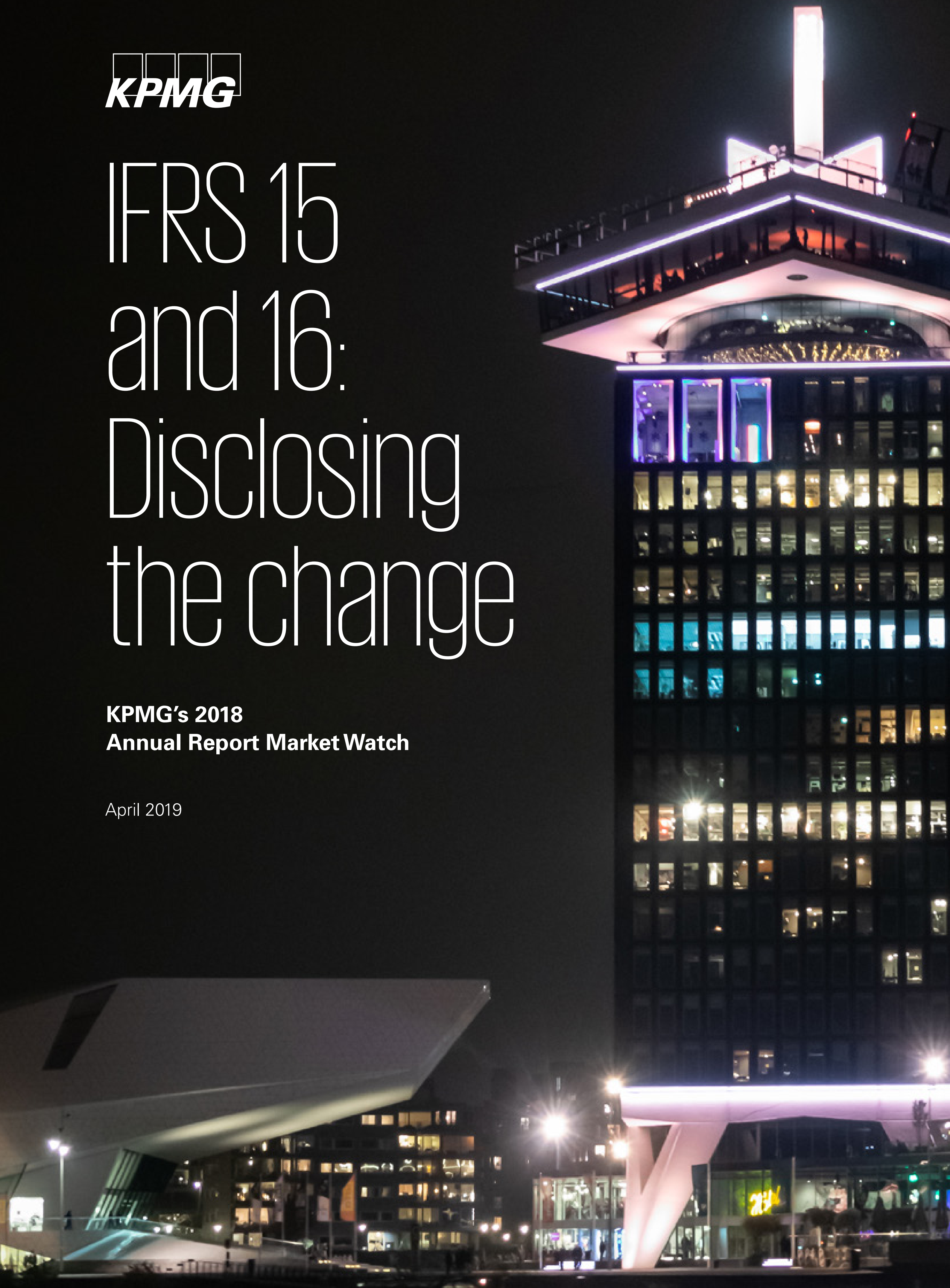


KPMG

IFRS 15 and 16: Disclosing the change

KPMG's 2018 Annual Report Market Watch

April 2019

IFRS 15 and 16: Disclosing the change

Introduction

IFRS 15 *Revenue from Contracts with Customers* came into effect on 1 January 2018, and with IFRS 16 *Leases* effective on 1 January 2019 the impact of these new standards is increasingly measurable.

This market watch publication analyzes the presentation of IFRS 15 and the disclosures for IFRS 16 as shown in the 2018 annual reports of 75 Dutch listed companies[1 2]. We consider how the standards have been implemented or (for non-early adopters of IFRS 16) are anticipated to be implemented: transition choices, practical expedients and recognition exemptions, and how the standards will affect presentation and amounts on the balance sheet.

Sample populations

At the time the research was conducted, 69 of the 75 listed Dutch companies on AEX, AMX, and AScX had issued their 2018 annual reports. Currently, we have noted 8 companies that are listed in the Netherlands that opted to early adopt IFRS 16. The early adopters are: ASML Holding, RELX, Air France-KLM, SBM Offshore, TomTom, WDP, Kiadis, and Kendrion[3]. In total, 62 companies were considered for the non-early-adopter IFRS 16 analysis.

In this publication, we have presented the analysis by standard.

IFRS 15: First year application - What have companies disclosed?

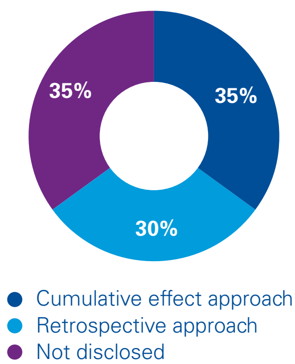
As of 1 January 2018, the new standard on revenue recognition (IFRS 15) became effective. Our 2017 Annual Report Market Watch[4] revealed that, for the majority of the listed companies, the impact of IFRS 15 was not expected to be material. Studying the IFRS 15 disclosures in the 2018 annual reports resulted in the following observations.

Transition approach

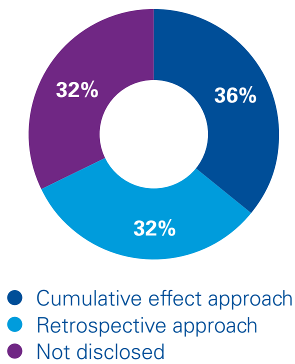
The actual transition approach has not changed significantly compared to the announcements made in the 2017 financial statements.

- While IFRS 15 requires entities to disclose the applied transition approach, 22 companies (32%) have not disclosed this information. These entities mentioned that the impact of IFRS 15 is considered immaterial.
- The companies that used the cumulative effect method, 25 companies (36%), did not restate comparative period amounts, in line with the transition requirements of IFRS 15. Instead they recorded the cumulative effect as an adjustment to the opening balance in equity at the date of initial application.
- The companies using the retrospective method, 22 companies (32%), restated each period before the date of initial application presented in the financial statements and recognized the cumulative effect in equity at the start of the earliest comparative period presented.

Transition approach 2017



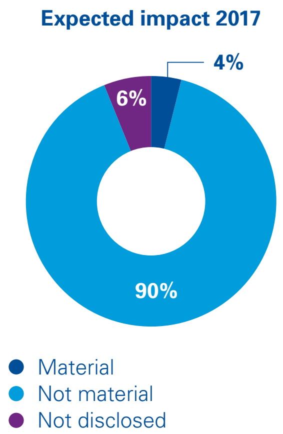
Transition approach 2018

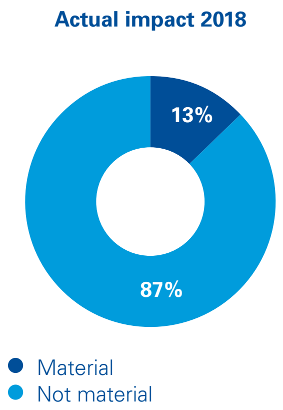


[1] Companies included in AEX, AMX and AScX-indices. At the time of the study 6 annual reports were not yet available. In total 69 annual reports were investigated for IFRS 15.
[2] IFRS 9 has not been considered in this year's Annual Report Market Watch.
[3] Kiadis had not yet issued its financial statements at the date of the analysis, however it was included in the early-adopter analysis using the disclosures from its 2018 Q2 interim report.
[4] KPMG: IFRS 9, 15 and 16 – a leap forward

The impact of IFRS 15

The majority of companies included in the survey (87% or 59 companies) disclosed that the implementation of IFRS 15 has no significant impact on the financial statements. Only 9 companies (13%) disclosed that the implementation of IFRS 15 is material. We noted that companies for which the impact is material operate in the telecommunication, technology, health care and construction industry. The increased number of companies disclosing a material impact of IFRS 15 is mainly driven by the fact that last year some companies were still assessing the impact of IFRS 15.

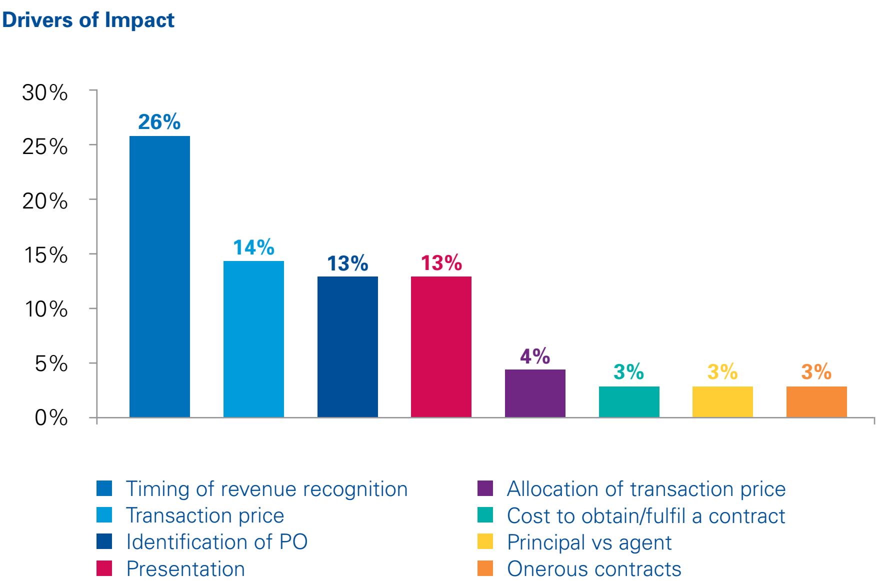




Drivers of Impact

The most significant disclosed drivers explaining the impact of IFRS 15 are:

- timing of revenue recognition (26% or 18 companies): a change in the timing of revenue recognition from being at a point in time to over time or vice versa, resulting from criteria of IFRS 15.35 and new license guidance;
- the determination and allocation of the transaction price to the identified performance obligations (14% or 10 companies): variable consideration, such as discounts and rebates;
- the identification of performance obligations (13% or 9 companies): the recognition of separate performance obligations that previously were not taken into consideration as separate performance obligations, such as unbundled goods and services, shipping activities and service-type warranties;
- presentation and enhanced disclosures (13% or 9 companies): IFRS 15 impacted the presentation of financial statements, such as introducing contract assets and contract liabilities, and the quality/ quantity of the disclosures.



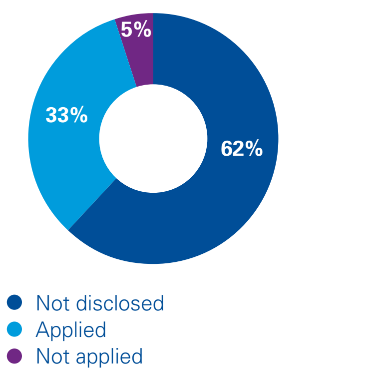
Practical expedients

The new standard gives the opportunity to companies, based on the transition approach chosen, to elect the use of certain practical expedients. Some facts: 3 of the companies (5%) disclosed that they will not apply any practical expedients, 43 companies (62%) did not disclose this information and 23 companies made use of one or more practical expedients. From the 23 companies that applied the practical expedients, 13 companies applied the retrospective approach, 9 applied the cumulative effect approach and 1 company did not disclose which approach it applied.

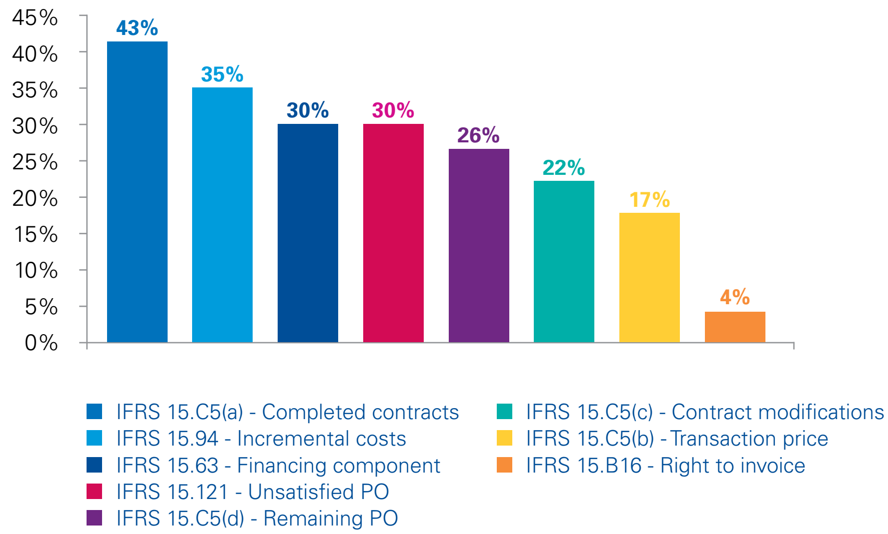
The most-used practical expedients were:

- IFRS 15.C5(a): companies have chosen not to restate contracts that are completed contracts at the beginning of the earliest period presented.
- IFRS 15.94: companies did not capitalize incremental costs to obtain a contract if the amortization period for the asset is one year or less.
- IFRS 15.63: companies did not adjust the transaction price for the effects of a significant financing component if, at contract inception, the entity expects that the period between customer payments and the transfer of the goods or services is one year or less.

Practical expedients



Practical expedients applied

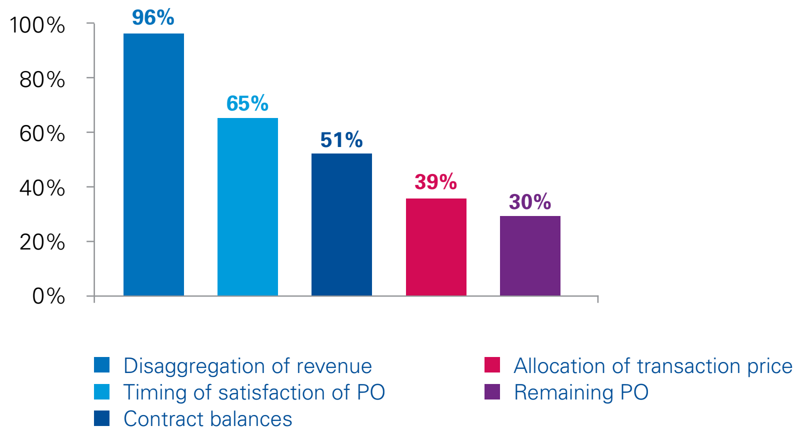


Disclosures

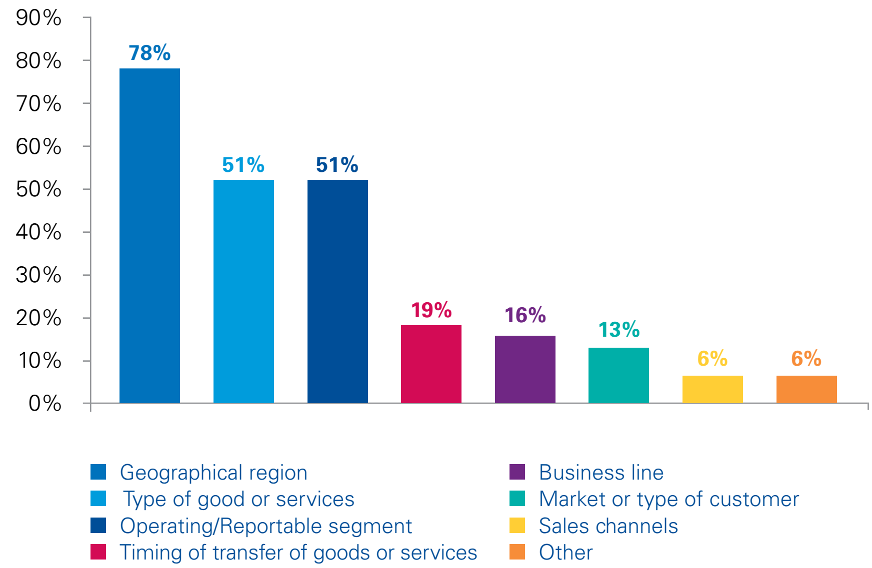
IFRS 15 introduces new qualitative and quantitative disclosure requirements. The aim of the new disclosure requirements is to enable financial statement users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. We analyzed the new revenue disclosure and noted that:

- 66 companies (96%) have disclosed disaggregation of revenue, either as part of the revenue disclosure or as part of the IFRS 8 segment reporting disclosure. We observed that companies disaggregated revenue mainly by geographical region (54 companies, 78%), by type of goods or services (35 companies, 51%) or by operating or reportable segment (35 companies, 51%).
- 45 companies (65%) disclosed whether they recognize revenue over time or at a point in time.
- Disclosures for other requirements, such as the transaction price allocated to the remaining performance obligations in a contract, opening and closing balances of contract assets and liabilities and detailed disclosure on the timing and amounts allocated to (unsatisfied) performance obligations, were limited.

Disclosures



Disaggregation of revenue



Things to consider

1 In general, the extent of the disclosures under IFRS 15 has increased compared to last year, when IAS 18 and IAS 11 were still applicable. This is also what we would expect as IFRS 15 requires new and more disclosure notes compared to the previous standards. However, we also noticed that not all information that may be required under IFRS 15 has been separately disclosed by all companies, such as how the transaction price and the amounts allocated to performance obligations are determined. Limited disclosures are mainly observed in those financial statements of companies where the introduction of IFRS 15 had a limited financial impact. Overall, we believe that there is room for improvement in the quantity and therefore also the quality of IFRS 15 disclosures.

2 IFRS 15 is a complex and comprehensive accounting standard, with much more prescriptive guidance and disclosure note requirements. Companies need to assess how applying the new standard will affect current and new contracts, as commercial business models are consistently changing. In particular, due to the complexity of IFRS 15, companies need to take into consideration that the new standard may deviate from current accounting treatment and further analysis may be needed for topics such as identifying a contract and its performance obligations, determining the stand-alone selling prices, when to recognize revenue, licenses and principal vs agent. In addition, IFRS 15 is a residual standard, and a part of a contract could be in scope of another standard, such as IFRS 16 *Leases*.

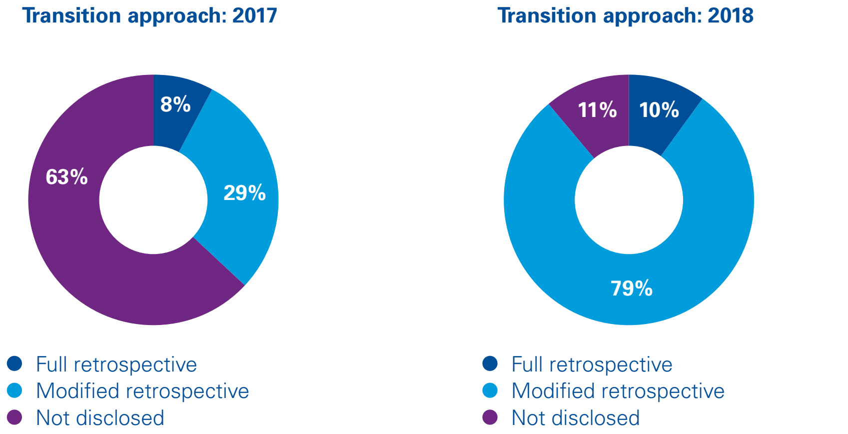
3 We encourage companies to continuously assess the impact of IFRS 15, as more experience is gained in applying the standard. The new standard remains a focus point for regulators and companies should stay alert for findings from the regulators and see if they are applicable to them.

IFRS 16: Are companies ready for implementation?

IFRS 16 Leases is effective from 1 January 2019, and while more than half of the companies analyzed in the 2017 Annual Report Market Watch identified that the expected impact would be material, nearly two-thirds had not yet disclosed their transition approach at that time. This year, the transition projects have progressed further, with most companies disclosing their transition approach and quantifying the impact, and many sharing details of their expected implementation including the application of practical expedients. We also looked into 8 companies who early-adopted IFRS 16 in 2018 to understand their implementation choices.

Transition approach

- 10% of companies reported in 2018 that they are applying the full retrospective approach, compared to the 8% reporting this in 2017. One company that had announced in 2017 that the modified retrospective approach would be used changed this to the full retrospective approach in their 2018 annual report.
- 79% of companies disclosed that they are adopting the standard using the modified retrospective approach in 2018, compared to 29% disclosing this in 2017, which indicates that the majority of the companies decided last year on the transition method to be applied. 11% have not disclosed their transition approach in 2018.
- Of those that are using the modified retrospective approach, none indicated explicitly that they will re-measure the right-of-use asset for all leases, although 6% disclosed that they will use a combination of the re-measurement option and the option to set the right-of-use asset at an amount equal to the lease liability adjusted for prepayments and accruals on transition.
- 41% of those using the modified retrospective approach explicitly stated that they will use the option to set the right-of-use asset at an amount equal to the lease liability on transition, with 53% not disclosing which asset measurement option will be used.



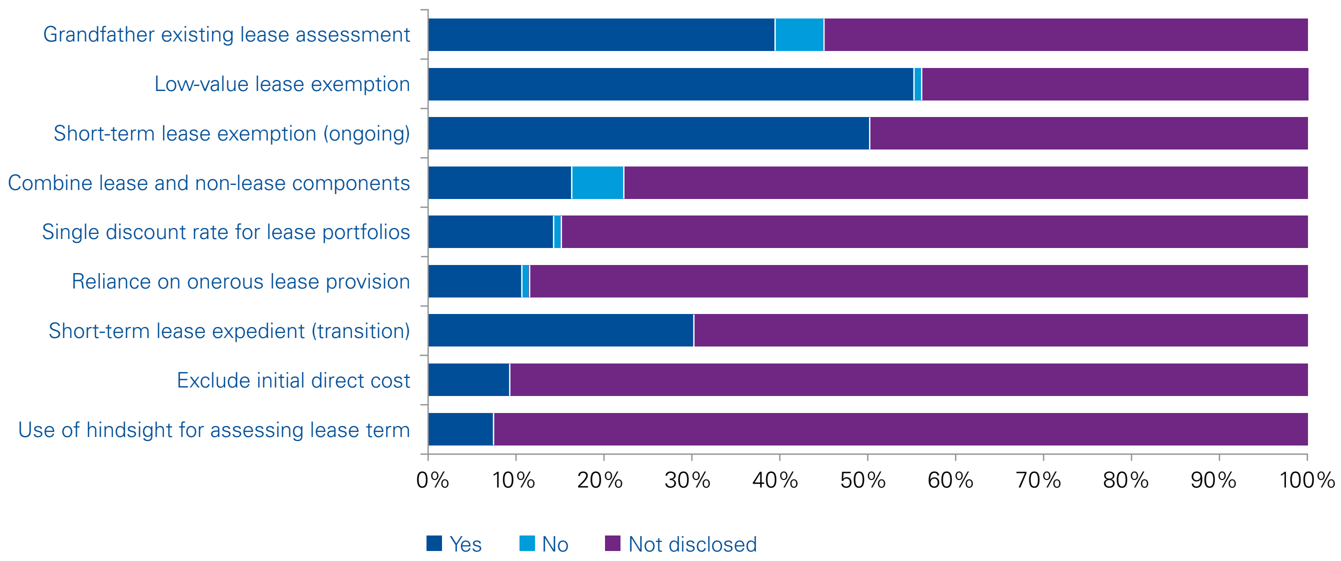
How do they compare to early adopters?

- In the early-adopter group, 50% applied the full retrospective transition method.
- For non-early adopters, the modified retrospective approach is more popular than the full retrospective transition method.

Practical expedients

- The majority of companies did not disclose what practical expedients they plan to apply.
- 39% indicated that they will use the practical expedient to grandfather their lease assessments, while 56% did not disclose whether this practical expedient would be used. The remaining 5% indicated that they will not grandfather their lease definitions.
- More than half of companies (55%) intend not to recognize low-value leases, with only 1 company identifying that it will not use the low-value lease recognition exemption.
- With regard to the short-term exemption, there are separate options on transition and for ongoing accounting.
- 50% of companies indicated that they will use the short-term lease exemption on an ongoing basis, while 30% indicated that they will use the practical expedient for short-term leases on transition.
- 11 companies (18%) explicitly identified that they will use both the option to exempt leases ending within 12 months on transition, and use the short-term lease exemption on an ongoing basis.
- 45% of companies disclosed that they will use both the short-term and the low-value lease exemptions.
- Only 16% of companies disclosed that they will elect to combine lease and non-lease components for one or more asset classes, with 6% identifying that they will separate lease and non-lease components for all leases.
- While most companies (85%) did not disclose whether or not they will apply a single discount rate to similar assets, 13% indicated that they will use the portfolio approach for the discount rate.
- 11% of companies disclosed that they will rely on their current provision for onerous leases rather than perform an impairment test on the transition to IFRS 16.
- 8% of companies disclosed they will use the practical expedient to exclude initial direct costs from the measurement of the right-of-use asset.
- 6% of companies disclosed they intend to use the expedient to use hindsight in assessing the lease term.

Practical expedients applied



While most companies disclosed the transition method applied for IFRS 16, the level of detail varied in disclosing transition details such as which practical expedients are applied. Many companies disclosed some but not all recognition exemptions or practical expedients and provided limited detail of the accounting policy choices.

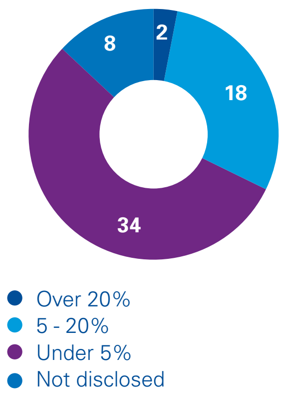
How do they compare to early adopters?

- The practical expedient to grandfather the lease definition upon transition from IAS 17 to IFRS 16 is available under both the full retrospective and the modified retrospective transition approach. Of the early adopters, 50% will grandfather their lease definitions. The remaining 50% did not disclose whether or not they will reassess their lease definitions.
- 75% of early adopters elected to apply the practical expedient to exclude short-term and low-value leases from their IFRS 16 lease liability, with the remaining 25% opting not to apply this practical expedient.
- As with the main group, most of the early adopters did not disclose whether or not they would separate lease and non-lease components. However, 25% expect to apply the option to combine lease and non-lease components, while only 13% stated that they would not use this option.

Quantification of expected impact

- 94% of companies quantified the estimated impact of IFRS 16 on their balance sheet. This is a significant increase compared to 2017 when only 47% quantified the estimated impact. We expect this increase is driven by the progress that companies have made in their IFRS 16 projects as well as the public statement issued by the ESMA and AFM on the priorities for 2018 annual financial reports. The remaining 6% identified that the impact would not be material to their financial statements without further quantification.
- Nearly three-fourths (74%) of companies quantified the impact as a single value, with 21% providing a range of the expected impact amounts. 5% of the companies described the impact as a percentage increase to assets or liabilities rather than describing this in absolute terms.
- 35% of companies disclosed the impact of IFRS 16 on their net profit figure. Of those, 23% indicated that there was no impact on the net result.

What is the percentage increase in total assets as at 1 January 2019?



- While 34 companies expected the impact on total assets to be under 5% compared to their 2018 total assets, 18 companies expect this to be between 5% and 20%, and 2 companies indicated the impact will be over 20%. The remaining 8 companies had not disclosed the impact.

Operating lease commitments

- The movement in total operating lease commitments from 2017 to 2018 was mixed, with 53% showing an increased amount of total operating leases disclosed (in some cases with the total operating lease commitment more than doubling from one year to the next), and 37% showing a decreased operating lease commitment. In their IFRS 16 disclosures, most companies identified that the increase in their total operating lease commitments from 2017 to 2018 is partially explained by additions of leases. 5% of companies had no change to the operating lease disclosure and 5% did not disclose any lease commitments in 2017.
- The operating lease commitment note can give an indication of the IFRS 16 lease liability, and movements in the total amount from 2017 to 2018 may be partially explained by new leases identified in implementing IFRS 16. However, movements may also be caused by extension options exercised, acquisitions, disposals, and other factors that are not disclosed.
- Nearly two-thirds (65%) have a higher total operating lease commitment disclosed at the end of 2018 as compared to the expected maximum lease liability that will be recognized on 1 January 2019. This is expected given that the lease liability is discounted to the present value, while the operating lease commitments are generally disclosed as gross amounts. Furthermore, many companies are opting for recognition exemptions and practical expedients, which will reduce their overall lease liability.
- Only 18% expect that their lease liability will be higher than their operating lease commitments, and some of these companies identified that the lease liability is higher due to the recognition of extension and renewal options when applying IFRS 16.

How are early adopters presenting their right-of-use assets and lease liabilities?

- While 50% of the early adopters are presenting their ROU assets as a separate financial statement caption in the balance sheet, the other 50% included the ROU asset within Property, Plant and Equipment. In these cases the note to Property, Plant and Equipment provides the required disclosures on the ROU asset.
- This is different from the presentation of the lease liability, with 5 early adopters (63%) showing the lease liability as a separate financial statement caption in the balance sheet, and 3 early adopters (38%) showing this within other debt.

Disclosure requirements: some complexities seen in practice

- As a result of IFRS 16 becoming effective, new and additional disclosure requirements are applicable.
- We note that in practice some of these disclosures are easier to generate for some companies than for others.
- Companies are expected to separately disclose: (1) expenses relating to short-term leases where the exemption was applied, unless the term is under one month; (2) expenses relating to low-value assets, excluding those which are also short-term; and (3) expenses relating to variable lease payments that are not included as part of the measurement of the total lease liability. This is illustrated in the below example[5] disclosure.

	Amounts recognised in profit or loss	
	In thousands of euro	2019
IFRS 16.53 (b)	Interest on lease liabilities	**(1,369)**
IFRS 16.53 (e)	Variable lease payments not included in the measurement of lease liabilities	**(1,700)**
IFRS 16.53 (f)	Income from sub-leasing right-of-use assets	**950**
IFRS 16.53 (c)	Expenses relating to short-term leases	**(1,470)**
IFRS 16.53 (d)	Expenses relating to leases of low-value assets, excluding short-term leases of low-value assets	**(750)**

	Amounts recognised in the statement of cash flows	
	In thousands of euro	2019
IFRS 16.53 (g)	Total cash outflow for leases	**(11,809)**

[5] Refer to the KPMG illustrative disclosures publication, IFRS 16 supplement for more details.

- In practice, not all the amounts are disclosed separately. Some companies disclose the expenses on short-term and low-value leases as one aggregated amount.
- In addition to these expenses, lessees should also disclose, by class of underlying asset: the depreciation charges, additions to right-of-use assets and the carrying amount at the end of the reporting period.
- Quantitative disclosures are also required for interest expenses on lease liabilities, income from subleasing, total cash outflow relating to leases, and gains or losses from sale-and-leaseback transactions.
- IFRS 16 also dictates that lessees should disclose quantitative and qualitative information about the nature of their leasing activities. In particular, lessees should disclose details about their potential exposure to additional cash outflows, such as those arising from the exercise of extension options that are not reasonably certain. An illustrative example of such disclosure is shown below.

Extension options[b]

Some leases of office buildings contain extension options exercisable by the Group up to one year before the end of the non-cancellable contract period. Where practicable, the Group seeks to include extensions options in new leases to provide operational flexibility. The extension options held are exercisable only by the Group and not by the lessors. The Group assesses at lease commencement whether it is reasonably certain to exercise the extension options. The Group reassesses whether it is reasonably certain to exercise the options if there is a significant event or significant change in circumstances within its control.

In thousands of euro	Lease Liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (discounted)	Historical rate of exercise of extension options
Office buildings	1,733	2,915	33%

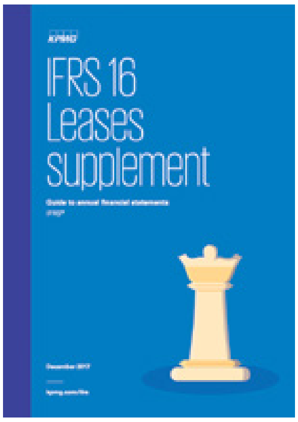
Additionally, lessees should provide information about: residual value guarantees, leases not yet commenced to which the lessee is committed, restrictions or covenants imposed by leases and sale-and-leaseback transactions.

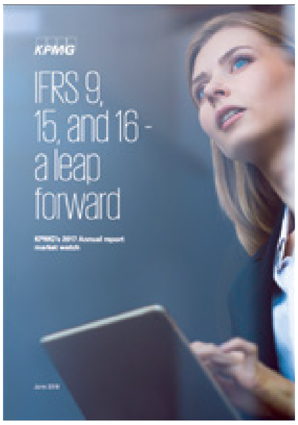
Conclusion

IFRS 15 is already effective, and many companies have clearly presented this change and the impact it has had for them. For these companies, it is easier to understand how the change is impacting their financial figures, and improves comparability between companies within the same sector. For those companies that have only provided limited disclosures of IFRS 15, it will be difficult to understand how the changes affect the way revenue is recognized.

For IFRS 16, the vast majority of companies have completed their impact assessments and disclosed the expected quantitative impact to their balance sheet. However, IFRS 16 is not just changing the numbers on the balance sheet: the income statements and cash flow statements and many KPIs and ratios will also be affected. Furthermore, we see that many companies are implementing a lease accounting tool to capture the lease data and generate their IFRS 16 journal entries. Due to the significance of the change, companies should carefully consider how IFRS 16 will be disclosed on implementation, so that the users of financial statements are able to clearly understand the impact of the new standard.

Sources





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