

Audit and Risk Committee Report



Richard Holmes
Chair of the
Audit and Risk
Committee

“On behalf of the Committee I am pleased to present its report for the year ended 31 December 2022. During the year, and throughout the continuing pandemic, the Committee continued to play an important oversight role in ensuring the integrity of the Group’s financial reporting and the effectiveness of its internal control and risk management systems.”

Committee members

Richard Holmes, Chair and Senior Independent non-executive director

Deborah Davis, Independent non-executive director

Katrina Cliffe, Independent non-executive director

The table below shows the number of meetings held and the directors’ attendance during 2022.

Committee member	Scheduled meetings ¹	No. of meetings attended	% of meetings attended
Richard Holmes	6	6	100%
Deborah Davis	6	6	100%
Bronwyn Syiek ²	6	5	83%
Katrina Cliffe ³	2	2	100%

Notes

1. The scheduled meetings that each individual was entitled to, and had the opportunity to, attend.
2. Bronwyn Syiek stepped down as a member of the Committee on 20 July 2022.
3. Katrina Cliffe was appointed as a member of the Committee effective 1 August 2022.

Dear shareholder,

On behalf of the Committee, I am pleased to present the Audit and Risk Committee’s Report for the year ended 31 December 2022.

The year in review

This section of the Annual Report sets out how the Committee has addressed both routine and emerging issues during the year. As mentioned elsewhere in this Annual Report, the key challenges for the business and for the Committee continued to be the impacts of the pandemic, combined with the war in Ukraine, an uncertain macroeconomic environment, the development of an ESG strategy, and regulatory challenge. The Committee closely monitored the consequent impacts on the Group’s Financial Statements and despite continuing uncertainty, was pleased to see the delivery of a very good financial performance and sustainable profitability. The Committee also addressed a range of routine matters, including the management of cyber threat and information security and the continuing development of the Group’s framework for internal non-financial control. The Committee’s time was also dedicated to considering and then approving Deloitte LLP’s plan for the 2022 external audit and the 2023 internal audit plan.

The year ahead

Although macroeconomic uncertainty is having a significant impact on the sector in which we operate, we continue to respond to the challenges and opportunities that this brings. The Committee notes the UK Government’s reforms to the audit and corporate governance regime which were published on 31 May 2022 and will continue to monitor the development of this initiative including requirements in relation to assurance of non-financial information and increased disclosure requirements in respect of internal control systems. The Committee is well placed to discharge its duties in the year ahead.

Composition, role and responsibilities

The Committee consists of independent non-executive directors and met six times during the year. Members and their attendance at meetings can be found on the left.

The external auditor, Deloitte LLP, the CEO, the CFO, and the Group Head of Internal Audit are invited to attend all meetings. Periodically, senior management from across the Group are invited to present on specific aspects of the business. The members of the Committee meet on a regular basis outside of scheduled Committee meetings, and the Committee also meets from time to time with the external auditor, without an executive director or another member of the senior leadership team being present.

Functionally, the Group Head of Internal Audit reports directly to the Chair of the Committee. For routine administrative matters, the Group Head of Internal Audit's principal contact is the CFO. The Group Head of Internal Audit operates within a clearly defined remit and has good linkage to the CEO and to the rest of the organisation.

The Committee supports the Board in fulfilling its responsibilities in relation to financial reporting, monitoring the integrity of the Financial Statements and reviewing and challenging any significant financial reporting issues and judgements in relation to the Financial Statements. The Committee's responsibilities are outlined in its terms of reference which are available on our website at www.ipfin.co.uk. The Committee's main responsibilities are to:

- monitor the Group's systems of internal control, including financial, operational and compliance controls and risk management systems, and to perform an annual review of their effectiveness;
- monitor the integrity of the Financial Statements of the Company and the formal announcements relating to the Company's financial performance, reviewing the significant financial reporting judgements contained in them;
- provide advice to the Board on whether the Annual Report and Financial Statements, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy;
- make recommendations to the Board, for the Board to put to shareholders in general meeting, relating to the appointment, reappointment and removal of the external auditor and to approve its terms of appointment; review and monitor the objectivity and independence of the external auditor and the effectiveness of the external audit process, taking into consideration relevant UK professional and regulatory requirements;
- review and approve the internal audit programme for the year and monitor the effectiveness of the internal audit function in the delivery of its plan;
- keep under review the work of the Risk Advisory Group, in particular the Group schedule of key and emerging risks and consider the principal and emerging risks stated on pages 58 to 62 facing the Group and their mitigation; and
- review and approve risk appetite proposals, together with the mechanisms that will be used for monitoring adherence to them.

Progress against 2022

Key objectives

- Monitored the Group's management of Covid-19 generated risks for the business.
- Maintained a strong focus on the continuing development of the Group's internal control framework.
- Closely followed the execution of ESG strategic developments.
- Provided oversight to the management of consumer credit regulatory challenges.
- Received assurance on cyber security measures and operational resilience across the Group.

Key objectives for 2023

- Receive and review regular reports on regulatory developments.
- Continue to focus on the development and execution of an ESG strategy.
- Keep under close review the Group's responses to developments in the macro economy, in Ukraine, with cost-of-living concerns and with the ongoing pandemic.
- Monitor the expansion of the Group's product and channel choices.
- Continue to monitor the ongoing alignment of the Company's purpose, values, strategy and culture.
- Provide oversight to the audit tender process.

Activities in 2022

Financial reporting

The Committee reviewed and considered the following areas in respect of the preparation of the half-year and full-year Financial Statements:

- the appropriateness of accounting policies used;
- compliance with external and internal financial reporting standards and policies;
- significant judgements made by management regarding areas of uncertainty;
- disclosures and presentations; and
- whether the Annual Report and Financial Statements are fair, balanced and understandable.

In carrying out this review, the Committee considered the work and recommendations of management and received reports from the external auditor setting out its view on the accounting treatments and judgements underpinning the Financial Statements.

The significant accounting judgements considered by the Committee were:

- **Impairment of receivables:** the application of IFRS 9 to the ongoing issues arising from Covid-19 and the impact of the rising costs-of-living had a significant impact on the impairment charge and the calculation of provisions. The key areas of judgement in respect of impairment provisions made against amounts receivable from customers are the parameters used in the expected loss models, the expected timing of future cash flows and post-model overlays. The expected loss models are driven by historical data in respect of probability of default and exposure at default together with loss given default for each portfolio. At both the half-year and full-year results, the Committee considered a paper prepared by management summarising the work performed to update parameters used in the expected loss and the cash flow timing models, and the judgements applied in this process. This paper also addressed the use of post-model overlays in instances where the most recent trends in the data were felt to be more relevant than some of the more historical information. This was particularly relevant in 2022 due to the use of Covid-19 and rising costs-of-living post-model overlays arising from a full assessment of expected collection cash flows in order to calculate the expected impact of these issues on the Group's impairment provisions. Further detail on the post-model overlays considered is given in the key sources of estimation uncertainty section of this Annual Report on page 141. The external auditor performed audit procedures on impairment provisioning and reported its findings to the Committee. The Committee concluded that the receivables impairment provisioning in the Financial Statements was appropriate.
- **Revenue recognition:** the judgement in respect of revenue recognition is the methodology used to calculate the effective interest rate. The calculation takes into account all the contractual terms together with the extent and timing of customer early settlement behaviour. The external auditor performed procedures to assess management's calculations and assumptions used to calculate the effective interest rate and reported its findings to the Committee. The Committee concluded that revenue recognition in the Financial Statements was appropriate.
- **Taxation:** IPF operates in multiple jurisdictions where the taxation treatment of transactions is not always certain. Management is therefore required to make judgements, based on internal expertise and external advice, on the methodology to be adopted for accounting for uncertain tax positions. Key areas of focus in 2022 included judgements taken relating to accounting for the impact of the European Commission's State Aid decision (see Financial review on page 34). The external auditor performed procedures to assess management's judgement and reported its findings to the Committee. The Committee concluded that the provision for uncertain tax risks included in the Financial Statements was appropriate.
- **Regulation:** the business is subject to regulatory scrutiny in multiple jurisdictions and at times it is appropriate to make provisions for potentially adverse rulings by regulatory authorities. The Board was advised by the Chief Legal Officer in relation to any enquiry it had on this area.

Internal control and risk management

While the Board is responsible for overseeing the Group's systems of internal control, including risk management, the review of its effectiveness is delegated to the Committee. The Group recognises the importance of strong systems of internal control in the achievement of its strategy and objectives. It is also recognised that any system can provide only reasonable and not absolute assurance against material misstatement or loss.

The Committee reviews and approves the Group schedule of key risks, which describes the principal risks and uncertainties facing the business. The Board formally considers the schedule on a six-monthly basis and approves risk appetite annually. The Committee closely monitors and is supported in its work by the Risk Advisory Group, which in 2022 comprised the CEO, CFO, Group Credit Director and Chief Legal Officer, together with other members of the senior leadership team. The Risk Advisory Group meets four times a year. It reports to the Audit and Risk Committee and considers the risk assessments and risk registers produced in each country and updates the Group schedule of key risks. It also considers emerging risks, areas of specific risk and particular issues.

During the year, the Committee closely monitored the implementation of risk management process improvement recommendations by a third-party assurance provider in 2021.

The Committee challenged robustly the identification, assessment and planned mitigation of the principal risks facing the business, notably in the light of the Covid-19 pandemic which continued to impact the Group in the first quarter of 2022 and the cost-of-living crisis. See principal risks and uncertainties on pages 58 to 62.

Close attention continued to be paid by the Committee to the management of the threat of cyber security breach due to our employees working remotely from home during the year, in response to the ongoing Covid-19 pandemic and flexible working patterns, and to the threat of fraud, given the changed working environment.

In terms of regulatory developments, 2022 was characterised by the two key external factors that impacted the lives of our customers, the thinking of politicians and the economy in general; i.e. the ongoing Covid-19 pandemic and the war between Russia and the Ukraine. Temporary payment moratoria and price caps were introduced. In addition to temporary measures targeted directly at the financial sector, other new regulation introduced to the wider market also impacted our operations. There was new regulation tailored around special or "windfall" taxes to enable governments to tackle the impacts of the ongoing pandemic and energy crises. There were also regulatory changes related to labour regulations, typically manifesting as minimum wage increases as a reaction to inflation. Additionally, following six years of discussions, the Polish total cost of credit regulation came into force at the end of 2022. The review of the Consumer Credit Directive in the European Union is still underway with updates expected in 2023.

Additionally, the Committee continued to monitor developments in respect of the European Commission's State Aid challenge. The Committee also received regular updates on associated matters related to this and ongoing tax audits within the Group, together with OECD and European Union international tax initiatives that could potentially impact the Group in the future. Details of the current status of tax audits are included in our principal risks and uncertainties on page 61.

The Committee will continue to assess the impact of these matters on the business and will monitor management's response throughout 2023.

The internal control environments in place to manage the impact of each risk are monitored by the Committee on a regular basis, as are the principal actions being taken to mitigate them. The Committee requests additional presentations on key business areas as necessary to supplement its understanding of control environments in place. The areas covered by these in 2022 are referred to in the 'Training' section on page 94.

Through the Committee, the Group internal audit function provides independent assurance to the Board on the effectiveness of the systems of internal control. The Committee provides oversight and direction to the internal audit plan, which was developed using an inherent risk-based approach, to ensure that it provides independent assurance over the integrity of internal controls and the operational governance framework. In addition, the external auditor communicates to the Committee any control deficiencies in the internal control environment it observes as part of its audit procedures. Deloitte LLP, as part of its audit, did not highlight any control weaknesses that we, as a Committee, considered to be material.

Internal audit

Group Internal Audit is an independent assurance function within the Group providing services to the Committee and all levels of management. Its remit is to provide objective assurance over the design and operating effectiveness of the system of internal control, through a risk-based approach. It also provides insight, delivers value, and helps the organisation to achieve its priorities. Group Internal Audit does this by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.

The Group Head of Internal Audit reports into the Chair of the Committee with administrative oversight from the CFO. Group Internal Audit is composed of teams across the markets and at the Group head office in the UK and has a high level of qualified personnel with a wide range of professional skills and experience. Co-sourcing agreements with the largest professional services firms ensure access to additional specialist skills and an advanced knowledge base.

Group Internal Audit activities are based on a robust methodology and are subject to an ongoing programme of internal quality assurance reviews. The function has invested in several initiatives to continuously improve its effectiveness including a third-party quality assessment which reported in early 2019, and concluded positively on the effectiveness of the function. The aim is for a similar exercise to be undertaken in 2024. The team follows a continuous improvement plan and measures its operational effectiveness via a set of key performance indicators which are reported at each meeting of the Committee, and via individual post-audit quality assessments by auditees, the results of which are also reported to the Committee.

The Committee has a permanent agenda item to cover internal audit-related topics. Prior to the start of each financial year, and at the half year, having considered the principal areas of risk within the business, the Committee reviews and approves an inherent risk-based internal audit plan, assesses the adequacy of the available internal audit resources and considers the operational initiatives for the continuous improvement of the function's effectiveness.

The Committee reviews progress against the approved internal audit plan and the results of audit activities, with a focus on unsatisfactory audit results which require timely attention.

During the year, Group Internal Audit focused on the principal risks which included regulation, reputation, cyber threat and information security, and the execution of projects and initiatives of strategic importance.

The Committee monitors progress on the implementation of any action plans arising on significant audit findings to ensure they are completed satisfactorily.

The Committee is satisfied that the quality, experience and expertise of the function are appropriate for the business.

External auditor effectiveness and independence

The Committee considered the external auditor's assessment of the significant risks in the Group's Financial Statements set out in its audit plan and approved the scope of the external audit that addressed these risks. The Committee considered these risks and the associated work undertaken by the external auditor when forming its judgement on the Financial Statements.

In line with its established practice, the Committee monitored the effectiveness and conduct of the external auditor by reviewing:

- the experience and capabilities of the auditor and the calibre of the audit firm;
- provision of non-audit services;
- robustness and perceptiveness of the external auditor in its handling of key accounting and audit judgements;
- the interaction between management and the external auditor;
- the delivery of its audit work in accordance with the agreed plan; and
- the quality of its report and communications to the Committee.

The effectiveness of the external audit process continues to be evaluated via a questionnaire which was completed by the Committee members and attendees, and by business unit finance directors across the Group. The results of the evaluation were reviewed and considered by the Committee which concluded that the external audit process is effective.

In order to confirm its independence and objectivity, the external auditor issued a formal statement of independence to the Committee. In addition, the Committee ensured compliance with the Group's policy on the use of the external auditor for non-audit services.

Non-audit services carried out by Deloitte LLP in 2022

Fee £000

Other assurance services

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The key requirements of this policy are:

- the external auditor is prohibited from providing certain services which include the following: tax services; payroll services; designing and implementing internal controls or risk management procedures; legal services; internal audit services; human resource services; valuation services; or general management consultancy; and
- the Committee Chair must approve any individual non-audit service over a specific fee level.

The policy of the Committee in respect of non-audit services is that the external auditor is only appointed to perform a non-audit service when doing so would be consistent with both the requirements and overarching principles of the Financial Reporting Council's Revised Ethical Standard (2019), and when its skills and experience make it the most suitable supplier.

The Committee believes that the Group receives a particular benefit from certain non-audit services where a detailed knowledge of its operations is important or where the auditor has very specific skills and experience. However, other large accountancy practices are also used to provide services where appropriate. During the year, the non-audit services carried out by Deloitte LLP are set out in the table on the previous page.

Audit tendering and auditor rotation

The Statutory Auditors and Third Country Auditors Regulations 2016 requires public interest entities to undertake a tender exercise at least every 10 years and rotate auditors after at least 20 years. The Company last went out to tender in 2010 when Deloitte LLP was appointed as Group auditor. However in 2020, the Group requested and received the approval of the Financial Reporting Council to defer the tender process for up to two years due to the challenges associated with the process in the context of Covid-19 and other competing priorities for management time arising from the pandemic. This deferral period has now ended and therefore the Company is required to undertake a tender and audit rotation process for the 2023 financial year. The Company sought to run a tender process in 2022 and contacted nine firms to ascertain if they would participate in such a process. All firms contacted have indicated that they do not wish to participate in such a process, primarily due to the volume of auditing activity they are currently undertaking for other clients or because of other non-audit activity they have undertaken for the Company. The Company has notified the Financial Reporting Council and the Registrar of Companies of the position and of its intention to run another tender process in 2023 for the 2024 financial year. In addition the Company has taken steps to reduce the amount of non-audit work being provided to accounting firms who may wish to take part in such tender. In the meantime the Company's current auditor has indicated its willingness to continue acting for the Company.

Training

The Committee, with the Board, undertook a significant amount of training during 2022. This included presentations on the following key business areas:

- overview of the Group's value-added services offering, including insurance, with a focus on financial performance and regulatory compliance;

- an update on e-Money Licence regulatory requirements in Estonia;
- an explanation of Small Payment and Payment Institution Licence requirements in Poland;
- an assessment of potential outcomes of planned changes to the European Union Consumer Credit Directive
- the management of credit risk;
- a deep dive into the management of foreign exchange risks embedded in the business;
- an explanation of political and regulatory frameworks and developments as a result of the European Union's review of the Consumer Credit Directive;
- a recap by the external auditor on Audit and Risk Committee responsibilities, focus areas and best practice; and
- calculation and oversight of revenue and impairment under IFRS 9 in the continuing uncertain economic environment.

This training was complemented by discussions directly with management teams in connection with specific focus areas in the Group.

Committee effectiveness

An externally-facilitated Board evaluation was undertaken at the end of 2022, including an assessment of the Committee's performance. The results of the evaluation indicated that the Committee had operated effectively throughout the year, with particular strengths, common to all the Committees, relating to good chairing, strong support, reporting of its activities, oversight of the independence and performance of the external auditor, as well as the effectiveness of the internal audit function. The Committee continues to be considered as providing the Board with a high level of assurance that audit matters are dealt with appropriately.

Review of the effectiveness of the internal control and risk management systems

On behalf of the Board, with the assistance of the Internal Audit function, the Committee has monitored the Group's internal control and risk management systems, and its processes for managing principal and emerging risks throughout 2022, and has assessed that these are effective. In addition, the Committee, where appropriate, ensures that necessary actions have been or are being taken to remedy identified failings or weaknesses in the internal control framework. These processes were in place throughout 2022 and up to 1 March 2023.

Annual Report and Financial Statements

The Committee has reviewed and considered the Annual Report and Financial Statements, in line with other information the Committee has considered throughout the course of the year. It concluded, and recommended to the Board, that the Annual Report and Financial Statements 2022, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

Richard Holmes

1 March 2023