In Balance 2018 - part B

Thematic review of new IFRSs

Publication date: 13 December 2018

The Dutch Authority for the Financial Markets

The AFM is committed to promoting fair and transparent financial markets.

As an independent market conduct authority, we contribute to a sustainable financial system and prosperity in the Netherlands.

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1. Management summary

With three new standards, the IASB has changed the way in which companies applying IFRS have to prepare their financial reporting. The rules governing the valuation and determination of the result of financial instruments (IFRS 9) and the recognition of revenue (IFRS 15) have changed with effect from 1 January 2018. The item 'leases' follows with effect from 1 January 2019 with IFRS 16, although this standard may be applied earlier.

We believe it is important that listed companies that apply IFRS inform investors and other stakeholders in a relevant and timely manner regarding the impact of these new standards on their financial reporting. For this reason, we carried out a survey of listed companies in 2017 to establish the status of the implementation of these new reporting standards (new IFRSs). The survey took the form of a questionnaire.

In our review, we note that IFRS 9 and IFRS 15 will only have a significant impact on the reported figures for a limited number of companies. By contrast, IFRS 16 will have a significant impact on many more companies. Only a few companies have already provided a quantitative disclosure regarding the impact of IFRS 16 on the figures.

The AFM urges companies to formulate their disclosures of the expected effects of IFRS 16 – both qualitative and quantitative – and on the accounting policy (IFRS 9 and IFRS 15 and early adopters of IFRS 16) in their 2018 financial statements with due care. In addition, new disclosure requirements with respect to financial instruments and revenue apply to the 2018 financial statements. Companies will have to comply with these new disclosure requirements as well.

Moreover, the AFM points out to users of financial statements that key figures and ratios (such as solvency, EBITDA, interest expense) may change to a significant degree as a result of the implementation of IFRS 16 and that they will have to take account of this in their valuation models.

The most important conclusion from our review is that:

- IFRS 9 and IFRS 15 will have a significant impact on a limited number of companies. Most companies have disclosed this impact and the accounting policy change properly in their 2017 financial statements and their interim financial statements for 2018. The AFM wishes to note that the disclosure requirements for the 2018 financial statements are more onerous.

In addition, the AFM expects listed companies to provide quantitative disclosures with respect to the impact of IFRS 16 in their 2018 financial statements.

The AFM expects listed companies to provide quantitative disclosures with respect to the impact of IFRS 16 in their 2018 financial statements

Of the three new IFRSs, IFRS 16 is the standard that will have the greatest impact on most companies. Upon the implementation of IFRS 16, the company will have to take account of its communication with investors concerning the impact of this standard. Investors are entitled to expect listed companies to have proper control of their administrative processes so that these companies report essential information in a timely manner. We expect listed companies to quantify the expected impact of IFRS 16 on balance sheet items and ratios, operating result and EBITDA and (where applicable) financial covenants not later than in their financial statements for 2018. Certainly since most companies have been able to do this for the - much more complex - standards IFRS 9 or IFRS 15, if these standards have a significant impact.

IFRS 9 and IFRS 15 have a significant impact on a limited number of companies. Most companies have disclosed this effect and accounting policy change properly. The disclosure requirements for the 2018 financial statements are more onerous.

Our review shows that few companies report a significant impact on the financial statements in the 2017 financial statements and the interim statements for 2018 where it concerns the implementation of IFRS 9 (twelve companies) or IFRS 15 (fourteen companies). Regarding the consequences of IFRS 9 for financial reporting by banks, we note that the results of the accounting policy changes will be offset by the currently favourable economic circumstances: contributions to credit loss provisions are expected to increase if the economy slows down. Our conversations with banks and other stakeholders reveal that these organisations have had to undertake a great deal of work in order to implement the standard properly and embed it in the existing administrative systems.

IFRS 15 affects a greater number of sectors, mainly telecommunications, pharmaceuticals and biotechnology and construction. The effects of this standard depend mainly on the business model of the companies concerned. Implementation becomes correspondingly more complex for companies with multiple performance obligations per contract and with many different contracts and contract terms and conditions. Differences with IAS 18 may arise as a result of the above or due to changed regulations concerning the timing of the revenue (during the contract or when it ends).

The disclosures on the accounting policy changes at companies where this has a significant impact on reporting are in general satisfactory. This applies to both the expected impact in the 2017 financial statements and the disclosure of the subsequent accounting policy change in the interim financial statements for 2018.

We will contact several companies to urge them to disclose the effects of the new IFRSs properly in their 2018 financial statements, whether this concerns the effects of standards yet to be implemented or the actual accounting policy changes. The reason being that this is the responsibility of companies and their executive boards. In addition, the disclosure requirements for the annual financial statements are more extensive than for the interim financial statements.

The AFM is available to discuss specific implementation issues resulting from IFRS with listed companies, whether this concerns old or new standards. The AFM encourages companies to present cases to the AFM[1].

[1] This can be done via fin.verslaggeving@afm.nl

2. Introduction

The IASB has developed new standards for financial instruments (IFRS 9), revenue from contracts with customers (IFRS 15) and leases (IFRS 16). These three new standards may have a significant impact on the financial reporting of listed companies. For efficient trading in the market, listed companies must be transparent and timely with their disclosure of the expected impact of standards yet to be implemented and the actual effects of newly implemented standards.

ESMA published the ECEP 2018 on 26 October 2018 in this context[2], in which its draws attention among other things to the following:

1. specific points with respect to initial application of IFRS 15,
2. specific points with respect to initial application of IFRS 9,
3. disclosures of the expected impact of IFRS 16.

Like the AFM, ESMA expects listed companies to provide quantitative and qualitative disclosure of the impact of IFRS 16 in their 2018 financial statements. In addition, ESMA calls for attention for the disclosure requirements of IFRS 15 and IFRS 9 regarding the initial application of these standards and the new disclosure requirements as a result of these new standards.

The AFM started a series of surveys and thematic reviews concerning the implementation of these new IFRSs in 2017. Since 2017, we have conducted surveys of listed companies, PIE audit firms and users of financial statements[3].

This year, we have focused on the 2017 consolidated financial statements of all Dutch companies with a listing in Europe (137 in total) to assess the extent to which these companies have provided both qualitative and quantitative disclosure of the impact of new standards that have not yet been implemented.

We also assessed how listed companies have disclosed the accounting policy changes necessary to adopt IFRS 9 and IFRS 15 in their interim financial statements. We looked at those companies that have disclosed a significant impact from one or both standards in their financial statements (in numbers: IFRS 9: twelve, IFRS 15: fourteen). We will continue to address this subject in the coming years. We expect listed companies to include qualitative and quantitative disclosures on the expected impact of IFRS 16 in their 2018 financial statements, in addition to the mandatory new disclosures on financial instruments and revenue and the disclosures on the transition to the new standards. We will then look at the final implementation of IFRS 16 in the 2019 financial statements and where necessary we will follow up on the initial findings with respect to the application of IFRS 9 and IFRS 15.

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[2] European Common Enforcement Priorities: https://www.esma.europa.eu/press-news/esma-news/european-enforcers-focus-new-ifrss-and-non-financial-information-in-issuers%E2%80%99

[3] See our publication dated 12 December 2017: https://www.afm.nl/~/profmedia/files/rapporten/2017/in-balance-part-b-eng.pdf

In section 3, we provide an overview of our findings on the standards that will apply for the first time to financial years beginning on or after 1 January 2018 (IFRS 9 and IFRS 15). Section 4 deals with the third standard, IFRS 16, which comes into effect on 1 January 2019.

3. IFRS 9, Financial Instruments and IFRS 15, Revenue from Contracts with Customers

Introduction

IFRS 9 and IFRS 15 apply to financial years beginning on or after 1 January 2018. As we communicated last year as well[4], we expect listed companies to inform their investors in good time regarding the impact of these new standards on their reporting, with a quantitative disclosure of this impact. We stated last year that the 2017 financial statements would be the last opportunity to share this information with investors. In this review therefore, we assessed the extent to which listed companies have been able to actually include this quantitative information in their 2017 financial statements. See section 3.1.

The fact that IFRS 9 and IFRS 15 are the applicable standards for the 2018 financial year means that the interim financial statements for 2018 are the first reporting moment at which listed companies have to disclose the actual accounting policy change. In this thematic review we have checked the interim financial statements of the companies that have disclosed a significant impact due to IFRS 9 or IFRS 15 for disclosures of the accounting policy changes. See paragraph 3.2.

In paragraph 3.3, we briefly consider the (coming) 2018 financial statements and the corresponding applicable requirements. We close this section with a list of good and bad practices in paragraph 3.4.

3.1 Disclosures in the 2017 financial statements

New reporting standards can have a significant impact on reporting. Listed companies can be faced with extensive introduction processes in order to implement a new standard properly. One important aspect of this implementation is communication of the effects of the new standard to investors. IFRS itself provides for this: IAS 8.30 and IAS 8.31 state the disclosure requirements a company must meet if a standard is not yet implemented.

IFRS 9 Financial Instruments

> *IFRS 9: a brief look at the changes*
>
> IFRS 9 sets new rules for the processing of financial instruments in reporting. In general, the changes concern the rules for how credit loss provisions are calculated and how financial instruments are classified and measured. The conditions under which hedge accounting may be applied have also been widened. The greatest impact by far concerns the changes to the calculation of the credit loss provisions.

[4] See ‘In balance 2017’: https://www.afm.nl/~/profmedia/files/rapporten/2017/in-balans-deel-b.pdf

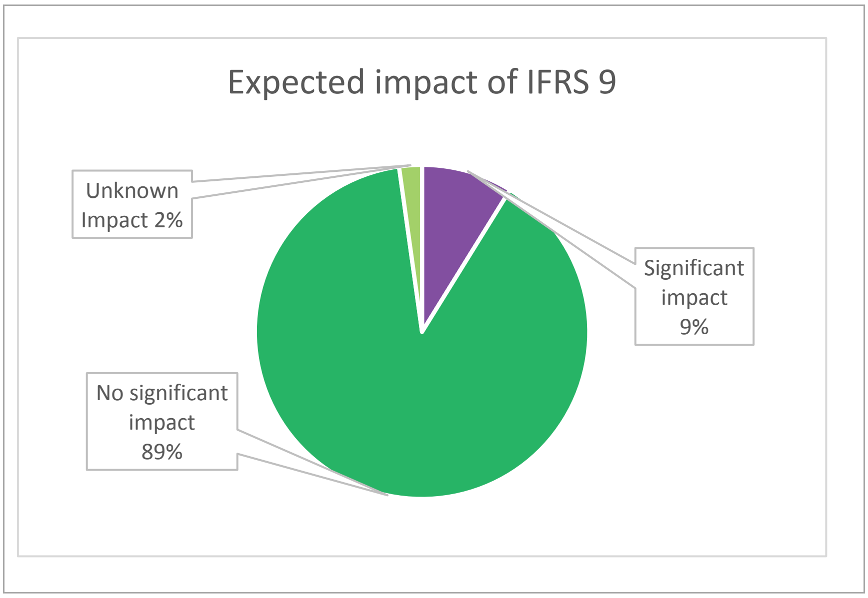


Figure 1: classification of disclosures on the expected impact of IFRS 9

Our review revealed that financial companies (banks and insurers) expect the implementation of IFRS 9 to have a significant impact and that they also disclosed this in their 2017 financial statements (twelve companies in total). IFRS 9 also has a significant impact on the information systems of banks. IFRS 9 requires a model-based approach for the calculation of the credit loss provision with numerous different input factors for calculating the expected loss. Four companies were not able to state in their 2017 financial statements whether IFRS 9 would have a significant impact.

Compared to estimates at the time IFRS 9 was published, it turns out that most banks did not have to increase their credit loss provisions by as much as was previously expected. This is mainly because the economic outlook is now more positive than it was at the time the standard was published. As soon as the economy weakens, the models used, which also include macroeconomic elements, probably *will* lead to larger provisions. These are therefore not a consequence of the accounting policy change and will have a direct impact on the results of financial companies.

Besides the regular reporting, another important prudential indicator for banks is their 'core tier 1 capital', which is the touchstone used by prudential supervisors in the banking sector. This 'core tier 1 capital' is only slightly affected by the implementation of IFRS 9. The standards for the core tier 1 capital[5] have been in force for some time. This means that the implementation of IFRS 9 can only lead to a technical difference of generally a few tenths of one percentage point.

Of the twelve companies stating that IFRS 9 would have a significant impact, three failed to provide quantitative information on the expected impact of the accounting policy change in the 2017 financial statements. However, these three companies are listed insurers, and they are not

[5] The prudential requirements for banks are established in legislation based on the Capital Requirements Directive (CRD IV, see http://www.toezicht.dnb.nl/5/50-228263.jsp#) and in the directly applicable Capital Requirements Regulation (CRR, see http://www.toezicht.dnb.nl/5/50-228261.jsp)

required to implement IFRS 9 until the 2021 financial year. This is intended to achieve a simultaneous implementation of this standard – for insurers – with IFRS 17, Insurance Contracts. IFRS 17 applies at the earliest to the 2021 financial year.

IFRS 15, Revenue from Contracts with Customers

IFRS 15: a brief look at the changes

This new standard sets the transfer of control of delivered goods or services as the moment at which revenue is recognised. IFRS 15 gives a 5-step model to determine the moment at which a company must recognise a particular item of revenue. These 5 steps are:

1. Identify the contract(s) with a customer,
2. Identify the performance obligations in the contract,
3. Determine the transaction price,
4. Allocate the transaction price to the performance obligations in the contract,
5. Recognise revenue when (or as) the entity satisfies a performance obligation and control of the goods or service passes to the customer.

In addition, the standard states when revenue has to be recognised during the fulfilment of the performance obligation and when it has to be recognised at the end of this.

There is also guidance on the issue of principal versus agent. The standard offers numerous examples of contract situations and how these should be dealt with in the reporting.

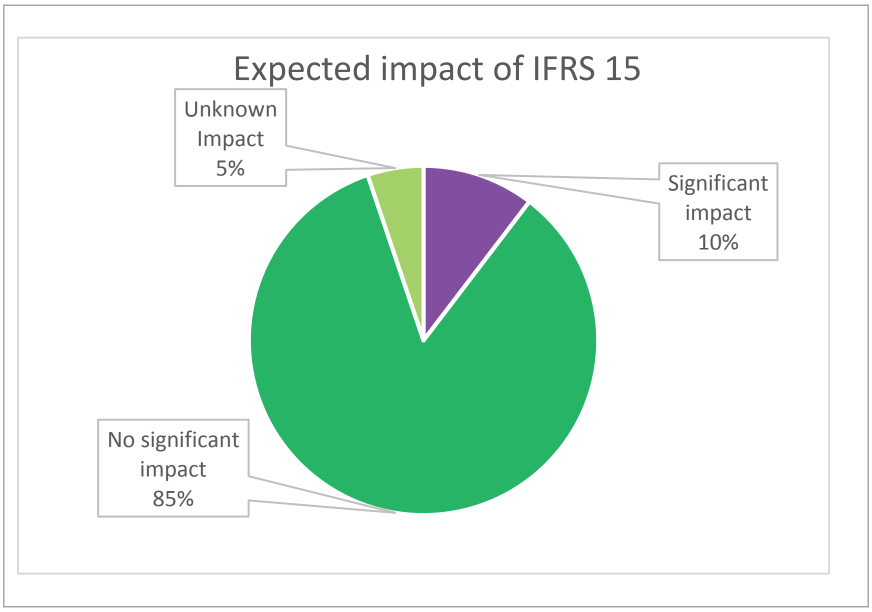


Figure 2: classification of disclosures on the expected impact of IFRS 15

Whereas IFRS 9 has material consequences mainly for financial companies, the impact of IFRS 15 in terms of sectors is less clear cut. The impact of IFRS 15 depends on the company's business model. If control passes from the company to the customer (for instance due to the provision of goods), the company meets its performance requirement and recognises revenue. The complexity in the implementation of the standard therefore depends very much on the complexity of the contracts a company concludes with its customers and/or its business model.

The timing of the revenue can vary substantially in comparison with the old standard IAS 18. IFRS 15 will have a material impact on financial statements and information systems in a number of sectors due to the business model and/or contracts in use, for example at telecommunications and construction companies. Biotechnology companies may also have to recognise revenue differently as a result of IFRS 15.

Many companies report little or no impact as a result of IFRS 15. These companies generally have less complex business models (for instance, only one performance obligation per contract) and/or there is little variation in the timing (at one moment or over time). Companies will have to bring their accounting policies in line with the requirements of IFRS 15 (see also the review of the interim financial statements for 2018 in section 3.2) in these cases as well.

A total of fourteen companies have stated that they expect to see a significant change in their reporting. Two companies stated in their 2017 financial statements that they are not able to determine a quantitative impact.

3.2 Disclosures in the interim financial statements for 2018

The accounting policy changes resulting from IFRS 9 and IFRS 15 have to be processed in the interim financial statements for 2018. We have selected the companies that disclosed in their 2017 financial statements that they expected a significant impact from the implementation of IFRS 9 or IFRS 15 for the second phase of the thematic review this year. This phase concerns a review of the disclosures of the accounting policy changes. We have also identified a number of good and bad practices that we have listed in paragraph 3.4. The good practices refer only to the manner of disclosure in the interim financial statements; disclosures in the 2018 financial statements will be more extensive, because fewer requirements apply to interim financial statements than to annual financial statements. The good practices therefore do not necessarily form a reference framework for adequate disclosure in the 2018 financial statements.

IFRS 9 accounting policy changes generally clear

For IFRS 9, we reviewed the interim financial statements of the twelve financial institutions and of four companies that were not yet able to provide clarity in their 2017 financial statements on the quantitative effects of the accounting policy change, or for which we expected to see a significant effect but this was not disclosed.

The banks in the selection generally provided good and clear disclosure regarding the transition to this new standard. This mainly concerned the qualitative disclosure of the classification and measurement and the provision for credit losses (the determination of the significant increase in credit risk ('SICR') and the lifetime expected credit loss ('LECL')). The quantitative impact was also disclosed. The impact of accounting policy changes on the classification of financial instruments and credit loss provisions was clear. The underlying input factors, assumptions and methodologies were not disclosed. Other companies in the selection generally disclosed reclassifications of financial instruments due to the fact that the classification methodology for IFRS 9 is different from that used for IAS 39. We expect to see significantly more disclosures in the 2018 financial statements of items including the input factors, the assumptions and the methodologies used for the credit loss provisions.

IFRS 15 accounting policy changes are mostly also properly disclosed

We assessed a total of 22 interim financial statements for the accounting policy change to IFRS 15; the fourteen companies that disclosed a significant impact in their 2017 financial statements, plus eight companies that either could not provide any clear information on the impact of the new standard or which on the basis of their business model or industry we would have expected to experience a significant impact but did not disclose this.

We found a significant impact in the interim financial statements of sixteen companies, made up of the fourteen that had already indicated this in their 2017 financial statements plus two that had not previously disclosed this. Two companies that we expected to experience a significant impact did not disclose the accounting policy change: the accounting policies are the same as those in the 2017 financial statements (see paragraph 3.4 below). For the remaining four companies, we found that the accounting policy change was not clearly disclosed. In all four cases, this concerned a part of the accounting policy change.

3.3 2018 financial statements – more onerous disclosure requirements

We expect to see more disclosures in the 2018 financial statements because the disclosure requirements under IFRS 7[6] and IFRS 15 will apply instead of the requirements applying under IAS 34[7]. Accordingly, we expect the banks to present a good classification of the portfolios for which the expected credit losses have to be determined when defining the level of detail of their disclosures (the granularity). For each portfolio for which the expected credit losses have to be calculated (or aggregation thereof), we expect full disclosure of the assumptions underlying the calculation of the credit loss provision, focusing on the assumptions that have the most influence on these provisions (including for example assumptions regarding the calculation of the significant increase in the credit risk, calculating the outlook for each portfolio, the expected term of loans and the cure period). For the disclosures of revenue, we expect companies for which IFRS 15 will have little impact on their reported figures to also improve their disclosure of their recognised

[6] IFRS 7 describes the disclosure requirements for financial instruments. This standard has been in force for some time and has been expanded with new disclosure requirements with the implementation of IFRS 9.
[7] IAS 34 describes the requirements that interim financial reporting must meet.

revenue and any related assets. The new standards also set additional disclosure requirements on the transition to the new standards.

3.4 Good and bad practices[8]

In our review, we encountered a number of good and bad examples of disclosures as referred to in IAS 8.30 and IAS 8.31. To assist companies and their auditors in the preparation of their future financial reporting, we have listed some of these examples below, with a brief explanation of why we consider a specific disclosure to be good or bad. There are more examples of both good and bad practices: the list presented is most definitely not exhaustive.

Disclosure of the expected impact of IFRS 9 – good practice in the 2017 financial statements

The qualitative disclosure of the impact of IFRS 9 is important for understanding the background to the quantitative effects. Certainly on the first adoption of a complex standard such as IFRS 9, it is important that the 'why' is explained clearly as well as the changes to the figures. We found an example of good practice in the disclosure of the expected impact of IFRS 9 in the 2017 financial statements of NIBC N.V. (pages 116 to 118). An extensive but clear disclosure of the expected effects of application of IFRS 9.[9]

Disclosure of the expected impact of IFRS 15 – good practice in the 2017 financial statements

In its disclosure of the quantitative effects of IFRS 15 on its income statement, Heineken N.V. provides a table with the 2017 figures as reported, the associated changes expected as a result of IFRS 15 and the 2017 figures adjusted for the effects of IFRS 15. This figure-based information is supplemented by a qualitative disclosure[10]. Heineken states:

> "The following table presents 2017 figures, including the impact of applying IFRS 15. The final impact is still under review and as a result the actual restated financial information may differ materially from those included in this overview. However this table gives Heineken's best estimate of the impact of IFRS 15[11]:"

[8] The good practices cited in this report are examples intended to increase the quality and relevance of the disclosures. These good practices should not be seen as a standard or as the only correct formulation of existing or future disclosures. Other content may be used to comply with legislation and regulations. Reference to good practices in this report does not imply any statement by the AFM regarding the financial statements in question as a whole.

[9] Given the length of the disclosure, we have not quoted it in its entirety here. The financial statements are available in the AFM's financial reporting register: https://www.afm.nl/en/professionals/registers/meldingenregisters/financiele-verslaggeving/details?id=31730&KeyWords=nibc

[10] For the figure-based disclosure, see the Heineken financial statements in our register: https://www.afm.nl/en/professionals/registers/meldingenregisters/financiele-verslaggeving/details?id=31359&KeyWords=heineken

[11] Table partially included

For the year ended 31 December

In millions of €	2017	Estimated impact IFRS 15	2017 including impact IFRS 15
Revenue	21,888	3,865	25,753
Excise taxes		(4,162)	(4,162)
Net revenue		(297)	21,591
Other income	141		141
Raw materials, consumables and services	(13,540)	297	(13,243)
Personnel expenses	(3,550)		(3,550)
Amortisation, depreciation and impairments	(1,587)		(1,587)
Total expenses	(18,677)	297	(18,380)

Heineken N.V., Annual Report, page 78

Heineken thus provides insight into the expected effects, but also notes that these are subject to change since the company is still engaged in the transition project. This is relevant information for investors, which adds more value than if Heineken had chosen not to disclose a quantitative impact because the project was not completed.

Disclosure of the expected impact of IFRS 9 – bad practice in 2017 financial statements

We see several companies providing an extensive disclosure for IFRS 9. Companies provide a good summary of IFRS 9 that in some cases stretches to several pages, only to conclude that the standard will not have an impact on their financial statements. We do not advocate inclusion of such disclosures that amount to clutter[12], which offers little relevant information to users of the reporting.

Disclosure of the expected impact of IFRS 15 – bad practice in 2017 financial statements

We see several disclosures that do not provide the information investors need to be able to make well-founded decisions. In one set of financial statements for 2017, we found a text stating that management expected IFRS 15 to have a significant impact on reporting and that the company was engaged in estimating the effect. These financial statements were published long after IFRS 15 was authorised for publication. Investors are entitled to expect a listed companies to have proper control of their administrative processes, particularly the processes relating to the preparation of its reporting, so that essential information can be reported in a timely manner. This was not the case in this instance.

[12] The term 'clutter' is used here to describe the inclusion of irrelevant or excessive information in financial statements.

Disclosure of the accounting policy changes in IFRS 9 – good practice in the interim financial statements for 2018

If a company has disclosed the expected impact adequately in its 2017 financial statements, it can build on this in its interim financial statements: NIBC Holding N.V. provides an update to the disclosure in its 2017 financial statements (pages 64 to 82) in its interim financial statements for 2018[13]. This thorough disclosure makes it possible to properly understand this comprehensive accounting policy change. The large number of pages due to the implementation of IFRS 9 at a bank is indeed no exception, due to the complexity of the standard and its effect on the reporting and the administrative processes.

Disclosure of the accounting policy change in IFRS 15 – good practice in the interim financial statements for 2018

For companies reporting a significant impact due to the implementation of IFRS 15, this standard is a reason to review contracts and carry out an analysis of the method of revenue recognition in the application of IFRS 15 for each revenue stream or performance obligation. For several companies, we see the expected impact (in the 2017 financial statements) or the actual impact (in the interim financial statements for 2018) properly presented in the disclosures, both qualitative and quantitative.

Airbus solves this by stating examples of contracts or parts of contracts for each revenue stream that are processed in a specific manner in the revenue, with separate attention for the manner in which engines are processed in the revenue:

> The most significant changes result from the following:
>
> - Several performance obligations are identified instead of recognising a single contract margin under IAS 11 (*e.g.* A400M, NH90 contracts). In some cases, the over time (*e.g.* percentage of completion (“PoC”) method) revenue recognition criteria are not fulfilled under IFRS 15. In particular, for A350 launch contracts, A400M series production and certain NH90 contracts, revenue and production costs relative to the manufacture of aircraft are recognised at a point in time (*e.g.* upon delivery of the aircraft to the customer).
> - Under IFRS 15, measurement of the revenue takes into account variable consideration constraints in order to achieve high likelihood that a significant reversal of the recognised revenue will not occur in the future. The constraint in assessing revenue at completion for some contracts (A400M) generates a decrease in recognised revenue.
> - For the application of the overtime method (“PoC method”), the Company measures its progress towards complete satisfaction of performance obligations is based on inputs (*i.e.* cost incurred) rather than on outputs (*i.e.* milestones achieved). For the Company’s current long-term construction contracts progresses were usually measured based on milestones achieved (*e.g.* Tiger programme, satellites, orbital infrastructures). Under IFRS

[13] For these interim financial statements, see our register: https://www.afm.nl/en/professionals/registers/meldingenregisters/financiele-verslaggeving/details?id=36996&KeyWords=NIBC

15, the Company measures progress of work performed using a cost-to-cost approach, whenever control of the work performed transfers to the customer over time.

IFRS 15 also impacts the presentation of the revenue from the sales of engines. Under IAS 18, the Company recognised revenue based on the amount of its contracts with its customer, unless it had confirmation of the amount of the price concession. In contrast, IFRS 15 requires the Company to estimate the amount of price concession in all cases and to treat the price concession as a reduction of revenue and cost of sales. Under IFRS 15, revenue and cost of sales decrease by the amount of the estimated concession granted by The Company's engine supplier to their customers.

Airbus SE, First half-year 2018 report, page 12

Disclosure of the accounting policy change in IFRS 15 – bad practices in the interim financial statements for 2018

One disclosure we came across many times in the interim financial statements for 2018 was the confirmation as described in IAS 34.16A(a) that the accounting policies were the same as those used in the previous financial statements, if that was the case. This is not logical if new standards are implemented, since the accounting policies of the old standard no longer apply. Even for standards where implementation does not lead to material changes, the accounting policies will be different. We also found this disclosure in the interim financial statements of a company that had stated in its 2017 financial statements that it expected IFRS 15 to have a material impact. In this case not only was the disclosed accounting policy incorrect, but different revenue should have been reported on the basis of the correct accounting policy.

Another bad practice concerns the inclusion of an extensive or even very extensive explanation of IFRS 15[14] while there was absolutely no change to the reported figures. Unlike the previous bad practice, this concerns clutter that provides no relevant information for the user of the reporting. A brief explanation of the standard and a statement that the change of accounting policies has had no effect and why this is the case would be sufficient to properly inform the user of the reporting.

[14] Obviously, this also applies to similar situations with respect to IFRS 9.

4. IFRS 16, Leases

Introduction

IFRS 16 applies to financial years beginning on or after 1 January 2019, but the standard may already be applied in the 2018 financial statements as well. Most listed companies will therefore not implement IFRS 16 until their 2019 financial statements.

IFRS 16: a brief look at the changes

The new standard for leases removes the difference between operating and financial leases for lessees. Under application of IFRS 16, lease contracts lead firstly to a capitalised right of use and secondly a lease commitment. Whereas under the old standard an operating lease was treated as off balance sheet finance, this is no longer permitted. There are two important consequences:

1. the balance sheet will show more assets and more loan capital, and therefore less solvency,
2. and the costs of the lease will 'move' from operating expenses to firstly a depreciation charge and secondly an interest expense. This will therefore lead to a higher EBITDA than under the old standard.

Short term and small leases do not have to be recognised in the balance sheet. The reporting of leases will not change that much for lessors.

We include two examples to illustrate the effects of IFRS 16 on the financial position and result of a company:

In the following hypothetical balance sheet, application of IFRS 16 will lead to a worsening of the solvency ratio from 25% to 19.2%:

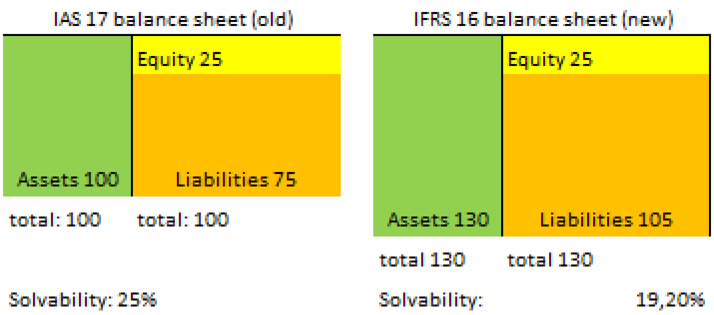
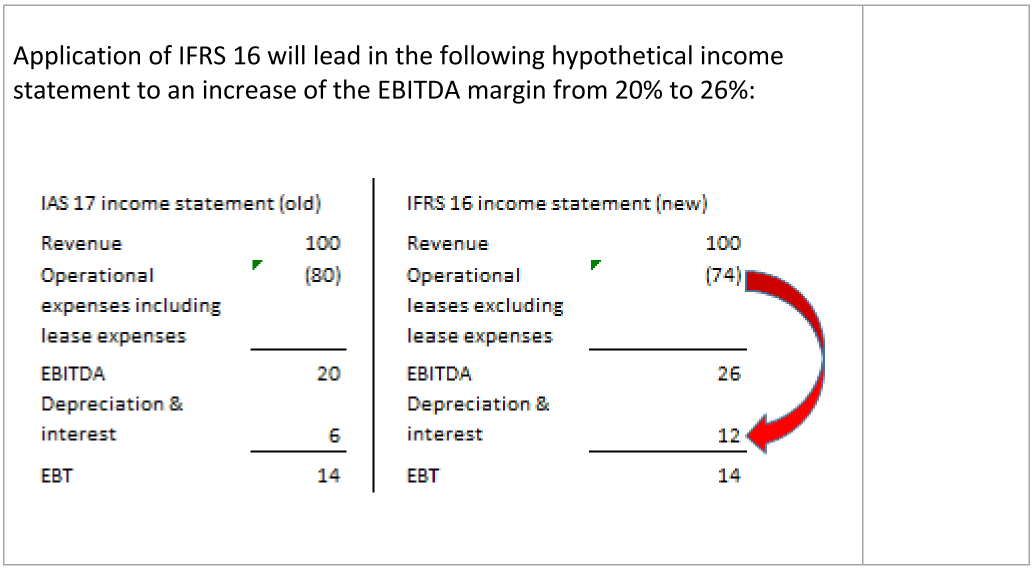


Figure 3: illustration of effects of IFRS 16 on the balance sheet



Application of IFRS 16 will lead in the following hypothetical income statement to an increase of the EBITDA margin from 20% to 26%:

IAS 17 income statement (old)		IFRS 16 income statement (new)	
Revenue	100	Revenue	100
Operational expenses including lease expenses	(80)	Operational leases excluding lease expenses	(74)
EBITDA	20	EBITDA	26
Depreciation & interest	6	Depreciation & interest	12
EBT	14	EBT	14

Figure 4: illustration of effects of IFRS 16 on the income statement

IFRS 16 did not become mandatory until 1 January 2019, but may be applied early in 2018. Incidentally, it is evident from the interim financial statements of the listed companies that only eight companies have chosen this option. We evaluated these eight interim financial statements for the presence of good or bad practices.

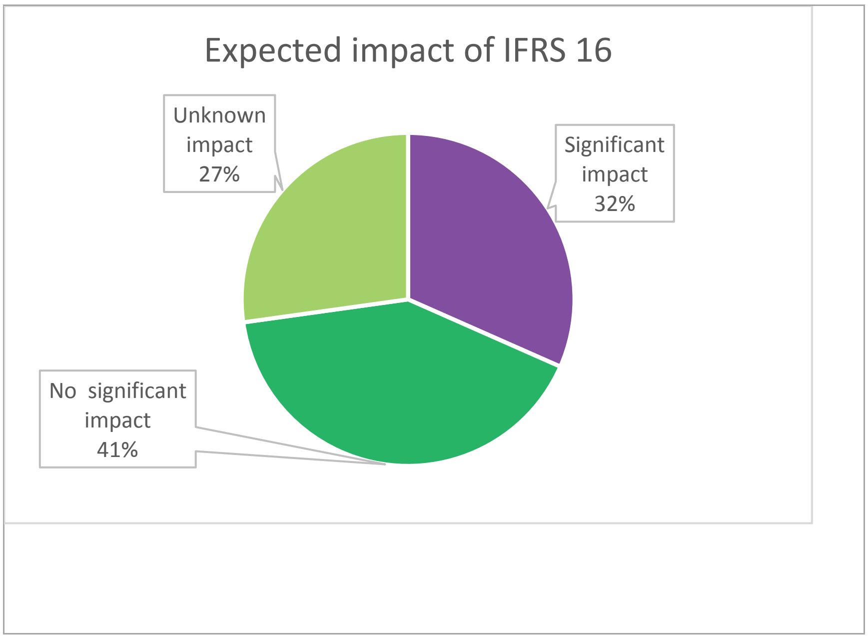


Figure 5: classification of disclosures on the expected impact of IFRS 16

4.1 Disclosures in the 2017 financial statements

Many companies were not ready for the implementation of IFRS 16 at year-end 2017. A total of only thirteen companies provided a quantitative disclosure in their 2017 financial statements and 37 of the 136 companies in the scope of the review did not know whether this standard will have a significant impact.

The review also shows that IFRS 16 will affect many more companies than IFRS 9 and/or IFRS 15. 43 listed companies disclosed in their 2017 financial statements that they expected a significant impact. This is more than the total for IFRS 9 and IFRS 15 together. For these companies, the new standard will have a significant impact on balance sheet ratios and/or operating results. Solvency, interest expenses and EBITDA can be important measures for loan covenants. Investors need to be aware of potential changes to solvency or interest expenses and the consequences of this for the funding of companies. On the other hand, they also need to realise that higher EBITDA due to the implementation of IFRS 16 could affect their valuation models.

4.2 Disclosures of the accounting policy change in the interim financial statements for 2018

Eight companies have applied IFRS 16 early in 2018. We have assessed the interim financial statements of these companies to see if the disclosures of the accounting policy changes are comprehensible. In this assessment, we established that the disclosures – depending on the chosen transitional arrangements – are included properly in the interim financial statements.

For the transition to IFRS 16, the standard offers the option of retrospective application, but with recognition of the cumulative effect of this in the opening assets of - in this case - the 2018 financial year[15]. The comparative figures will in this case not be adjusted, as would normally have been the case. The standard requires a disclosure clearly stating the cause of the difference between the new balance sheet item ‘right of use' on the one hand and the disclosure previously required on operating lease commitments (not recognised in the balance sheet) when the old standard was applied as at 31 December 2017 on the other. We note that this disclosure is included by the listed companies that exercised this option.

4.3 2018 financial statements

Upon the implementation of IFRS 16, the company will have to take account of its communication with investors concerning the impact of this standard. Investors are entitled to expect listed companies to have proper control of their administrative processes so that these companies report essential information in a timely manner. We expect listed companies to quantify the expected impact of IFRS 16 on balance sheet items and ratios, operating result and EBITDA and (where applicable) financial covenants not later than in their financial statements for 2018.

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[15] See IFRS 16 appendix C5(b), the ‘modified retrospective approach’

Certainly since most companies for which IFRS 9 or IFRS 15 have a significant impact have been able to achieve this for these much more complex standards.

4.4 Good and bad practices

Good practices in the 2017 financial statements

IFRS 16 affects both the balance sheet and the income statement. A good disclosure of the expected impact of this new standard should state the effect on both primary statements. Several companies do this. For example, Heijmans states[16]:

> "(…) the total assets would therefore increase by approximately 10%. There will be a shift in the income statement between the items in the operating result and interest (with no change to the net result), whereby the operating result will increase by several million euros, and the interest expenses will increase by a similar amount. There will be a shift in the operating result from operating expenses to depreciation expenses, as a result of which the EBITDA (earnings before interest, tax, depreciation and amortisation) will increase. This will have no effect on the net result. The impact on equity is expected to be limited at the time of the accounting policy change. The impact on the financial results in 2018 and subsequent years is expected to be of similar scale. (…)"
>
> *Heijmans N.V. 2017 annual report, p. 141*

What is important in this good practice is that Heijmans does not state a specific amount as such, but it gives a clear indication of the (potential) consequences of the new standard for its reporting. It is clear that this indication is not intended as an exact prediction, but the investor in any case has an idea of the effects of a new standard on the reporting.

[16] Heijmans N.V. 2017 annual report, p. 141

Good practice in the interim financial statements for 2018

The companies that have applied IFRS 16 early and those that have chosen to take the option of implementing the standard by including the cumulative effect of this in the opening assets for 2018 (the 'modified retrospective approach'), have included the required disclosure in proper form. As an example of good practice, Kiadis states:

	January 1, 2018
Lease liability recognized at date of initial application of IFRS 16	
Operating lease commitments disclosed as of December 31, 2017	**14,395**
Less: service components included in operating lease commitments	(5,144)
Less: short-term leases for which no lease liability is recognized	(24)
Add: adjustments as result of different treatment of extension options	210
Commitments for lease payments	**9,437**
Discounted using the Company's incremental borrowing rate of 7.38%	(2,583)
Lease liability recognized in statement of financial position	**6,854**

Kiadis, Interim report for the six months ended June 30, 2018, page 12

Bad practice in de interim financial statements for 2018

On the basis of IAS 34.16A(a), companies implementing several standards simultaneously have to disclose the effects of these accounting policy changes for each line in the primary statements. Where some companies choose to include a single table with a single column for each new standard, we also see that the companies combine the effects of all the new standards in a single column. This approach does not help the user to understand the effects of the various accounting policy changes and in our view constitutes a bad practice.

Appendix 1 Objectives, methodology and population of the review

Objectives

The key objectives of the review were:

- to motivate companies to implement the standards properly and to communicate this to the market in a timely manner,
- to identify and publish good and bad practices in the disclosures of expected effects (IAS 8.30 and IAS 8.31) and the actual effects of accounting policy changes (IAS 34.16A(a)),
- to gain an impression of which companies are or will be significantly affected by the new IFRSs. For IFRS 9 and IFRS 15, this also entails a refining of the scope of future thematic reviews, in which there will be greater focus on these companies,
- to form an opinion with respect to the quality of the disclosures of the expected and actual effects of these new IFRSs.

Methodology

We assessed the 2017 financial statements for the disclosures as required under IAS 8.30 and IAS 8.31. Among other things, these paragraphs state that companies must disclose the impact of a new standard not yet applied in both qualitative and quantitative terms, to the extent this is possible.

Then, we assessed the interim financial statements for 2018 for a smaller group of listed companies (see 'population' below) for the disclosures of the accounting policy changes as these have to be disclosed on the basis of IAS 34.16A(a).

As a result of this review, we will contact a number of companies that we consider have not adequately disclosed the accounting policy change so that these and other required disclosures in the 2018 financial statements will be included in accordance with the reporting standards.

Population

Our review focused on the 2017 financial statements of all listed companies that:

- have the Netherlands as their Member State of origin;
- are listed on a regulated market in Europe; and
- prepare consolidated financial statements in accordance with IFRS.

For the portion of the review concerning the disclosures in the 2017 financial statements, this means that the scope of our review included the review of 136 listed companies. The total population of financial statements subject to supervision with consolidated IFRS financial statements amounts to approximately 180 companies. The population for the review of the interim financial statements was smaller: 16 interim financial statements for our review of the accounting policy change to IFRS 9, 22 for the accounting policy change to IFRS 15 and 8 for the accounting policy change to IFRS 16. For IFRS 9 and IFRS 15, we limited the population to companies that disclosed an expected significant impact or companies for which we would have expected to see a significant impact or companies where the impact was not known. For IFRS 16, we assessed only the interim financial statements of the early adopters.

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