Accounting & Corporate Reporting Key considerations and reminders for clients 2022/23

Introduction

This technical publication sets out the ***key*** accounting and corporate reporting considerations and reminders for entities for the 2022/23 reporting season.

This publication is intended to be a quick reference guide of the top issues affecting entities reporting under IFRS or UK GAAP. It is not intended to be a detailed and exhaustive guide for all issues that could affect all entities. Your business may therefore be subject to other challenges and accounting issues not addressed in this publication. References have been included, where further information can be obtained.

This publication includes three sections:

1) Key focus areas from the Financial Reporting Council (FRC);
2) Key areas of impact from inflation, rising interest rates and volatile financial markets; and
3) Key common complex accounting areas.

Overview of key considerations

Businesses have continued to face significant uncertainty and challenges during 2022, principally as a result of the energy crisis, the situation in Ukraine and the unstable UK and geopolitical environment.

A number of these challenges linger from the Covid-19 pandemic years and the UK's exit from the EU in 2021, such as significant volatility in the financial markets, stresses in supply chains, constraints in the labour market and changing consumer behaviour. Businesses are, however, also now experiencing the effects of soaring energy costs, rising interest rates, high inflation and slowing economic growth. On top of this, efforts to assess and report on climate-related matters increase in urgency.

The impact of these continuing and developing challenges is pervasive in the annual report and financial statements.

Impact on the front-end reporting

The front-end reporting will need to explain clearly the effects of the risks, uncertainties and any opportunities facing businesses, ensuring:

- Evolving risks are explained and reflected in the business strategy and the principal risks reporting, with discussion around any mitigation strategies and actions;
- The impact on forecasts and scenarios is reflected in the viability statement and going concern reporting;
- The analysis of financial performance, including reporting on significant movements in cash flows and amounts within the statement of financial position (balance sheet), is balanced, including both positives and negatives;
- The impact on key stakeholders and decisions made during the reporting period are discussed in the Section 172 reporting, again including both positive and negative impacts; and
- Front-end reporting is consistent with and reflected in the financial statements.

Section 1: Key focus areas from the Financial Reporting Council (FRC)

The FRC has highlighted, via its *Annual Review of Corporate Reporting 2022* and *six thematic reviews* published this year, the key focus areas for entities when preparing financial statements for 2022/2023. This impacts where and how entities should focus their attention when preparing financial statements.

The key accounting areas for focus include:

1. **Cash flow statements** – Care is needed for classifying cashflows appropriately (particularly those classified as investing and financing activities), netting only in certain circumstances and excluding non-cash items (such as additions to right-of-use assets). Ensure cashflows and transactions reported elsewhere in the financial statements are consistent, such as for business acquisitions.
2. **Financial instruments reporting** – Disclosures on expected credit losses (ECLs), credit risk and liquidity risk must be complete and transparent, particularly around ECLs provisioning (ensuring appropriate adjustments are made for future economic conditions) and changes in significant increases in credit risk, along with the associated impact on provision staging between levels 1, 2, and 3. Where material, impairment losses must be disclosed on the face of the income statement, which may be a more likely occurrence for this year.
3. **Deferred tax assets and liabilities** – More details should be disclosed on the supporting evidence obtained for recognising deferred tax assets from losses, and consideration given to whether recognition and measurement should be disclosed as a significant judgement or area of estimation uncertainty. Care is also needed to ensure the requirements for netting are met.
4. **Judgements & estimates** – Judgements and estimates must be clearly explained and meaningful sensitivity disclosures provided. Estimates with a si*gnificant risk of a material adjustment to the carrying amounts of assets and liabilities within the next financial year* should be distinguished from other sources of estimation uncertainty.
5. **Climate change reporting** – There should be continued focus on how climate-related risks and opportunities impact the financial statements, in particular the connectivity between what is reported in the front-end and how this is reflected in the numbers. Where the impact of climate-related risks is not 'significant' but relevant to the entity, then disclosures may still be beneficial to users, for instance where climate risks are expected to impact in the medium or long-term rather than within the next financial year. *Click here for further information*.
6. **Revenue reporting** – Compliant, transparent and tailored disclosures are required in relation to revenue recognition and disaggregation of revenues, particularly for determining variable consideration, explaining the timing of revenue recognition for each performance obligation, the basis for recognising revenue over time and the methodologies applied.
7. **Corporation tax rate rise to 25%** – The rate rise to 25% is substantially enacted and therefore must be reflected in the measurement of deferred tax assets and liabilities from 1 April 2023.
8. **Parent individual financial statements** – The parent company individual financial statements are also important, whether reporting under IFRS or UK GAAP. Remember to consider the subsidiary investment carrying amounts and recoverability of any intercompany receivables, and ensure disclosures are complete.

Section 2: Impact of inflation, rising interest rates and volatile financial markets

The impact of inflation, rising interest rates and volatile financial markets is having a widespread impact on financial statements. Care is therefore needed when considering the impact of these challenges and preparing the numbers in the financial statements, particularly measuring assets and liabilities and determining judgements and estimates. Disclosures are equally important as they message to investors and other stakeholders that due care and consideration has been given to the ongoing sustainability and resilience of the business.

The key accounting areas impacted by inflation, rising interest rates and volatile financial markets include:

- ***Discount rates*** – There will be increased scrutiny on determining appropriate discount rates, for instance when measuring lease liabilities, determining value-in-use calculations for impairment reviews and measuring provisions. Assumptions about discount rates should be internally consistent with forecasted cash flows.
- ***Forecast cash flows and growth rates*** – There will be greater focus on how forecasted cash flows and growth rates are determined, for instance from expected future selling prices, rising costs and changes in consumer behaviour within value-in-use calculations and going concern assessments. This will lead to greater focus on disclosures of management estimates and assumptions applied within these budgets and forecasts, and could also impact on the recognition of deferred tax assets (due to uncertainty over future profits) and recognition or measurement of provisions, such as inventory provisioning and onerous contracts.
- ***Key inputs and assumptions*** – There will be increased scrutiny on market-based inputs and assumptions used to measure assets and liabilities, for instance expected volatility and risk-free rates within share-based payment transactions, expected salary levels and yields on high quality corporate bonds within defined benefit pension schemes, and variable lease payments linked to an index or rate (such as CPI) within lease arrangements.
- ***Determining fair values*** – There will be increased scrutiny on how fair values are determined, where they are not based on observable market prices, such as quoted prices. The inputs and assumptions used for determining forecast cashflows and discount rates within discounted cash flow techniques will be subject to greater focus, as explained above.
- ***Historical data*** – Historical information may need to be more significantly adjusted to be representative of current economic conditions, for instance determining loss rates within the simplified ECLs approach to take account of current expectations and forward-looking estimates.
- ***Sensitivity analyses*** – There will be greater focus on percentage changes that realistically represent “reasonable possible changes”, for instance within interest rate and foreign currency sensitivity analyses.
- ***Targets linked to future performance*** – Underperformance of the business could impact on targets or non-market performance conditions, such as revenue targets and EBIDTA measures, which may subsequently impact employee remuneration measurement, share-based payment vesting or contingent consideration measurement.
- ***Covenants*** – There will be increased risk around not meeting covenants on borrowings. Where covenants are breached, this may impact on the presentation (as non-current liabilities or amounts due in more than one year) and the disclosures requirements.

Section 3: Key common complex accounting areas

Where your business has carried out any of the following transactions or activities, ensure careful consideration is given to the accounting treatment applied and how the transaction or activity is reported within the financial statements.

Such transactions and activities are becoming more common place, however the accounting treatment to be applied is often complex, and in some case new and developing, and/or may be subject to significant accounting judgement or estimation uncertainty. These factors could therefore create greater risk.

The key common complex areas include:

- **SaaS (Software as a Service) cloud-based arrangements** – Determining whether the costs associated with the SaaS arrangement are required to be expensed or are permitted to be capitalised. *Click here for further information.*
- **Cryptocurrency assets** – Assessing whether the holding of cryptocurrency assets should be accounted for under IAS 38 *Intangible Assets* (Section 18 *Intangible Assets Other Than Goodwill*) or IAS 2 *Inventories* (Section 13 *Inventories*) and determining any related accounting issues. *Click here for further information.*
- **Principal versus agent relationship** – Determining whether or not, under IFRS 15 *Revenue from Contracts with Customer,* an entity controls a good or service before that good or service is transferred to a customer, and disclosing clearly the judgements applied in making this decision. *Click here for further information.*
- **Group reorganisations** – Ensuring that for group reorganisations, the requirements of group reconstruction relief or merger relief, as set out in the Companies Act, are appropriately applied within the individual financial statements of the entity issuing shares.
- **Management incentive arrangements linked to non-market objectives** – Ensuring that incentive arrangements that have links to non-market objectives, such as climate or diversity targets, are appropriately accounted for under IAS 19 *Employee Benefits* (Section 28 *Employee Benefits*) or potentially IFRS 2 *Share-based Payment* (Section 26 *Share-based Payment*).
- **ESG-linked loans** – Assessing how the holding of such loans should be accounted for under IFRS 9 *Financial Instruments* (Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*) and determining any related accounting issues.
- **Hyperinflation** – An entity whose functional currency is the currency of a hyperinflationary economy is required to apply IAS 29 *Financial Reporting in Hyperinflationary Economics* (Section 31 *Hyperinflation*), for instance entities operating within Turkey, Ethiopia or Sri Lanka may be impacted. Multinational groups with subsidiaries impacted by hyperinflationary economics will need to consider the impact on the consolidated financial statements as well.

And finally ……

- **European Single Electronic Requirements (ESEF)** – Main market listed companies must carry out phase 2 of mandatory tagging of annual financial reports. Phase 1 – tagging of the primary statements and basic information – was required during 2021, however the requirement now extends to block tagging of disclosures within the notes to the financial statements for accounting periods beginning on or after 1 January 2022.

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:

Steve Brice

Partner, Accounting Technical Services

T : +44 (0) 7795 348657

E: steve.brice@mazars.co.uk

Jessica Howard

Director, Accounting Technical Services

T: +44 (0) 7794 031373

E: jessica.howard@mazars.co.uk

mazars

The contents of this document are confidential and not for distribution to anyone other than the recipients. Disclosure to third parties cannot be made without the prior written consent of Mazars LLP.

Mazars is an internationally integrated partnership, specialising in audit, accountancy, advisory, tax and legal services*. Operating in over 90 countries and territories around the world, we draw on the expertise of more than 44,000 professionals – 28,000+ in Mazars' integrated partnership and 16,000+ via the Mazars North America Alliance – to assist clients of all sizes at every stage in their development.
*where permitted under applicable country laws

Mazars LLP is the UK firm of Mazars, an international advisory and accountancy organisation, and is a limited liability partnership registered in England with registered number OC308299. A list of partners' names is available for inspection at the firm's registered office, Tower Bridge House, St Katharine's Way, London E1W 1DD. Registered to carry on audit work in the UK by the Institute of Chartered Accountants in England and Wales. Details about our audit registration can be viewed at www.auditregister.org.uk under reference number C001139861.

© Mazars 2022

www.mazars.com