International Financial Accounting

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Notes to the financial statements

Session 5: Notes

Introduction to Notes to the financial statements

Operating segments (IFRS 8)

Related party disclosures (IAS 24)

Introduction to notes

Introduction

A wealth of information about the company – often ignored

- You will have to scrutinize the Notes for your group project

For example, following info disclosed:

- **Accounting policy descriptions – Note #1**
  - Tells you how figures prepared, assumptions made, estimates, etc
- **Contingent liabilities & contingent assets** – we talked about IAS 37 in Session 2
- **Segmental information (IFRS 8)**
- **Related party disclosures (IAS 24)**

Where to find the Notes

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STRATEGIC REPORT

DIRECTORS' REPORT

FINANCIAL STATEMENTS

SUPPLEMENTARY INFORMATION

Note #1: Accounting Policies Note

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Notes to the Financial Statements

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2020

1. Statement of accounting policies

General information

Kerry Group plc is a public limited company incorporated in the Republic of Ireland. The registered number is 111471 and registered office address is Prince's Street, Tralee, Co. Kerry, V92 EH11, Ireland. The principal activities of the Company and its subsidiaries are described in the Business Reviews and note 35 'Group entities'.

Basis of preparation

The consolidated financial statements of Kerry Group plc have been prepared in accordance with International Financial Reporting Standards ('IFRS'), International Financial Reporting Interpretations Committee ('IFRIC') interpretations and those parts of the Companies Act, 2014 applicable to companies reporting under IFRS. The financial statements comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Balance Sheet, the Company Balance Sheet, the Consolidated Statement of Changes in Equity, the Company Statement of Changes in Equity, the Consolidated Statement of Cash Flows, the Company Statement of Cash Flows and the notes to the financial statements. The financial statements include the information in the remuneration report that is described as being an integral part of the financial statements. Both the Parent Company and Group financial statements have also been prepared in accordance with IFRS adopted by the European Union ('EU') which comprise standards and interpretations approved by

Certain income statement headings and other financial measures included in the consolidated financial statements are not defined by IFRS. The Group make this distinction to give a better understanding of the financial performance of the business.

The consolidated and company financial statements have been prepared on the going concern basis of accounting. The Directors have considered the Group's business activities and how it generates value, together with the main trends and factors likely to affect future development, business performance including liquidity and access to financing as outlined in note 23, and position of the Group including the impact of the current COVID-19 pandemic. Due to the uncertainty of the ongoing duration and impact of the pandemic on mobility restrictions in different countries around the world, additional stressed scenarios, reflecting different levels and timing of the recovery, have been considered. This analysis indicated that, notwithstanding the current global pandemic, it does not affect the Group's ability to continue as a going concern.

There are no material uncertainties that cast a significant doubt on the Group's ability to continue as a going concern over a period of at least 12 months.

Basis of consolidation

Subsidiaries

The consolidated financial statements incorporate the

Note #1: Accounting Policies Note

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1. Statement of accounting policies (continued)

Property, plant and equipment

Property, plant and equipment, other than freehold land, are stated at cost less accumulated depreciation and any accumulated impairment losses. Cost comprises purchase price and other directly attributable costs. Freehold land is stated at cost and is not depreciated. Depreciation on the remaining property, plant and equipment is calculated by charging equal annual instalments to the Consolidated Income Statement at the following annual rates:

- Buildings	2% - 5%
- Plant, machinery and equipment	7% - 25%
- Motor vehicles	20%

The charge in respect of periodic depreciation is calculated after establishing an estimate of the asset's useful life and the expected residual value at the end of its life. Increasing/(decreasing) an asset's expected life or its residual value would result in a (decreased)/increased depreciation charge to the Consolidated Income Statement as well as an increase/(decrease) in the carrying value of the asset.

The useful lives of Group assets are determined by management at the time the assets are acquired and reviewed annually for appropriateness. These lives are based on historical experience with similar assets as well as anticipation of future events, which may impact their life, such as changes in technology. Historically, changes in useful lives or residual values have not resulted in material changes to the Group's depreciation charge.

Assets in the course of construction for production or administrative purposes are carried at cost less any recognised impairment loss. Cost includes professional fees and other directly attributable costs. Depreciation of these assets commences when the assets are ready for their intended use, on the same basis as other property assets.

Subsequent to the initial measurement, the liability will be reduced for payments made and increased for the interest applied and it is remeasured to reflect any reassessment or contract modifications. When the lease liability is remeasured, the corresponding adjustment is reflected in the right-of-use asset or in the Consolidated Income Statement if the right-of-use asset is already reduced to zero.

The Group has elected to record short-term leases of less than 12 months and leases of low-value assets as defined in IFRS 16 as an operating expense in the Consolidated Income Statement on a straight-line basis over the lease term.

The Group has also elected not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component further increasing the lease liability.

Assets classified as held for sale

Assets are classified as held for sale if their carrying value will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met if, at the financial year end, the sale is highly probable, the asset is available for immediate sale in its present condition, management is committed to the sale and the sale is expected to be completed within one year from the date of classification.

Assets classified as held for sale are measured at the lower of carrying value and fair value less costs to sell.

Intangible assets

Goodwill

Goodwill arises on business combinations and represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary entity at the date control is achieved.

Note for each line item

Consolidated Balance Sheet

AS AT 31 DECEMBER 2020

	Notes	31 December 2020 €'m	31 December 2019 €'m
Non-current assets			
Property, plant and equipment	11	**1,990.6**	2,062.9
Intangible assets	12	**4,687.1**	4,589.7
Financial asset investments	13	**37.0**	41.7
Investment in joint ventures	14	**17.8**	16.2
Other non-current financial instruments	22	**82.0**	82.7
Deferred tax assets	17	**33.8**	38.9
		6,848.3	6,832.1
Current assets			
Inventories	16	**975.6**	993.3

Note for each line item

16 April 2021. The consolidated financial statements do not reflect this dividend.

11. Property, plant and equipment

	Notes	2020 €'m	2019 €'m
Group:			
Property, plant and equipment	(i)	**1,916.2**	1,963.4
Right-of-use assets	(ii)	**74.4**	99.5
		1,990.6	2,062.9

Operating segments (IFRS 8)

Segmental information

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Financial statements are aggregate figures for **whole** business

Business may consist of distinct components – with different risk profiles, growth rates, etc

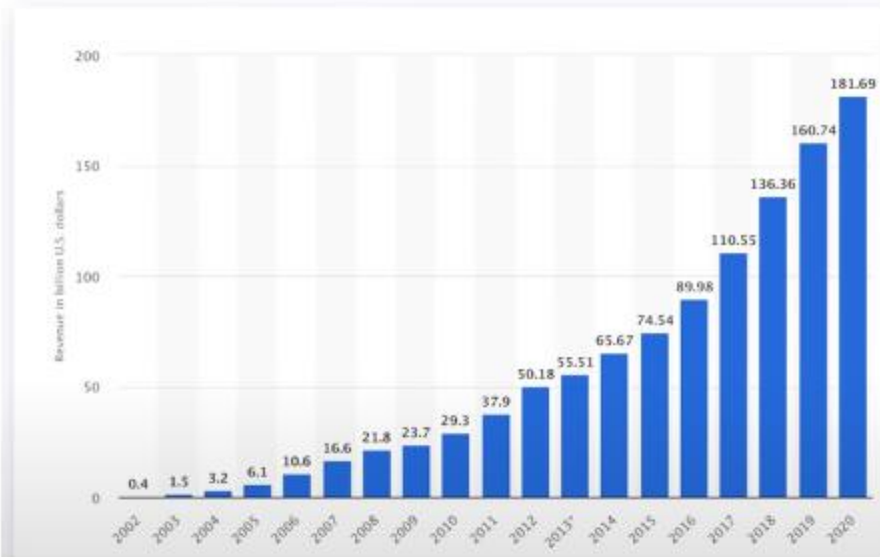
Google vs Amazon

- If you had to choose one, which one would you invest in today?
- Let's look at their income statements (remember: financial statements aggregate information for **entire** business)

Google income statements

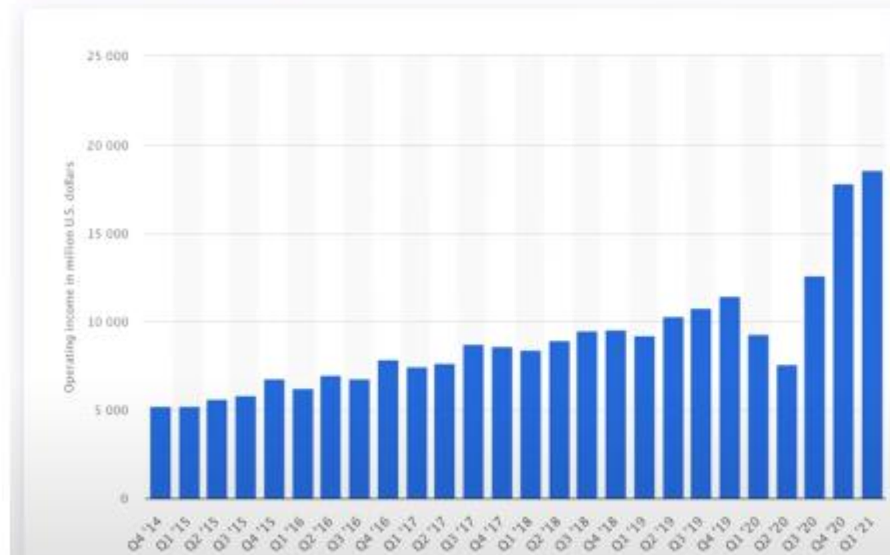
Annual revenue of Google from 2002 to 2020

(in billion U.S. dollars)



Operating income of Google from 4th quarter 2014 to 1st

(in million U.S. dollars)



Amazon income statements

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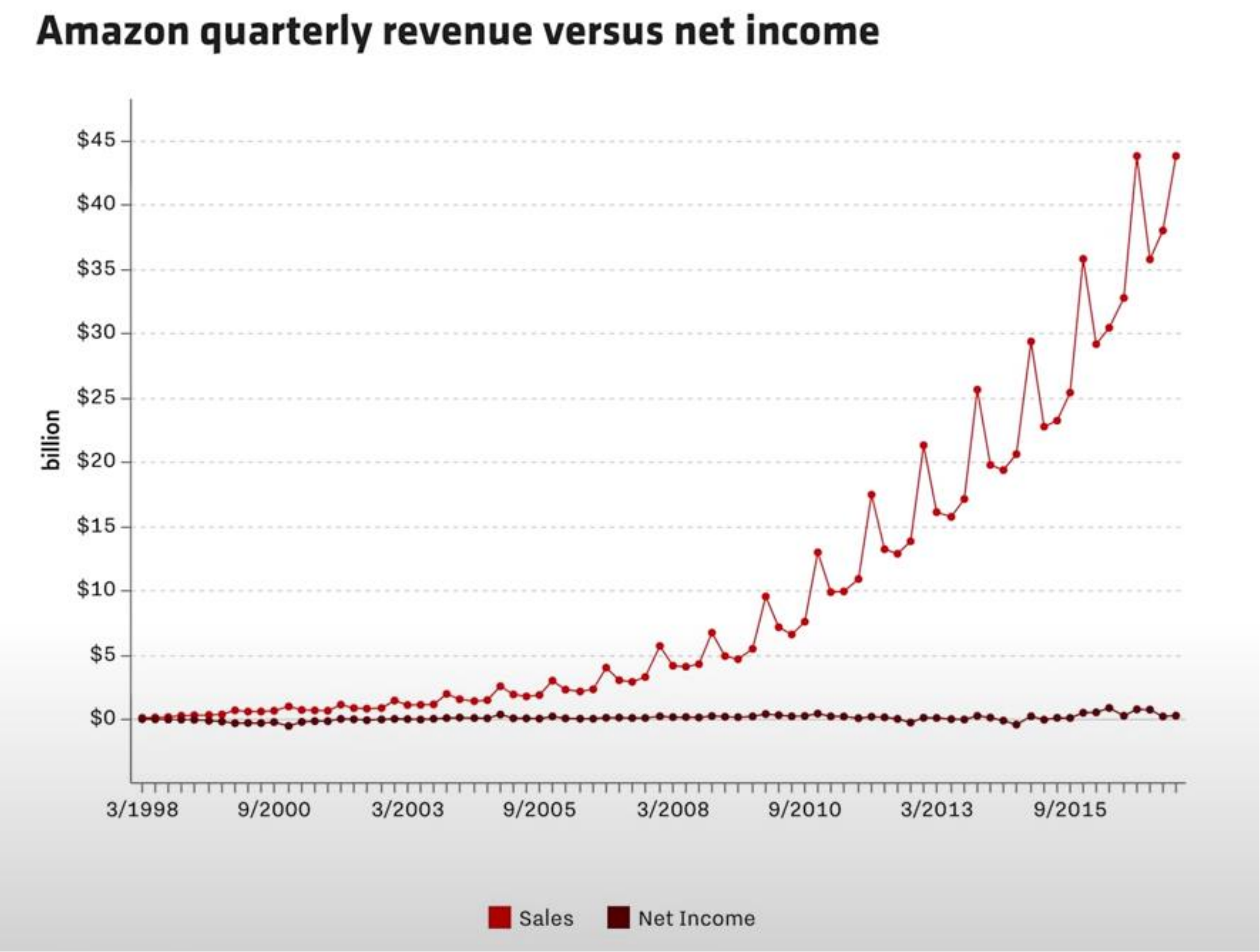
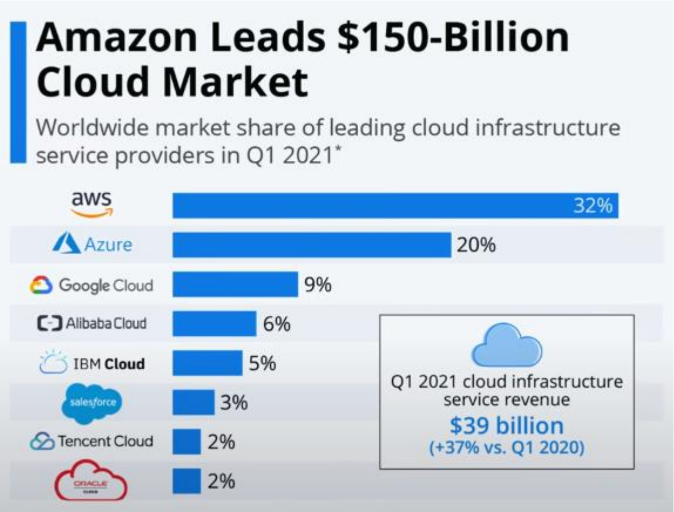


Innovation & Reinvestment

Previously we heard co-founder of Stripe saying accounting rules failed to capture value of intangible assets such as software

- Expenditure on developing new projects expensed rather than capitalized
- Deteriorates income statement / balance sheet / cash flow statement

How could this impact on the income statement (revenue / net profit) of Amazon & Google?



Innovation & Reinvestment

Amazon vs Google:

https://www.youtube.com/watch?v=9Fq15k9QPv8&list=PL91a1XTCKAC7DGcVG-LzpY3JoW0cThde_&index=4&t=365s

Watch: 6:05 - 8:53

Segmental information

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The examples of Google vs Amazon shows the importance of segmental information

To analyse businesses with distinct components (risk, growth, etc.) → you need more granular financial information

IFRS 8 is the accounting standard which regulates the preparation of segmental information that companies must disclose

Segmental information is disclosed in the Notes to the financial statements !

Let's look at the accounting rules / requirements

IFRS 8: Operating Segments

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IFRS 8 (Operating Segments) is a disclosure standard

Does not address how transactions should be accounted for

Only addresses how information should be disclosed

The objective of IFRS 8 is for the organisation

To disclose information to enable the users of its financial statements to evaluate the nature and financial effects of:

- Types of business activities the entity engages in and
- Economic environments the entity operates within

Definitions

‘Chief operating decision maker’

- Term ‘chief operating decision maker’ is referred to in IFRS 8 (Operating Segments).
- Not defined in standard
- Refers to a function, rather than a title.
- Function could be fulfilled by a group of directors rather than a single director.

Definitions

‘Operating segment’ – a component of an organisation

1) That engages in business activities from which it may earn revenues and incur expenses

- Including revenue & expenses relating to transactions with other components of the same organisation

2) Whose operating results are reviewed regularly by the organisation’s ‘chief operating decision maker’ to make decisions about:

- Resources to be allocated to the segment and
- To assess its performance

3) For which discrete financial information is available.

Definitions

‘Reportable segment’:

An ‘operating segment’ or aggregations of ‘operating segments’ that meet size criteria specified in IFRS 8 (Operating Segments)

Identifying ‘operating segments’

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Not all of the operations of an organisation will necessarily be an operating segment

For example, corporate headquarters does not have sufficient economic substance:

- it does not earn revenue or only earns revenue that is incidental to the activities of the organisation

Reportable Segments

Company must report financial & descriptive information about its 'reportable segments'.

'Reportable segments' are 'operating segments', or aggregations of 'operating segments', that meet specified size criteria:

(1) The operating segment's reported revenue, from both external customers and inter-segment sales or transfers, is 10% or more of the combined revenue, internal and external, of all operating segments	Income statement – sales revenue
OR	
(2) The absolute measure of the operating segment's reported profit or loss is 10% or more of the greater of: (i) The absolute combined reported profit of all operating segments that did not report a loss and (ii) The absolute combined reported loss of all operating segments that reported a loss.	Income statement – net profit or loss
OR	
(3) The operating segment's assets are 10% or more of the combined assets of all operating segments.	Balance sheet - assets

75% threshold for sales revenue

If total external revenue reported by reportable segments is less than 75% of the organisation's revenue:

Additional operating segments must be identified as reportable segments – even if they do not meet the size criteria for a 'reportable segment'

Additional reportable segments must be added until at least 75% of the organisation's revenue is included in the reportable segments

Example: Reportable Segments

P Ltd is a listed company. The following operating segments have been identified in the company:

	Revenue		Profit	Assets
	Internal	External		
Operating segment:				
A	550,000	300,000	70,000	5,000,000
B	300,000	2,600,000	750,000	10,800,000
C	50,000	450,000	100,000	1,000,000
D	-	1,550,000	200,000	5,000,000
E	100,000	400,000	80,000	2,200,000
TOTAL	1,000,000	5,300,000	1,200,000	24,000,000

<u>Question:</u>

Apply the principles in IFRS 8 (Operating Segments) to determine P Ltd’s reportable segments.

Example: Reportable Segments

Let's consider IFRS 8's size criteria for 'reportable segments':

Segment reporting

IFS 8 (Operating Segments) does not define:

- Segment revenue
- Segment expense
- Segment result
- Segment assets or
- Segment liabilities

Standard only requires an explanation of how segment profit or loss, segment assets and segment liabilities are measured for each operating segment

- Therefore, organisations are provided with the discretion to determine what is included in segment profit or loss
- But in practice, organisations will be limited by their internal reporting practices.

Related party disclosures (IAS 24)

IAS24 – Related Party Disclosures

IAS24 is a disclosure standard

- **Disclosures made in Notes to the financial statements**

It is important that a user be aware of parties with whom the entity is related

And of transactions that have taken place with those parties during the reporting period

Users need to know if the figures in the financial statements do not reflect arm's length transactions between independent parties

Example

If a subsidiary, its policies and decision-making powers are effectively controlled by its parent company

An awareness of the parent-subsidiary relationship is an important disclosure that should be made in both companies' financial statements

Example

An entity may extend a loan to one of its directors at a discounted interest rate

Disclosure of this transaction is important if the information provided in the financial statements is to be considered as complete

Objective of IAS24

Objective of IAS24 is to draw attention to the possibility that financial statements may have been affected by:

- existence of related parties &
- by material transactions & outstanding balances with such parties

What is a related party transaction?

A **related party transaction** is a transfer of resources, services, or obligations between related parties, regardless of whether a price is charged

The following are examples of transactions that are disclosed if they are with a related party:

- Purchases or sales of goods
- Purchases or sales of property & other assets
- Rendering or receiving of services
- Leases
- Transfers of research and development

Who are related parties?

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(a) An entity is related to a reporting entity if any of the following applies:

- Both entities are members of the same group
  - thus, a parent and a subsidiary are related parties, as are fellow subsidiaries
- One entity is an associate or joint venture of the other
- One entity is an associate or joint venture of a company in a group of which the other entity is a member

Who are related parties?

(a)…cont'd

- Both entities are joint ventures of the same third party
- One entity is a joint venture of a third entity, and the other entity is an associate of the third entity
- The entity is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity
- The entity is controlled or jointly controlled by a person identified in the next slide

Who are related parties?

(b) A person, or a close family member of the person, is related to a reporting entity if that person:

- Has control or joint control over the reporting entity
- Has significant influence over the reporting entity or
- Is a member of the key management personnel of the reporting entity or its parent.

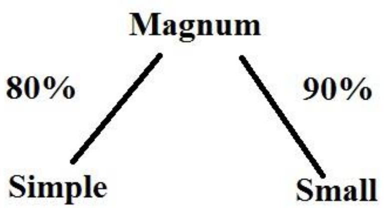
Definition

Key Management Personnel

those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including all directors (executive and non-executive)

Example 1: Parent & Subsidiaries

Magnum Limited controls two subsidiaries:
Simple Limited and Small Limited



Example 2: Member of Key Management Personnel

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On 1 December 2020, Magnum Limited extends a loan of €200,000 to Roy Scapens, who is a brother of Magnum director, Tom Scapens

Example 3: Customer

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- During 2020, Magnum Limited sold a large quantity of goods to Brice Limited

- Neither company holds shares in the other

The following are NOT related parties

Two enterprises simply because they have a director or key manager in common

Two venturers who share joint control over a joint venture

Providers of finance, trade unions, public utilities, and government departments & agencies in the course of their normal dealings with an enterprise

A customer, supplier, franchisor, distributor, or general agent, simply because they transact a significant volume of business with such a party

Disclosure

Related Party Transactions

If there has been material transactions between related parties, an entity must disclose separately, for each category of related parties, the info for an understanding of potential effect of transaction on financial statements

This will include:

- The nature of the related party relationship
- The amount of the transactions
- The amount of outstanding balances, including commitments
- Provisions for doubtful debts related to the amount of the outstanding balances
- The expense recognized during the period in respect of bad or doubtful debts due from related parties

Disclosure

Relationships between parents and subsidiaries

Irrespective of whether there have been any transactions between a parent and a subsidiary, an entity must disclose:

- Name of its parent and
- Name of ultimate controlling party (if different)

If neither the parent, nor the ultimate controlling party produces financial statements available for public use, disclose name of next most senior parent that does produce public financial statements.

Disclosure

Management Compensation

Disclose key management personnel compensation in total and for each of the following categories:

- Short-term employee benefits
- Post-employment benefits
- Other long-term benefits
- Termination benefits, and
- Share-based payment

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