.

Inflation and the resulting increase in the cost of living may lead to products becoming less affordable (either because of increased production costs or reduced customer spending power). Write-downs of inventory to net realisable value and recognition of onerous contract liabilities in respect of commitments to purchase inventory which cannot then be sold at a profit may be required. Inflation, specifically in salaries, can also be an important actuarial assumption factored in the measurement of defined benefit obligations accounted for under IAS 19 *Employee Benefits.* Where inflation is a major source of estimation uncertainty, an entity should consider the need to disclose the information required by paragraphs 125-133 of IAS 1 *Presentation of Financial Statements* such as a sensitivity analysis.

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Both interest rates and inflation can affect measurement of lease liabilities and right-of-use assets under IFRS 16 *Leases*. They can also lead to additional exposure to credit losses as borrowers' ability to repay their obligations is reduced, resulting in:

- Increases in expected credit losses to be recognised under IFRS 9 *Financial Instruments,* if it is expected that levels of default might increase due to increases in the borrowers' cost of living. Changes in expected models used by financial institutions or 'management overlays' to supplement those models should be accompanied by disclosures to enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows; and
- Expected credit losses becoming more significant to entities other than financial institutions if they expect increase in bad debts as customers struggle to pay outstanding amounts.

Assumptions used for discount rates and cash flows should be internally consistent within a particular calculation and consistent across calculations performed for different purposes.

Government interventions

The current economic climate (particularly in respect of energy prices) has led to government interventions to assist entities by either limiting prices that can be charged to customers or providing direct economic assistance.

It will be important to characterise these arrangements correctly as a government grant in the scope of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, a tax credit in the scope of IAS 12 *Income Taxes*, a below-market loan subject to the requirements of IAS 20:10A or potentially (if, for example, a government acts to limit the rates a utilities supplier can charge) simply a lower cost than might otherwise be the case. For instance, the UK Energy Bill Relief Scheme provides a cap on gas and electricity unit prices for businesses and results in recognition of a lower expense.

More broadly, government assistance may impact an entity's cash flow forecasts and assessments that utilise such forecasts (e.g., impairment reviews and going concern assessments) The assessment of an entity's best estimate of the impact of government assistance on cash flow forecasts, including the expected duration of a scheme, should be conducted carefully and, when significant to the outcome of the assessment, disclosed.

In many jurisdictions, governments have introduced (or announced plans to introduce) so called "windfall taxes" targeted at entities operating in specific industries and that benefitted from higher profits as a result of rising prices, notably in the energy sector. Entities affected will need to assess the nature of the tax to determine if it should be accounted for as an income tax applying IAS 12 or as a levy applying IFRIC 21 *Levies*. This distinction is important as it will determine whether the related charge is presented in the income tax line in profit or loss or above that line. If IAS 12 applies, the entity will also need to consider whether to recognise deferred tax asset or liability. Where the tax is announced but not yet effective, entities will need to consider whether they should disclose the expected impact of the tax on the entity's operations.

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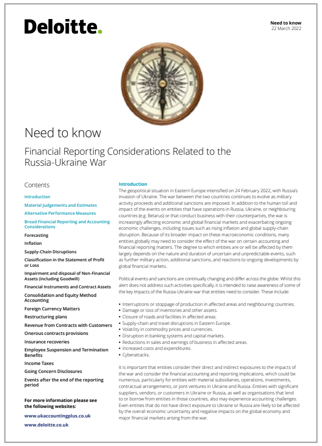
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Need to know

Financial Reporting Considerations Related to the Russia-Ukraine War

Contents

A Deloitte Need to Know discusses some of the key impacts of the Russia-Ukraine conflict that entities may wish to consider in more detail.

Restrictions on access to markets and cessation of operations

Following Russia's invasion of Ukraine, a number of companies announced their intention to exit the Russian market or experienced practical or political issues in continuing to access or manage operations in the region.

IAS 36 requires entities to assess whether there are any indications that an asset in the scope of IAS 36 may be impaired by considering internal and external sources of information. In making this assessment, entities should carefully consider whether the effects of Russia's invasion of Ukraine (direct and indirect) constitute an indication that one or more assets may be impaired. Decisions to abandon, dispose of, suspend operations, or cancel investments in Ukraine, Russia or Belarus could represent indicators of impairment necessitating a full impairment review of affected assets.

It is also possible that plans to dispose of operations give rise to classification of assets as held for sale or presentation as discontinued operations. Caution should be applied, however, as this is only appropriate when the strict criteria of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* are met. In particular, a plan to abandon a non-current asset or disposal group does not result in its classification as held for sale and judgement may be required to assess whether a sale can be considered highly probable in an uncertain political environment.

At the point when an entity's relationship with a foreign operation changes (either through choice or otherwise), it will also be necessary to consider whether the level of influence has reduced such that control, joint control or significant influence have been lost.

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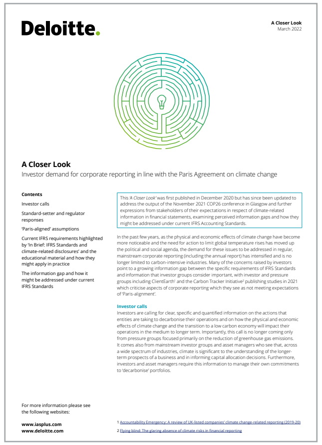
Climate change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A Closer Look
March 2022

A Closer Look
Investor demand for corporate reporting in line with the Paris Agreement on climate change

A Deloitte [A Closer Look](#) provides background on investor expectations in respect of climate as well as what requirements are highlighted by the IFRS Foundation's publication ['In Brief: IFRS Standards and climate-related disclosures'](#) and the [IASB's educational material on the effects of climate-related matters on financial statements](#) and how might they apply in practice.

Climate change

For some time, regulators have been urging entities to pay particular attention to climate-related matters and their effects when providing a balanced and comprehensive analysis of the development and performance of the entity's business and of its position together with a description of the principal risks and uncertainties that it faces (for example, climate-related matters are an ongoing focus area for the FRC and for the European Securities and Markets Authority (ESMA) [in its common enforcement priorities](#)).

If climate-related matters are material, it is expected that they are considered in the preparation of financial statements, even if IFRS Accounting Standards do not explicitly refer to those matters. It cannot be assumed that investors or regulators will deem boilerplate disclosures stating that climate-related matters have been considered (for instance, in impairment tests) without further explanation as to how and to what extent it affects (or does not affect) financial statements as sufficient to provide information that is relevant to an understanding of the financial statements. For example, investors want to understand whether an entity's forecasts used for financial reporting are aligned with the goals of the Paris Agreement. There are multiple possible scenarios and ranges of possible outcomes under different climate change trajectories. It is important for entities to be clear about the assumptions used and to make greater use of sensitivity analysis.

Where entities have concluded, in particular in highly exposed sectors, that no material financial impact from climate-related matters on their operations and/or in the measurement of their assets and liabilities is expected, regulators expect those entities to disclose the assessments performed, judgements made and the time horizon used to reach such a conclusion. Disclosures should be tailored to the specific circumstances of individual entities.

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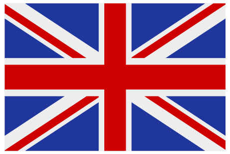
FRC focus area

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Need to know

FCA Policy Statement and Listing Rule promoting better climate-related financial disclosures aligned with TCFD

A Deloitte [Need to Know](#) discusses the requirements of the Listing Rules for premium and standard listed companies.

Current reporting against TCFD in the UK and regulatory expectations

For periods commencing on or after 1 January 2021, premium-listed commercial companies were required by the Listing Rules (LR 9.8.6R(8)) to make climate-related financial disclosures consistent with the recommendations and recommended disclosures of the Task Force on Climate-related Financial Disclosures (TCFD) on a 'comply or explain' basis. For periods commencing on or after 1 January 2022, this requirement is extended via LR 14.3.27R to companies with a standard listing of shares or Global Depositary Receipts (GDRs) representing equity shares.

Companies in scope of these Listing Rules must include a clearly identifiable statement in their annual report setting out whether they have made disclosures consistent with the TCFD's recommendations and recommended disclosures. Where those disclosures are included in a document other than the annual report, the statement must identify which disclosures are located elsewhere and explain why.

More information about the TCFD framework can be found in chapter G4 of GAAP in the UK on the Deloitte Accounting Research Tool (DART).

Where companies have not made disclosures consistent with all of the TCFD's recommendations and recommended disclosures, the statement must include an explanation of which recommendations and/or recommended disclosures are not provided, why they are not provided and a description of the next steps to be able to make consistent disclosures in the future, including the timeframes for being able to make those disclosures.

In 2022, the FRC and FCA both published findings from their thematic reviews of disclosures given by premium-listed companies under LR 9.8.6R(8). The FRC reviewed 25 larger companies more affected by climate change and the FCA reviewed 170 companies at a high level and 30 companies in more detail. Both found that companies were able to provide many of the TCFD disclosures expected by the FCA's Listing Rule, and included climate-related reporting in the financial statements, but they pointed out some clear areas for improvement and expectations for the coming reporting period, which can be articulated under five main themes:

- **Granularity and specificity:** the specificity and granularity of companies' climate-related disclosures is expected to improve as their processes to manage climate-related risks and opportunities become increasingly embedded into governance and management structures. The link with financial planning should also be clearer.
- **Balance:** companies should ensure that the discussion of climate-related risks and opportunities is balanced. In particular, opportunities arising from climate change and the transition to a low carbon economy should be described in context with existing, more carbon-intensive, businesses, and dependencies on new or future technology should be described.
- **Interlinkage with other narrative disclosures:** the FRC observed that in many cases the TCFD disclosures were not integrated with other elements of the narrative reporting and it recommends that companies consider the effects of climate-related scenario analysis on, for example, the company's business model, strategy and viability statement, or that they explain how climate-related risks have been assessed and prioritised compared to other risks.

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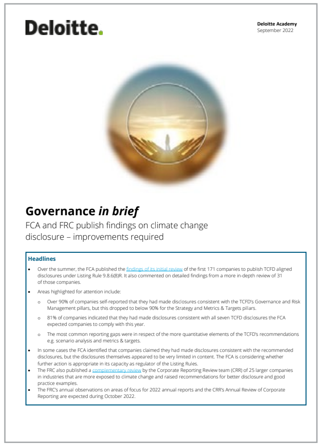

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Deloitte Academy
September 2022

Governance *in brief*
FCA and FRC publish findings on climate change disclosure – improvements required

Headlines

- Over the summer, the FCA published the findings of its initial review of the first 171 companies to publish TCFD aligned disclosures under Listing Rule 9.8.6(8)R. It also commented on detailed findings from a more in-depth review of 31 of those companies.
- Areas highlighted for attention include:
  - Over 90% of companies self-reported that they had made disclosures consistent with the TCFD's Governance and Risk Management pillars, but this dropped to below 90% for the Strategy and Metrics & Targets pillars.
  - 81% of companies indicated that they had made disclosures consistent with all seven TCFD disclosures the FCA expected companies to comply with this year.
  - The most common reporting gaps were in respect of the more quantitative elements of the TCFD's recommendations e.g. scenario analysis and metrics & targets.
- In some cases the FCA identified that companies claimed they had made disclosures consistent with the recommended disclosures, but the disclosures themselves appeared to be very limited in content. The FCA is considering whether further action is appropriate in its capacity as regulator of the Listing Rules.
- The FRC also published a complementary review by the Corporate Reporting Review team (CRR) of 25 larger companies in industries that are more exposed to climate change and raised recommendations for better disclosure and good practice examples.
- The FRC's annual observations on areas of focus for 2022 annual reports and the CRR's Annual Review of Corporate Reporting are expected during October 2022.

A Deloitte Governance in Brief discusses the FCA's and FRC's findings from their respective reviews of mandatory climate reporting under the Listing Rule requirements.

- **Materiality:** companies should ensure that they explain how they have applied materiality to their TCFD disclosures, being clear on how they have taken into account the TCFD Guidance for All Sectors (the "all-sector guidance") and other documents referenced in LR 9.8.6CG when determining whether their disclosures are consistent with the TCFD recommendations. Where a disclosure is omitted, it should be clear whether this is because it is considered immaterial. The FRC has indicated that it may challenge companies claiming consistency with a recommended disclosure where it is not clear that all relevant and material elements of the recommended TCFD disclosures – including the all-sector guidance and, where appropriate, the relevant supplemental guidance - have been addressed.
- **Connectivity between TCFD and the financial statements:** the degree of emphasis placed on climate change risks and uncertainties in the narrative reporting should be consistent with the extent of disclosure about how those uncertainties have been reflected in judgements and estimates applied in the financial statements. The FRC confirmed that it may challenge companies disclosing significant climate risks or net zero transition plans in narrative reporting, but without an appropriate explanation as to how this has been taken into account when preparing their financial statements. Companies should also consider explaining whether:

  – assumptions and sensitivities considered in TCFD scenarios, including any Paris-aligned scenarios, are consistent with those applied in the financial statements or explain any differences;
  – the effects of any emissions reduction commitments and strategies on the financial statements have been appropriately reflected in the financial statements;
  – the scale of growth of businesses and extent of progress against climate-related opportunities discussed in the narrative reporting is reflected in the segmental disclosures; and
  – discussion of matters which may have an adverse effect on asset values or useful lives in the narrative reporting is consistent with related disclosures in the financial statements.

The FCA reiterates that it expects all in-scope companies to make the governance and risk management disclosures set out by the TCFD recommendations and recommended disclosures and the FRC notes that it may challenge companies if they do not provide these disclosures.

The FCA also asks companies to continue to develop their internal processes and understanding of the TCFD recommendations, particularly in contemplation of adoption of the ISSB sustainability standards by the UK in due course, and to consider the relevant Sustainability Accounting Standards Board (SASB) metrics when making wider sustainability-related financial disclosures.

Overall, although climate reporting is improving, the expectations of regulators and investors are increasing. From both reviews it is clear that the regulators' assessment of the level of companies' compliance with TCFD was consistently lower than that claimed by companies. As a result, they will be looking for continued improvement in 2022. In particular, it is clear that disclosures should be provided at the TCFD all-sector guidance level and, where appropriate, the supplemental guidance for the financial sector and for non-financial groups should also be addressed. Further, the 2021 updated TCFD guidance will apply this reporting season. As a result, companies that claimed consistency with all TCFD recommendations and recommended disclosures last year will likely need to provide additional disclosures this year to continue to claim that their disclosures are consistent.

The FRC's thematic review sets out its findings and expectations in five sub-sections, addressing the statement of consistency required by the Listing Rules and each of the four TCFD pillars. It also looks more broadly at how climate change is addressed in the financial statements. The FCA's review findings are also included under the relevant headings.

In December 2022 the FCA followed its review with an article on 'Climate-related Financial Disclosures – ongoing monitoring' in its Primary Market Bulletin. It reminds both premium and standard listed issuers of its guidance and expectations in this area and confirms that it will continue to monitor climate-related disclosures and envisages further reviews to consider the disclosures published next year.

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Statement of consistency with TCFD and materiality considerations

The FRC expects companies to make a clear statement in the annual report on consistency with TCFD as required by the Listing Rules and to ensure that any references to the TCFD disclosures elsewhere in the annual report are also clear on the level of consistency with the TCFD framework (for instance, avoiding terminology elsewhere in the annual report referring to the TCFD disclosures as "TCFD compliance" where the disclosures are not fully consistent). Clear terminology is important; statements such as "we support the TCFD framework" do not make it evident to users whether or not the disclosures are consistent. The statement should provide specific signposting to where the TCFD disclosures can be found, including specific page references or hyperlinks. Any referenced information presented outside of the annual report should cover the same time period and be made available no later than the publication of the annual report.

Companies need to ensure that they disclose the reasons for including relevant disclosures in a document other than the annual report, where relevant, and give a clear, granular explanation of any recommendations and/or recommended disclosures for which consistent information is not included, the reason why and the expected timeline for being able to include information that is consistent. The level of any external assurance obtained also needs to be set out clearly and described accurately.

The FRC also expects companies to disclose the basis on which they have assessed the materiality of climate-related disclosures. This helps users to understand whether information has been omitted because it is considered immaterial, or for other reasons such as non-availability of information. Companies are reminded of the need to consider the all-sector guidance and, where relevant, the supplementary guidance, in making their assessment of consistency with the TCFD framework and to retain appropriate records to support that statement of consistency in the annual report.

Governance

The TCFD considers that matters relating to governance provide important context for investors and recommends that these disclosures should be included irrespective of a materiality assessment; the FCA accordingly expects that ordinarily, all disclosures will be made.

The FRC found that although all companies provided some information about governance, many did not include all of the suggested disclosures from the all-sector guidance and did not explain why these were omitted. Companies are expected to explain clearly how the highest governing body in the company (i.e. the board of directors) monitors and oversees progress against goals and targets related to addressing climate issues and also discuss how management assesses and manages climate-related issues. The level of detail should be sufficient to enable users to understand how the board exercises its governance of climate-related matters, including the channels and frequency of communication between management and the board; this was not always made clear. Companies should also consider how the TCFD governance disclosures interact with other aspects of the annual report, including the corporate governance statement.

Strategy

Companies should explain how climate change considerations and any scenarios inform the company's strategy and financial planning. They should provide explanations for the time periods chosen in determining the short, medium and long term, particularly where they differ from those used for financial targets, financial reporting or viability. Policies and strategies should address climate risks, opportunities, and the climate transition across each time period and should also include sufficient detail to enable users to understand the varying level of risk in different business sectors and geographical markets.

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The discussion of risks and opportunities arising from climate should be fair and balanced and should not place undue emphasis on the opportunities arising. Where possible, companies should disclose the expected impact of climate-related risks and opportunities on financial metrics. Companies should also ensure that any descriptions of low-carbon business streams which are small in the context of other operations are not emphasised in a way that is misleading.

The FRC expects companies to discuss and, where possible, quantify the expected impact of climate-related risks and opportunities on operating costs and revenues, capital expenditures and capital allocation, acquisitions or divestments, and access to capital, consistent with the all-sector guidance. It is also important to explain the extent to which the proposed strategy is reliant on technology, particularly where that technology is not yet proven or indeed available.

In the context of scenario analysis, sufficient detail should be given to enable users to understand the analysis undertaken and the potential impact on the business strategy. This may include:

- explaining why the specific scenarios have been chosen;
- stating key input assumptions, analytical methods, outputs and sensitivities;
- discussion of how the outcomes have influenced strategic planning and any actions taken as a result; and
- explanations of how the scenarios discussed correspond to the discussions in the financial statements.

Risk management

The TCFD considers that matters relating to risk management provide important context for investors and recommends that these disclosures should be included irrespective of a materiality assessment; the FCA accordingly expects that ordinarily, all disclosures will be made. The FRC found that in most cases companies did provide most of the recommended risk management disclosures and noted that this was the area in which its assessment of consistency with the TCFD framework aligned most closely with that of the companies reviewed.

While most companies made disclosures about the processes in place for identifying, assessing and managing risks and opportunities, far fewer made clear disclosures about the processes for assessing their size and relative significance, although some companies did note that they are undertaking work to improve their data in this regard.

Companies need to ensure that they articulate clearly the process used to identify and assess climate-related risks, including the relative importance of climate to other risks and how regulatory risks that arise because of climate are considered. This should also link to the company's strategic priorities and to other risk disclosures in the annual report. The FRC notes that general information about risk management processes is not sufficient; it needs to be clear how those processes apply to climate-related risks.

The FRC expects companies to describe the principal risks and uncertainties facing the company which relate to climate change, and any significant impacts on the business model. It also notes that if users would reasonably expect climate to be identified as a principal risk but it is not, the FRC encourages companies to explain their rationale for not including it.

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Although the FRC found that companies are generally providing some detail on how they manage risks it notes that this should include how risks are prioritised, explaining any relevant materiality considerations. This should also include discussion of how the company makes decisions to mitigate, transfer, accept, or control climate-related risks.

Companies should also demonstrate clearly how climate-related risk disclosures are linked to or integrated with other general risks (which may include the precise use of cross-references where appropriate) and explain, either in the TCFD disclosures or in the discussion of principal risks, how management of climate-related risk is integrated into the overall risk management process.

Metrics and targets

There should be clear linkage between the metrics reported and the risks and opportunities set out in the strategy and risk management disclosures. The FRC observed that where opportunities were discussed, these were not always clearly linked to metrics. Historic data and future targets should also be given and movements explained as far as possible to enable users to understand the direction of travel and progress made.

The FRC expects companies to consider whether the metrics they report are the most appropriate in the context of the strategy and business model as well as their risks and opportunities, and it advises companies to review and ensure they comply with the updated TCFD guidance on metrics, targets and transition plans on an ongoing basis. Reporting should clearly highlight which KPIs are used to monitor progress against targets and provide sufficient information to assess performance.

Users need to be able to understand how metrics disclosed have been calculated. The FRC states that companies should explain the methodology used to calculate emissions metrics, including whether it is in accordance with the GHG Protocol, the reporting boundaries applied and any changes in the basis of reporting. Companies should explain any judgements made in determining boundaries and which emissions are included; this will be particularly important where disclosed metrics underpin a major policy or strategy. Where there have been changes in methodology or other restatements, those changes and the effect on metrics should be explained.

Although not all companies are reporting Scope 3 emissions as yet, the FRC expects companies to be undertaking assessments to determine the materiality of Scope 3 emissions to users of the financial statements and to report emissions where required, clearly identifying which categories are included. The FRC also notes that failure to disclose Scope 3 emissions, where they are considered material, should be considered in the context of the statement of consistency with TCFD including the reason for the non-disclosure and the anticipated timeframe and steps to be taken to enable reporting.

When reporting intensity ratios, companies should consider whether their chosen ratio is relevant for their business model and industry and if it differs from the ratio commonly used in that industry, they should explain why they have selected it. If there have been significant movements due to business activities such as unplanned shut-downs, acquisitions or disposals, these should be explained.

The TCFD all-sector guidance recommends disclosing internal and external carbon prices where relevant. When discussing carbon pricing, the FRC expects companies to consider the impact of carbon pricing on their strategy and targets as part of any transition plans and consider how this may change in future. It also notes that where relevant, companies should explain how climate-related metrics are incorporated into remuneration policies and whether those targets were met in the year.

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The FRC observed that in disclosures of targets, companies did not always provide sufficiently detailed information around how the targets are defined and progress is assessed. Companies need to use terminology with care, distinguishing between 'targets', 'pledges', 'goals', 'aims', 'commitments' and 'ambitions' and providing explanations where terms such as 'net zero' or 'carbon neutral' are used. Discussion of such targets should include interim milestones, the steps being taken to meet them, the expected timelines and the main areas of uncertainty. In particular, where carbon offsets are used to meet targets this should be made clear.

When making net zero or similar commitments, the FCA notes that companies should ensure that they refer to the TCFD's guidance on Metrics, Targets and Transition Plans.

Linkage between narrative reporting and the financial statements

The FRC and FCA found that although companies are increasingly acknowledging the effects of climate change in the financial statements, more needs to be done to improve consistency with discussion in the narrative reporting. In particular, it expects companies to consider whether climate-related risks that are discussed in the narrative reporting are reflected to the same degree in financial statement disclosures such as judgements and estimates. The report confirms that the FRC may challenge annual reports where companies disclose significant climate risks or net zero transition plans in their narrative reporting but do not explain clearly how these have been taken into account in the financial statements. Companies should also consider financial statement materiality in relation to climate change in the financial statements in the same way as for other accounting and disclosure matters.

The FRC also set out its findings on and expectations for the following specific areas of the financial statements: judgements and estimates, impairment of assets, discount rates, useful lives of assets and segmental disclosures. It also continues to look at whether companies are appropriately addressing the effect of climate change in the context of going concern, inventories, provisions and contingent liabilities, deferred tax assets, expected credit losses and fair value measurement. Further detail on the FRC's findings on climate change and the key expectations for good reporting of climate in the financial statements are discussed in the relevant sections of this publication.

Net zero disclosures

In October 2022, the FRC Lab published a report on net zero disclosures. The report looks at investor expectations and provides substantial guidance for companies on how best to describe and explain their net zero commitments and plans to achieve them. The Lab report covers three key elements of disclosure: commitments, impacts and performance, and investor expectations for each are then assessed as either foundational (providing a basic understanding of the commitment including high-level targets, timelines and impacts) or advanced (giving updates on progress and more detailed information on impact and accountability).

In respect of commitments, investors expect foundational disclosures to set out a clearly defined commitment, including the types of GHG and scopes of emissions included in that commitment, the type of reduction committed to, any boundaries on the commitment and whether they align to the financial statements, the timelines and any plans to use carbon offsets. Advanced disclosures may then include information about whether and when the commitment might be updated, for instance to introduce a more ambitious target.

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When looking at impacts, companies should set out their strategy to net zero and the risks and opportunities associated with it, including how they may affect the business model and broader strategy. Future costs should be estimated, including on capital expenditure and research and development, and any uncertainties or assumptions should be explained and be consistent with other areas of the annual report such as the viability statement. Advanced disclosures may address financing requirements, detailed transition plans and scenario analysis.

Finally in the context of performance, investors expect companies to set out clearly the methodologies and frameworks used for setting targets and measuring progress in the short, medium and long term, including the metrics used. Information should also be given on governance and any links to remuneration. Advanced disclosures may include discussion of any external assurance obtained.

The FRC Lab plans to continue work in this area over the coming year as both investor expectations and reporting requirements for companies increase.

Application of UK company law requirements for climate-related disclosures

Streamlined Energy and Carbon Reporting (SECR)

This is the third December year-end for which the Streamlined Energy and Carbon Reporting (SECR) regulations have been effective. Following its 2021 thematic review of reporting under the SECR regulations, the FRC continues to monitor energy and carbon disclosures as issues continue to arise around SECR compliance, including failure to include required metrics such as energy consumption, and failure to disclose the methodology used. In its reviews of the accounts of unquoted companies, the FRC found that energy and carbon disclosures required by SECR were omitted, in some cases entirely. The messages set out in last year's Closing Out continue to be relevant for UK quoted and unquoted companies and LLPs.

Climate-related financial disclosures for companies and LLPs

In January 2022, the UK government published two statutory instruments which require certain companies and LLPs to make climate-related financial disclosures. These take effect for periods commencing on or after 6 April 2022.

The following entities are in scope:

- All UK companies that are already required to produce a non-financial information statement (i.e. UK public interest entities ('UK PIEs')), being UK companies that have more than 500 employees and:
  - have transferable securities (whether debt or equity) admitted to trading on a UK regulated market; or
  - are banking companies; or
  - are insurance companies.
- UK registered companies with securities admitted to the Alternative Investment Market (AIM) with more than 500 employees.
- UK registered companies which are not included in the categories above, which have more than 500 employees and a turnover of more than £500m (referred to in the legislation as "high turnover companies").
- LLPs which have more than 500 employees and a turnover of more than £500m (referred to in the regulations as "large LLPs").

There are eight disclosure requirements which broadly align to the TCFD recommendations as shown below. Requirements a)-d) are always required, while e)-h) need not be disclosed if not necessary for an understanding of the company's business. However, the reason for any such omissions must be explained .

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TCFD — four pillars of recommended climate-related financial disclosures

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

Government regulations — climate-related financial disclosure

a) a description of the company's governance arrangements in relation to assessing and managing climate-related risks and opportunities	d) a description of: – the principal climate-related risks and opportunities arising in connection with the company's operations, and – the time periods by reference to which those risks and opportunities are assessed; e) a description of the actual and potential impacts of the principal climate-related risks and opportunities on the company's business model and strategy; f) an analysis of the resilience of the company's business model and strategy, taking into consideration different climate-related scenarios.	b) a description of how the company identifies, assesses, and manages climate-related risks and opportunities; c) a description of how processes for identifying, assessing, and managing climate-related risks are integrated into the company's overall risk management process.	g) a description of the targets used by the company to manage climate-related risks and to realise climate-related opportunities and of performance against those targets; h) a description of the key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities and of the calculations on which those key performance indicators are based.

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Companies are required to report this climate-related financial information in the non-financial information (NFI) statement, which is renamed to become the non-financial and sustainability information statement ("the NFSI statement") once the legislation is effective. Companies not currently producing an NFI statement but required by this legislation to prepare an NFSI statement only need to include climate-related information; they do not need to include the other information required by the 2016 Non-Financial Reporting Regulations. LLPs are required to include the information in the energy and carbon report (with the exception of traded and banking LLPs which are required to include the information in the strategic report).

If a company is a subsidiary undertaking at the end of a financial year and is included in the consolidated NFSI statement of a UK parent company, it is exempt from preparing an NFSI statement. Likewise, if an LLP is a subsidiary at the end of the financial year, it is exempt from preparing its own energy and carbon report if it is included either in the consolidated energy and carbon report of a UK parent LLP or in the consolidated NFSI statement of a UK parent company.

Certain companies will find themselves within the scope of both these requirements and those of the Listing Rules discussed above. In such cases, if Listing Rule disclosures consistent with the TCFD framework are included in the annual report, these should normally be sufficient to comply with the legal requirements as well, provided that they are included in the NFSI statement, or by cross-reference if presented elsewhere in the annual report. However, the disclosures must be in the annual report itself to be compliant.

The government has issued non-binding guidance to help with application of these requirements.

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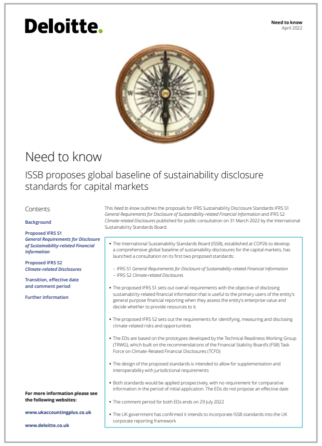
Need to know

UK Government publishes Greening Finance:
A Roadmap to Sustainable Investing

A Deloitte Need to Know gives background information on the UK government's SDR and broader plans for "greening" the UK financial system.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Need to know

ISSB proposes global baseline of sustainability disclosure standards for capital markets

A Deloitte Need to Know gives background information on the ISSB and summarises the proposals in the first two EDs in more detail.

Other global climate-related developments

Progress towards global sustainability reporting standards

The International Sustainability Standards Board (ISSB) is emerging as the global standard-setter for standards on sustainability reporting for capital markets. The UK government has stated that it intends to require UK businesses to report against the standards developed by the ISSB and that it will create a mechanism to adopt and endorse standards issued by the ISSB for use in the UK. These will form part of the UK government's Sustainability Disclosure Requirements (SDR), a single framework of economy-wide disclosures for companies, asset managers and owners, and investment products.

In March 2022, the ISSB published two Exposure Drafts (EDs) for its first IFRS Sustainability Disclosure Standards:

- [Draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information
- [Draft] IFRS S2 Climate-related Disclosures

The ISSB is currently redeliberating the proposals in the EDs in view of the responses received to its consultation and publication of the final standards is expected early in 2023. A recent Financial Stability Board report indicated that 14 out of 24 jurisdictions that are its members reported that they are putting in place structures and processes to bring the ISSB standards into local requirements.

IOSCO has set out its expectations that both disclosures and assurance standards should be ready for use by corporates for their end-2024 accounts. At COP 27 in November 2022, IOSCO Board Chair Jean-Paul Servais said, "In 2023, the ISSB will issue its standard for climate disclosures and general requirements. IOSCO will move promptly to decide on endorsement and will develop a support program for its members to assist them in moving forward immediately should IOSCO decide to endorse these standards. IOSCO also supports the efforts of the ISSB in seeking to be inclusive through its capacity building partnership initiative."

European developments with significant extraterritorial reach

In November 2022, the European Union's Corporate Sustainability Reporting Directive (CSRD) was adopted by the European Parliament and approved by the Council of the European Union. The CSRD aims to improve sustainability reporting in an entity's management report for investors, civil society and other stakeholders, thereby contributing to the transition to a fully sustainable and inclusive economic and financial system in line with the European Green Deal and the UN Sustainable Development Goals (SDGs).

The scope of the CSRD is very wide and extends to many non-EU undertakings not listed on an EU regulated market, including those with substantial activity in the EU (defined as turnover of more than €150 million arising from EU operations) and with at least one subsidiary or branch in the EU.

Entities will have to report on a wide range of sustainability matters using European Sustainability Reporting Standards (ESRS) developed by the European Financial Reporting Advisory Group (EFRAG).

The first set of draft ESRS was submitted to the European Commission (EC) in November 2022 and the EC will now consult EU bodies and Member States on the draft standards, before adopting the final standards as delegated acts in June 2023 (expected), followed by a scrutiny period by the European Parliament and Council.

The effective date of the CSRD depends on the type of company. For EU companies already required to prepare a non-financial information statement, the CSRD is effective for periods commencing on or after 1 January 2024. Large UK and other non-EU companies listed on an EU regulated market (i.e. those meeting two of the three following criteria: more than €20 million total assets, more than €40 million net turnover and more than 250 employees), will be subject to the CSRD requirements for periods commencing on or after 1 January 2025.

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UK and other non-EU companies that are not listed in the EU but which have substantial activity in the EU will be subject to the CSRD for periods commencing on or after 1 January 2028. It will be the EU subsidiary or EU branch of the non-EU company that is responsible for publishing the sustainability report required by the CSRD. However, the specific information required to be included in the sustainability report of a such EU subsidiary or EU branch has not yet been finalised. The Regulation states that it should be prepared in accordance with "standards to be adopted by 30 June 2024 by the EC".

In the USA, the SEC consulted on a proposed rule *The Enhancement and Standardization of Climate-related Disclosures for Investors* in March 2022. Among other things, the proposed rule considers whether foreign private issuers can meet its requirements by reporting under substantially similar guidance to that in the proposed rule.

Integrated reporting

In 2021, the International Integrated Reporting Council (IIRC) published revisions to the International Integrated Reporting Framework (<IR> Framework), originally released in 2013. The revisions place more emphasis on value creation, preservation and erosion; provide for more disclosure from those charged with governance to promote further the integrity of reporting; and expand the coverage of outcomes. The revised <IR> Framework is maintained under the auspices of the IFRS Foundation and is applicable for reporting periods commencing on or after 1 January 2022. Where an entity chooses to adopt the <IR> Framework only in part, the Framework now encourages it to identify which requirements have not been applied and the reasons why. Where an entity states that it follows the Framework, it would be helpful to make clear which version of the Framework is being used.

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FRC focus area

Economic uncertainty

Other narrative reporting requirements

Regulatory messages continue to emphasise the need for authentic, balanced and comprehensive disclosures in annual reports to satisfy the needs of investors. To achieve this, information in the annual report should be integrated and connected between the strategic report and the rest of the annual report.

In this year's annual review, the FRC raised more questions on the strategic report and non-financial reporting requirements of the Companies Act 2006 than in previous years. In some cases, it raised challenges over whether the strategic report was fair, balanced and comprehensive, noting that the financial review should address not only financial performance but also significant changes to the financial position of the company (i.e. the balance sheet) and significant movements in the cash flow statement. It also noted that where matters appear significant, such as prior year restatements, use of government funding and climate-related risks, companies need to ensure that these matters are discussed in appropriate detail and in a balanced manner in the strategic report.

In the current uncertain economic environment, the FRC particularly expects companies to use the strategic report to articulate clearly the risks and uncertainties the business faces as a result of economic pressures, together with mitigation strategies and any effects on the strategy and business model. These discussions should be consistent with disclosures made in the financial statements, particularly regarding sensitivities, assumptions and sources of uncertainty.

The FRC also noted some instances of non-compliance with other legal requirements for company narrative reporting. In its reviews of the accounts of large private companies, it noted that the s172(1) statements of large private companies were not always complete, missing information about the directors' engagement with suppliers, customers and others in a business relationship, and the effects of that engagement on the principal decisions taken by the directors during the year.

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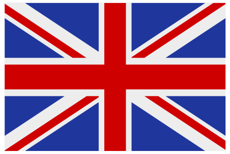
FRC focus area



Corporate governance

In November 2022, the FRC published its annual Review of Corporate Governance Reporting which sets out its observations on key developments and areas of focus for 2022/23 annual reports. The FRC observed improvements in corporate governance reporting, but noted that companies still need to go further in reporting how they apply the principles of the UK Corporate Governance Code ("the Code") and comply with the provisions. The report highlights areas of high-quality reporting and provides good practice examples, but also draws attention to improvements needed in reporting on areas such as workforce and wider stakeholder engagement, diversity and oversight of the effectiveness of the risk management and internal control systems.

Compliance with the Code

The FRC highlights that high-quality reporting should show in a clear manner how the board has successfully applied the principles of the Code to achieve effective outcomes for the company, shareholders and other stakeholders. In terms of compliance with the provisions, the FRC expects companies to make it easy for users of the annual reports to understand whether the company has fully complied with all elements of the provisions of the Code throughout the financial year; or in the case of departure from the Code, the provision(s) it has not complied with and the explanation for non-compliance. A clear and meaningful explanation should be provided for any departures, particularly where non-compliance is long-term or indefinite. The explanation should include the following elements: the context and background; a convincing rationale for the approach being taken; any risk and mitigating actions considered; and a timescale to set out when the company intends to comply (where relevant).

Culture, purpose and values

The FRC continues to focus on culture, purpose and values and enhanced reporting is expected. The report should demonstrate how the company's culture is aligned to its purpose, values and strategy. Well aligned reporting on corporate purpose, values, strategy and culture demonstrates that a company is fully leveraging the benefits that this alignment can have on its performance and stakeholders. The FRC expects companies to report not only on the outcomes from their culture assessment and monitoring activities, but also on the impact of any remedy initiatives to assess their effectiveness in the following reporting year.

Diversity

While it noted an improvement in the disclosure of diversity policies, the FRC continues to highlight that those policies should include objectives and targets, and link to company strategy, along with actions taken to implement the policy and progress on achieving objectives. These elements form part of the reporting requirements in Provision 23. Also, companies should make clearer links on how their targeted diversity objectives and initiatives link to company strategy.

Remuneration

Companies should look to provide specific explanations and directly refer to their corporate purpose and values when discussing their executive remuneration arrangements. The remuneration framework should demonstrate how purpose and values are aligned to the benefits. Further, the FRC reminds companies that Provision 40 requires the board to engage effectively with shareholders and the workforce on remuneration issues. In line with Provision 41, the annual report should describe how the company has engaged with the workforce to explain how executive remuneration aligns with wider company pay policy. To comply with these provisions, companies should not only engage with shareholders and employees but also explain the outcome of their engagement.

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Review of the risk management and internal control systems

As last year, the report makes clear that improvements are required in this area and that companies are expected to explain how they have monitored their risk management and internal control systems throughout the year and any changes made to ensure their continuous effectiveness. As a reminder, Code Provision 29 states the following: *"The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls."* This is supplemented by paragraph 58 in the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting which states that *"the board should summarise the process it has applied in reviewing the effectiveness of the system of risk management and internal control. The board should explain what actions have been or are being taken to remedy any significant failings or weaknesses."*

In relation to reporting on the outcome of the review, the FRC makes clear that disclosure should demonstrate the current state of the risk management and internal control systems confirming the effectiveness of these systems or, where weaknesses or inefficiencies have been found, describing these in the report and explaining what actions the board has taken, or will take, to remedy these.

Stakeholder engagement

For stakeholder engagement the FRC wants companies to demonstrate how the board ensures effective engagement with shareholders and stakeholders by including details of actions taken by the board and outcomes from the engagement, i.e. what was the feedback from the shareholders and stakeholders, and the impact it had on board discussions and decision-making.

In particular, the FRC reminds boards that Provision 3 encourages committee chairs to seek engagement with shareholders on significant matters related to their areas of responsibility. The review notes that they found only two companies within their sample stating that the chair of the nomination committee met with the shareholders, and that none of the companies sampled reported engagement from the chair of the audit committee.

Good practice workforce engagement reporting includes an explanation of why the company has chosen their engagement mechanism and how it will monitor this mechanism to ensure that it is and remains effective.

Linked to the changes arising from the government's White Paper: 'Restoring trust in audit and corporate governance', the FRC intends to consult in 2023 on changes to the UK Corporate Governance Code and supporting material, with a view to the new Code applying to periods commencing on or after 1 January 2024.
The consultation will focus on:

- provision of a stronger basis for reporting on and evidencing the effectiveness of internal control around the year end reporting process;
- inclusion of wider responsibilities of the Board and Audit Committee for expanded sustainability and ESG reporting and, where commissioned by the company, assurance of that reporting;
- consideration of how audit tendering undertaken by the company takes account of the need to expand market diversity;
- strengthened reporting on malus and clawback remuneration arrangements; and
- areas of reporting already identified by the FRC as being weaker as set out in their most recent reviews of governance reporting.

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Capital maintenance and distributable reserves

Investors continue to call for clearer disclosures and greater transparency around distributable reserves, while broader stakeholders are also looking for visibility over how companies allocate their capital beyond returns to shareholders and debt investors. In its annual review, the FRC noted that in a number of instances, distributions or share repurchases out of distributable profits appeared to have been made unlawfully and it reiterated its expectation that companies clearly comply with their legal obligations in this regard.

In May 2022, the government's response to feedback on its White Paper: 'Restoring trust in audit and corporate governance' set out its intention to introduce stronger disclosure requirements on distributable reserves. Although it is not yet clear when these requirements would come into force, the direction of travel is clear and companies are therefore advised to consider disclosing their distributable reserves and increased information about capital allocation and dividend policies now.

Under the government's plans, companies with 750 or more employees and at least £750m annual turnover would be required to disclose their distributable reserves together with an explanation of the board's long-term approach to the amount and timing of returns to shareholders (including dividends, share buybacks and other capital distributions) and how this policy has been applied in the year. The distributable reserves disclosure would be subject to audit.

Directors would also need to make an explicit statement confirming the legality of proposed dividends and any dividends paid in-year. The successor of the FRC, the Audit, Reporting and Governance Authority (ARGA), will, once established, issue guidance on what should be treated as realised profits and losses for the purposes of determining distributable reserves, replacing the existing guidance in TECH 02/17BL *Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006*, published by ICAEW and ICAS. However, the Government has decided not to proceed with the proposal for a directors' assurance that a dividend would not be expected to jeopardise the future solvency of the company over a period of two years.

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Economic uncertainty

Going concern and viability

Many companies will be affected by the current uncertain economic environment which may lead to uncertainty about the ability of an entity to continue as a going concern, either through direct disruption of the operations of a business or more indirectly through the effects of inflation, increased energy prices and other macroeconomic developments. Such economic pressures or changes might render a business model unviable or access to necessary debt financing might be limited.

As a result, companies will need to take into account all of these considerations in assessing a) whether they might be unable to continue as a going concern for a period of at least 12 months from the date of approval of the financial statements and b) the effect of uncertainty on risks, assumptions, scenarios and mitigating actions discussed in the longer-term viability statement.

The annual report should be prepared on a going concern basis unless management intends either to liquidate the entity or to cease trading or has no realistic alternative but to do so. When making this assessment, if management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity must disclose those uncertainties or significant judgements taken in reaching a conclusion that no material uncertainty exists.

In May 2022, the government's response to feedback on its White Paper: 'Restoring trust in audit and corporate governance' set out new plans to require companies with 750 or more employees and at least £750m annual turnover to prepare a resilience statement. These companies would be required to report on matters that they consider a material challenge to resilience over the short and medium term, together with an explanation of how they have arrived at this judgement of materiality. Guidance would be developed by the FRC (or its successor, ARGA) and it is intended that the resilience statement would replace the current requirement to prepare a viability statement.

The statutory reporting requirements would set out a list of matters which boards should "have regard to". Boards would be free to choose the length of the assessment period for the medium-term section but an explanation must be provided. At least one reverse stress test should be included. Companies would be required to:

- identify annually a combination of adverse circumstances which would cause its business plan to become unviable;
- assess the likelihood of such a combination of circumstances occurring; and
- set out any mitigating actions put in place as a result.

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The European Single Electronic Format (ESEF)

For periods commencing on or after 1 January 2021, companies listed on UK regulated markets were required for the first time to publish and file their annual financial reports in XHTML web browser format and upload to the FCA's National Storage Mechanism under the UK implementation of the European Single Electronic Format (ESEF). For periods commencing on or after 1 January 2022, the remaining requirements of ESEF come into effect, meaning that issuers preparing consolidated annual financial statements in accordance with International Financial Reporting Standards (IFRS) are required to tag financial information including the notes to the financial statements.

Following its October 2021 report on early adopters, which identified significant issues, in September 2022 the FRC's Financial Reporting Lab published a further review of structured digital reporting which noted some improvement but that much remains to be done and that data quality and usability do not yet meet the standards that the FRC expects to see from listed companies. The full report, which is split into three areas – Process, Usability and design and Tagging - is accompanied by a one-page summary of findings, expectations and suggestions for better practice. The FRC Lab also sets out some advice for applying the new requirements for 2022 to tag the notes to the financial statements, including accounting policies.

Process

Although the FRC Lab noted that companies are now making use of the FCA's test facility to minimise submission issues, there are still numerous rejected filings due to incorrect naming or structure of the submitted file. It also highlighted that more needs to be done to educate and engage management and the board in the tagging process. As the process is often outsourced to external providers, this would help to ensure that there is clear ownership and review of the structured report by the company.

Usability and design

Overall the design of structured reports is improving with fewer issues arising around incorrect fonts and images displaying. The FRC Lab recommends that companies should make a validated report available on their websites with an inline viewer to enhance usability of the report, and it also cautions companies to be mindful of the shorter timing of publication of the report which is now reverting to four months following the year-end. Companies are also encouraged to consider accessibility needs in designing their structured reports.

Tagging

The FRC Lab noted that the use of 'concealed tags' has now largely disappeared, but advises that companies need to consider carefully their selection of tags, focusing on the accounting meaning of their disclosures and avoiding unnecessary extensions. Companies may also now wish to think about introducing voluntary tagging in more detail where the information is of particular interest to users; examples given by the FRC Lab include disclosure of retrospective restatements, reconciliation of alternative performance measures to the nearest GAAP measure and segmental reporting.

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FRC focus area

Economic uncertainty

The use of 'non-GAAP' or alternative performance measures

Alternative performance measures (APMs), also known as non-GAAP measures, are any financial measures of an entity's historical or future performance, position or cash flows other than those defined or specified in the applicable financial reporting framework.

Significant economic changes or unusual events often and understandably lead to a desire to highlight their effects on performance or what an entity's profit may have been had an event not occurred. However, care must be taken in following such an approach. The pervasive nature of the impact of such changes or events means that a separate presentation may not faithfully represent an entity's overall financial performance and may be misleading to users' understanding of the financial statements (for example, an 'excluding impact of the increase in energy prices' profit figure would reflect an economic environment that did not, in 2022, exist).

In general, when evaluating whether the effect of an economic or geopolitical event can appropriately be reflected via a non-GAAP measure or APM, factors including, but not limited to, the following should be considered:

- Can the item to be excluded from an adjusted measure be demonstrated to directly relate to the event or economic condition?
- Is the item incremental to or discrete from normal operations rather than a reflection of 'the new normal'?
- Is the item objectively quantifiable, as opposed to an estimate or projection?

Instead of seeking to present the wide-ranging impacts of such an event separately in profit or loss, it is more likely to be appropriate to disclose, in the notes, qualitative and quantitative information on the significant impacts, the judgements and assumptions applied in the recognition, measurement and presentation of assets, liabilities and impacts on profit or loss.

Such impacts should be provided in a clear and unbiased way. When including non-GAAP measures or alternative performance measures (APMs) in management reports, entities should also consult the still relevant IOSCO Statement on Non-GAAP Financial Measures and ESMA Guidelines on Alternative Performance Measures (updated in 2020), both of which remain relevant.

APMs continue to feature in the FRC annual review and many of the messages are similar to previous years. The FRC reminds companies that they should apply the ESMA Guidelines on Alternative Performance Measures when preparing their annual report. It noted that some companies continue to present APMs which contain adjustments related to the effects of COVID-19, without explaining how such items were identified and quantified or how any potential future reversals would be tracked. Companies should also refer back to the FRC's COVID-19 thematic review published in July 2020.

Some companies continue to use APMs with greater prominence than GAAP measures in the narrative reporting, particularly in the chair's statement and CEO's review. Where APMs are discussed, the related GAAP measures should also be given and should have at least equal prominence. APMs should be used consistently from year to year and companies should not stop presenting them solely because they become negative.

Classification of amounts as "adjusting", "non-underlying", "non-core" or similar terminology should be adequately explained along with any changes to APMs, including the reasons for those changes. Definitions of adjustments and APMs should be applied consistently, and multi-year restructuring programmes should not be referred to as 'one-off' or 'non-recurring'.

APMs should be labelled consistently and reconciled to the most directly reconcilable line item, sub-total or total of the financial statements. The reconciling figures should also agree to their corresponding amounts in the financial statements. Explanations and calculations should be given, (for example for APMs such as financial ratios and constant currency measures) and the tax effect of adjusting items should be disclosed.

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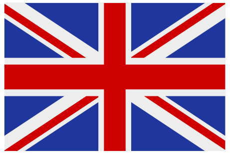
FRC focus area



Cash flow statements

Cash flow statements have been identified as the most frequently raised topic in the FRC annual review. This is an area which requires significant improvement and therefore remains a major focus area going into the 2022/23 reporting season. In November 2020, the FRC issued a thematic review on cash flow and liquidity disclosures which provides details on issues raised in the statement of cash flows in recent years.

In the annual review, the FRC noted that as a result of its enquiries, 15 companies were required to restate their cash flow statements. The restatements related to both consolidated and parent company accounts. Most of the errors identified related to the classification of cash flows as operating, investing or financing cash flows. Other areas identified related to reported cash flows and disclosures.

Classification of cash flows

The FRC found that companies were applying their accounting policies inconsistently for similar items, such as interest on leases and interest on borrowings. In the parent company financial statements, classification issues specifically related to amounts borrowed from subsidiaries which were classified as operating activities rather than financing cash flows and amounts lent to subsidiaries which again were classified as operating activities rather than investing cash flows.

Reported cash flows

The FRC noted inconsistencies between amounts in the statement of cash flows and amounts disclosed elsewhere in the annual report and has included a useful consistency checklist in the appendix to the thematic review. Other issues related to inappropriate reporting of cash flows on a net basis and inappropriate inclusion of non-cash transactions in the statement of cash flows. In addition, it reminded companies that meaningful descriptions should be provided for reconciling items in the reconciliation to cash generated from operations and inappropriate aggregation of items should be avoided.

Disclosures

Disclosures required by IAS 7 *Statement of Cash Flows* were often missing, the most common of which was the requirement to disclose "the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group" (often referred to as 'restricted cash'). This disclosure requirement may be impacted by the current economic environment, as it not only relates to cash held in 'escrow' accounts, but also cash held by subsidiaries that cannot easily be remitted to the parent due to exchange restrictions in existence in several jurisdictions.

The reconciliation of liabilities from financing activities, introduced in 2017, requires disclosure of movements (both cash and non-cash) in financing liabilities. Companies should avoid inappropriate aggregation of balances within the reconciliation with the FRC specifically noting that movements relating to lease disposals and lease modifications should be presented separately.

At a high level, the purpose of the statement of cash flows is to show movements in the opening and closing balances of 'cash and cash equivalents', therefore careful consideration needs to be given as to the amounts included within that balance. In particular, only investments with a maturity of three months or less from the date of acquisition would normally be considered a cash equivalent.

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Demand deposits with restrictions on use

In April 2022, the IFRS Interpretations Committee ('the Committee') published an agenda decision about whether a demand deposit that is subject to contractual restrictions on use agreed with a third party meets the definition of 'cash' in IAS 7. In the fact pattern discussed, the entity had to keep a specified amount of cash in a separate demand deposit and could use the cash only for specified purposes.

The Committee concluded that restrictions on the use of a demand deposit arising from a contract with a third party do not result in the deposit no longer being cash, unless those restrictions change the nature of the deposit in a way that it would no longer meet the definition of cash in IAS 7. In the fact pattern discussed, the contractual restrictions do not change the nature of the deposit—the entity can access those amounts on demand. Therefore, the Committee concluded that the entity includes the demand deposit as a component of 'cash and cash equivalents' in its statement of cash flows and in its statement of financial position.

When relevant to an understanding of its financial position, the entity would disaggregate the 'cash and cash equivalents' line item and present the demand deposit separately in an additional line item. The demand deposit should be classified as current unless it is "restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period". The entity would also consider whether to disclose additional information in the context of the requirements in IFRS 7 about liquidity risk arising from financial instruments and how an entity manages that risk. Further disclosure may be appropriate if the information an entity provides in applying the disclosure requirements in IAS 7 and IFRS 7 is insufficient to enable users of financial statements to understand the impact of the restrictions on the entity's financial position.

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FRC focus area

Climate change

Economic uncertainty

Financial instruments

Financial instruments were the second most-commonly challenged topic in this year's FRC annual review, with more substantive questions raised this year compared to the previous year. The FRC found that in several cases, accounting policies or disclosures did not fully explain how particular transactions or financing arrangements were reflected in the financial statements and questions continued to be raised regarding disclosure of expected credit loss (ECL) provisions.

> The requirements for FRS 102 reporters in respect of financial instruments differ from those in IFRS Accounting Standards. More detail can be found in chapters B11 and B12 of GAAP in the UK on DART.

Scope, recognition and measurement

The FRC noted that companies need to provide clearer explanations of the accounting treatment in certain areas, including derivatives used in cash flow hedges, financial guarantees, forward purchase contracts of own shares and non-controlling interest (NCI) put options. It expects accounting policies to be provided for all material financing (including factoring and reverse factoring) and hedging arrangements, and any changes in the arrangements.

ECL provisions and credit risk

In the context of ECL provisions and credit risk, the FRC observed that some companies were failing to disclose their impairment assessment for financial assets other than trade receivables, including contract assets, intercompany balances and other related party receivables. Non-banking companies should also ensure that they include the necessary credit risk-related disclosures around inputs, assumptions and estimation techniques used to apply the IFRS 9 impairment requirements, and information about credit risk management practices, including the company's definitions of default and the basis for selecting those definitions. For financial institutions, the FRC noted some cases where insufficient information was given to explain post-model adjustments and overlays. The FRC expects companies to discuss their approach and significant assumptions in measuring ECL provisions, including disclosure of concentrations of risks where material. Historical default rates used in making ECL assessments should also be reviewed and adjusted, particularly in the context of forecast future economic conditions.

Other disclosures

The FRC also identified some areas for improvement around liquidity disclosures, including information about invoice discounting arrangements, terms and conditions of bank loans and borrowings and banking covenants. It expects sufficient information to be given about banking covenants and the effect of refinancing arrangements to enable users to understand their terms and the potential impact of any changes or breaches, unless considered remote.

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Economic uncertainty

Reporting the effects of income taxes

Entities should consider how lower or more volatile profit levels stemming from the current macroeconomic environment might influence income tax accounting. For example, a reduction in current-period income or the incurrence of losses, coupled with a reduction in forecast income, could result in a reassessment of whether it is probable that some or all of an entity's deferred tax assets can be recovered. If declining earnings or impairments generate losses, entities will need to consider whether there is sufficient income within the carry-back and carry-forward period available under tax law to full or partially realise the related deferred tax asset.

Applying IAS 12, an entity may not have recognised deferred tax liabilities for taxable temporary differences associated with subsidiaries, branches and associates, and interests in joint arrangements, because it concluded that it controls the timing of the reversal of the temporary difference and it has been deemed probable until now that the temporary difference will not reverse in the foreseeable future. Conversely, an entity may have recognised deferred tax assets for deductible temporary differences associated with such investments because it determined that it was probable that the temporary difference would reverse in the foreseeable future (and it was probable that the deferred tax asset could be recovered). If an entity or its subsidiaries have liquidity issues or other challenges resulting from the current macroeconomic environment such that there is a change in intent with respect to the repatriation of undistributed earnings in an investee, it may be appropriate to reconsider these conclusions.

Disclosure is also important in this area, in particular of entity-specific information about the nature of the evidence supporting the recognition of deferred tax assets when there is a recent history of losses, and deferred tax judgements and estimates, including relevant sensitivities and/or the range of possible outcomes in the next 12 months.

FRC focus area

Deferred tax assets

During the COVID-19 pandemic, more companies reported losses or a reduction in profits. This has led to an increase in the recognition of significant deferred tax assets prompting the FRC to perform a thematic review on this topic. The thematic review, published in September 2022, considered the basis of recognition of deferred tax assets and the related disclosures under IAS 12 as well as the guidance set out in the ESMA public statement "Considerations on recognition of deferred tax assets arising from the carry-forward of unused tax losses" ('the ESMA public statement'), issued in July 2019.

Basis of recognition

IAS 12 requires deferred tax assets to be recognised to the extent that it is probable (i.e. more likely than not) that sufficient future taxable profits will be available against which the deductible temporary difference or unused tax losses or credits can be recovered or utilised. In assessing the availability of future taxable profits, companies should consider all available evidence and forecasts of future taxable profit and should use the same underlying assumptions as the company's forecasts of future cash flows used for impairment, going concern and longer-term viability assessment purposes, noting the following exceptions:

- Cash-generating units for IAS 36 might not align with taxable companies for IAS 12 purposes.
- Pre-tax cash flows used for IAS 36 may not be the same as taxable profits.
- Discounting is not permitted under IAS 12.
- IAS 12 permits the consideration of tax planning opportunities, so it may be possible to reflect future restructuring plans for IAS 12 purposes but not in IAS 36 forecasts.

The FRC expects companies to disclose clearly the assumptions used and scenarios considered in forecasting future taxable profits, and state whether these are consistent with other forecasts and assumptions in the financial statements.

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IAS 12 does not provide a specific period for the profit forecast, but the FRC noted that companies often used a longer period than that covered by the company's viability statement. The FRC encourages companies to disclose the period of the assessment, their rationale for the assessment period used and to consider disclosing it as a key judgement.

IAS 12 states that where unused tax losses exist, this provides strong evidence that future taxable profits may not be available. However, in recent years the COVID-19 pandemic may have given rise to unusual losses which are not expected to recur. The FRC expects companies to disclose the key assumptions made in determining whether such losses may give rise to the recognition of a deferred tax asset.

The FRC also reminded companies in its review of the need to reassess the level of recognition of deferred tax assets when material new deferred tax liabilities arise in the same taxable entity and relating to the same tax authority. Where there are material deferred tax liabilities and unrecognised deferred tax assets, it also notes that it is helpful for companies to explain why the assets have not been recognised.

Disclosure

Through its review, the FRC did not identify any obvious issues in relation to the amount of deferred tax assets recognised but found it difficult to make a full assessment in some cases due to the lack of informative disclosures. The FRC expects companies to make transparent and informative tax disclosures that are consistent across the annual report as summarised below.

History of losses:

- Disclosures should be specific to the company's situation and make reference to specific improvements in profitability expected to occur during the forecast period.
- Companies should state the period over which the forecast is made and explain whether the forecasts used are consistent with those used elsewhere in the annual report (e.g. impairment, viability); if they are not consistent, companies should explain why not.
- Where a loss is due to an event that is not expected to recur (e.g. COVID-19), this should be stated.

Unrecognised deferred tax assets:

- Companies should ensure that they disclose the gross amount of any deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised, and not the amount of the unrecognised deferred tax asset alone.
- Better disclosures analysed the expiry dates of unused tax losses and credits in time bands, and quantified losses with no expiry date.

Judgements and estimates:

- Disclosure of judgements and estimates related to the recognition and measurement of deferred tax assets should be specific to the company's circumstances. The level of detail given should be consistent with the level of judgement and estimation uncertainty involved in assessing the recovery of the deferred tax assets.
- The FRC identified minimal disclosure of sensitivities or reasonably possible outcomes in relation to deferred tax. If a significant estimate has been made, the FRC expects companies to disclose any relevant sensitivities and/or the range of reasonably possible outcomes in the next year.

Impact of climate change on deferred tax:

- As also highlighted in its TCFD thematic review, the FRC expects the extent of disclosure about how climate change risks have been reflected in deferred tax judgements and estimates to be consistent with the degree of emphasis placed on those risks in the narrative reporting, including TCFD disclosures.

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Other disclosures:

- IAS 12 requires deferred tax assets and liabilities to be disclosed by type of temporary difference, unused tax loss and unused tax credit. The FRC therefore expects the nature of temporary differences giving rise to individually material deferred tax balances, and material movements in balances, to be disaggregated and explained.
- Individually material components of the tax expense should be presented separately and appropriately and specifically described.
- There should be consistency between the discussion of the current and expected future expected tax rate in the strategic report with the related tax disclosures in the accounts.
- In describing the accounting policy for deferred tax, companies should use language and terminology consistent with IAS 12 and should ensure that the policy covers all material aspects of deferred tax that arise in the financial statements.

OECD Pillar 2

In March 2022, the Organisation for Economic Co-operation and Development (OECD) released technical guidance on its 15% global minimum tax agreed as the second 'pillar' of a project to address the tax challenges arising from digitalisation of the economy. This guidance elaborates on the application and operation of the Global Anti-Base Erosion (GloBE) Rules agreed and released in December 2021 which lay out a co-ordinated system to ensure that Multinational Enterprises (MNEs) with revenues above €750 million pay tax of at least 15% on the income arising in each of the jurisdictions in which they operate.

Over 135 countries and jurisdictions have agreed processes to incorporate the 'Pillar Two' into tax law are underway in a number of jurisdictions. It should be noted that IAS 10 *Events After the Reporting Period* gives as an example of non-adjusting events that generally require disclosure "changes in tax rates or tax laws enacted or announced after the reporting period that have a significant effect on current and deferred tax assets and liabilities".

Accordingly, entities should assess whether the OECD technical guidance together with the level of commitment of the applicable governments to its implementation constitute the announcement of a change in tax laws in the jurisdictions in which they operate. If this is the case and if the entity concludes that the rules may have a significant effect on its operations, it would disclose that fact in its financial statements along with an estimate of the impact or a statement that such an estimate cannot be made.

Relevant to this disclosure might be the considerations of the IASB on how to deal with the challenges of applying IAS 12 (particularly in respect of deferred tax) to a Pillar Two framework. At its November 2022 meeting, the IASB tentatively decided to introduce a temporary exception from accounting for deferred taxes arising from the implementation of Pillar Two, together with targeted disclosures requirements for affected entities.

Publication of an exposure draft of these proposals is expected in January 2023, with finalisation of any amendments targeted for the second quarter of 2023.

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FRC focus area

Revenue

The FRC noted in its annual review that fewer substantive queries on revenue recognition and related disclosures were raised in comparison with recent years. It raised challenges where it was unclear whether the identification of performance obligations was appropriate or whether revenue should be recognised at a point in time or over time. Missing accounting policies for contract modifications or lack of entity-specific details about variable consideration were also challenged, and in some cases it was unclear how an entity had concluded whether it was acting as agent or principal. Inconsistencies were also noted where the narrative reporting suggested that certain revenue streams existed but these were not adequately explained in the financial statements.

For 2022, the FRC expects companies to ensure that inflationary features in contracts with customers are described and the accounting treatment for such clauses (that is, whether the feature is an embedded derivative or variable consideration) is explained. Accounting policies should be provided for all significant performance obligations and should address the timing of revenue recognition, the basis for recognising any revenue over time and the methodology applied. Finally, the FRC reiterates that significant judgements made in relation to revenue recognition need to be disclosed (for example, in relation to the allocation of the transaction price and the timing of satisfaction of performance obligations).

The requirements for FRS 102 reporters in respect of revenue differ from those in IFRS Accounting Standards. More detail can be found in chapter B23 of GAAP in the UK on DART.

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FRC focus area

Climate change

Economic uncertainty

Provisions and contingent liabilities

The FRC raised more substantive queries on provisions and contingencies in its annual review this year, although these included some that were identified as part of its thematic review on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, published in October 2021. In particular, the FRC found a number of instances where it was not clear how companies had accounted for insurance/self-insurance arrangements and associated reimbursement assets. It also noted that it challenged companies where disclosures elsewhere in the annual report suggested that there might be undisclosed contingent liabilities or unrecognised provisions.

Going forward, companies should ensure that the inputs used in measuring provisions follow a consistent approach in incorporating the effects of inflation. Nominal cash flows, which include the effect of inflation, should be discounted at a nominal rate and real cash flows, which exclude the effect of inflation, should be discounted at a real rate. Details of how the inflation assumptions have been calculated should be provided where they have a material impact on the financial statements. Clear and specific descriptions of the nature and uncertainties need to be given for each material exposure for which a provision is recognised or a contingent liability is disclosed, as well as the timeframe over which it is expected to crystallise and the basis for determining the best estimate of the probable or possible outflow.

Negative Low Emission Vehicle Credits

In July 2022, the IFRS Interpretations Committee published an agenda decision that discusses whether particular measures to encourage reductions in vehicle carbon emissions give rise to obligations that meet the definition of a liability in IAS 37. In the fact pattern discussed, entities receive positive credits if, in a calendar year, they have produced or imported vehicles whose average fuel emissions are lower than a government target. Entities receive negative credits if, in that year, they have produced or imported vehicles whose average fuel emissions are higher than the target.

In the fact pattern considered, an entity can settle an obligation to eliminate negative credits either by purchasing credits from another entity or by generating positive credits itself in the next year. The Committee concluded that either method of settling the obligation would result in an outflow of resources embodying economic benefits. These resources are the positive credits the entity would surrender to eliminate the negative balance. The entity could otherwise have used self-generated positive credits for other purposes—for example, to sell to other entities with negative credits.

The Committee concluded that in the fact pattern the activity that gives rise to a present obligation is the production or import of vehicles whose fuel emissions, averaged for all the vehicles produced or imported in that calendar year, are higher than the government target.

The Committee concluded that the measures described in the fact pattern could give rise to a legal obligation that arises from measures as a result from an operation of law. The sanctions the government can impose under the measures would be the mechanism by which settlement may be enforceable by law.

An entity would have a legal obligation that is enforceable by law if accepting the possible sanctions for non-settlement is not a realistic alternative for that entity. The Committee observed that determining whether accepting sanctions is a realistic alternative for an entity requires judgement—the conclusion will depend on the nature of the sanctions and the entity's specific circumstances.

The Committee concluded that, if an entity determines that it has no legal obligation to eliminate its negative credits, it would then need to consider whether it has a constructive obligation to do so. It would have a constructive obligation if it has both:

- in a calendar year, produced or imported vehicles with average fuel emissions higher than the government target; and
- taken an action that creates valid expectations in other parties that it will eliminate the resulting negative credits—for example, made a sufficiently specific current statement that it will do so.

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FRC focus area

Climate change

Economic uncertainty

Presentation of financial statements – IAS 1 considerations

Judgements and estimates

When reporting in uncertain times, it is particularly important to provide users of the financial statements with sufficient information to enable them to understand the key assumptions and judgements made when preparing financial information. Depending on an entity's specific circumstances, many of the areas discussed in this publication may give rise to a significant judgement over the characterisation of an item or transaction or a source of estimation uncertainty over its measurement, for which disclosures may be required by IAS 1:122-133.

During the year, the FRC issued an update to its 2017 thematic review on judgements and estimates. While no longer the most commonly challenged area in the annual review, disclosure of judgements and estimates continues to feature in the FRC's list of the top ten topics that arose most frequently in correspondence with companies. The FRC noted further improvements in the quality of reporting of judgements and estimates, particularly highlighting that significant estimates are now better supported by quantification and some degree of sensitivity analysis disclosure, and companies are making better use of effective cross-referencing to other areas of the financial statements and annual report as a whole. However, there is still work to be done.

Distinction between judgements and significant estimates

Judgements made by management in applying an entity's accounting policies should be shown separately from estimates that depend on management assumptions about the future and other major sources of estimation uncertainty required by IAS 1.125. Where companies are unable to present these separately due to the nature of the underlying issue (for instance, because the judgements and estimates made are so interrelated), the individual areas of judgement or estimation uncertainty should be made clear.

Significant estimates are those estimates with a significant risk of resulting in a material adjustment to carrying amounts of assets and liabilities in the next financial year. The FRC expects companies to make explicit statements about whether estimates have a significant risk of a material adjustment to the carrying amount of assets and liabilities within the next financial year, rather than simply label estimates as 'critical' or 'key sources of estimation uncertainty'. If other estimates are also disclosed, these should be clearly distinguished from those classified as significant and the reason for their disclosure should be explained.

In discussing estimates, the FRC expects companies to provide sufficient granularity in the descriptions of assumptions and/or uncertainties to enable users to understand management's judgements, particularly where these are difficult, subjective or complex in nature. Companies should also assess whether disclosures made in previous periods need to be revised on an annual basis as sources of estimation uncertainty can vary from year to year and disclosures should distinguish those estimates that have lower attached risk, smaller impact or coming to fruition over a longer period from those with a significant, short-term effect.

Sensitivities and range of outcomes

The FRC reminded companies that it expects disclosure of the sensitivity of carrying amounts to assumptions and estimates, and/or the range of reasonably possible outcomes within the next financial year more often, and in the way that is most meaningful to users of the financial statements. Sensitivity disclosures should be consistent with other disclosures in the annual report and companies should state whether sensitivities reflect reasonably possible changes in assumptions or are provided for another reason. Consideration should also be given to whether quantification is necessary for any other significant estimates to fully understand their effects.

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Judgements and estimates in respect of climate change
The thematic review on judgements and estimates notes that all expectations raised in the thematic apply equally to significant estimates relating to climate change. Where significant estimates relating to climate change are disclosed in a separate note or section of the financial statements, companies should consider the use of cross referencing to highlight clearly these issues to users. Additionally, the FRC TCFD thematic review notes that in disclosing judgements and estimates, companies should consider providing additional explanations of how Paris-aligned outcomes have been taken into account when preparing the financial statements.

Where the impact of climate change is mentioned within estimates disclosures, better practice is to be clear as to the timing of such impact, in particular, whether there is a significant risk of material adjustment to carrying values in the next year, or, where not, that they could have a medium to longer-term impact. For instance, government regulation to decarbonise the economy may have a material impact over a longer timeframe and companies should consider whether related disclosure may be relevant in accordance with IAS 1.112(c). Conversely, where climate change is not expected to lead to a significant risk of material adjustment and is therefore not discussed as a source of estimation uncertainty, it may be helpful to confirm this, particularly where users may reasonably expect climate change to have a significant impact on the business.

Other presentation and disclosure issues

The FRC annual review also addressed some further issues related to the presentation of financial statements and related disclosures. In particular, it expects that:

- companies should take care not to offset income and expenses inappropriately;
- companies should ensure that the classification of assets and liabilities as either current or non-current under IAS 1 is appropriate;
- accounting for material transactions should be accompanied by an accounting policy and more generally any material accounting policy information should be clearly disclosed;
- material transactions should be further supported with sufficient relevant detail for users to understand the substance of the transaction;
- items of a similar nature should be presented and classified consistently year on year; and
- where compliance with the specific requirements of IFRS Accounting Standards is insufficient to explain the impact of transactions, events or conditions on the company's financial position and performance, additional disclosures should be provided and should be specific to the company.

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FRC focus area

Climate change

Economic uncertainty

Impairment and the useful lives of assets

The FRC notes that it has seen improvements in the quality of disclosures in this area, but there remains scope for further improvement, considering particularly the ongoing uncertainties in the economic environment. It expects companies to explain the sensitivity of recoverable amounts to changes in assumptions, particularly where the range of reasonably possible outcomes has widened under a more uncertain outlook. Companies should also address any effects on the assumptions made in the impairment assessment relating to potential reduced customer demand, increased costs and other factors that affect the business in the current economic environment.

Companies are also reminded that, particularly in the current environment of high inflation, inputs used in value-in-use calculations need to be consistent in incorporating the effect of inflation (i.e. nominal cash flows should be discounted at a nominal rate and real cash flows should be discounted at a real rate). Impairment reviews and disclosures should appropriately reflect information provided elsewhere in the annual report and accounts and the composition of cash-generating units (CGUs) and the basis for the allocation of goodwill to CGUs or groups of CGUs should be adequately explained.

Impact of climate change on impairment reviews

The FRC's TCFD thematic review sets out several expectations for how companies should address climate change in the context of impairment. In discussing assumptions and sensitivities, companies should:

- quantify significant climate-related assumptions affecting management's estimate of the recoverable amount of assets subject to impairment review;
- explain how net zero commitments or plans to transition to a low-carbon economy discussed in the strategic report have been taken into account in impairment review calculations. This should include any effect on the period for which cash flows have been included, terminal growth rates, and discussion of any judgements associated with whether forecast expenditure linked to these plans will enhance or maintain assets;
- explain any significant movements in assumptions associated with climate change;
- disclose how climate risks have been incorporated into sensitivity disclosures, with clear links to the company's narrative disclosures;
- where significant, explain the basis for including climate-related capital expenditure in cash flow forecasts in value in use calculations; and
- avoid boilerplate statements like "climate has been incorporated into our impairment review assumptions".

If users might reasonably expect that an indication of impairment exists as a result of climate change impacts discussed elsewhere in the annual report, but no impairment indicator has been identified, the FRC advises entities to consider whether their disclosures adequately explain why this conclusion has been reached. This may also warrant disclosure as a critical judgement under IAS 1.122.

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FRC focus area

Climate change

Economic uncertainty

Discount rates

Whilst discount rates are not directly in the list of the CRR team's top ten challenges, they are present in a number of key areas such as impairment and have featured in some of CRR's most challenging cases and significant findings. In light of the current economic and geopolitical uncertainty, with rising inflation and interest rates, this year the FRC issued a thematic review on discount rates, focusing on three main areas: assumptions used for discount rates and cash flows, use of third-party specialists and the importance of high-quality disclosures.

Assumptions used for discount rates and cash flows

The value of future cash flows is affected by both the time value of money and the variability of cash flows, i.e. the risk associated with the cash flows. The effect of the variability of the cash flows can be reflected in two ways: either the cash flows themselves can be adjusted for risk (and then discounted at a risk-free rate) or the cash flows can be discounted at a risk-adjusted rate. Whilst both methods should provide identical results, the former approach will generally be easier. The FRC expects companies to explain the factors which are considered in arriving at the present value of future cash flows. It notes that better disclosure examples include explanations of the approach taken, either adjusting the cash flows or the discount rate used.

IAS 36 requires the discount rate for a value in use (VIU) measurement to be a pre-tax rate that reflects the current market assessments of both the time value of money and the risks specific to the asset which have not been reflected in the cash flows. However, mathematically, applying a pre-tax discount rate to pre-tax cash flows or post-tax discount rate to post-tax cash flows should give the same result. The IASB's research on discount rates found that many companies were using their weighed average cost of capital (WACC) as a starting point to determine the discount rate for VIU, which is usually a post-tax rate. Companies would therefore have to convert this to a pre-tax rate. This conversion is not always straightforward and has led to diversity in practice. The FRC expects companies using post-tax discount rates and post-tax cashflows to consider whether this will provide an answer that is materially similar to a calculation on a pre-tax basis and states that it is less likely to challenge where clear explanations are provided for how the discount rates have been determined. It also advises companies to take particular care when incorporating risk into the discounting of a liability, as this is an area where it has seen a number of errors.

In the current economic environment, inflation is increasingly relevant and as with tax, inputs can either be pre-inflation or post-inflation, as long as they are consistently one or the other. The FRC notes that better disclosure examples explain how inflation was taken into account, either in the cash flows or the discount rate. It also suggests that companies may need to consider whether rising inflation may amount to a source of estimation uncertainty that could have a material impact on the financial statements in the next year and therefore require disclosure under IAS 1. This may be the case where, for instance, a company has a long term liability which could be subject to material future price increases.

Use of third-party specialists

The FRC has not commonly found issues with recurring fair value measurements, however errors are found in ad-hoc fair value measurements such as deferred consideration, royalty and earn-out agreements. Where a company is required to value a material item, and where no internal expertise exists, the FRC expects companies to consider whether specialist third party input is required. The FRC has highlighted that it may challenge companies where it is not clear how a valuation has been performed or if a discount rate does not appear to reflect the factors a market participant would include.

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Disclosures
The disclosure of the discount rate itself and the method used to determine the discount rate is not required by all relevant standards but may fall in the scope of other more general disclosure requirements such as sources of estimation uncertainty or disclosure of accounting policies and estimates.

The FRC expects companies to apply judgement to determine what information is to be disclosed but where the effect of discounting is material, they expect companies to disclose the discount rates used and how they are calculated, including explaining the inputs that were used.

Clear and concise narrative commentary, both in the financial statements and the strategic report, should be provided where changes in discount rate assumptions have or could have a material impact on the financial statements.

Impact of climate change on discount rates
In its TCFD thematic review, the FRC notes that where the business is exposed to significant climate risks, companies should explain how climate risk has been incorporated into their cash flow projections or discount rates.

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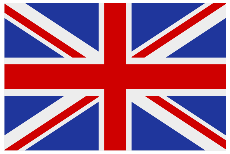
FRC focus area



Earnings per share

Although not one of the top ten challenge areas noted in the FRC annual review, the FRC issued a thematic review on earnings per share (EPS) in September 2022 stating that it frequently identifies in routine reviews that the main principles of IAS 33 *Earnings Per Share* are not always well understood or applied correctly. Much of the thematic review is devoted to explaining the principles of IAS 33 and how to calculate basic and diluted EPS. Throughout, the FRC offers a number of observations and recommendations.

The importance of EPS for investors

EPS is a widely used metric, not only as a key performance indicator (KPI) used by management to assess company performance but also as an input into valuation models and price-earnings ratios, which are frequently used by investors and analysts. Unlike many other KPIs, it is both defined in accounting standards and subject to audit. The FRC has therefore set out ways in which companies can improve the reliability of their EPS figure by ensuring that they are complying fully with the requirements of IAS 33 and providing informative disclosures. It also notes that where EPS metrics are used in a directors' remuneration policy, it should be made clear whether this is the same EPS figure as reported elsewhere in the annual report. Where it differs, the basis should be explained together with any changes (and the reasons for those changes) year-on-year as well as their effect on remuneration.

The numerator

The thematic review sets out the principles of determining the numerator, being profit or loss attributable to ordinary equity holders. IAS 33 requires certain adjustments to be made to profit or loss in respect of preference shares that are classified as equity and the FRC reminds companies that where a company has preference shares classified as equity, adjustments to profit or loss need to be made for all effects of the equity preference shares or their equivalent, if they will have a material effect on EPS, including dividends and redemption premiums.

The denominator

The principles for determining the denominator, being the weighted average number of shares, are also explained. The FRC advises companies that it should be made clear how the weighted average number of ordinary shares outstanding relates to the number of shares in issue and potential ordinary shares, although it acknowledges that there is no specific disclosure requirement that addresses this. It also recommends that further information is disclosed to users to help identify the basis for the weighted average number of shares where it is significantly different from information about the issued ordinary and potential ordinary shares.

Companies should ensure that their disclosures are clear regarding the use of judgements about the substance of a share reorganisation or other arrangement which affect how the transaction is treated in the EPS calculation. The FRC expects judgements of this nature to be disclosed in accordance with IAS 1. When a judgement has been made over the inclusion of vested but unissued ordinary shares in the weighted average number of ordinary shares, and the effect on EPS is material, it should be disclosed under paragraph 122 of IAS 1.

Definition of dilutive and antidilutive

The FRC reminds companies that profit or loss from continuing operations forms the basis for the assessment of whether potential ordinary shares are dilutive or antidilutive. It also flags that where there is a loss from continuing operations, the diluted loss per share for continuing operations cannot be lower than the basic loss per share for continuing operations.

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Adjusted EPS

Many companies present adjusted EPS measures which are based on a different profit or loss figure to the number calculated using IAS 33 methodology. Disclosures using adjusted EPS measures should not be given more prominence than the IAS 33 EPS measures and in general, adjusted EPS measures should meet the ESMA Guidelines on APMs, including an explanation of the methodology applied in the calculation including the tax basis used on adjusting items. When asset-based per share measures are presented, companies should comply with IAS 33.73 in respect of the calculation of the denominator. The basis used for the denominator in this instance should be clearly explained.

Reverse acquisitions

Paragraph B27 of IFRS 3 *Business Combinations* states that in a reverse acquisition, "the weighted average number of ordinary shares is the legal acquiree's historical weighted average number of ordinary shares outstanding multiplied by the exchange ratio established in the acquisition agreement". Companies that have achieved a listing via a reverse acquisition are expected to explain how this methodology has been applied in its accounting policies for the periods affected.

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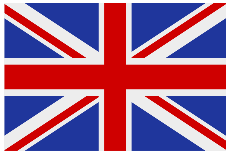
FRC focus area



Business combinations

Whilst issues related to business combinations are frequently among the findings identified by the FRC, this is the first year in which it has undertaken a thematic review on the topic. The FRC notes that the current uncertain economic environment and the risks and opportunities posed by climate change may drive increasing numbers of business combinations as companies may become more vulnerable to takeover and growth through acquisition may become more attractive. It also flags that business combinations have the potential to have a significant and wide-ranging impact on a company's annual report and accounts.

> The requirements for FRS 102 reporters in respect of business combinations differ from those in IFRS Accounting Standards. More detail can be found in chapter B19 of GAAP in the UK on DART.

Management commentary

The FRC noted that companies are ensuring they discuss material business combinations in their narrative reporting. It expects that the impact of the business combination on the group's strategy, resources, operations and performance is explained in a clear and concise way, providing a comprehensive understanding of the effects of the business combination supported by consistent information throughout the annual report. Companies are expected to provide explanations that reflect the specific circumstances rather than boilerplate disclosures.

However, it also had a number of observations and recommendations for improvement. In particular:

- Where business combinations are subject to regulatory or other approvals and judgement is therefore required to determine when control is obtained, the narrative reporting should set out how this assessment was made and confirm the date from which the acquiree is consolidated.
- Companies should explain changes to their liquidity profile and risk arising from financing of acquisitions.
- Where companies change their APMs, either by selecting different APMs or amending the definition of existing APMs, they should explain why those changes result in more reliable and relevant information and should also ensure that comparatives are restated.
- Companies should consider whether their principal risks and uncertainties have changed as a result of the business combination and update their disclosures accordingly.
- Where the company applies the UK Corporate Governance Code, it should ensure that business combinations during the period are considered by the audit committee where they are considered significant to the financial statements, and disclose this in the annual report.
- Any changes in remuneration schemes or targets as a result of a business combination should be clearly explained.
- Directors should consider whether the business combination represents a significant decision during the period which should be discussed within the s172(1) statement.

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Fair value

In most cases, companies made it clear that they had recorded assets and liabilities acquired at their acquisition date fair values. The FRC also noted that most companies recognised separately identifiable intangible assets as part of the business combination, with sub-categories of intangibles being quantified and explained, including in some instances the valuation technique applied and key assumptions used in the valuation. The FRC expects companies to provide meaningful sensitivities and/or ranges of reasonably possible outcomes for significant estimates made in accounting for the business combination. Areas for improvement identified include:

- Where the accounting for a business combination is incomplete, companies should explain the areas where the accounting remained incomplete and the reasons why this was the case as required by paragraph B67(a) of IFRS 3.
- Where companies acquire material employee benefit liabilities/assets, they should disclose the nature of the acquired schemes and detail how they have been valued.
- Companies are expected to explain in their disclosures or accounting policies how lease assets acquired have been valued. Such explanations should include the difference between the value of the right-of-use (ROU) asset and the lease liability where applicable, the former being adjusted to reflect differences between the lease terms and market terms rather than company specific circumstances.

Consideration

The FRC noted a number of instances of better practice in the disclosure of consideration but advises that:

- Where companies issued equity instruments as part of the consideration for the business combination, they should disclose the number and total fair value of the instruments issued, as well as the method of measuring the fair value of the equity instruments.
- Where companies acquired businesses with existing share-based payment arrangements, the replacement of these may form part of the consideration. This suggested that the companies were obliged to replace the awards. It is helpful when companies explain where share-based payment schemes are replaced, and the resulting accounting applied.
- Where companies disclose the amount of contingent consideration recognised at the acquisition date, they are expected to provide further details, avoiding boilerplate disclosures.
- Companies should also consider whether contingent consideration represents a major source of estimation uncertainty requiring disclosure under paragraph 125 of IAS 1.

The FRC also noted some instances where the terms 'deferred consideration' and 'contingent consideration' were used interchangeably. Companies are expected to be accurate and consistent when using these terms. The FRC also expects companies to clearly disclose any potential variability in future amounts payable as contingent consideration.

For business combinations achieved in stages, companies are expected to disclose the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination, as well as the line item in the statement of comprehensive income in which that gain or loss is recognised.

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Statement of cash flows

The FRC reminds companies that cash flows for acquisition-related costs should be recognised within operating cash flows within consolidated accounts as these do not give rise to an asset. The same is true for contingent payments that are linked to future employment which are excluded from the acquisition accounting.

Deferred taxation

The FRC notes that companies should make it clear whether deferred tax has been recognised in a business combination and should ensure that they disclose the amount of goodwill that is expected to be deductible for tax purposes as this is not always given.

Other IFRS 3 disclosures

The FRC also reminds companies of a number of other disclosures required by IFRS 3 which are not always provided:

- Where a gain on a bargain purchase is significant, it should be disclosed separately on the face of the income statement and an explanation should be given as to how it arose.
- If goodwill is recognised in a business combination, companies are required to explain the factors that make it up. This should include detailed descriptions which are specific to the business acquired.
- Companies should ensure that they correctly exclude acquisition costs from the acquisition accounting and explain where they are presented in either the statement of comprehensive income or, if appropriate, in equity.
- Where companies have made multiple acquisitions within the period, the FRC expects separate disclosure for each material acquisition.
- For large acquisitions where the period of time to secure all relevant approvals before final completion is significant, with acquisition-related costs incurred over multiple periods, clear disclosure should be provided to explain the costs incurred and the period in which they were recognised.
- Companies are expected to provide disclosures of revenue and profit or loss for both the acquiree since the acquisition date and the whole combined entity as if all acquisitions took place as of the beginning of the period.
- For acquired trade receivables, the FRC expects clear disclosure of the gross contractual amounts receivable and the best estimate of cash flows not expected to be collected. Where the fair value of receivables is equal to contractual amounts companies should make this clear in the disclosure.
- Companies should explain how transactions not accounted for as part of the business combination have been treated and the line item(s) in the financial statements. In particular, the FRC reminds companies that when contingent payments are linked to continuing employment of personnel they should be excluded from consideration for the business combination and accounted for as post-acquisition employment expense.

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Currency and hyperinflation

The steep rise in global energy prices has contributed to higher levels of general inflation in many jurisdictions, increasing the number of jurisdictions that are subject to hyperinflation (as defined in IAS 29 *Financial Reporting in Hyperinflationary Economies*). Entities are therefore increasingly facing the following challenges:

- Determining whether an economy is hyperinflationary as defined in IAS 29 can sometimes prove difficult. The definition includes several characteristics of hyperinflation, although hyperinflation is most often evidenced when the cumulative inflation rate over three years approaches or exceeds 100%. It can also be challenging to decide which general price index should be applied to amounts in the financial statements.
- Entities may face difficulties in determining an entity's functional currency in circumstances where both a local and international currency are in common use. This can be particularly significant where the local currency is hyperinflationary. IAS 29 is only applied by entities whose functional currency is the currency of a hyperinflationary economy (rather than by any entity operating in that economy). It should also be noted that IAS 21 *The Effects of Changes in Foreign Exchange Rate*s specifically states that "[a]n entity cannot avoid restatement in accordance with IAS 29 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its parent)".
- When exchanges between a local currency and globally traded currencies are restricted, it may be difficult to identify a suitable exchange rate for translating monetary items in individual financial statements and translating the financial statements of a foreign operation in its parent's presentation currency. Although this issue not specific to hyperinflationary economies, a shortage of 'hard' currency and therefore a need for exchange restrictions is often a feature of economies who local currency is losing value

When inflation or exchange issues result in a significant judgement or give rise to a source of estimation uncertainty, disclosure should be provided as required by IAS 1:122 and 125.

Based on data available at the time of writing, including inflation forecasts from the International Monetary Fund (IMF) and the indicators laid out in IAS 29, the following economies should be considered hyperinflationary economies for the purposes of applying IAS 29 and for retranslation of foreign operations in accordance with IAS 21 in financial statements for the year ending 31 December 2022:

- Argentina
- Ethiopia
- Iran
- Lebanon
- South Sudan
- Sudan
- Suriname
- Syria
- Türkiye
- Venezuela
- Yemen
- Zimbabwe

Ethiopia and Türkiye (formerly known as Turkey) have become hyperinflationary during 2022.

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Application of IFRS 17 *Insurance Contracts*

IFRS 17 is effective for annual reporting periods beginning on or 1 January 2023. Given limited early adoption, both insurers and non-insurers need to consider the disclosure requirements under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* of the impact of new IFRS Accounting Standards issued but not effective. The impact of IFRS 17 for insurers will be significant as may the impact of IFRS 9 for those insurers that chose to defer the application of IFRS 9 as they will also be applying IFRS 9 for the first time. As December 2022 annual reports will be published after the date of initial application of IFRS 17, the analysis of the impact of implementation of the new Standard will be more advanced than was the case a year ago, allowing further elaboration and development of information provided in previous financial statements. As such, the provision of entity specific, quantitative disclosures on the likely changes in accounting is expected to be an area of increased regulatory focus. The level of disclosure, and particularly the extent to which quantification is possible, will be affected by the status of each entity's implementation project, but when practicable should include:

- Accounting policies to be applied, including the use of scope exceptions and transition reliefs.
- The methodology to be applied to key aspects of accounting for insurance contracts such as discounting, adjustment for non-financial risks, allocation of premia and recognition of the contractual service margin (CSM) as revenue.
- If known or reasonably estimable, the quantum of IFRS 17's effect on financial position, financial performance and equity at the start of the start and end of 2022.
- The expected effect on accounting for financial assets, for entities that will be applying IFRS 9 for the first time, as well as changes in classification elections for financial assets where IFRS 9 is currently applied.

If quantitative information is not disclosed because it is unknown or not reasonably estimable, the importance of qualitative information enabling users to understand the nature and likely magnitude of the expected impact on the financial position is heightened.

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Appendices

UK GAAP developments

Updates to FRS 100 *Application of Financial Reporting Requirements*

In November 2022 the FRC issued amendments to FRS 100 to update the Application Guidance to FRS 100 *The Interpretation of Equivalence*. These updates reflect changes to UK company law and decisions on equivalence as a result of the UK's exit from the European Union. The amendments address the assessment of equivalence for both UK and Irish companies for two purposes:

- exemption from preparation of consolidated accounts (in UK law, in accordance with s401 of the Companies Act 2006); and
- for qualifying entities under FRS 101 and FRS 102, to determine whether equivalent disclosures have been made in the consolidated accounts in which the qualifying entity is included for the purpose of assessing whether certain of the available disclosure exemptions may be taken.

For UK companies, the revised Application Guidance notes that the UK government has recognised equivalence to UK-adopted IFRS Accounting Standards of the following Generally Accepted Accounting Principles (GAAP), which includes GAAPs previously recognised by the European Commission as equivalent to EU-adopted IFRS Accounting Standards:

- GAAP of Canada
- GAAP of the People's Republic of China
- GAAP of Japan
- GAAP of the Republic of Korea
- GAAP of the United States of America
- IFRS Accounting Standards as adopted by the EU
- IFRS Accounting Standards as issued by the IASB.

In respect of other GAAPs not deemed equivalent by the government, the Application Guidance states that the directors may assess the consolidated financial statements of the group in which the UK company is consolidated (and, where appropriate, the group's annual report) to determine whether they are drawn up in a manner equivalent to the requirements of Part 15 of the Act (i.e. equivalent to either UK GAAP or UK-adopted IFRS Accounting Standards).

The revised Application Guidance took immediate effect on publication.

Updates to FRS 101 *Reduced Disclosure Framework*

The FRC carries out an annual review of FRS 101 to provide additional disclosure exemptions as IFRS evolves and to respond to stakeholder feedback about other possible improvements. No amendments were made as part of the 2021/22 cycle other than to the Basis for Conclusions and no amendments have been proposed in the 2022/23 exposure draft FRED 81 *Amendments to FRS 101 – 2022/23 Cycle.*

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Periodic Review of UK and Republic of Ireland accounting standards

The next periodic review of UK and Republic of Ireland accounting standards is underway and an exposure draft proposing amendments to FRSs 100-105 was published in 2022 , with comments requested by 30 April 2023. While the first periodic review of FRS 102 was largely intended to fix implementation issues, this second periodic review is much more significant and the exposure draft includes the introduction of the principles of IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* into Sections 23 and 20 of FRS 102, respectively, as well as a number of other changes. The amendments are proposed to take effect for periods beginning on or after 1 January 2025.

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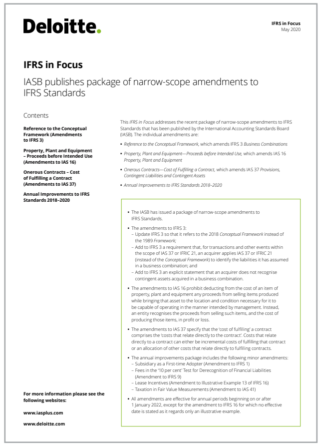
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IFRS in Focus

IASB publishes package of narrow-scope amendments to IFRS Standards

A Deloitte [Need to Know](#) provides more details on the Amendments to IFRS 3—*References to the Conceptual Framework* and to the Amendments to IAS 16 - *Proceeds before Intended Use.*

New and revised IFRS Accounting Standards and Interpretations mandatorily effective for years ending 31 December 2022

Amendments to IFRS 3—References to the Conceptual Framework

The amendments to IFRS 3 replace references to the 1989 *Framework* with references to the 2018 *Conceptual Framework*. They also add explicit requirements that:

- For obligations within the scope of IAS 37, an acquirer applies IAS 37 to determine whether at the acquisition date a present obligation exists as a result of past events.
- For a levy that would be within the scope of IFRIC 21, the acquirer applies IFRIC 21 to determine whether the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date.
- An acquirer does not recognise contingent assets acquired in a business combination.

Amendments to IAS 16—Proceeds before Intended Use

The amendments to IAS 16 *Property, Plant and Equipment* require the recognition of proceeds from sales of items produced before an item of property, plant and equipment is available for use (for example, samples produced when testing whether the asset is functioning as intended) to be recognised in profit or loss together with the costs of that item, replacing a previous requirement for the net proceeds of such sales to be deducted from the cost of property, plant and equipment.

The costs of testing whether the asset is functioning properly continue to form part of the cost of property, plant and equipment.

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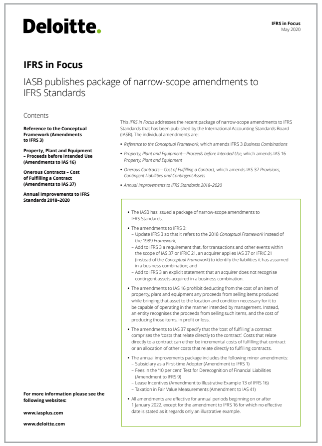
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IFRS in Focus
May 2020

IFRS in Focus

IASB publishes package of narrow-scope amendments to IFRS Standards

A Deloitte [Need to Know] provides more details on the Amendments to IAS 37—*Onerous Contracts, Cost of Fulfilling a Contract* and on *Annual Improvements to IFRS Standards 2018-2020 - Amendments to IFRS 1, IFRS 9, IFRS 16 and IAS 41.*

Amendments to IAS 37—Onerous Contracts, Cost of Fulfilling a Contract

The amendments to IAS 37 specify that, in determining whether a contract is onerous, the costs that relate directly to that contract should be considered. The amendments also specify that these costs consist of both the incremental costs of fulfilling a contract (for example, direct labour and materials) and an allocation of other direct costs (giving the example of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract among others).

Annual Improvements to IFRS Standards 2018-2020—Amendments to IFRS 1, IFRS 9, IFRS 16 and IAS 41

The annual improvements make narrow scope amendments to four IFRS Accounting Standards:

- IFRS 1—*Subsidiary as a First-time Adopter*—Permitting a subsidiary adopting IFRS Accounting Standards later than its parent and which uses the existing provision in IFRS 1 *First-time Adoption of International Financial Reporting Standards* to measure its assets or liabilities at the carrying amounts that would be included in its parent's consolidated financial statements to measure cumulative translation differences on its foreign operations on the same basis. As with the existing relief, a similar election is available to associates and joint ventures
- IFRS 9—*Fees in the '10 per cent test' for Derecognition of a Financial Liability*—Specifying that only fees paid or received between the entity (the borrower) and the lender, including fees paid or received by either the entity or the lender on the other's behalf, should be included in a quantitative assessment of whether the revised terms of a financial liability are substantially different from the terms that existed before the instrument was amended.
- IFRS 16—*Lease Incentives*—Removing the illustration of reimbursement of leasehold improvements from Illustrative Example 13.
- IAS 41—*Taxation in Fair Value Measurements*—Aligning the fair value measurements of IAS 41 *Agriculture* with those of IFRS 13 *Fair Value Measurement* by removing a requirement to exclude tax cash flows from that measurement.

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IFRS Interpretations Committee agenda decisions in 2022

Along with its activity developing formal interpretations of IFRS Accounting Standards and proposing that the IASB make amendments to these standards, the Committee regularly publishes summaries of issues that it has decided not to add to its agenda, generally accompanied by a discussion of the accounting issue submitted.

In August 2020, The Trustees of the IFRS Foundation issued an updated IFRS Foundation Due Process Handbook establishing that the explanatory material in the agenda decisions published by the IFRS Interpretations Committee derives its authority from the IFRS Standards themselves and, therefore, that its application is required with the general requirements of IAS 8 for retrospective application applying when an agenda decision results in a change of accounting policy.

The IFRS Foundation Due Process Handbook and each *IFRIC Update* also note that it is expected that an entity would be entitled to sufficient time to make that determination and implement any necessary accounting policy change (for example, to obtain new information or adapt its systems). Determining how much time is sufficient to make an accounting policy change is a matter of judgement that depends on an entity's particular facts and circumstances. Nonetheless, an entity would be expected to implement any change on a timely basis and, if material, consider whether disclosure related to the change is required by IFRS Accounting Standards.

The following agenda decisions have recently been published by the Committee:

November 2021 *IFRIC Update*	IFRS 16—Economic Benefits from Use of a Windfarm
February 2022 *IFRIC Update*	IFRS 9 and IAS 20—TLTRO III Transactions
March 2022 *IFRIC Update*	IAS 7—Demand Deposits with Restrictions on Use arising from a Contract with a Third Party
April 2022 *IFRIC Update*	IFRS 15—Principal versus Agent: Software Reseller
June 2022 *IFRIC Update*	IFRS 17—Transfer of Insurance Coverage under a Group of Annuity Contracts IAS 32 *Financial Instruments: Presentation*—Special Purpose Acquisition Companies (SPAC): Classification of Public Shares as Financial Liabilities or Equity IAS 37—Negative Low Emission Vehicle Credits
September 2022 *IFRIC Update*	IFRS 9 and IFRS 16—Lessor Forgiveness of Lease Payments IFRS 17 and IAS 21—Multi-currency Groups of Insurance Contracts Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition

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New and revised standards available for early application in years ending 31 December 2022

Paragraph 30 of IAS 8 requires entities to consider and disclose the potential impact of new and revised IFRS Accounting Standards that have been issued but are not yet effective. As discussed above, the sufficiency of these disclosures is a current area of regulatory focus.

The list below reflects a cut-off date of 2 December 2022. The potential impact of the application of any new and revised IFRS Accounting Standards issued by the IASB after that date, but before the financial statements are issued, should also be considered and disclosed.

For each, a link is provided to a Deloitte publication presenting an overview of the new or amended IFRS Accounting Standard.

To be available for application in the UK, the standard or amendment must have been endorsed by the UK Endorsement Board.

IFRS	Effective date—periods commencing on or after:	Endorsed for use in the UK?*
New standards		
IFRS 17 *Insurance Contracts* including *Amendments to IFRS 17* and *Initial Application of IFRS 9 and IFRS 17—Comparative Information*	1 January 2023	Y
Amended Standards		
Amendments to IAS 12—*Deferred Tax related to Assets and Liabilities arising from a Single Transaction*	1 January 2023	Y
Amendments to IAS 1 and IFRS Practice Statement 2 *Making Materiality Judgements*—*Disclosure of Accounting Policies*	1 January 2023	Y
Amendments to IAS 8—*Definition of Accounting Estimates*	1 January 2023	Y
Amendments to IAS 1—*Classification of Liabilities as Current or Non-current*	1 January 2024	N
Amendments to IAS 1—*Non-current Liabilities with Covenants*	1 January 2024	N
Amendments to IFRS 16—*Lease Liability in a Sale and Leaseback*	1 January 2024	N

* At the time of writing. Please refer to the current endorsement status at https://www.endorsement-board.uk/adoption-status-report

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Deloitte resources

There are several resources prepared by Deloitte that can assist you during the upcoming reporting season. Many have been highlighted throughout this publication; key resources are listed below.

The Closing Out 2022 page on UK Accounting Plus
A dedicated page on UK Accounting Plus, providing links to a full suite of resources. This page will continue to be updated to reflect developments after the date of this publication.

Corporate Reporting Insights 2022 – Surveying FTSE reporting
Our dedicated Corporate Reporting Insights 2022 page contains the results of our 2022 survey of FTSE 350 companies, addressing the hot topics that companies themselves are focusing on across five areas: Purpose, People, Planet, Prosperity and resilience and Procuring assurance. It includes insight on responses to changing report requirements, areas for improvement, regulatory hotspots and examples of good practice.

On the board agenda 2023
On the board agenda 2023 highlights the recent and upcoming changes in the corporate governance environment, including the ever-increasing reporting requirements regarding company activities. There is much to consider. This year our flagship publication for boards is structured around a series of short articles covering a number of hot topics from resilience to workforce strategies to the public interest statement to executive remuneration to name a few.

The Deloitte Accounting Research Tool (DART)
DART is a comprehensive online library of accounting and financial disclosures literature, allowing access to the full IFRS Accounting Standards and UK accounting standards, linking to and from:

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