

Audit and Risk Committee Report



Richard Holmes
Chair of the Audit
and Risk Committee

“Throughout the year, we continued to monitor the effectiveness of the Group’s systems of internal control and risk management, and provided effective oversight and independent scrutiny to ensure the presentation of a balanced, true and fair view of the Group’s performance during 2023.”

Committee members

Richard Holmes, Chair and non-executive director

Deborah Davis, Independent non-executive director

Katrina Cliffe, Senior independent non-executive director

The table below shows the number of meetings held and the directors’ attendance during 2023.

| Committee member ² | Scheduled meetings ¹ | No. of meetings attended | % of meetings attended |
|-------------------------------|---------------------------------|--------------------------|------------------------|
| Richard Holmes ³ | 6 | 6 | 100% |
| Deborah Davis | 6 | 6 | 100% |
| Katrina Cliffe ³ | 6 | 6 | 100% |

Notes

- The scheduled meetings that each individual was entitled to, and had the opportunity to, attend.
- The Committee members’ expertise, qualifications and relevant experience is set out in each of their biographies on pages 86 to 87.
- Richard Holmes stepped down as Senior independent director on 1 December 2023 and on the same date was succeeded in that role by Katrina Cliffe.

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 2023, which explains our work and how we met our audit, risk management and internal control responsibilities.

The year in review

This section of the Annual Report and Financial Statements 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 uncertain global macroeconomic environment and cost-of-living crisis which impacted our customers and our own cost-base, driven in part by the wars in Ukraine and more recently the Middle East; continuing regulatory challenge; and our approach to ESG through the development of our Responsible Business Framework strategy.

The Committee monitored the consequent impacts on the Group’s Financial Statements closely and, despite continuing uncertainty, was pleased to see the delivery of a very good operational and financial performance.

The Committee also addressed a range of routine matters, receiving regular updates from the internal audit team on internal control matters, including the management of cyber threat, information security and business continuity, and the continuing development of the Group’s framework for internal non-financial control. Where the Committee identified areas requiring improvement, processes were put in place to ensure that the necessary action was being taken and that progress was being monitored. The Committee also dedicated time to approving Deloitte LLP’s plan for the 2023 external audit, and for the 2024 internal audit plan. A final focus for the Committee this year was our oversight of the ongoing external auditor tender process.

Since receiving a letter from the Polish financial supervision authority, KNF, in late February 2024, the Committee has provided oversight on this matter including disclosures in this Annual Report and Financial Statements. See page 30 for more information.

The year ahead

Although macroeconomic uncertainty continues to have a significant impact on the sector in which we operate, we will respond to the challenges and opportunities this brings. The Committee will continue to oversee the development of the Group’s systems of risk management and internal control, and monitor developments in relation to the UK Government’s internal control systems reforms. We will follow and respond to the new requirements and the resulting impacts on the Committee’s annual cycle of work. We are well placed to discharge our duties in the year ahead.

Committee effectiveness

An effectiveness review of the Board and its Committees was undertaken internally at the end of 2023, which comprised a questionnaire completed by the Committee and its regular attendees together with an analysis of compliance with the Committee's Terms of Reference. Overall, the Committee concluded that it had operated effectively and that the Committee's Terms of Reference had been complied with throughout the year.

Feedback from this process indicated that the Committee's main areas of focus for 2024 should be on:

- ensuring the risks arising from credit are appropriately managed, including ensuring any judgements made on credit card receivables are appropriate;
- oversight of plans to address technology-related risks and plans to address new EU regulatory requirements such as DORA and CCD 2;
- ensuring an appropriate balance between reviewing risk frameworks and policies and reviewing specific risks; and
- enhancing the integration of risk management and strategic planning.

Progress against 2023 key objectives

- Regularly received and reviewed reports on regulatory developments.
- Continued to focus on the development and execution of the Group's ESG strategy.
- Kept under close review the Group's responses to developments in the macroeconomy and cost-of-living crisis.
- Continued to monitor the ongoing alignment of the Company's purpose, values, strategy and culture.
- Provided oversight to the audit tender process.

Key objectives for 2024

- Respond to the impact of changes resulting from the Audit Reform debate on assessments by the Committee of the effectiveness of the risk management and internal control systems.
- Receive and challenge as necessary regular reports on the continuing development of a three lines of defence model.
- Review progress on the development of a control framework for managing technology, change management and inherent information security risks for the Group.
- Continue to provide oversight to the audit tender process.

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 page 104.

The external auditor, Deloitte LLP, the Chief Executive Officer, Chief Financial Officer, Chief Information Officer, Group Financial Controller, and the 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 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 Head of Internal Audit reports directly to the Chair of the Committee. For routine administrative matters, the Head of Internal Audit's principal contact is the Chief Financial Officer. The Head of Internal Audit operates within a clearly defined remit and has good linkage to the Chief Executive Officer and to the rest of the organisation.

The Committee ensures shareholders' interests are protected and long-term value is created. 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 explained fully in its Terms of Reference which are available on our website at www.ipfin.co.uk. The Committee works to a structured programme of activities and meetings to coincide with key events around our financial calendar. Its 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 78 to 83 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.

Activities in 2023

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 is 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 issues arising from 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 still relevant in 2023 due to the use of rising costs-of-living post-model overlays arising from a full assessment of expected repayment 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 153. The external auditor performed audit procedures on

impairment provisioning, challenging management on its approach to the Group's cost-of-living crisis provision and on its planned accounting treatment for the Group's new credit card product. The external auditor 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.
- **Accounting for credit card receivables:** the Company does not yet have sufficient historical credit card data in order to calculate an expected loss provision for the credit card receivables portfolio. At both the half-year and the full-year results, the Committee considered a paper produced by management summarising the approach taken to determine the most appropriate expected loss parameters for this portfolio, and the judgements applied in this process. Further detail on the credit card valuation methodology is given in the key sources of estimation uncertainty section of this Annual Report and Financial Statements on page 154. The external auditor performed audit procedures on the credit card receivables valuation and reported its findings to the Committee, who concluded that the credit card receivables valuation 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 2023 included justification of the Group's deferred tax asset. 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 considers the schedule formally on a six-monthly basis and approves risk appetite at least annually. The Committee is supported in its work by the Risk Advisory Group, which in 2023 comprised the Chief Executive Officer, Chief Financial Officer, 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. For further details, see pages 78 to 83.

The Committee challenged robustly the identification, assessment and planned mitigation of the principal risks facing the business, notably in the light of the cost-of-living crisis.

The Committee also continued to pay close attention to the heightened information security and cyber risk of hybrid working and to the threat of fraud, given the changed working environment. The rapid rollout and uptake of Generative AI and its utilisation by those with malicious intent has increased the cyber threat, as well as the risk of inadvertent data loss from colleagues and customers using these new tools. A new AI Adoption Policy has been introduced and this will continue to be an area of focus for the Committee. The implications of the new Digital Operational Resiliency Act (DORA), which comes into full force in January 2025, is also being monitored closely.

Regulatory developments in 2023 were in three important areas. Firstly, market-specific regulatory changes driven by political environments. These included a lower total cost of credit cap and new affordability regulations which came into force in Poland in December 2022 and May 2023 respectively, following seven years of debate and discussion; changes in the areas of responsibility of the Romanian Consumer Protection Office and tightening of the price and affordability rules in the Baltics. There were also positive changes such as an opportunity to dedicate a part of tax paid to NGOs in Romania; and the abolition of the personal identification system in the Czech Republic.

Secondly, regulatory change was driven by high inflation and low economic growth environments, which took the form of increasing personal tax payments and minimum wages.

Finally, an increasingly important third area of regulatory change was emerging regulation from the European Union, including the conclusion of its review of the Consumer Credit Directive, and a series of changes in the areas of distance marketing of financial products, IT, business continuity and information security, sustainability reporting, and open banking. See pages 30 and 80 for more information on the Consumer Credit Directive.

To ensure we are prepared sufficiently for regulatory developments, we reviewed and refreshed the regulatory change management framework which governs our responses, from monitoring and appropriately influencing to implementation and compliance.

Additionally, the Committee received regular updates on key tax issues 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 81.

The Committee will continue to assess the impact of these matters on the business and will monitor management's response throughout 2024.

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 2023 are referred to in the 'Training' section on page 109.

Through the Committee, the 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 is 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. The Committee monitors the resolution of outstanding actions from internal audits, with a focus on action-owner accountability, and was pleased to note the solid rate of completed actions during the year. In addition, the external auditor communicates to the Committee any deficiencies in the internal control environment it observes as part of its audit procedures. Deloitte LLP, identified a number of IT deficiencies in the Company's control environment. Despite these deficiencies, the Committee remains confident that the overall control environment remains sufficiently robust.

Internal audit

The internal audit function's purpose, authority and responsibilities are defined in its Charter, which is reviewed and approved annually by the Committee. Internal audit is an independent assurance function within the Group providing services to the Committee and all levels of management. It has no responsibility for operational business management and 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. The internal audit function does this by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.

The Head of Internal Audit reports into the Chair of the Committee with administrative oversight from the Chief Financial Officer.

The internal audit function comprises teams across our 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.

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 team's operational initiatives for its continuous improvement.

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, the internal audit function focused on the Group's efforts to control its principal inherent risks which included regulation, reputation, information security and cyber threat, 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.

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 last 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 measures its operational effectiveness and efficiency 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 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 with the timely resolution of an identified opportunity for improvement in one of the markets, 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.

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. Other large accountancy practices are also used to provide services where appropriate. Consequently the Committee is satisfied that Deloitte LLP were independent throughout 2023.

| Non-audit services carried out by Deloitte LLP in 2023 | Fee £000 |
|--|----------|
| Other assurance services | 140 |

Audit tender 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. In 2020, however, 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 ended, and therefore the Company was 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. All firms contacted indicated that they did not wish to participate, due primarily to the volume of auditing activity they were undertaking for other clients or because of other non-audit activity they had undertaken for the Group. In January 2023, the Company notified the Financial Reporting Council and the Registrar of Companies of this position and its intention to run a tender process in 2023 for the 2024 financial year.

During 2023, a formal and competitive audit tender process was overseen by the Audit and Risk Committee. The objective of the process was to ensure a fair and transparent tender process and to appoint the audit firm that will provide the highest quality in the most effective and efficient manner. An invitation to tender was sent to a number of firms, following which two firms, Deloitte LLP and PKF Littlejohn LLP, elected to submit a proposal for providing audit services to the Group.

A selection committee, chaired by the Chair of the Audit and Risk Committee, was established to run the audit tender process and provide a recommendation to the Audit and Risk Committee. The firms were assessed against detailed criteria which considered audit approach, audit quality, capacity and capability, understanding of the Group and our market, independence and team and cultural fit. The process was as follows:

- management meetings were held between the firms and various members of Group management.
- formal tender proposal documents were issued in line with the requirements set out in the invitation to tender.
- both firms presented to the selection committee, followed by a meeting of the selection committee to discuss both tender proposals.
- follow-up questions were issued to both firms.
- formal responses on the follow-up questions were submitted by both firms.
- a final meeting of the selection committee was held to discuss the results of the tender process and conclude on which firm best met the detailed selection criteria.
- the selection committee submitted a proposal paper to the Audit and Risk Committee which was discussed and approved at the Committee meeting in February 2024.

Following this process, the Board agreed its intention to recommend to shareholders for approval at the Company's 2024 AGM the appointment of PKF Littlejohn LLP as external auditor of the statutory audits of the Company for the financial year ending 31 December 2024 and beyond.

Training

The Committee, with the Board, undertook a significant amount of training during 2023. This included presentations on the following key business areas:

- an update on licensing application progress in our Polish home credit market;
- a clarification of arrangements in the Group in respect of the three lines of defence model;
- an internal control update regarding the Group's whistleblowing arrangements;
- explanation of oversight arrangements in place in respect of bribery, compliance and privacy;
- an assessment of the level of technology, information security and change management risk to the Company was presented by the new Chief Information Officer;
- the management of climate change risk;
- a European regulatory update;
- 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.

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 monitored the Group's internal control and risk management systems, and its processes for managing principal and emerging risks throughout 2023, and on the basis of the work performed by the management team throughout the year and reported to the Committee at each meeting, 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 2023 and up to 14 March 2024.

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 2023, 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

Chair of the Committee

14 March 2024