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2024 Hot topics for FRS 102 reporters

Macro-economic uncertainty

During 2024 to date several countries have experienced improvements in macroeconomic stability, with decreases and stabilisation in inflation, unemployment, and interest rates. In the USA, inflation is steadily cooling, prompting the Federal Reserve to lower interest rates in September - the first reduction since the pandemic. Unemployment has also declined indicating a strong labour market. The UK has seen similar trends, with inflation dropping and the Bank of England cutting interest rates for the first time since March 2020. Whilst the worst of the cost-of-living crisis may be behind us, and the UK economy has shown signs of recovery, growth and productivity measures remain weak.

Here are some key considerations when preparing the financial statements:

- **Impairment triggers and losses** – Volatility in interest rates and inflation affect the discount rates and future cash flow projections used in impairment calculations, potentially leading to impairment losses. Revenue projections may reduce due to economic slowdown which may trigger impairment tests and losses. Fluctuations in exchange rates impact the value of foreign operations and assets, affecting impairment calculations.
- **Review useful lives and residual values** – Slowdown or limited growth that may lead to reduction in consumption can impact the expected usage of assets. Rapid technological changes (e.g., increasing demand of AI products and services) may make existing assets obsolete more quickly. New environmental laws (e.g., Zero Emission Vehicle (ZEV) Mandate which is part of the UK government commitment to end the sale of new petrol and diesel cars by 2035) and net-zero strategies may affect the useful economic life of assets.
- **Remeasure assets and liabilities at fair value** – Interest rate and inflation changes may impact the measurement assets and liabilities reported at fair value – such as derivatives and certain other financial assets and liabilities and many investment properties. Resulting gains and losses should be reported in profit or loss or other comprehensive income as required by the application Section of FRS 102.
- **Impairment of financial assets** – Economic uncertainty should be incorporated into the Expected Credit Loss (ECL) model under IFRS 9 by using forward-looking information that reflects these conditions. Entities should consider multiple economic scenarios, including potential downturns, and adjust their cash flow projections and discount rates accordingly.
- **Consider impact on provisions and contingencies** – Economic uncertainty impacts the estimation of provisions. Higher input costs (e.g., rising costs of labour and material due to inflation or for example tough tariffs on Chinese products) may require remeasurement of any provisions based on future cash flows and recognition of new ones (e.g., onerous contracts, commitments to be net-zero).
- **Update sensitivity analysis for key estimates** – Entities may need to conduct sensitivity analysis to evaluate the possible impact of different economic scenarios and update forward-looking information to reflect the latest economic conditions in a range of areas.
- **Hyperinflation** – All economies that were hyper-inflationary in 2023 remain hyper-inflationary in 2024, including Turkey, with the exception of Yemen, which is no longer hyper-inflationary as of June 2024. Egypt, Lao P.D.R. and Malawi are expected to become hyper-inflationary by the end of 2024. When a reporting entity's functional currency is from a hyperinflationary economy, section 31 of FRS 102 mandates restatement of financial statements using a general price index that reflects changes in purchasing power.
- **Narrative reporting** – The business review in the Strategic Report should take into consideration how the current economic conditions affect the business performance and position. It should particularly address the impact on principal risks and uncertainties, KPIs, S172 statement including the effects on key stakeholders and decisions made during the reporting period.

Climate related matters

Climate change, associated risks and regulatory responses are and will continue to have wide-ranging financial and strategic impacts on business. Financial impacts could include costs of regulatory compliance, higher insurance premiums, and the need for investment in sustainable practices. It can affect asset valuations through potential impairment of physical assets and increased depreciation from accelerated wear and tear. Revenue may be impacted by changing market demands and disruptions in supply chains. Additionally, climate-related risks may influence long-term financial planning and disclosures related to environmental sustainability.

Climate change will therefore affect both financial and narrative reporting.

Strategic report

As noted below, entities subject to specified economic significance thresholds are now required to include a non-financial and sustainability information statement in their Strategic Report. However, all entities that prepare a Strategic Report should consider the impact of climate change on other elements, for example:

- the impact of climate risks and opportunities on the company's business model, strategy, and performance
- potential financial implications, such as changes in operating costs, asset valuations, and revenue streams
- the effects on key stakeholders (S172 reporting)
- whether and how climate risk is or affects the principal risks and uncertainties.

UK mandatory climate-related financial disclosures

For financial years starting on or after 6 April 2022, UK mandatory climate-related disclosures are required in the annual reports of the entities within scope. These requirements have been built into the Companies Act 2006.

Entities in scope are:

- All UK companies that are currently required to produce a non-financial information statement, being UK companies that have more than 500 employees and have either transferable securities admitted to trading on a UK regulated market and banking companies or insurance companies (Relevant Public Interest Entities (PIEs))
- UK registered companies with securities admitted to AIM with more than 500 employees
- UK registered companies not included in the categories above, which have more than 500 employees and a turnover of more than £500m
- Large LLPs, which are not traded or banking LLPs, and have more than 500 employees and a turnover of more than £500m
- Traded or banking LLPs which have more than 500 employees

Disclosure requirements include descriptions of governance arrangements, how climate-related risks and opportunities are identified and the actual and potential impacts of the climate-related risks and opportunities identified. This is not an exhaustive list of the requirements.

These disclosures should be given in the Strategic Report in a "non-financial and sustainability information statement" (entities subject only the sustainability requirements commonly refer to this as the "sustainability information statement"). LLPs should include their disclosures either in the Energy and Carbon Report or, if a Strategic Report is prepared, within that report.

Directors' report

If the entity meets the reporting thresholds, the Directors' Report must include the SECR disclosures:

- The annual carbon dioxide equivalent emissions (in tonnes) from gas combustion and fuel consumption for transport, as well as emissions from purchased electricity used by the company, including for transport, and it should provide the total energy consumption (in kWh) from these activities
- If the entity has implemented any energy efficiency measures during the financial year, the report should describe these measures
- Offshore undertakings may exclude emissions and energy consumed outside the UK and offshore areas, while other companies may exclude emissions and energy consumed outside the UK. Disclosure is not required if the company used 40,000 kWh of energy or less in the UK, or if disclosure would seriously harm the company's interests, with the report noting the reasons for non-disclosure.

Financial statements

- Recognise provisions, accruals and contingent liabilities related to climate matters (e.g. environmental remediation, climate-related litigation or compliance with new environmental regulation)
- Assess climate impacts on asset values and consider impairment where applicable (e.g. due to damage from extreme weather or changing environmental conditions).
- Disclose climate-related assumptions used in critical accounting judgments and estimates
- Update relevant accounting policies related to climate, e.g., impairment and provisions.

Political situation and developments

Ongoing global conflicts, and to some extent political shifts including elections in major countries, may create or increase uncertainties that impact financial statements. Entities with operations or exposure in affected regions need to consider the potential implications on their financial reporting. These may include need to reassess principal risks, update provisions and asset impairments, adjust fair value estimates, and consider contingent liabilities. Narrative reporting should reflect any changes in strategy, risk management, along with any measures taken to support affected stakeholders. Additionally, entities should review their sensitivity analyses and critical estimates, ensuring that disclosures accurately reflect the effects of these geopolitical developments on their financial position and outlook.

Tax updates

- **Personal taxes** - the basic rate of income tax has been cut from 20% to 19% from 2024. The main rate of employee National Insurance has been cut by 2p from 10% to 8% from April 2024.
- **Corporate taxes** - the new government has not introduced changes to the corporation tax rate which remains in 25% since 1 April 2023.
- **UK implementation of Pillar 2** - The UK has made significant strides in implementing the OECD's Pillar Two model rules, which aim to establish a global minimum tax of 15% for large multinational enterprises (MNEs). The UK's Finance (No. 2) Act 2023 introduced the Multinational Top-Up Tax (MTUT) and the Domestic Top-Up Tax (DTT) to align with the OECD's Pillar Two model rules. These taxes ensure MNEs with consolidated revenues over €750 million pay a minimum 15% tax rate globally, starting from accounting periods commencing on or after 31 December 2023. The regime includes transitional provisions which are a short-term measure designed to exclude a group's operations in lower-risk countries from the compliance obligation of preparing full Pillar Two calculation. Extensive reporting obligations apply, regardless of the availability of these transitional provisions, with first filings in the UK due mid-2026 for entities with accounting periods ending in December 2024.

FRC updates applicable to FRS 102 reporters

Amendments to FRS 102

On 27 March 2024, the FRC issued Amendments to FRS 102, concluding its second periodic review of the financial reporting standard. Most amendments are effective for accounting periods beginning on or after 1 January 2026, with earlier adoption permitted. Amendments for supplier finance arrangements will be effective from 1 January 2025. Entities must consider the wide-reaching commercial impacts that these amendments may have on key financial metrics, remuneration structures, distributable reserves, and covenant compliance.

The most significant changes are to Revenue (Section 23, now renamed *Revenue from Contracts with Customers*) and Leases (Section 20):

- The new Section 23 aligns revenue recognition with IFRS 15 *Revenue from Contracts with Customers*, with minor simplifications. Entities will need to reassess the accounting treatment of most revenue contracts, especially those with bundled goods/services, variable consideration, warranties, customer options, and significant financing components. Principal vs agent assessments and 'over time' revenue recognition may also change. The amendments apply retrospectively, with the cumulative effect adjusted in the opening balance of retained earnings. Restatement of comparatives is not required, but full retrospective application is permitted as per Section 10.
- The new Section 20 introduces an on-balance sheet lease accounting model based on IFRS 16 *Leases*, with certain practical exemptions. Most lessees will now recognise leases, except short-term or low-value ones, on the balance sheet without distinguishing between operating and finance leases. The amendments must be applied retrospectively, adjusting the opening balance of retained earnings at the date of initial application, without restating comparatives. Various simplifications are available for transition. Accounting by lessors is largely unchanged.

Other updates and publications

- **Thematic Review "Reporting by the UK's largest private companies" issued in January 2024:** This thematic aims to enhance understanding of corporate reporting quality among the UK's largest private companies, focusing on critical areas of the annual report and accounts where non-compliance risk is highest. The reviewed companies are large entities with complex structures, business models, and significant pension obligations.
- **Annual Review of Corporate Reporting 2023/24:** This report offers information relevant to financial statement preparers, auditors, investors, and other corporate report users, as well as wider FRC stakeholders. The Highlights section summarises 2023/24 activities and findings, expectations for 2024/25 reports, and key corporate reporting issues for stakeholders. The more detailed sections provide insights into topical reporting challenges. The Appendices include data on monitoring activities, priority sector findings, upcoming reporting changes, and an overview of the scope of FRC reviews.
- **Amendments to FRS 101:** on 9 August 2024, the FRC issued minor amendments to FRS 101 *Reduced Disclosure Framework* as part of the 2023/24 annual review. These updates introduce a disclosure exemption for certain comparative information and a conditional exemption for qualifying entities concerning specific supplier finance arrangement disclosures required by IAS 7 *Statement of Cash Flows*. Furthermore, Appendix II (Note on Legal Requirements) has been revised to ensure consistency with IAS 1 *Presentation of Financial Statements*.
- **Second Review of reporting against the Wates Principles:** on 12 August 2024, The FRC released its second assessment of private companies following the Wates Principles. While some improvements in disclosure were noted, many companies still struggle to provide meaningful, company-specific information, often relying on generic statements. Stakeholders have called for more focused and transparent governance reporting, better linking company actions to governance activities.
- **Thematic Review "Offsetting in the financial statements" issued in September 2024:** This thematic highlights that the inappropriate use of offsetting can obscure financial risks and lead to material errors, prompting restatements of primary financial statements. The review sets out the most commonly found issues, particularly in the areas of the cash flow statement, financial instruments and provisions and provides examples of good practice disclosures.
- **Thematic Review "IFRS 17 'Insurance Contracts' Disclosures in the First Year of Application" issued in September 2024:** The FRC carried out a review of disclosures in entities' first annual reports and accounts following their adoption of IFRS 17. Overall, the quality of the disclosures was good, with noted improvements from interim reports. While further enhancements were identified, particularly in judgements, estimates, and alternative performance measures, the high compliance levels across the sample of 17 insurance companies reflect significant effort in the transition.
- **Possible changes to UK company size thresholds:** In March 2024, under the previous government, a reform package was announced which included a proposal to raise company size monetary thresholds by 50% for accounting periods beginning on or after 1 October 2024. If adopted, micro entity turnover limits would rise from £632,000 to £1m, small companies from £10.2m to £15m, and medium-sized companies from £36m to £54m, with balance sheet thresholds increasing to £500,000, £7.5m, and £27m, respectively. However, at the time of publication, the proposed changes had not actually been enacted and it remains unclear whether or when these changes will come into effect.

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