In Balance 2017- part B

Survey of the implementation of new IFRSs at listed companies

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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.

This is an English translation of the original Dutch text, furnished for convenience only. In the event of any conflict between this translation and the original Dutch text, the latter will prevail.

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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 recognition of financial instruments (IFRS 9) and the recognition of revenue (IFRS 15) will change with effect from 1 January 2018. This will be followed a year later by the standard for leases, IFRS 16.

We believe it is important that listed companies that apply IFRS inform investors and other stakeholders properly and in a timely manner regarding the effects of these new standards on their financial reporting.

We decided to carry out a survey this year[1]. By means of a questionnaire, we asked 135 companies to describe the impact of and the progress they had made on implementing the new IFRSs.

In the answers from the 103 respondents, we see that IFRS 9 mostly affects banks (due to the changes in determining the provision for loan losses). The picture with respect to IFRS 15 is more diffuse, but in any case telecommunications, construction and biotechnology companies are affected (mainly on revenue and disclosures). IFRS 16 affects companies across the breadth of the market (balance sheet ratios, EBITDA, financing costs). A small number of companies state that one of the new standards could also affect their business model. The changes mentioned are, however, highly business-specific and are therefore not referred to further in this report.

The quantitative impact of the new standards has not yet been communicated with the market in many cases. This is a recurring pattern when new standards are introduced, and is a cause for concern. The predictability of accounting policies in financial reporting is an important condition for the functioning of the capital markets.

Our conclusions from the responses by the companies are[2]:

- most companies say they will inform investors on the potentially significant quantitative effects of IFRS 9 and IFRS 15 not later than in their 2017 financial statements;
- of the three IFRSs surveyed, IFRS 16 will significantly affect the reporting of the largest number of listed companies.

Most companies say they will inform investors on the potentially significant quantitative effects of IFRS 9 and IFRS 15 not later than in their 2017 financial statements

Most of the companies that say that the new IFRSs will significantly affect their financial reporting state that until now they have provided little information to investors and other stakeholders

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[1] See the newsletter dated 26 April 2017: https://www.afm.nl/nl-nl/nieuws/2017/apr/onderzoek-overgang-regels-ifrs

[2] We did not check the information collected from the questionnaires against other documentation such as financial statements or interim statements. The findings of this survey are a summary of the observations and standpoints of the listed companies themselves, which we reviewed at company level to establish the plausibility of the answers. See also appendix 1, objectives, scope and population.

regarding the quantitative effects of the changes. Moreover, we see little other communication on the effects of the new IFRSs by listed companies to the market (at road shows, analyst meetings, etc.). Most companies have however involved their CFO and external auditor in the process of implementing the new standards.

IFRS 9 and IFRS 15 will take effect on 1 January 2018. IFRS 16, which takes effect on 1 January 2019, can be adopted early by companies from 1 January 2018. Like ESMA, the AFM takes the view that companies must include a qualitative and quantitative disclosure of the impact of the new standards that they apply from 1 January 2018 not later than in their 2017 financial statements (so including the impact of IFRS 16 if they adopt this standard early). In case of potential inside information with respect to this impact, a company must inform the market by means of a press release earlier and without delay. Virtually all companies expect to be able to disclose the quantitative impact of IFRS 9 and IFRS 15 not later than in their 2017 financial statements.

The AFM calls on listed companies to inform users properly with regard to the expected impact of the new IFRSs on their reporting. We expect all companies to provide a quantitative disclosure of the impact of the standards they will apply with effect from 1 January 2018 in their 2017 financial statements.

IFRS 16 significantly affects far more listed companies than IFRS 9 and IFRS 15

The main changes due to the introduction of IFRS 16

Leased assets (operating leases) are to be recognised in the statement of financial position, as well as the associated liabilities. This will reduce the solvency ratio. In addition, the presentation of expenses in the determination of results will shift: whereas operating lease costs are included in alternative performance indicators such as EBITDA, depreciation and interest expenses (the new presentation in accordance with IFRS 16) are not. A higher interest expense and a higher EBITDA could change the interest cover ratio (interest expense/EBITDA).

Many listed companies state that IFRS 16 will have a material effect on their financial statements. 12 companies, mostly banks, say that IFRS 9 will have a significant impact. 15 respondents say that IFRS 15 will have a significant impact (including the telecommunications industry). More than half of the respondents, spread widely across the participating population and regardless of size or sector, say that IFRS 16 will have a significant impact. Solvency, EBITDA and interest cover are ratios that may be included in bank covenants. In cases where listed companies have not concluded 'GAAP-frozen'[3] covenants, without some flexibility or adjustment compliance with these covenants could be threatened.

[3] Agreement with the bank that compliance with covenants will be determined on the basis of the same accounting policies as the policies that were applied at the time of conclusion of the original loan. Subsequent regulatory changes will then not have the effect that covenants are suddenly not met.

IFRS 16 was approved by the European Commission on 9 November 2017. To the extent that companies do not adopt IFRS 16 early, we call on them to provide this quantitative disclosure to the market as soon as possible, preferably well before their 2018 financial statements.

Lastly, the AFM notes that the issues cited by companies regarding the implementation of the new standards are either technically highly complex or very company-specific, and are therefore not appropriate for this report. Some issues are appropriate for discussion of case studies at the level of ESMA (in the European Enforcers Coordination Sessions (EECS)).

The AFM is open for discussion with listed companies regarding specific implementation issues resulting from IFRS, whether this concerns old or new standards. The AFM encourages companies to discuss cases with the AFM[4]. In certain cases, the AFM has contacted or will contact companies in connection with the responses to the questionnaire.

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

2. Introduction

The IASB has introduced three standards that will come into effect in 2018 or 2019. IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from Contracts with Customers) apply to financial years starting on or after 1 January 2018. IFRS 16 comes into effect one year later. All three standards have now been approved by the European Commission[5].

These three new standards may entail significant changes to the financial reporting of listed companies. On 27 October 2017, ESMA expressed the expectation that the majority of these companies will communicate the effects of IFRS 9, IFRS 15, and in case of early adoption, IFRS 16, to investors not later than in their 2017 financial statements[6]. Since at the time of publication of the 2017 financial statements IFRS 9 and IFRS 15 will actually be in effect (for the 2018 financial year), ESMA expects the qualitative and quantitative effects of IFRS 9 and IFRS 15 to be disclosed not later than in the 2017 financial statements. The same applies to IFRS 16, in case of early adoption.[7]

The survey that is the subject of this report is the first step by the AFM in its thematic approach to supervision of the implementation and application of the new IFRSs at listed companies. This is part of our strategy to draw the attention of companies to the new standards before they are applied. Next year, we will focus on the disclosures provided by listed companies in their financial statements as a result of the requirements of IAS 8.30. This paragraph requires a qualitative and quantitative disclosure of the impact of new standards not yet adopted in the reporting (so including IFRS 9, 15 and 16).

In 2019 and 2020, the AFM will focus its supervision on the actual application of the standards.

Sections 3, 4 and 5 state the results of the questionnaire, divided into IFRS 9 Financial Instruments, IFRS 15 Revenue from Contracts with Customers and IFRS 16 Leases respectively.

Appendix 1 describes the objectives, the scope and the population.

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[5] See https://www.efrag.org/News/Public-129/EFRAG-Endorsement-Status-Report---Update-9-November-2017

[6] See for instance for IFRS 15: https://www.esma.europa.eu/sites/default/files/library/2016-1148_public_statement_ifrs_15.pdf

[7] See https://www.esma.europa.eu/sites/default/files/library/esma32-63-364_summary_of_results_of_the_fact_finding_exercise_on_ifrs_9_and_ifrs_15.pdf

3. IFRS 9 Financial Instruments

Introduction

IFRS 9 replaces some of the standards for financial instruments that applied until now. The IASB has changed the classification model for financial instruments (under IFRS 9 related to the company's business model with the specific instruments and the 'SPPI' test[8]), the writedown of receivables (from an 'incurred loss' model to an 'expected loss' model) and changes to hedge accounting. Insurers in Europe do not have to apply IFRS 9 until 1 January 2021, the date on which IFRS 17 (Insurance Contracts) also takes effect.

12 companies state that IFRS 9 will significantly affect their financial reporting. The following is an overview of the main results from the 12 completed questionnaires.

Most of the companies that state that impact of IFRS 9 will be significant have not yet reported any quantitative impact

9 of the 12 companies that expect a significant impact from IFRS 9 have not yet reported the quantitative impact of the new standard. The main reasons cited for the fact that the quantification of the impact is not yet final are the validation of the models for determining loan losses and final coordination with the auditor. These companies expect to include a disclosure of the quantitative impact of IFRS 9 in their 2017 financial statements.

Around half the companies that state that the impact of IFRS 9 is significant have sought a dialogue with users regarding the transition to IFRS 9

Virtually all the companies that expect a significant impact on their financial reporting have involved the CFO and the external auditor in the process of implementing IFRS 9. Nearly half of them state that they have also held discussions with users of the reporting in order to include them in the process of transition to the new IFRS.

It is important that users are involved at the earliest possible stage in order to achieve a smooth transition to the new reporting standards that will disrupt the market as little as possible. Investors and analysts will thus be able to adjust their valuation models to the new standards in a timely manner and continue to make well-founded investment decisions. One company explicitly states that inclusion of users in the changes to the reporting as a result of IFRS 9 was or is one of the many challenges during this transition.

IFRS 9 affects a limited number of companies, mainly banks

From the responses to our questionnaire, it emerges that 12 companies expect IFRS 9 to significantly affect their financial statements. These are mainly banks. Figure 1 shows the impact of IFRS 9 on various items in the financial statements. Five companies (banks) expect there to be a material effect on the provisions for loan losses.

[8] Solely Payments of Principal and Interest.

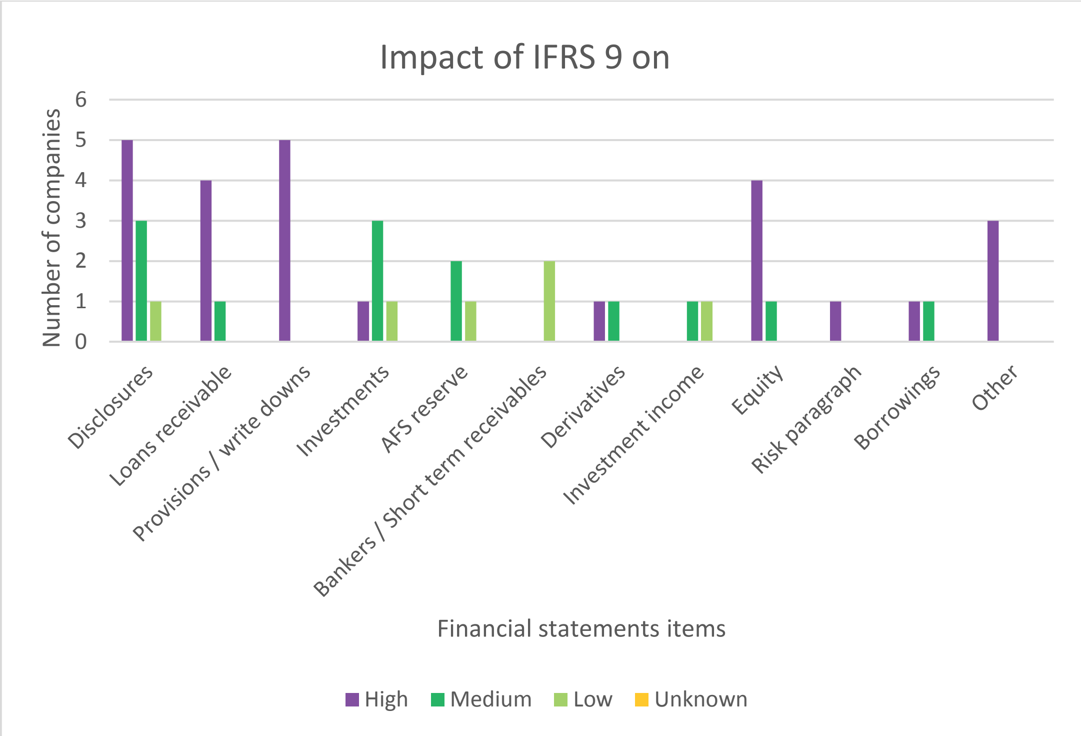

Figure 1: Impact of IFRS 9 on financial statements items

The Tier 1 capital (the most solid basis to meet the minimum capital requirements) of the banks that completed the questionnaire will change as a result of IFRS 9, but they estimate that the effect will be limited (between 0.25 and 0.5 of a basis point).

10 other companies state that the impact of IFRS 9 on their reporting is not yet known. At the time of completing our questionnaire, three of these had not yet started their analysis of the IFRS 9; none of these are banks. Nearly all the companies state they expect to be able to disclose the impact not later than in their 2017 financial statements.

Companies are using practical expedients in various ways

No clear picture was obtained from the responses to our questions regarding the use of practical expedients that the IASB has included in the standard. These practical expedients mainly concern simplified impairment models for trade receivables or the continuation of the 'old' IAS 39 rules for hedge accounting. While some companies apply a practical expedient, others do not. This also varies per practical expedient. Users of the reporting therefore need to be aware of potential disruptions to the comparability of the reporting of different companies.

4. IFRS 15 Revenue from Contracts with Customers

Introduction

With IFRS 15, the IASB is replacing the old standards for Revenue (IAS 18) and Construction Contracts (IAS 11), standards that first appeared in 1993. In addition, a number of interpretations are included in IFRS 15 (IFRIC 13, 15, 18 and SIC 31). IFRS 15 is based on a 5-step plan to establish when and how much revenue has to be recognised from contracts with customers. The impact of this new standard on reporting depends on the sector or sectors in which the company operates. For instance, for sales that are directly paid for in the retail industry, the impact on the recognised revenue will in most cases not be material.

15 companies state that IFRS 15 will significantly affect their financial reporting. The following is an overview of the main results from the 15 completed questionnaires.

Companies have so far made little effort to engage in dialogue with users in the transition to IFRS 15

Of the 15 companies, only 2 state that they have held discussions with users regarding the transition to IFRS 15. This is clearly less than is the case with the companies that qualified IFRS 9 as significant. Communication with users regarding the consequences of the new standard for e.g. valuation models and trend analyses used by investors is very important for enabling the implementation of the new standards to pass off as smoothly and seamlessly as possible in the market. All the 15 respondents state that the CFO is involved in the implementation of IFRS 15. Only 1 of the 15 companies has not (or not yet) involved the external auditor in the implementation.

Still no insight into the quantitative impact of the implementation of IFRS 15 in 13 cases

Only 2 of the 15 companies (not the same companies as in the previous point) state in their response to the questionnaire that they have already issued a disclosure of the quantitative impact of the implementation of IFRS 15. In its publication of 28 October 2017[9], ESMA also reported that many companies had still not issued a quantitative disclosure. Our findings confirm this is the case in the Dutch market.

IFRS 15 affects slightly more companies than IFRS 9, including telecommunications companies and construction companies

There will be not much change to the revenue recognition for most companies. Of the 15 that state they expect to see a significant impact, most say that they expect a number of important changes in their disclosures (see figure 2 - high and average impact on disclosures in total 10 of the 15). We can imagine that for companies for which the revenue itself is not directly affected, new disclosure requirements may have a significant impact on reporting within the group. Operating companies will have to provide new information in order to meet the new disclosure requirements. More sectors are involved among these 15 respondents than is the case with IFRS

[9] See footnote 5.

9; these companies operate in sectors including telecommunications, construction and biotechnology.

It is not clear for all companies whether IFRS 15 will have an impact

20 companies of the 103 state that it is not yet clear whether the implementation of IFRS 15 will have an impact. Most of these companies do not have a business model based on multiple performance obligations under a single contract. This means that no material impact on the primary statements is expected. Only 2 companies state that they had not yet started on the implementation of IFRS 15 when they completed the questionnaire. Nearly all the companies state they expect to be able to disclose the impact not later than in their 2017 financial statements. One company states that it will not be able to provide a disclosure on the quantitative effect until its 2018 interim statement. This is late, especially if the effects turn out to be significant.

Impact of IFRS 15 on financial reporting

The figure below shows for instance that 5 of the 15 companies expect a high (1) or average (4) impact on revenue. Across all 103 respondents therefore, the effect on recognised revenue will be limited.

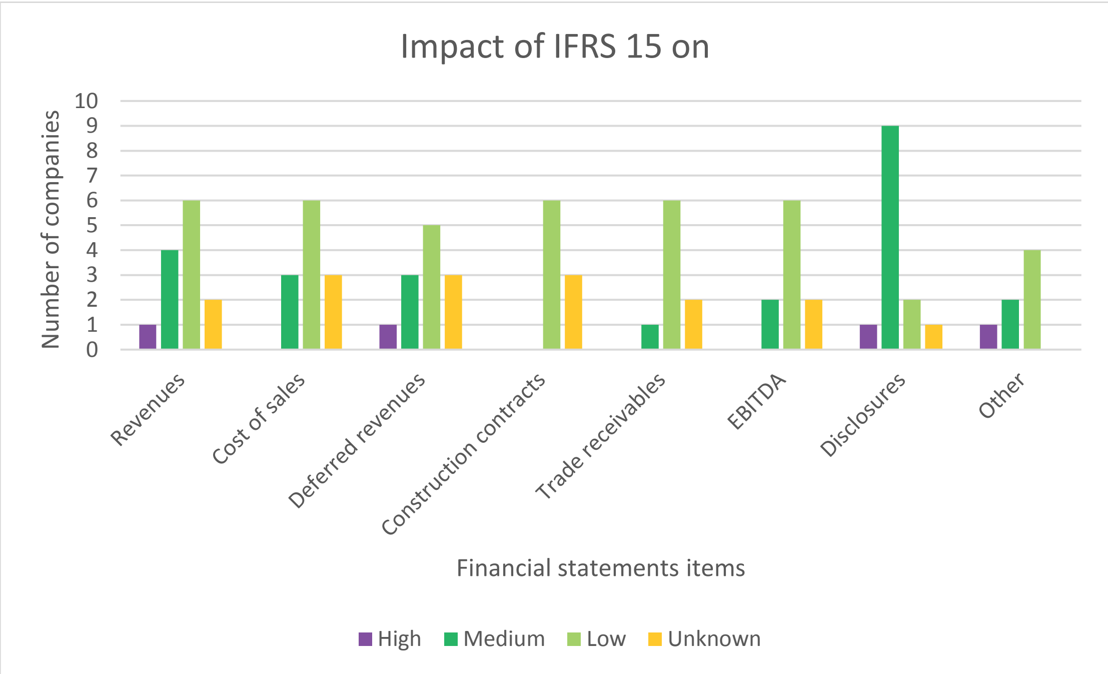

Figure 2: Impact of IFRS 15 on financial statements items

Variable application of practical expedients

The use of practical expedients for the implementation of IFRS 15 is also variable. For example, almost half of the respondents have chosen to adjust their comparative figures for 2017 with respect to the transition provision included, while the other half have decided not to do this. Users of the reporting therefore need to be aware of potential disruptions to the comparability of the reporting of different companies.

5. IFRS 16 Leases

Introduction

IFRS 16 will apply to financial years commencing on or after 1 January 2019. This standard replaces IAS 17 on leases. The new standard will not have much effect on the reporting of lessors; however, the effect for lessees may be significant. While IAS 17 distinguished between financial leases (the leased asset is recognised in the lessee's statement of financial position) and operating leases (known as off-balance sheet finance), this distinction will be removed for lessees under IFRS 16.

With effect from the introduction of IFRS 16, companies must recognise lease contracts in their statement of financial position. This will lead to changes in measures such as the solvency ratio (indeed, the credit side of the statement of financial position will show more liabilities when these are recognised under IFRS 16), but EBITDA will also increase because operating expenses will decline. Interest expense will also become a separate item. This means that the interest cover ratio (interest expense/EBITDA) will change as well. Companies that have concluded loan covenants that are not GAAP-frozen may encounter problems with respect to their funding.

58 companies state that IFRS 16 will have a significant impact on their financial reporting. The following is an overview of the main results from the 58 completed questionnaires.

Many more companies expect IFRS 16 to significantly affect their financial reporting compared to the effects expected from IFRS 9 and IFRS 15

Although the standard takes effect a year later than IFRS 9 and IFRS 15, most companies are already preparing for IFRS 16. Only 3 companies say they have not yet started on the transition to IFRS 16. 58 companies take the view that the standard will significantly affect their reporting, particularly with reference to the total assets, the total liabilities and EBITDA. A total of 14 companies are as yet undecided with respect to the impact of the standard.

Not many companies have as yet disclosed the quantitative effects of IFRS 16

Of the 36 companies that state they have provided a qualitative disclosure of the effects of IFRS 16 on the financial reporting, only 8 say that they have also communicated the quantitative effects of the implementation of IFRS 16 to the market. In addition, 20 of the 58 companies state that they will include a quantitative disclosure in their 2017 financial statements.

This standard will come into effect a year later than IFRS 9 and IFRS 15. The companies thus have a year longer to inform the market properly and in a timely manner regarding the impact of IFRS 16 on their financial reporting. Since IFRS 16 firstly is less complicated to implement than the other two standards and secondly will have a much larger impact on the reporting of many more companies, the AFM expects companies to inform the market of the qualitative and quantitative effects of the implementation of IFRS 16 in a timely manner.

The AFM accordingly calls on companies to inform users of the quantitative effects on their financial reporting as soon as possible, but in any case prior to publication of their 2018 financial statements.

12 companies plan to adopt IFRS 16 early

12 companies state that they wish to implement IFRS 16 early if the EU approval process is completed on time (IFRS 16 was not yet approved at the time the questionnaire was completed[10]). 8 of these companies state that IFRS 16 will have a significant impact on their reporting.

Also with reference to the implementation of IFRS 16, we see that companies have had little discussion with users regarding the consequences of IFRS 16

Virtually all the companies that see a significant effect of IFRS 16 on their reporting have involved their CFO and external auditor in the implementation of the standard. 12 of them say that they have also held discussions with users in this process. Here too it is very important that users are informed in a timely manner of the effects of changing rules applying to reporting on that reporting or on the company concerned.

IFRS 16 will significantly affect many items in the financial statements

The picture presented from the responses by the listed companies that expect IFRS 16 to have a significant effect on their financial statements is as follows:

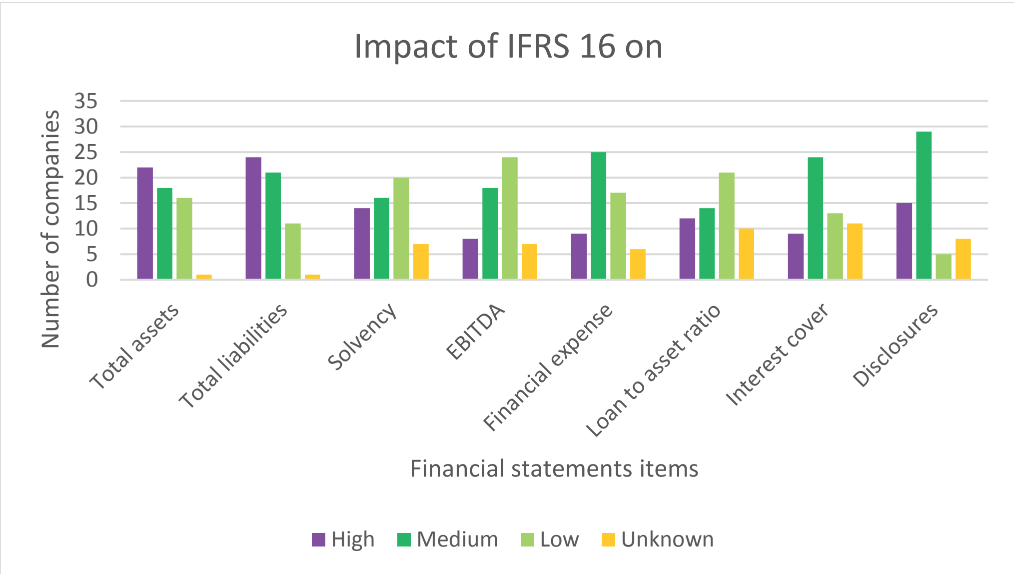

Figure 3: Impact of IFRS 16 on financial statements items

[10] The European Commission approved IFRS 16 on 9 November 2017.

Appendix 1 Objectives, scope and population

Objectives

We have carried out a survey of three new international reporting standards in order to draw attention to timely and proper implementation of the new standards (preventive supervision). The aim of the survey was to gain an impression of:

- progress on implementation of the new IFRSs;
- the impact of the new IFRSs on financial reporting;
- the progress on informing investors and other stakeholders regarding the impact of the new IFRSs on reporting;
- any issues encountered by listed companies regarding the implementation of the new IFRSs (we will contact companies if appropriate and case by case discussions will be held at ESMA level where necessary).

The survey also aimed to stimulate companies to take appropriate actions in a timely manner to ensure correct implementation.

This survey is the first step in a series of thematic surveys of the implementation of IFRS 9, IFRS 15 and IFRS 16 at listed companies. With this series of surveys, the AFM aims to closely monitor the implementation of these new IFRSs and to stress the importance of proper and timely implementation and information to the market regarding the implications.

Scope

Our survey consisted of distributing an online questionnaire regarding the implementation of the new IFRSs on 30 June 2017 and analysing the responses. For each standard, we asked questions on:

- the impact of the standard on reporting;
- the method and timing of communication with the market on the effects of implementation;
- the items affected by the standard;
- the governance in relation to implementation;
- issues encountered during implementation.

In addition to this reporting, we have approached or will approach individual companies if the responses to the questionnaire raised questions from our side. These one-to-one contacts are of course not included in public reporting.

Population

We distributed our questionnaire to all listed companies that:

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

On 30 June 2017, we accordingly sent an online questionnaire to 135 companies subject to our supervision. 103 of these 135 companies completed the questionnaire. We have not checked the information collected from the questionnaires against other documentation such as financial statements or interim statements. The findings of this survey are a summary of the observations and standpoints of the listed companies themselves, which we reviewed at company level to establish the plausibility of the answers. All the findings stated in this report thus relate exclusively to these 103 companies and do not offer a general opinion regarding the market as a whole or companies other than these 103. In addition, most of the listed companies completed the questionnaire in the third quarter. As the end of 2017 approaches, there may be new developments affecting progress.

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