

# Beyond the GAAP

Mazars' newsletter on accounting standards

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## Editorial

After focusing on half-yearly reporting and on IFRS 15 and IFRS 9 in our last edition, this month's special study presents a Benchmark on disclosures by entities at 31 December 2017 on the future impact of IFRS 16. The level of information provided varies greatly, and, unsurprisingly, is on average rather limited. It is as well to remember that entities should expand these disclosures at 30 June 2018.

And to give its stakeholders some holiday reading, the IASB has just published a discussion document on the long-standing issue of the distinction between debt and equity. Evolution or revolution for IAS 32? Make up your own mind!

A happy summer to you all.

Edouard Fossat

Isabelle Grauer-Gaynor

# IFRS Highlights

## The IASB publishes its FICE discussion paper

On 25 June, the IASB published a discussion paper presenting its current thinking on the Financial Instruments with the Characteristics of Equity project (FICE). This project focuses on the distinction between debt and equity for financial instruments in the issuer's accounts. The discussion paper is open for comments until 7 January 2019, and this feedback will help the Board to decide whether it should publish an exposure draft to amend or replace IAS 32 and/or non-mandatory application guidance.

The IASB would like to address the growing number of financial instruments that combine the characteristics of debt and equity, which are sometimes difficult to account for under IAS 32. The hope is that this discussion paper will enable it to tackle these particular problems without amending the classification of the majority of other, less complex, instruments. Some key principles therefore remain unchanged, such as the exclusion of economic compulsion from the analysis of the classification.

The Board's preferred approach to classification depends on two new criteria:

- a timing feature: there is an unavoidable obligation to transfer economic resources at a specified time other than at liquidation;
- an amount feature: there is an obligation to transfer an amount independent of the entity's available economic resources.

A financial instrument with either of these two characteristics would be classified as a financial liability. Only instruments with neither characteristic are classified as equity.

A financial instrument only presenting the timing feature would be classified in debt but gains would be accounted for in other comprehensive income (OCI) rather than in profit or loss.

The discussion paper also presents the application of this approach to derivatives on own equity (including puts on non-controlling interests) and to compound instruments.

The IASB also offers some new avenues of thought with respect to the impact of these instruments on the statement of financial position and the statement of comprehensive income, along with new disclosures to be provided in the notes.

We will present this discussion paper in more detail in a future edition of Beyond the GAAP.

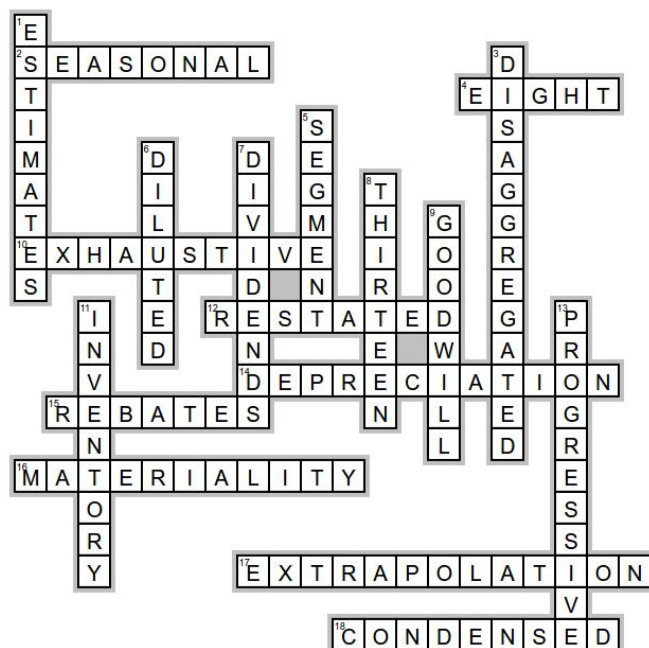
## The IFRS Foundation consults on trustee service length

On 25 June 2018 the IFRS Foundation launched a consultation with a view to enabling the Trustee Chair (recruited either from among the Trustees or externally) and its two Vice-Chairs (recruited from among the Trustees) to serve three three-year terms of office. This would enable the Foundation to benefit from continuity and the valuable experience gained whilst in office.

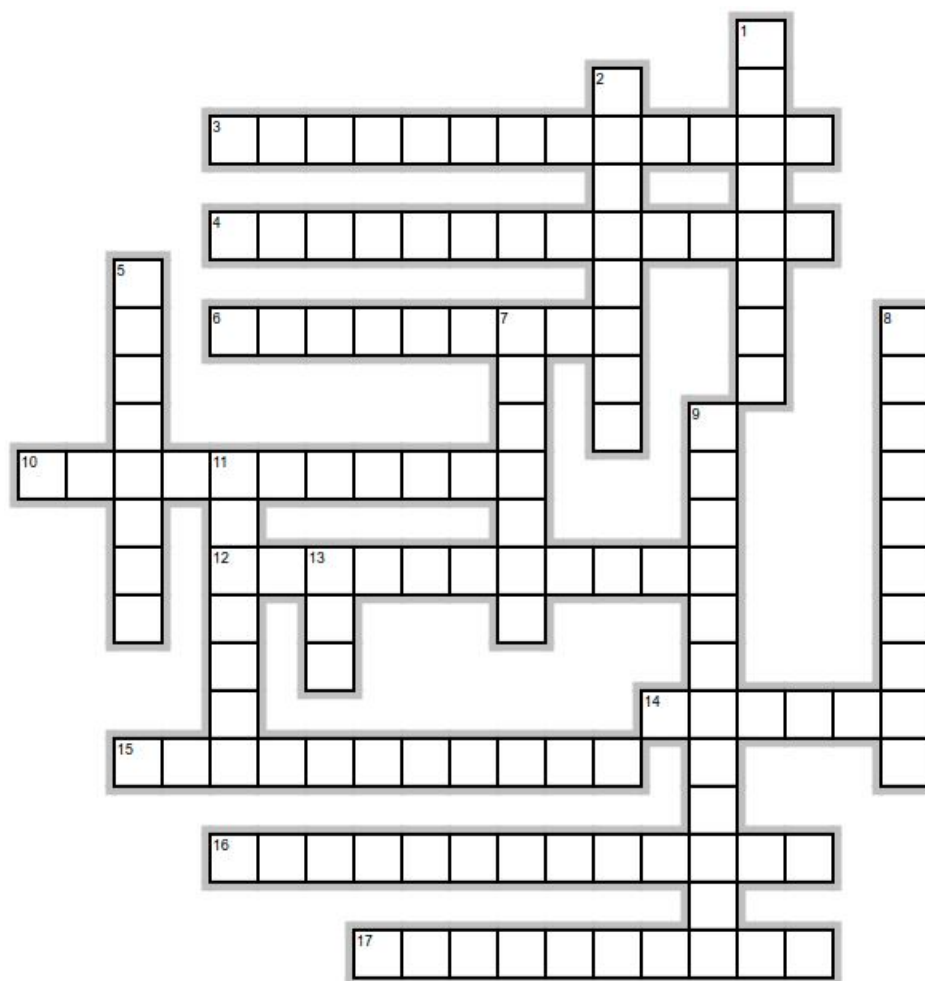
Another amendment aims to enable former Trustees who have completed their maximum term of office to be reappointed once only after a lapse of six years, for a term of three years, renewable only once.

The IFRS Foundation consultation is open until 19 September 2018 and is available at: <https://www.ifrs.org/-/media/project/amendments-to-the-terms-of-the-trustees-chair-and-vice-chairs/exposure-draft-amendments-to-the-terms-of-the-trustee-chair-and-vice-chairs.pdf?la=en&hash=AF81EC379B7E624D81B521BC57D62AA465795859>.

## Crossword: last month's solution



# Crossword: How well do you know IAS 37?



## Across

3. Such obligations often give rise to the recognition of a provision (especially in the oil industry)
4. It is not offset against a provision but, subject to certain conditions, it may be recognised as an asset
6. Their benefits are not within the scope of IAS 37
10. Only these costs are to be taken into account to assess the existence of a provision in the context of onerous contracts
12. Entities must resort to them to measure the provisions
14. IAS 37 does not allow the recognition of provisions relating to these operating losses
15. It is taken into account in the measurement of a provision if its effect is material
16. If an entity is not committed to it, it cannot give rise to a provision
17. As opposed to provisions, these liabilities are recognised only in the case of a business combination

## Down

1. These costs may not be included in a restructuring provision
2. When the obligation giving rise to a provision no longer exists, the provision must be this
5. A provision must be recognised for an obligation when a transfer of economic resources is this.
7. Resorting to them may be relevant in the assessment of the amount of a provision
8. When granted to customers, they may, depending on the context, give rise to a provision or to a performance obligation in accordance with IFRS 15
9. Obligation resulting from an entity's past practices and not from legal or contractual requirements
11. Such contracts give rise to a provision
13. The amount of a provision is determined before this effect

# A Closer Look

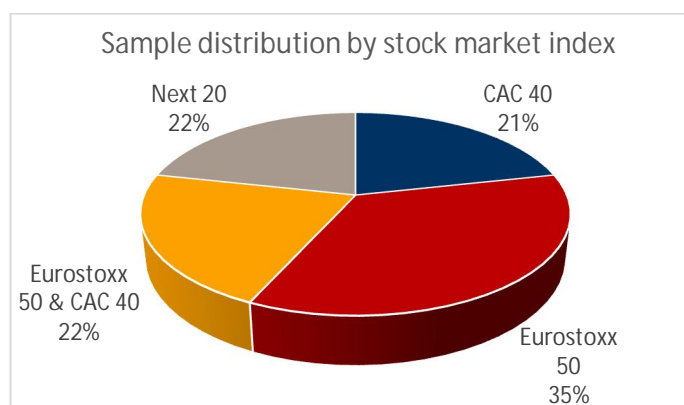
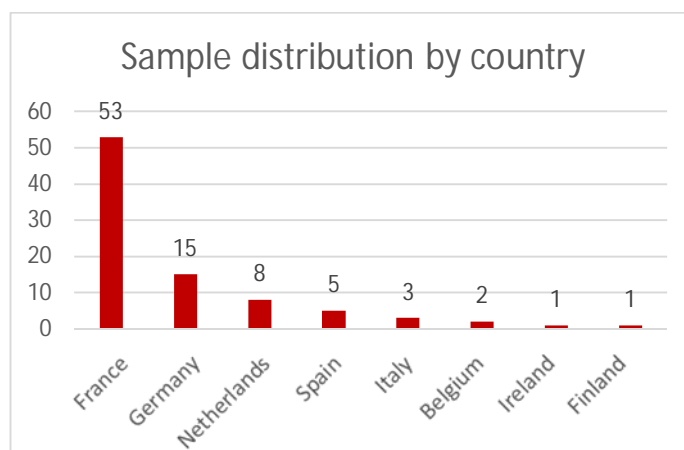
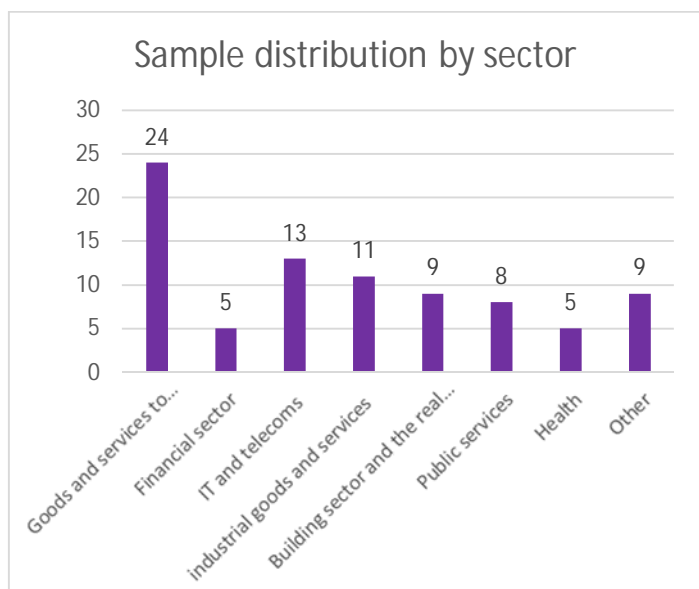
## IFRS 16: financial communication is still limited a year before its effective date

Just a year ahead of the mandatory effective date of IFRS 16 on leases, our study summarises the reporting in 2017 year-end financial statements on the progress towards implementation of this standard and its expected impacts..

### 1. The sample

The study used a sample of 88 European entities (two of which apply the US standard) in various sectors, including finance, with a reporting date at 31 December 2017.

This sample consists of CAC 40, EUROSTOXX 50 and Next 20 entities.



### 2. Main lessons

The level of detail and the quality of the information on the introduction of the new standard provided by entities in the sample are very diverse. They range from the bare minimum (mention of the effective date of IFRS 16 and of the launch of an implementation project) to a detailed analysis, passing through a more or less detailed description of the main general principles and the generic impacts of the standard.

However, despite this diversity, the great majority of entities provided rather scant financial information at the end of 2017 as to the implementation of the project and the expected impacts.

Consequently, the 2017 reporting in the sample remains insufficient to an overall appreciation of progress towards introducing the standard, the structuring accounting choices and those requiring judgment, or the expected impact of the standard on the financial statements of these entities.

## 2.1. IFRS 16 implementation projects are under way

Most of the entities in our sample report that implementation projects have been launched and will continue throughout 2018, generally merely mentioning the year in which the project began. Some also mention the departments involved, or whether preliminary analyses are complete.

Rarely do entities provide specific information about their progress towards the choice of an IT solution to be adopted with a view to IFRS 16 compliance.

*Just one of these companies says it has chosen the IT solution it will use in order to comply with the provisions of IFRS 16.*

## 2.2. Few entities have opted for early application of IFRS 16

Only three of the entities in our sample (AIR FRANCE – KLM, ASML and DEUTSCHE POST) clearly state that they have decided to apply IFRS 16 early, with effect from

1 January 2018. The information provided by these companies is as follows:

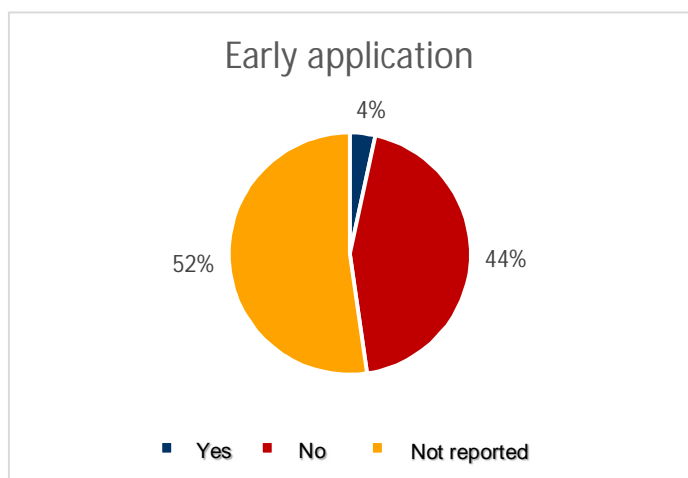
|   | AIR FRANCE:              | ASML                         | Deutsche Post                                 |
|---|--------------------------|------------------------------|---|
| Transition method                                     | Yes (full retrospective) | Yes (modified retrospective) | Yes (modified retrospective)                  |
| Transitional options                                  | N/A                      | No                           | Yes (valuation of right of use)               |
| Quantified impact on statements of financial position | Yes                      | No                           | Yes   |
| Impacts on cash flow statement (not quantified)       | Yes                      | No                           | Yes   |
| Impacts on performance indicators                     | Yes (direction)          | No                           | Yes (quantified for the debt to equity ratio) |
| Nature of leases and associated impacts               | Yes (not quantified)     | No                           | No  |
| Other impacts   | Yes (maintenance)        | No                           | No  |

44% of entities report that they will not apply IFRS 16 early, while the remaining companies in the sample (52%) do not state whether or not they will do so. However, the information reported by these entities suggests that most of them will apply the standard from its effective date.

## 2.3. Entities leave room for doubt as to the transition method to be used

IFRS 16 offers entities two transitional methods:

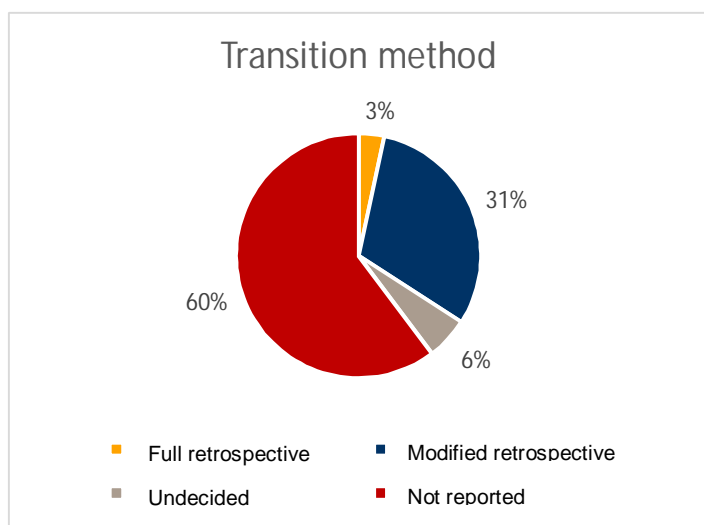
- The “full retrospective method”, which consists in restating past periods as if the new standard had always been applied. This method means that the restatement will entail adjusting the opening equity of the earliest comparative period presented (for implementation on 1 January 2019, this would be equity at 1 January 2018); and
- The “modified retrospective” method, which applies the new standard retrospectively from 1 January 2019, the cumulative impacts being adjusted in the opening equity of 2019. Under this method, the 2018 accounts are not restated. This method also offers a number of simplifications than can be used when determining the amounts to be recognised at 1 January 2019.



Hence, the transition method is one of the trickier aspects of the implementation of the new standard on leases, because of the impact of the chosen method not only at the transition date but also on subsequent financial years. There are also considerations regarding the efforts and resources that will be required.

The full retrospective method is much more burdensome and resource-heavy than the modified retrospective approach, which offers options and exemptions all of which may influence the amounts recognised in the financial statements and hence their comparability.

Only 34% of the entities in the sample report that they have chosen their transitional method, but of these, 90% have opted for the modified retrospective method.



#### 2.4. Qualitative disclosures are (almost) always generic

60% of the entities in the sample make no qualitative disclosures, or else report generic information on the broad principles of IFRS 16 (in particular the impacts of the standard on the presentation of the statement of financial position, the profit or loss accounts, the statement of cash flows, or even performance ratios in some cases).

Some entities (11%) have listed - generally without quantification - the classes of assets that are the subject of leases and which are consequently more likely to be impacted by the new standard. Few entities have provided a company-specific analysis of sensitive subjects such as lease terms, the variability of payments or the discount rate.

#### 2.5. Accounting exemptions and options: entities list the available opportunities

82% of the entities in the sample do not report which options and exemptions they intend to use when applying IFRS 16, whether these are transitional options and exemptions (apart from the choice of transitional arrangements; see above) or those regarding the application of the standard under normal circumstance (short-term contracts, contracts low-value assets, no separation of lease and service components in a contract).

Entities that have reported on the options and exemptions they intend to use when applying IFRS 16 have chosen one or more of the following options:

- application of IFRS 16 at the transition date only to contracts classified as leases under IAS 17 (option offered as part of the two transition methods): five entities;
- valuation of the right of use for the amount of the lease liability (modified retrospective method only): two entities;
- no application of IFRS 16 to short-term contracts (exemption applicable per asset class) and/or to low-value assets (exemption applicable on an asset by asset basis): ten and nine entities respectively; and
- no separation of lease and service components in a contract: three entities.

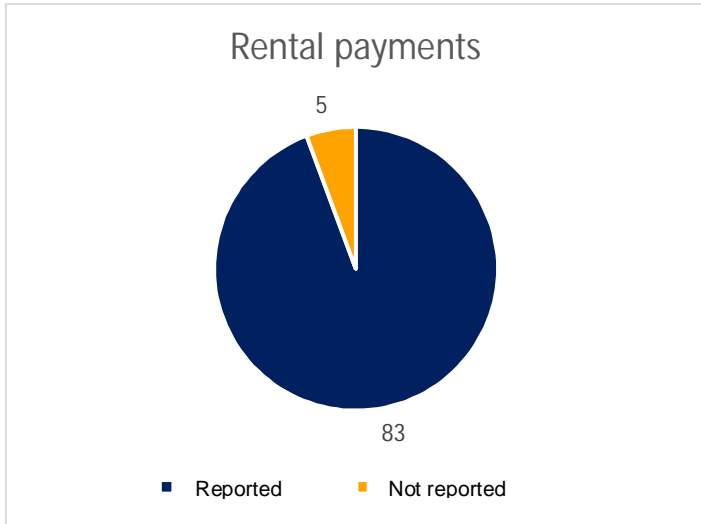
One entity states that it will use some of the simplifications where they are offered for application contract by contract, while another reports that it intends to make use of some simplifications without saying which.

#### 2.6. At this stage entities are wary of reporting quantified expected impacts

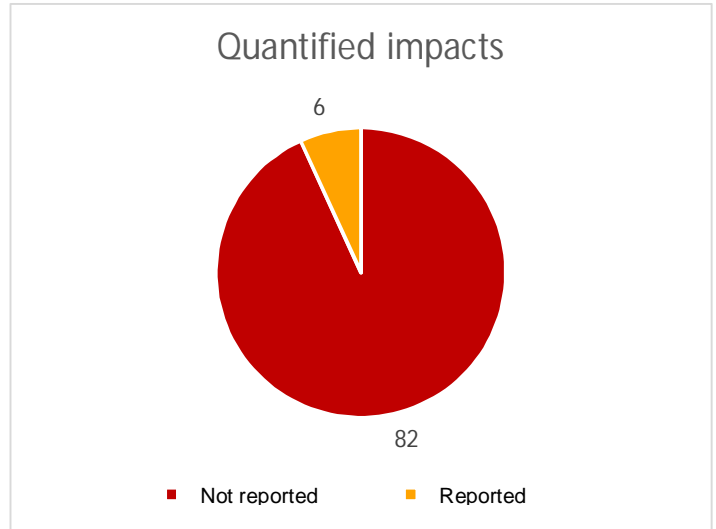
Whereas all the entities will be impacted by the standard, and some sectors will be very significantly affected, only 18% of the entities in the sample clearly state that the impact will be significant, 77% preferring not to address this issue at this stage.

Only three entities (two of which are active in the real estate sector) clearly indicate that the impacts expected as a result of the application of IFRS 16 will not be significant.

Apart from the three entities that say they will apply IFRS 16 early (as of 1 January 2018), three others provide a quantified estimate of the expected impact in terms of lease liabilities recognised on the statement of financial position, while making it clear that these estimates are based on the composition of the lease portfolio at the estimate date, and on calculation parameters that may not be the same at the transition date.



In compliance with IAS 17, almost all the entities in the sample (94%) report the minimum amount of future payments due on their operating leases, but several went out of their way to observe that the amount of these commitments does not necessarily reflect the level of lease liabilities which will be recognised at the transition date, because of potentially different bases of calculation.



### 3. Conclusion

The 2017 financial reporting of our sample entities on IFRS 16, while fairly diverse in terms of the information provided, is essentially generic in nature, unquantified, and of minimal informative value. This is not necessarily surprising, given past experience of the information provided on IFR 15 during the equivalent period, namely a

year before the standard came into force. Since implementation projects are now under way, we can expect these disclosure to be developed, in particular in quantitative terms, in the forthcoming half-yearly and annual financial statements.

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# Events and FAQ

## Frequently asked questions

### IFRS

- Determining the lessee's incremental borrowing rate under IFRS 16
- Conditions for classification as an asset held for sale (IFRS 5)
- Shareholders' agreement: what level of control?
- Information in the half-yearly accounts on the first application of IFRS 15.
- Assignment of receivables: treatment of costs incurred by a legal acquirer in a reverse acquisition
- Distribution contract: agent/principal analysis

| IFRS            |                 | EFRAG        |               |
|-----------------|-----------------|--------------|---------------|
| IASB            | Committee       | Board        | TEG           |
| 16-20 July      | 11-12 September | 21 August    | 25 July       |
| 17-21 September | 27-28 November  | 3 September  | 5-6 September |
| 22-26 October   |                 | 20 September | 27 September  |