Accounting Technical Services

Hot Topic

FRC's Annual Review of Corporate Reporting 2021/22 – Key Highlights Checklist

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FRC's Annual Review of Corporate Reporting 2021/22 – Key Highlights

Introduction and overview of the FRC's key findings

Introduction

This Hot Topic sets out the key highlights identified by the Financial Reporting Council (FRC) in their *Annual Review of Corporate Reporting for 2021/22* by providing a checklist of the key common areas where companies tend to be non-compliant, poor on quality, or omit from their annual reports.

The checklist therefore sets out the key common areas that companies should ensure they include and improve within their annual reports, as well as those that they should look to avoid within their reporting.

- Section 1 provides a high-level overview of the key points from within the top 10 accounting areas.
- Section 2 provides more detail on each of the key points to include and to avoid within the accounting areas.

Priorities for 2022/23

The FRC has stated that its focus for its thematic reviews 2023 will be on:

- IFRS 17 implementation;
- Large private companies;
- Climate-related reporting, particularly TCFD;
- Industry specific reviews; and
- Smaller and private banks and IFRS 9.

The FRC has stated that its priority sectors for 2023 will be

- Travel, Hospitality and Leisure;
- Retail;
- Construction and Materials; and
- Gas, Water and Multi-utilities.

Top ten accounting areas

The table opposite sets out the top ten topic areas that arose most frequency when the FRC conducted its reviews of the 252 annual reports for 2021/22 (2021/21: 246), along with the corresponding place for each topic area within the top ten for the previous two years.

The FRC's reviews covered public and large private UK companies, as well as some public overseas companies that prepare their accounts under IFRS or UK GAAP.

57% of the reviews were attributed to FTSE 350 companies and 43% of the reviews were attributed to AIM-quoted, large private companies and LLPs

Topic	2021/22	2020/21	2019/20
Statement of Cash Flows	1	3	7=
Financial Instruments (for corporates)	2	6	4
Income Taxes	3	9=	-
Strategic Report & Companies Act	4	7	6
Revenue	5	2	3
Provisions & Contingencies	6	8	7=
APMs	7	5	5
Judgements & Estimates	8	1	1
Impairment of Assets	9	4	2
Presentation of financial statements and related disclosures	10	-	-
Leases	-	9=	9=
Business Combinations	-	-	9=

Section 1: High-level overview of the key points from within the top 10 accounting areas

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Section 1: Checklist of key points raised by the FRC – Overview

Companies should ensure that……

1. Cash flow statements	2. Financial instruments	3. Income taxes
Classification - Classification of cash flows comply with relevant definition and relevant criteria, in particular relating to investing activities and financing activities. • Investing: 'Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.' • Financing: 'Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.'	**Explanations of risks** - The nature and extent of material risks arising from financial instruments (including inflation and rising interest rates) and related risk management are adequately disclosed, including: • the methods used to measure exposure to risks and any changes from the previous period; and • any hedging arrangements put in place to fix interest rates or hedge against the effects of inflation.	**Uncertainty going forward** - Forward-looking assessments take account of the difficult economic environment ahead of us. Companies should remain alert to changes in tax regimes introduced in response to the inflationary environment.
Consistency - Reported cash flows are consistent with amounts reported elsewhere in the annual report and accounts.	**ECL assumptions and concentrations of credit risk** - The approach and significant assumptions applied in the measurement of ECL, and the concentrations of risks, where material, are disclosed.	**Recognition of deferred tax from losses** - Where material deferred tax assets are recognised by loss-making entities, the nature of the evidence supporting their recognition is disclosed. Significant accounting judgements and sources of estimation uncertainty will also often need to be disclosed in such cases.
Non-cash items - Non-cash items are excluded from the cash flow statement and adjustments for material non-cash transactions are disclosed.	**ECL default rates** -Historical default rates are reviewed and adjusted for forecast future economic conditions.	**Reconciling items** - Material reconciling items in the effective tax rate reconciliation are adequately explained.
Cash and cash equivalents - Cash and cash equivalents comply with definitions and relevant criteria.	**Accounting policies** -Accounting policies are provided for all material financing (including factoring and reverse factoring) and hedging arrangements, and any changes in those arrangements.	**Consistency** - Tax-related disclosures are consistent throughout the annual report and accounts.
Netting - Cash flows are presented gross, unless they meet the criteria to be netted.	**Covenants** - Information about banking covenants is provided (unless the likelihood of any breach is considered remote).	
Parent company - The parent company cash flow statement (unless an exemption is taken under FRS 101 or FRS 102 from presenting one) complies with the requirements of the standard.	**Refinancing** - The effect of refinancing and changes to covenant arrangements are explained.	

Section 1: Checklist of key points raised by the FRC – Overview

Companies should ensure that……

4. Strategic Report and Companies Act	5. Revenue	6. Provisions and contingencies	7. Alternative Performance Measures (APMs)
Strategic report - the strategic report: • articulates the effect of economic and other risks and uncertainties facing the business (including inflation, rising interest rates, supply chain issues and labour relations in the inflationary environment); • explains the mitigation strategies; and • where relevant, links to the discussion of the entity's strategy and business model, and information disclosed in the financial statements.	**Accounting policies** - Accounting policies are provided for all significant performance obligations and address: • the timing of revenue recognition; • the basis for recognising any revenue over time; and • the methodology applied.	**Inflation** - 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.	**Prominence** - APMs are not displayed with more prominence, emphasis or authority than measures directly stemming from financial statements
Review of the business - The strategic report explains significant movements in the statements of financial position and cash flows, and not be limited to an explanation of financial performance.	**Judgements** - Significant judgements made in relation to revenue recognition are disclosed (for example, in relation to the allocation of the transaction price and the timing of satisfaction of performance obligations).	**Inflation assumptions** - Details of how the inflation assumptions have been calculated are provided where they have a material impact on the financial statements.	**Basis for APMs** - The basis for classifying amounts as adjusting, 'non-underlying' or 'non-core' are explained.
Consistency - Linkages between information presented within the strategic report and the accounts are highlighted and explained.	**Inflation features** - Inflationary features in contracts with customers and accounting for such clauses (that is, whether the feature is an embedded derivative or variable consideration) are disclosed.	**Specificity** - Clear and specific descriptions of the nature and uncertainties are disclosed for each material exposure for which a provision is recognised or a contingent liability is disclosed.	**Changing APMs** - Any changes to APMs are explained, together with the reasons for those changes.
Distributions - Specific legal requirements around distributions are complied with, including the requirement to file interim accounts to support distributions in excess of distributable profits shown in the relevant accounts (usually the most recent audited accounts).		**Timing and uncertainty** - The timeframe over which the cash outflows are expected to crystallise and the basis for determining the best estimate of the probable or possible outflow must be disclosed.	**Reconciliations** - APMs are reconciled to the most directly reconcilable line item of the financial statements.

Section 1: Checklist of key points raised by the FRC – Overview

Companies should ensure that……

8. Judgements and estimates	9. Impairment of assets	10. Presentation of financial statements and related disclosures
Inflation - Significant judgements involved in going concern assessment and accounting for inflationary features are explained and sensitivity quantified where inflation represents a significant source of estimation uncertainty.	**Sensitivity analyses** – Explanations are provided regarding the sensitivity of recoverable amounts to changes in assumptions, particularly where the range of reasonably possible outcomes has widened under a more uncertain outlook.	**Accounting policies** - Material accounting policy information is clearly disclosed.
Reporting date updates - Sources of estimation uncertainty and the related disclosures are updated at the balance sheet date.	**Impact of the economic environment** - The 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 environment are disclosed.	**Disclosing additional information** - Additional company-specific disclosures are provided when compliance with the specific requirements in IFRS is insufficient to explain the impact of particular transactions, events and conditions on the company's financial position and financial performance.
Sensitivity analyses - Sensitivity disclosures are provided in the most meaningful way for readers, by, for example, sensitising the most relevant assumptions, choosing alternative assumptions that are considered reasonably possible and explaining changes to the assumptions, particularly, where the range of possible outcomes has widened under the more uncertain environment.	**Inflation** - The inputs used in value in use calculations are consistent in incorporating the effect 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.	
Significant estimates - Estimates with a significant risk of a material adjustment to the carrying amounts of assets and liabilities within the next financial year are clearly distinguished from other sources of estimation uncertainty.	**Consistency** - Impairment reviews and/or disclosures appropriately reflect information elsewhere in the report and accounts.	
	CGUs - The composition of cash generating units (CGUs) and the basis for the allocation of goodwill to CGUs or groups of CGUs is adequately explained.	

Section 2: More detail on each of the key points to include and to avoid within the accounting areas.

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Companies should look to include and to avoid - Cash flow statements (1)

What to provide:		What to avoid:
Indirect method	• Ensure the net operating cash flows reconciliation starts by adjusting profit or loss as reported under IFRS (such as profit before income tax), rather than an APM. • Ensure that the net cash flows from operating activities are adjusted only for the effects of: changes during the period in inventories, operating receivables and operating payables; non-cash items; and all other items for which the cash effects are investing or financing cash flows.	• **Presenting non-cash items:** Ensure non-cash amounts are excluded from the cash flows e.g. assets purchased under lease arrangements. • **Discrepancies:** Ensure there are no discrepancies between the amounts in the cash flow statement and the amounts reported elsewhere in the annual report and accounts.

Classification of cash flows	• Ensure cash flows are classified appropriately:
	  • dividends received from associates and joint ventures - classified as investing activities;
	  • interest payments on lease liabilities presented separately from the lease payments, and classified as either operating or financing activities depending upon the accounting policy;
	  • net cash paid on acquisitions - classified as investing activities;
	  • acquisition-related costs - classified as operating activities;
	  • cash flows from acquisitions of non-controlling interests - classified as financing activities;
	  • cash flows from derivatives - classified as operating activities where relating to an economic hedge, or where relating to a designated hedge then classified in the same manner as the cash flows of the position being hedged; and
	  • amounts borrowed from, and lent to, subsidiaries (within parent entity financial statements) - classified as investing and financing respectively.	

Reporting cash flows from investing and financing activities on a gross basis	• Major classes of gross cash receipts and gross cash payments must be reported separately (i.e. no netting of cash flows), for instance new borrowings from repayments (including intra-group borrowing and lending in parent individual financial statements), and lease incentives from lease repayments, unless the specific requirements of reporting on a net basis under IAS 7.22 are met. Cash flows may be reported on a net basis when: (a) cash receipts and payments are for items in which the turnover is quick, the amounts are large and the maturities are short; and (b) cash receipts and payments are on behalf of customers when the cash flows reflect the activities of the customer rather than the entity.	
Changes in liabilities arising from financing activities	• Disclosures must include the reconciliation of cash flow changes in liabilities arising from financing activities. • The reconciliation must: only include cashflows relating to financing activities, for instance it should exclude derivative cash flows classified as investing activities; include lease cash flows; include a sub-total for cash flows from financing activities, where the reconciliation includes other items such as cash and cash equivalents; and agree back to the amounts reported in the cash flow statement.	

Section 2: Checklist of key points raised by the FRC – Detail

Companies should look to include and to avoid - Financial instruments (2)

What to provide:	
Overarching disclosure objective*	• Disclosures should focus on the overarching disclosure objective of IFRS 7, as well as the specific disclosure requirements, being to "*enable users to evaluate the significance of financial instruments for its financial position and performance, and the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.*"
Other financial assets*	• Disclosures should be provided about the recoverability of all financial assets, for instance not just trade receivables but contract assets, related party receivables, parent company receivables from subsidiaries and 'other' financial assets, along with the methodology used to assess recoverability.

Estimation of ELC provisions and credit risk*	• Disclosures should quantify weightings applied to forward-looking economic scenarios and quantify key variables.
	• Explanations should be given about the factors considered when determining whether there had been a significant increase in credit risk (i.e. quantitative and qualitative thresholds triggering a transfer form stage 1 to stage 2).
	• For compliance, disclosures must include:
	  • the inputs, assumptions and estimation techniques used to apply the IFRS 9 impairment requirements;
	  • the gross carrying amounts of financial assets by credit risk rating grades;
	  • information about the credit risk management practices, including definitions of default and the reasons for selecting specific definitions; and
	  • information about the concentration of credit risk.

Offsetting of bank overdrafts	• Ensure the offsetting of bank overdrafts against cash and cash equivalents meet the requirements under IAS 32.42b, which require offset only when the entity currently has a legally enforceable right to set off the recognised amounts, and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. These offset requirements are different to the netting requirements under IAS 7 for presentation within the cash flow statement.
Bank loans and covenants	• Ensure information about the terms and conditions of bank loans and borrowings are disclosed, including any refinancing arrangements. • Information about banking covenants should be provided (unless the likelihood of any breach is considered remote). Ensure the breaches of any covenants, including any subsequent waivers, are explained along with the impact on the financial statements.

** The FRC's Annual Review of Corporate Reporting 2020/21 provides an illustrative example of better disclosure to explain some of the issues raised. It does not represent any particular company's reporting. This illustrative example is replicated in this publication on page 18.*

What to avoid:

- **Insufficient explanations:** Where there have been significant and/or one-off transactions, sufficient information should be provided to explain the effect on the financial statements.
  Common unexplained areas include:
  - Modification of debt;
  - Financial guarantees;
  - Options over non-controlling interests; and
  - Impact on hedge accounting and the associated assessment of whether a forecast transaction is highly probable or not.

Section 2: Checklist of key points raised by the FRC – Detail

Companies should look to include and to avoid - Income taxes (3)

<table>
<tr><th colspan="2">What to provide:</th><th>What to avoid:</th></tr>
<tr><td>Recoverability of deferred tax assets*</td><td>• Disclosures should be clear and specific regarding the nature of evidence supporting recognition of deferred tax assets by loss-making entities, where the utilisation of those assets depends on future profits. For instance, disclosing:
  • the amount of recognised DTAs;
  • the nature of evidence considered;
  • critical judgements used in the recognition of DTAs (e.g. how the probability of recoverability of deferred tax assets was determined); and
  • the key sources of estimation uncertainty, including the carrying amounts affected and an explanation of the effect of any significant changes in key assumptions on the recovery of DTAs.</td><td rowspan="8">• Unexplained reconciling items: Ensure that explanations are disclosed for significant reconciling items affecting the relationship between income tax expense and the accounting profit multiplied by the tax rate, for instance providing clear line item headings or additional information if necessary.</td></tr>
<tr><td>Effective tax rate reconciliations</td><td>• Ensure adequate explanations are provided for significant reconciling items (i.e. either in the line item description or disclosures).
• Where there has been a change in the effective tax rate, there would be expected to be a reconciling item for the change in tax rate used to calculate deferred tax assets and liabilities.</td></tr>
<tr><td>Unused tax losses*</td><td>• For compliance, disclosures must include:
  • the amount (and expiry date, if any) of deductible temporary differences, unused tax losses or unused tax credits for which no deferred tax asset is recognised; and
  • for each type of temporary difference and unused tax losses: the amount of deferred tax assets recognised and related movements in profit or loss.</td></tr>
<tr><td>Deferred tax arising on business combinations</td><td>• Be clear on the recognition of deferred tax associated with adjustments to recognise acquired assets as part of a business combination.</td></tr>
<tr><td>Offsetting</td><td>• Be clear on the basis for offsetting deferred tax assets and liabilities relating to different classes of temporary differences.</td></tr>
<tr><td>Uncertain tax positions</td><td>• Explain clearly the significant judgements or estimation uncertainties in relation to uncertain tax positions.</td></tr>
<tr><td>Judgements and estimates*</td><td>• Provide sufficiently specific explanations of the judgements and estimates made, recognised amounts at risk and potential additional exposure to tax of the significant judgements and key sources of estimation made.</td></tr>
<tr><td colspan="2">* The FRC's Annual Review of Corporate Reporting 2020/21 provides an illustrative example of better disclosure to explain some of the issues. It does not represent any particular company's reporting. This illustrative example is replicated in this publication on page 19.</td></tr>
</table>

Section 2: Checklist of key points raised by the FRC – Detail

Companies should look to include and to avoid - Strategic Report and Companies Act (4)

What to provide:		What to avoid:

Fair, balanced and comprehensive	• Ensure significant matters discussed elsewhere in the annual report or financial statements are addressed in the strategic report, such as prior year restatements, government funding and climate-related matters.
	• Consider the performance *and* position of the business by including information about the balance sheet and cash flows, rather than solely the results for the period.
	• Give a balanced view that discusses both positive and negative matters, for instance a financial review that discusses an adjusted profit should also discuss the IFRS loss;
	• Compare year-on-year performance using a like-for-like basis, for example by stripping out the impact on a new standard adopted in the year.
		• **Omitting risks:** Omitting risks that appear to merit inclusion, for instance the impact of:
		  • the energy crisis;
		  • the situation in Ukraine;
		  • high inflation and rising interest rates;
		  • climate change;
		  • supply chain issues; and
		  • the ongoing impact of Covid-19.

Contents of the strategic report	• Ensure the strategic report contains the five main content-related objectives:
	  • insight into the entity's business model and its main strategy and objectives;
	  • the principal risks the entity faces and how they might affect its future prospects;
	  • relevant non-financial information;
	  • an analysis of the entity's past performance; and
	  • information to enable shareholders to assess how directors have had regard to stakeholders and other matters when performing their duty under section 172.	

Impact of climate change	• Ensure the non-financial reporting disclosures address climate change 'to the extent necessary for an understanding of the entity's development, performance and position and the impact of its activity' [CA2006 414CB(1)(a))]. Disclosures should:
	  • provide a description of significant climate-related policies pursued rather than simply naming them, or explain the reason if no such policies are pursued;
	  • provide clear explanations to understand and compare major commitments such as 'net zero emissions' targets or 'Paris aligned' strategies, linking into the financial statements were applicable.
	  • describe performance against climate-related targets, with any changes from the previous year explained;
	  • describe the impact of the entity's business on the environment, as well as the risks that climate change gives rise to for the entity, including those from within the entity's supply chain and from use of products.
	• Describe the principal climate-related risks and uncertainties, and any significant impacts on the business model. Be specific to the entity's circumstances, and clear on the magnitude of the risk. Consider explaining the rationale if it is concluded that climate change does not give rise to any significant risks for the entity.	

Section 2: Checklist of key points raised by the FRC – Detail

Companies should look to include and to avoid - Revenue (5)

What to provide:	
Overarching disclosure objective	• Disclosures should focus on the overarching disclosure objective of IFRS 15, as well as the specific disclosure requirements, being to "*disclose sufficient information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows*."
Consistency with front-end reporting	• Ensure the accounting policies sufficiently explain all revenue streams so that there is clear linkage between what is reported in the narrative disclosures in the front-end reporting.
Timing of revenue recognition and recognition at a point in time	• Fuller explanations should be provided to explain the timing of revenue recognition, including whether revenue is recognised at a point in time, or over time. Where it is a point in time, stating exactly when the revenue is recognised for the performance obligations e.g. explaining why dispatch of goods coincides with the transfer of control.
Revenue recognised over time	• Disclosures should clearly explain the methods used to measure the extent to which performance obligations are satisfied over time, explaining a description of the methods used, how they have been applied in practice and why the methods provided a faithful depiction of the transfer of goods or services.

Judgements	• Applying the requirements of IFRS 15 often requires entities to apply judgements. Judgements must be disclosed under IFRS 15.123 in relation to:
	  • the timing of satisfaction of performance obligations; and
	  • the transaction price and the amounts allocated to performance obligations.
	• Additionally, disclosures relating to judgements that have had the most significant effect on the amounts recognised in the financial statements should be provided under IAS 1.122.

Principal versus agent	• Where judgements have been made regarding the assessment of whether the entity is acting as a principal or an agent in a customer contract, such judgements should be clearly explained.
Variable consideration	• Accounting policies should clearly describe the types of any variable consideration receivable, the methods used to estimate the variable consideration (either the expected value or most likely amount approach), and how the variable consideration constraint has been applied to the estimated amount.
Performance obligations	• Disclosures should clearly explain the judgements made in identifying separate performance obligations, and why goods and services were concluded as being distinct from other promises in customer contracts.

What to avoid:

- **Insufficient explanations:** Where there have been significant and/or unusual revenue-related transactions, sufficient information should be provided to explain the effect on the financial statements.
  Common unexplained areas include:
  - Refund liabilities;
  - Contract modifications;
  - Contract balances; and
  - Acting as a principal vs agent, particularly the judgements made to conclude.

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Companies should look to include and to avoid - Contingencies and provisions (6)

<table>
<tr><th colspan="2">What to provide:</th><th>What to avoid:</th></tr>
<tr><td>Consistency</td><td>• Ensure that information disclosed elsewhere in the annual report is consistent with that provided within the financial statements, for instance that contingent liabilities are disclosed or provisions are recognised.</td><td rowspan="5">• Netting provisions covered by insurance: Netting of provisions that are covered by insurance; the claim and related reimbursement asset must be recognised on a gross basis.

A clear description should be provided of the underlying claims covered by insurance arrangements to help users understand the nature of the company’s exposure.</td></tr>
<tr><td>Recognition and measurement</td><td>• Sufficient information should be provided about the basis for recognition i.e. explaining the obligating event that has given rise to the provision.
• Ensure clear explanations are provided where there are changes in accounting policies, significant increases or releases of provisions.
• For dilapidation provisions, the treatment of costs should be clearly explained and consistently applied across a portfolio of leased properties.</td></tr>
<tr><td>Judgements</td><td>• Significant judgements should include those taken to recognise provisions, as well as not to recognise provisions, for instance a decision taken not to recognise an onerous lease provision.</td></tr>
<tr><td>Disclosures</td><td>• Sufficient information should be provided to explain the nature of provisions, related uncertainties and the potential timing of cash outflows.
• Ensure that the disclosures contain sufficient information to explain provisions and contingent liabilities that are indicated elsewhere in the financial statements, such as for potential litigation.</td></tr>
<tr><td>Seriously prejudicial exemption</td><td>• Where full disclosure about a provision is not provided, information is still required to be disclosed about the general nature of the dispute and the reason why the information has not been disclosed due to the information being seriously prejudicial.</td></tr>
</table>

Section 2: Checklist of key points raised by the FRC – Detail

Companies should look to include and to avoid - Alternative Performance Measures (7)

<table>
<tr><th colspan="2">What to provide:</th><th>What to avoid:</th></tr>
<tr><td>Labels</td><td>• Labels should be consistent with their content and basis of calculation, and avoid being overly optimistic or positive. Labels, titles or descriptions should not be the same or confusingly similar to GAAP measures.</td><td rowspan="6">• Undue prominence: Giving undue prominence to APMs, for instance by only giving meaningful commentary on non-GAAP measures, by presenting more APMs than IFRS measures, or by focussing discussions in key statements on APMs rather than IFRS measures. For instance, avoid comments that indicate APMs have more authority than their GAAP equivalents (e.g. comments that only highlight the limitations of GAAP measures or comments that imply that APMs are superior to their GAAP equivalents).</td></tr>
<tr><td>Definitions and explanations</td><td>• Definitions should be provided for all APMs.
• Tailored explanations should be provided that articulate why each APM provides useful information about financial performance, position or cashflows.
• Explanations should provide whether each APM is used internally, by whom and for what purpose.
• Specific disclosures should be given to explain what is meant by terms such as ‘underlying profit’, ‘non-underlying items’ or ‘core-operations’.</td></tr>
<tr><td>Adjusted items, or exceptional items</td><td>• Definitions should be clear on why items are included as ‘adjusted items’, or ‘exceptional items’.
• Disclosures should be clear on what items are included as part of ‘adjusted items’, or ‘exceptional items’, ensuring that the amounts include meet the definition.</td></tr>
<tr><td>Reconciliations and calculations</td><td>• Reconciliations should be given for all APMs, including ratios, with clear explanations of how reconciling items relate to the amounts in the financial statements.
• The APMs should be able to be recalculated using the information in the financial statements.
• Adjustments made in calculating APMs from IFRS numbers should include gains, as well as losses, when relevant to the definition of the APMs.</td></tr>
<tr><td>Consistency and non-recurring items</td><td>• Disclosures should explain why costs are considered to be non-recurring, in particular for restructuring costs that recur over a number of years.
• For multi-year programmes, the disclosures should reference each year affected and provide the costs to-date, total expected costs and timeframes.</td></tr>
<tr><td>ESMA Guidelines</td><td>• UK entities should continue to apply the ESMA Guidelines on Alternative Performance Measures. The guidelines are consistent with the Companies Act 2006 and codify best practice.</td></tr>
</table>

Companies should look to include and to avoid - Judgements and estimates (8)

<table>
<tr><th colspan="2">What to provide:</th><th>What to avoid:</th></tr>
<tr><td>Critical judgements</td><td>• Disclosures should be clear, explaining the reasons why the judgements were necessary, the factors that had been considered and the outcomes reached.
• Ensure the judgements and related disclosures are consistent with other parts of the annual report, such as those indicated in the audit committee report, audit report, viability statement and going concern disclosures.</td><td rowspan="2">• Repetition of the standards: Simply just repeating the requirements of the accounting standard when explaining the judgement that has been made.

• Limited information: Only giving a cross-reference to the relevant note to the financial statements (unless all the required information about the judgment or estimate is provided in the note).</td></tr>
<tr><td>Sources of estimation uncertainty</td><td>• Ensure the carrying amounts of the assets and liabilities subject to estimation uncertainty are stated (as the amount may not be as that stated in the statement of financial position (balance sheet).
• Disclosures of the key assumptions used in the measurement of assets and liabilities subject to significant estimation uncertainty must be provided.
• Disclosures should be quantified through sensitivity analyses or ranges of outcomes.
• Ensure sensitivities performed represent reasonably possible changes within the next financial year. This is of particular importance given the current economic environment, such as inflation and rising interest rates.
• Values should be assigned to key inputs and assumptions.
• Where cross-references to notes are given, ensure the required information is provided in the note.
• Where additional disclosures regarding estimation uncertainties are deemed to be relevant to users, but do not satisfy the IAS 1.125 requirement because the estimate does not have a “significant risk of resulting in a material adjustment within the following year”, then disclosure is encouraged but a clear distinction is made from those estimates that are significant. For example where the risk of a material adjustment is not significant or arises over a longer period. This helps users to focus on the most important areas of estimation uncertainty.</td></tr>
</table>

Companies should look to include and to avoid – Impairment of assets (9)

What to provide:		What to avoid:

Cash generating units (CGUs)	• Disclosures should give specific information about:
	  • the basis on which CGUs are identified; and
	  • any changes year-on-year, such as the reason for changing the basis of the CGUs and methodology applied.
	• For goodwill impairment testing, the highest level for which testing can be performed is at the operating segment level.
		• **Boilerplate terminology:** Avoid the use of boilerplate information, such as about the basis/nature of CGUs and the basis for carrying out value in use testing (based on the requirements of the standard).

Investment in subsidiaries (in parent individual financial statements)	• Ensure a review is carried out for indicators of impairment on investments in subsidiaries at each reporting date, for instance where the parent company net assets exceed market capitalisation this would be an indicator of impairment. Where there is such an indicator, then an impairment review should be carried out. • Consider whether the judgements around assessing if there has been any indicators of impairment should be disclosed as a significant judgement, as well as whether the impairment review (if applicable) should be disclosed as a key source of estimation uncertainty.	
Impairment testing method	• Value in use calculations should include only cash flow estimates for the asset in its current condition, rather than cash flows from enhancing the asset’s performance. Disclosures should support this and explain clearly the assumptions applied.	
Inputs and assumptions	• The period used for projected cash flows, based on budgets/forecasts approved by management, should be 5 years, unless a longer period can be justified and explained. • Ensure inputs and assumptions used in the calculations are consistent with those inputs and assumptions reported elsewhere in the financial statements.	
Discount rate	• Explanations should be provided about how discount rates have been derived, and where there has been a significant change, reasons should be given.	
Impairment losses	• Disclosures should give information about the losses recognised in the year, for instance the recoverable amount of the impaired asset and the events and circumstances that led to the impairment.	
Sensitivity analysis	• Sensitivity analysis should be performed to explain whether reasonably possible changes in key assumptions could result in an impairment loss. • Values should be assigned to key assumptions. • Better disclosure should help users to understand how assumptions and sensitivities correspond to scenarios discussed in the front-end reporting. • Where a reasonably possible change in a key assumption would lead to an impairment loss, disclosures should be provided to state the value of the assumption, headroom and amount by which that assumption would need to change to drive an impairment.	
Impact of climate change	• Entities must consider the impact of climate change on their impairment reviews, especially in those industries where investors may reasonably expect climate change to significantly affect future expected cash flows for particular assets or cash generating units. Disclosures should ensure that this is addressed in the description of management’s approach to determining the risk of impairment and any key assumptions.	

Companies should look to include and to avoid – Presentation of financial statements (10)

What to provide:		What to avoid:
Accounting policies of material transactions or amounts	• Ensure material accounting policy information is disclosed. • For material transactions or amounts, ensure that an appropriate accounting policy is included or sufficient relevant detail is disclosed to help users under the nature of the transaction or event.	• **Netting of income and expenses:** Ensure income and expenses are not offset (i.e. netted), unless required or permitted by an IFRS. For instance recognising gains and losses on disposals of assets, recognising gains an losses on foreign exchange and revenue net of trade discounts and volume rebates. However where any gains or losses are material, then these should be presented separately.

Changes in presentation or classification	• Presentation and classification of items should remain consistent unless an IFRS requires a change in presentation, or another presentation or classification is more appropriate because it provides reliable and more relevant information to users and that revised structure is likely to continue (so that comparability is not impaired).
	• Where a change is made to the presentation of information or classification of items, comparative information should also be reclassified (unless it is impracticable to do so), with disclosures provided to state:
	  • The nature of the representation or reclassification;
	  • The amount of each item that has been represented or reclassified; and
	  • The reason for the representation or reclassification.	

Additional disclosure to explain the impact	• When compliance with the specific requirements of an IFRS is not sufficient to explain the impact of a particular transaction, event or conditions on a company's financial position and financial performance, then additional company-specific disclosures should be provided.	

Minimum line items	• The face of the statement or profit or loss (income statement) must present certain minimum line item headings, including:
	  • revenue;
	  • finance costs; and
	  • impairment losses on financial assets (measured under the expected credit loss approach).
	• When items of income and expense are material, the nature and amount shall be disclosed separately, on the face of the statement or profit or loss (income statement) or in the notes.	

Illustrative example – Financial instruments

Case Study[8]

Impairment of financial assets

The Group measures the loss allowance at an amount equal to lifetime expected credit losses for all trade receivables.

> The disclosures explain that the simplification available under paragraph 5.5.15 of IFRS 9 has been applied to all trade receivables.

Intercompany receivables

Included in loans to subsidiary undertakings is an £85 million unsecured subordinated loan to TradeCo Limited. The loan was advanced on 27 September 2012, at a fixed rate of 9.5%, with a repayment date of 27 September 2032.

TradeCo Limited has cash and cash equivalents of £614.7 million and borrowings of £240.0 million. Based on its liquidity and expected cash generation, there has been no significant increase in credit risk and the expected 12 months credit loss for TradeCo Limited trade and other receivables is not considered to be significant. As a result, no impairment has been recorded for amounts owed by Group companies on the grounds of materiality.

> Disclosure explains how ECLs have been assessed for intercompany receivables.

Receivables excluding trade receivables

The Group's credit risk is primarily attributable to its trade receivables and the risk of customer default. Credit risk also arises on accrued income, which primarily arises where services have been provided but the amount has yet to be invoiced on to the client. The accrued income balance is short term in nature, with an average ageing of 21 days, and relates to clients with a strong credit history. Therefore, the expected credit losses on receivables, other than trade receivables, were negligible.

> The company confirmed that it considered impairment of receivables other than trade receivables, and provided specific detail in respect of the accrued income balance.

Concentrations of credit risk

The Group has no significant concentrations of credit risk. The trade receivables balance is spread across a large number of different customers with no single debtor representing more than 5% of the total balance due (last year: 6%).

> The company provided a helpful indication that there is no significant concentration of credit risk to individual customers.

However, the Group's debtors include counterparties in sectors that have increased exposure to Government-imposed Covid-19 lockdown restrictions, which may increase the risk of non-payment. The proportions of the trade receivables balance relating to these sectors are: Retail 12%, Leisure 5%, and Office Space 18%.

> The company highlights its credit exposure to certain sectors which may result in increased credit risk as a result of the economic impact of Covid-19.

8 The case study provides an example of better disclosure, annotated to explain what makes it better. It has been developed from our observations during the year, but does not represent any particular company's reporting.

Illustrative example – Income taxes

Case Study[18]

Deferred tax assets of £30m (2020: £28m) include £20m (2020: £26m) relating to the carry forward of unused tax losses. These arose predominantly in Subsidiary A, domiciled in country A (£10m), and Subsidiary B, domiciled in country B (£8m), which have a recent history of losses for tax purposes. However, due to the reasons set out below, the directors consider it probable that sufficient taxable profit will be available against which the unused tax losses can be utilised. Management expects these deferred tax assets to be utilised over a period of between five and seven years.

In the prior period, Subsidiary A reported a one-off loss due to the recognition of a provision for legal claims arising from a breach of health and safety regulations at Factory A. Management does not consider this event will affect the sustainability of future taxable profits in the jurisdiction.

The losses recorded by Subsidiary B in the current and previous period were due solely to losses suffered by division P as sales of product X diminished. Following the strategic decision to cease manufacture of product X, management is confident that this division will return to profitability on the basis of the historical profitability of the ongoing activities and previous forecasting accuracy.

In evaluating whether it is probable that taxable profits will be earned in future accounting periods, management derived their forecasts from the approved three-year budget and the forecasts used for the purposes of reviewing goodwill for impairment, updated for the effect of applicable tax laws and regulations relevant to those future taxable profits. No reasonably possible change in any of the key assumptions would result in a significant reduction in projected tax profits such that the recognised deferred tax asset would not be realised.

At the balance sheet date, the group had total tax losses arising in countries C and D of £21m (2020: £18m) for which no deferred tax asset is recognised because of the unpredictability of future taxable profits. These tax losses can be carried forward indefinitely.

Amount of deferred tax assets disclosed in respect of subsidiaries with a recent history of losses.

Periods over which deferred tax assets are expected to be utilised.

Explanation of the evidence supporting recognition of the deferred tax assets, despite the companies reporting a recent history of losses.

The company considers that there are no significant sources of estimation uncertainty.

18 The case study provides an example of better disclosure, annotated to explain what makes it better. It has been developed from our observations during the year, but does not represent any particular company's reporting.

Contact

Mazars has a specialist Accounting Technical Services team dedicated to providing support on accounting and corporate reporting matters.

This technical publication aims to provide you with a high-level briefing of the changes and developments impacting accounting and corporate reporting. For more detailed information and a comprehensive understanding of how these issues impact your business, please contact:

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