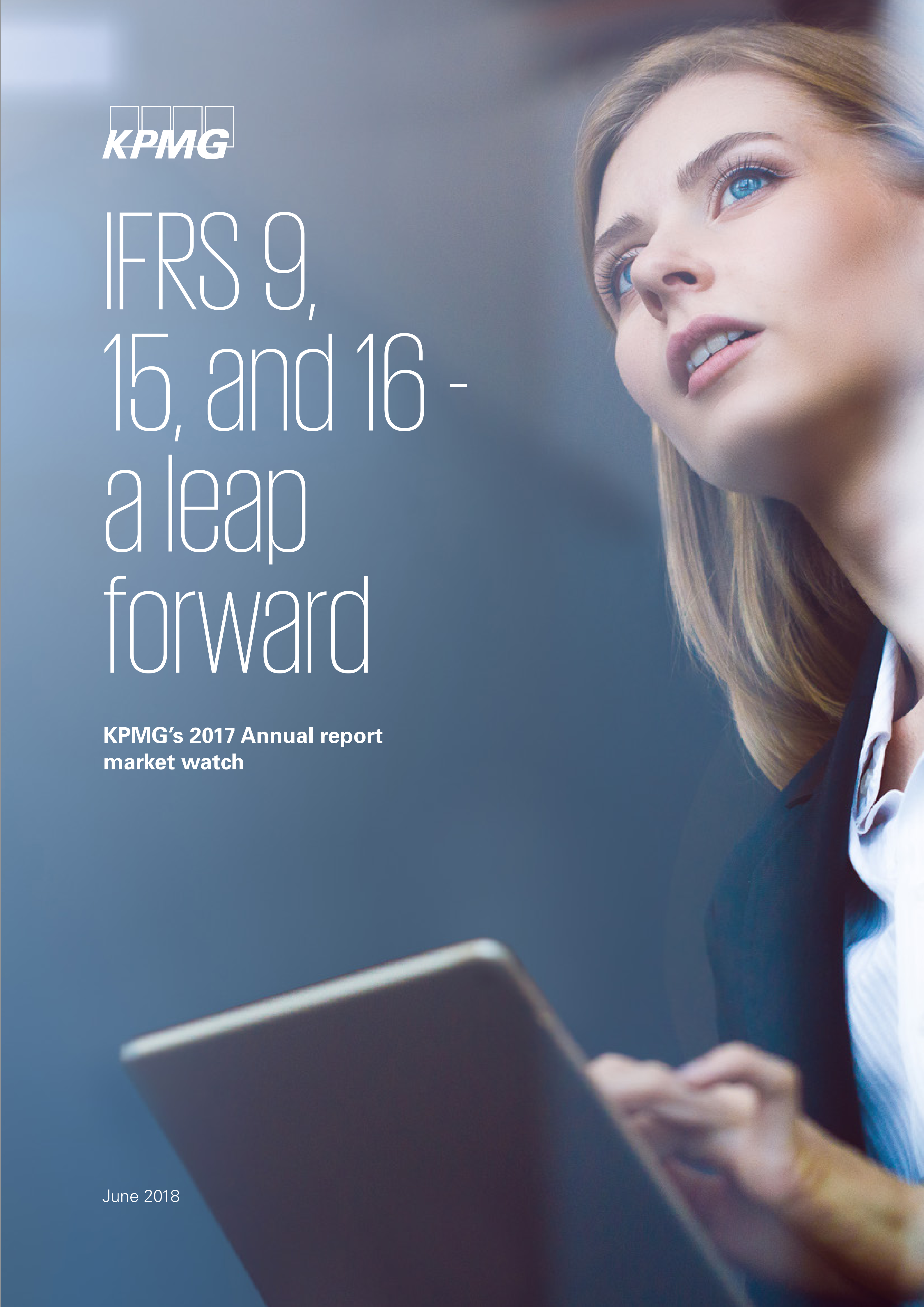


IFRS 9, 15, and 16 - a leap forward

KPMG's 2017 Annual report market watch

June 2018

IFRS 9, 15, and 16 - a leap forward

Introduction
With the introduction of IFRS 15 *Revenue from Contracts with Customers* (effective 1 January 2018), IFRS 9 *Financial Instruments* (effective 1 January 2018), and IFRS 16 *Leases* (effective 1 January 2019), IFRS reporters currently face a tide of change.

Ahead of the adoption dates of these new standards, the European Securities and Markets Authority (ESMA)[1] published its expectations with regards to the level of detail in companies' transition disclosures as required by IAS 8.

In this market watch publication, we have analysed the transition disclosures in the 2017 annual reports of 75 Dutch listed companies and summarised our key observations on the disclosure details, expected impact, and transition approach.

The review has prompted our thoughts on key items for reporters to consider for 2018 reporting and beyond. (refer to "things to consider").

Sample populations
The IFRS 15 and 16 analysis covers the 2017 annual reports of the top 75 Dutch listed companies[2].

The IFRS 9 analysis focuses on corporate entities only. The impact on financial institutions is far greater and demands its own separate review. We have therefore excluded such entities from this analysis[3]. This has resulted in a sample size of 55 entities for IFRS 9.

The analysis for each standard is presented separately.

IFRS 9: hedge accounting options available!

The following observations regarding IFRS 9 have followed from a review of the 2017 annual reports of 55 Dutch listed corporates:

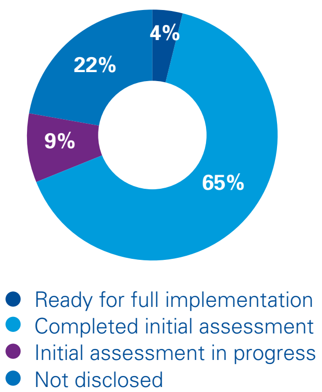
Stage of transition project

- 2 companies (4%) indicated they are ready for full implementation of IFRS 9 as at the 2017 year-end.
- 36 companies (65%) indicated that their initial impact assessment is complete.
- A further 5 companies (9%) explained that their IFRS 9 impact assessment is still in progress, and
- The remaining 12 companies (22%) did not explicitly comment on the progress of the project.

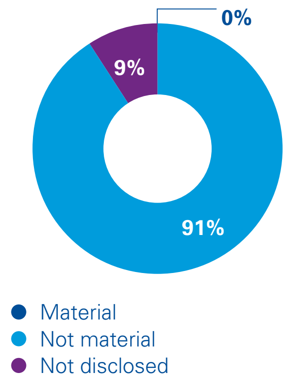
Expected impact

- 50 companies (91%) stated that the impact of IFRS 9 will be immaterial.
- The remaining 5 companies (9%) did not explicitly qualify the significance of the IFRS 9 impact.

Stage of transition project IFRS 9



Expected impact IFRS 9



[1] In October 2017 ESMA published its Public Statement on the European common enforcement priorities for 2017 IFRS financial statements that 2017 annual reports would contain specific quantitative and qualitative disclosures regarding the new standards to be adopted in the following period (https://www.esma.europa.eu)
[2] Companies included in AEX, AMX and AScX-indices. One company early adopted IFRS 15 and is therefore excluded from the IFRS 15 analysis.
[3] For an analysis of IFRS 9 impact on financial institutions, we refer readers to the KPMG Real-time IFRS 9 web page.

Type of disclosure

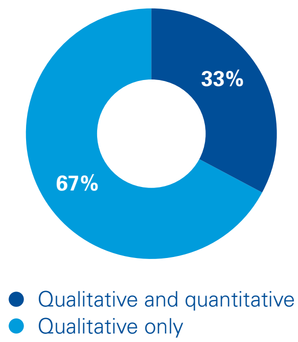
- All companies provided qualitative disclosures on the impact of IFRS 9.
- 18 companies (33%) also disclosed the expected quantitative impact of the transition. This corresponds with the fact that for the vast majority of corporate entities the impact of IFRS 9 is immaterial.
- The quantitative impacts that were disclosed related mainly to the impact of the new Expected Credit Loss impairment methodology. These disclosed impacts had a negligible impact on equity. This is expected given the stable credit environment we are currently in.

Transition approach

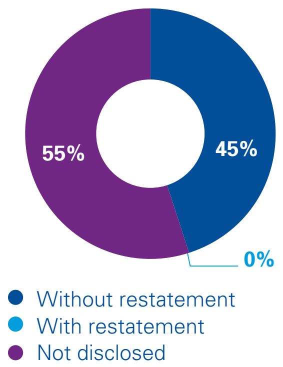
- 25 companies (45%) have chosen to make use of the available practical expedient to not restate the comparative period.
- The remaining 30 companies (55%) did not comment on the transition approach.

In summary the review shows that for the vast majority of Dutch listed corporate companies the impact of IFRS 9 is relatively minor. Nevertheless, there are still things to consider.

Type of disclosure IFRS 9



Transition approach IFRS 9



Things to consider

1

Hedge accounting
IFRS 9 offers additional hedge accounting options for corporates in comparison to IAS 39. Such opportunities include hedging of risk components of non-financial items and hedging of aggregate exposures. The "cost of hedging" method also reduces P&L volatility further. Effectiveness testing under IFRS 9 is required only on a prospective basis and includes a qualitative assessment of economic relationships instead of the 80%-125% rule.

Our review of the annual reports highlighted that only 20 companies (36%) have chosen to adopt IFRS 9 for hedge accounting on transition[4]. The remaining 35 companies (64%) plan to defer the adoption of hedge accounting under IFRS 9 or did not provide disclosures on this topic. Given the benefits and new options provided by IFRS 9 in the area of hedge accounting, this may be a topic for additional considerations for corporate companies.

2

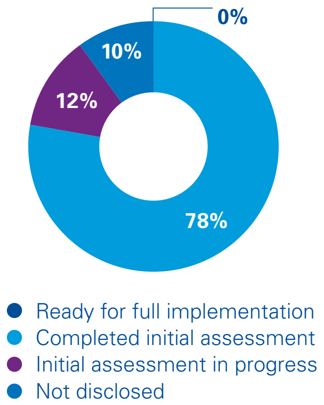
Disclosures
IFRS 9 expands the disclosure requirements for all companies. The additional information required will of course depend on the relevance of the different requirements for each individual company. It is important to assess the additional disclosures rules fully. Changes to data-gathering processes, IT systems and controls are likely to be required. It is also important to note that the new hedge accounting disclosures in IFRS 7 may not be deferred even if an entity continues to apply the IAS 39 hedge accounting model.

[4] A deferral of applying IFRS 9 hedge accounting is available until the standard resulting from the IASB's project on accounting for dynamic risk management is completed.

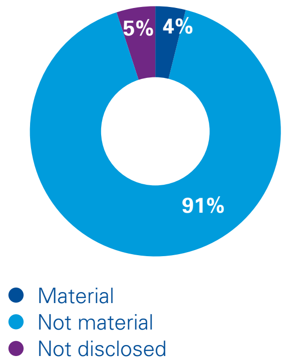
IFRS 15: we are not yet there!

Last year's 2016 Annual report market watch[5] revealed that the majority of the companies listed in the Netherlands were still assessing the impact of IFRS 15 or had not commenced implementation. Studying the 2017 annual reports resulted in the following observations:

Stage of transition project IFRS 15



Expected impact IFRS 15



Stage of transition project

- Our review found that 58 companies (78%) indicated that their initial impact assessment is complete.
- A further 9 companies (12%) indicated that their IFRS 15 impact assessment is still in progress.
- The remaining 7 companies (10%) did not disclose the stage of their IFRS 15 transition project.

Expected impact

- Only 3 companies (4%) disclosed that the implementation of IFRS 15 will have a material impact on the financial statements. Software licensing and telecommunications are the revenue streams driving these material impacts.
- A large majority (91% or 67 companies) have indicated the new standard will not have a material impact on their financial statements.
- The remaining 4 companies (5%) have not disclosed the impact of IFRS 15.
- We understand that a small number of companies are continuing to work through the implications of all areas of the standard and consequently were unable to include a reasonable estimate of the financial impact in their 2017 transition disclosures.

[5] KPMG: IFRS 15 Revenue recognition – A (final) call to action

Type of disclosure

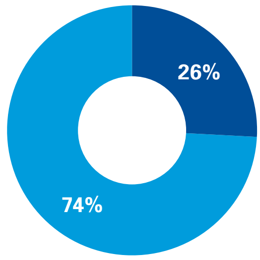
- All companies provided qualitative information on the impact of IFRS 15.
- 19 companies (26%) included a quantitative disclosure of the expected financial effect on results and the statement of financial position.
- The remaining 55 companies (74%) relied solely on the qualitative disclosure to inform readers of the expected impact of IFRS 15.
- Often the qualitative disclosure explains that the initial effect is expected to be immaterial and that IFRS 15 will not have a significant impact on revenue recognition compared to the current accounting policy.

Transition approach

- With regards to the transition approach 26 companies (35%) indicated that they have opted for the cumulative effect method.
- A further 22 companies (30%) have chosen the full retrospective approach.
- The remaining 26 companies (35%) did not disclose whether they would opt for the cumulative effect method or the full retrospective method.
- The choice of transition option will depend on each companies' unique set of circumstances. The cumulative effect method involves no restatement of the comparative period but does require dual reporting under both the outgoing standards and IFRS 15 in the year of adoption. The retrospective method does involve restating the comparative period but in turn does not require dual reporting. Each company therefore faces a level of trade-off between effort and comparability.

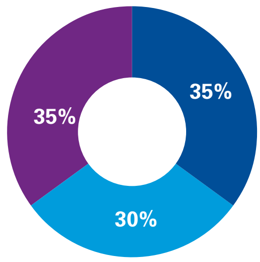
In summary the review shows that the impact of IFRS 15 is expected to be immaterial for the vast majority of Dutch listed companies. Despite this there are some items which are worth considering no matter how minor the impact.

Type of disclosure IFRS 15



- Qualitative and quantitative
- Qualitative only

Transition approach IFRS 15



- Cumulative effect approach
- Retrospective (full or modified)
- Not disclosed

Things to consider

1

New disclosure requirements
IFRS 15 introduces new qualitative and quantitative disclosure requirements. The aim of the new disclosure is to enable financial statement users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. No matter how minor the impact of IFRS 15, the requirement to build the new disclosures remains. We would encourage all reporters to ensure sufficient time is allocated in the coming months to consider this topic. To meet these new disclosure requirements will require an increase in efforts.

2

Systems
Aligned to the new disclosure, companies need to assess whether their current systems and processes are capable of capturing, tracking, aggregating and reporting information to meet the new disclosure requirements in an efficient manner. This may require significant changes to the existing data-gathering processes and cause companies to reassess their IT system capabilities.

3

Embedding new processes
Companies may wish to embed the new accounting rules which IFRS 15 introduces beyond the finance function. For example, bid or sales teams can benefit from the knowledge when negotiating new contracts. It is important to create momentum and bring all internal stakeholders on board. For large companies with a decentralized structure and multiple operating companies, managing this process can require extra effort, especially when IFRS knowledge is organised centrally at group level.

IFRS 16: what has been disclosed so far?

The review of the 2017 annual reports resulted in the following observations regarding IFRS 16:

Status of impact assessment

- 15 companies (20%) have indicated that they have completed a detailed assessment of the impact of IFRS 16, of which 5 are early adopters who will adopt IFRS 16 in 2018 alongside IFRS 15 and IFRS 9.
- A further 23 companies (31%) have stated that they have conducted an initial impact assessment and are planning to conclude their detailed assessment in 2018.
- The remaining 37 companies (49%) have disclosed the assessment phase to be in progress or did not include any specific disclosure on the status of their IFRS 16 projects.
- These results agree with what we are seeing in the market: there are a handful of front-runners, with the majority of companies at the beginning or in the midst of their transition project.

Expected impact

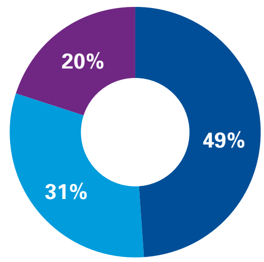
- 20 companies (27%) have indicated that the effect of IFRS 16 is likely to be material, while 11 companies (15%) anticipate the effect of IFRS 16 to be immaterial.
- The companies that indicated the impact will be immaterial are mainly from the financial services sector, and hence are businesses with small operating lease (lessee) portfolios relative to their balance sheet.
- The majority of the companies (44 companies or 58%) did not disclose the expected impact. We understand many companies are reluctant to quantify the impact of IFRS 16 as it will depend on the characteristics and size of the lease portfolio on transition date. As the transition date approaches we expect the impact will become increasingly clear.

Transition approach

- In total 47 companies (63%) have not disclosed their transition method to IFRS 16. Based on the status of IFRS 16 implementation projects, this proportion is not surprising, as we expect the detailed impact assessment to influence the transition method decision.
- Those companies that did disclose their transition approach are overwhelmingly choosing the modified retrospective approach (29%) instead of the full retrospective approach (8%). This is understandable given the additional practical expedients on offer and the simplified nature of the modified retrospective approach.
- From the 22 companies (29%) which have disclosed they will use the modified retrospective approach, only 3 companies have already confirmed they will calculate the RoU (Right of Use) asset as equal to the lease liability (modified retrospective -option 2). This option is available on an asset by asset basis, so it is interesting to note that these 3 companies appear to have ruled out the alternative option of measuring any RoU assets retrospectively (modified retrospective – option 1).

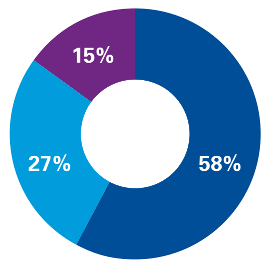
In summary, our analysis shows that whilst Dutch listed companies are making progress with their IFRS 16 implementation projects there is still much to do in the upcoming months to be ready for transition.

Stage of transition project IFRS 16



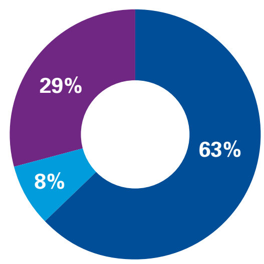
- In progress
- Initial assessment completed
- Detailed assessment completed

Expected impact IFRS 16



- Not disclosed
- Material
- Not material

Transition approach IFRS 16



- Not disclosed
- Full retroscpective
- Modified retroscpective

Things to consider

1

Transition approach and practical expedients

IFRS 16 offers a number of practical expedients under the modified retrospective transition approach. The standard also offers reporters ongoing elections to simplify the accounting process. It is highly recommended that the decisions regarding these expedients and elections are made as early as possible. Items such as the decision to combine lease and non-lease components (which can be selected by asset class), can have a significant impact on the data collection process and the design of the future accounting process.

2

Discount rates

IFRS 16 requires application of the implicit discount rate in a lease when it is "readily available". In the event the implicit rate is not "readily available" the lessee applies the incremental borrowing rate. Under the modified retrospective approach the standard mandates the use of the incremental borrowing rates on transition. IFRS 16 requires that incremental borrowing rates reflect factors such as the credit risk of the lessee, the term of the lease, the economic environment, and specific risks associated with the lease asset. Determining an asset-specific discount rate is a challenge. We note that companies are developing models to calculate the discount rates alongside a process to update these rates periodically. The development of these models can be complex and is highly dependent upon the company's lease portfolio.

3

Data extraction

Collecting the initial lease data requires dedicated resources. The required data points are often captured in multiple sources, such as the original contract, contract addenda, invoices, or other correspondence. Lease administration systems or contract management systems may already hold some of this data, but in our experience it is rare for all the data points to be available in a single location. Rent review decisions or CPI increases may only be located in emails or via invoicing. Decisions on the reasonably certain lease term may need to be set and recorded. Collating an IFRS 16 data set, therefore, requires coordinating inputs from multiple parties. A structured approach is advised in order to collect the data in a consistent and timely manner.

4

IT systems – Excel versus dedicated lease software

The added complexity to generate journal entries under IFRS 16, which standard ERP systems are not capable of, means that many companies are choosing to implement dedicated lease accounting software or an add-on to their existing ERP system. The option of using Excel remains attractive for many companies. However, in our view this would only be recommended for companies with a very small number of leases and few anticipated changes in their portfolio. With the transition date fast approaching, standalone tools with minimal integration offer the lowest implementation effort.

5

Processes and judgements

IFRS 16 brings a whole new set of judgements and accounting. A new end-to-end process is required, reaching from the identification of new lease contracts through to the determination of discount rates and the reconciliation between the actual lease payments and the IFRS 16 depreciation and interest charges. Given the impact new leases and lease modifications can have on the financial statements and related KPIs, new controls and safeguards are required. To support a smooth transition it is recommended to design the new process in detail and ensure all the involved parties are engaged and aware of the role they will need to play.

Conclusion

IFRS 9, 15 and 16 represent significant change in financial reporting.

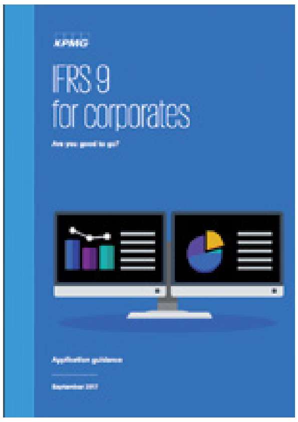
The review of the 2017 annual reports shows that although many reporters have fulfilled ESMA's expectation of providing specific quantitative and qualitative information on the forthcoming standards in the period immediately prior to their adoption, there are outstanding items to be considered in the coming months.

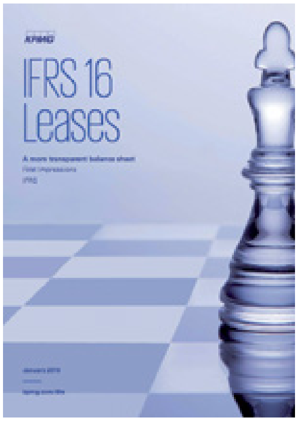
For IFRS 9 and 15 we are entering the final stretch: companies must be ready to report under these standards in their 2018 (interim) financial statements.

In the case of IFRS 16, reporters may have one additional year (assuming no early adoption) for full implementation, but the expected impact will have to be disclosed in the 2018 annual report to meet the IAS 8 disclosure requirements on new standards.

Our "things to consider" for each standard highlight some key topics which reporters should take into account. These lists are, of course, non-exhaustive and the relevance of each topic will differ according to the nature of each reporter, but like any financial reporting implementation, one thing remains constant: the clock is ticking and there's work to do!

Sources





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