A Closer Look

IFRS 16: Disclosures required in the first interim financial statements

IFRS 16 – *Leases* came into effect on 1 January 2019. **The first interim financial statements**, which are usually presented in a condensed format in accordance with IAS 34 – *Interim Financial Reporting*, **must take account of the implementation of the new standard.**

1. Interim financial report in accordance with IFRS 16

The condensed interim financial report to 30 June 2019 must include, in accordance with IAS 34, and in conjunction with IFRS 16:

a) a condensed statement of financial position that takes account of **the new principles for presentation of the statement of financial position in IFRS 16** and the elections made by the entity for the presentation of lease assets and lease liabilities;

   Readers will remember that IFRS 16 permits entities to either present right-of-use assets separately from other assets or aggregate them with the line items representing the underlying fixed assets. Similarly, lease liabilities may be either presented separately, or aggregated with other liability line items.

b) one or more condensed statements of profit and loss and other comprehensive income;

c) a condensed statement of changes in equity:

   This statement shall include a separate line item for the **impact of the change of accounting principle on opening equity** (i.e. at 1 January 2018 if the full retrospective approach is used and only one comparative period is presented, or at 1 January 2019 if the modified retrospective approach is used);

d) a condensed statement of cash flows; and

e) a **selection of explanatory notes**:

   - IAS 34 requires an explanation of **significant events and transactions** to enable users to understand how the entity's financial position and performance have changed since 31 December 2018. These disclosures must update the relevant information contained in the most recent annual report.
   - IAS 34 also includes a **minimum list of disclosures required** in the notes (or elsewhere in the interim financial reporting, incorporated by cross-reference to the interim financial statements) including a description of the <u>nature and impact of the change of accounting policy in response to the introduction of the new standards (IFRS 34.16 A (a)).</u>

Entities may also need to disclose any other information that is relevant, particularly if IFRS 16 has a significant impact.

In its 2018 year-end enforcement priorities, ESMA noted that once IFRS 16 is applied, disclosures required by Appendix C of the standard relating to the initial application and chosen method of transition need to be provided. This applies in our view to the first financial statements issued in the first year of application, i.e. to the interim financial statements, as well as to the annual financial statements.

It had also indicated that it should be expected that users would try to make a link between minimum lease payments for operating leases based on the requirements of IAS 17 and IFRS 16 impacts and therefore encouraged entities to provide an explanation for any differences between these two amounts. In our view, this disclosure is more particularly relevant in the interim financial statements if the entity had not provided such explanation in the 2018 annual financial statements.

2. Transition disclosures required under IFRS 16

IFRS 16 – *Leases* offers lessees the choice between:

- full retrospective application (which involves restating the comparative financial statements presented and disclosing the impact of first-time application on opening equity for the first comparative period presented);
- or modified retrospective application (which involves recognising the impact of first-time application on equity at the transition date, i.e. at 1 January 2019).

Therefore, the transition disclosures required under IFRS 16 differ depending on the transition approach chosen by the entity.

Full retrospective approach

If the entity has elected to use the full retrospective approach, IFRS 16 refers back to IAS 8. In this case, the entity shall disclose the following information on first-time application of IFRS 16 (IAS 8.28):

a) the title of the IFRS;

b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;

c) the nature of the change in accounting policy;

d) when applicable, a description of the transitional provisions;

e) when applicable, the transitional provisions that might have an effect on future periods;

f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
   - for each financial statement line item affected; and
   - if IAS 33 – *Earnings per Share* applies, for basic and diluted earnings per share;

g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

h) if the required retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Modified retrospective approach

If the entity has elected to use the modified retrospective transition approach, IFRS 16 states (IFRS 16.C12) that the entity shall disclose all the information required by paragraph 28 of IAS 8, except for the information required by 28(f), i.e. the amount of the adjustment for each financial statement line item affected, and for earnings per share.

This amendment to the requirements of IAS 8 stems from the fact that **the modified retrospective approach prohibits entities from restating comparative information presented** (in the primary financial statements and in the notes). However, if it wishes, an entity may still present this information outside the financial statements. This "non-financial" reporting would thus fall within the scope of ESMA's Guidelines on Alternative Performance Measures, as recalled by ESMA in its 2018 European Common Enforcement Priorities.

Instead of this information, IFRS 16 requires first-time adopters using the modified retrospective approach to disclose the following (IFRS 16.C12):

- the weighted average lessee's incremental borrowing rate applied to lease liabilities at the date of initial application; and
- an explanation of any difference between (i) operating lease commitments disclosed applying IAS 17 (i.e. the amount of commitments disclosed immediately preceding the date of initial application), discounted using the incremental borrowing rate at the date of initial application; and (ii) lease liabilities recognised at the transition date.

Finally, as the modified retrospective approach permits entities to choose from a list of available practical expedients (i.e. applying a single discount rate to a portfolio of leases with reasonably similar characteristics, relying on assessments made under IAS 37 immediately before the transition date rather than carrying out an impairment test, not restating leases with a remaining term of less than 12 months, excluding initial direct costs, etc.), entities that elected to apply this transition approach shall disclose which of these practical expedients they used.

3. Presentation of an additional balance sheet in the interim financial statements

If an entity elects to apply the full retrospective approach, there is **no obligation to present an additional balance sheet** at the start of the earliest period presented. The presentation of a "third balance sheet" (generally at 31 December 2017) is only required in the 2019 annual financial statements. However, an entity may elect to present this information in the financial statements to 30 June if IFRS 16 has a significant impact.

The question of whether or not to present an additional balance sheet does not arise if the entity uses the modified retrospective transition approach, as this approach prohibits restatement of comparative information presented.

4. Benchmarking

The interim and annual financial reports of the few companies that elected to early apply IFRS 16 provide a useful **benchmark** for others.

The companies that opted for early application and chose a full retrospective approach include Air France-KLM and Nestlé.

The companies that opted for early application and chose a modified retrospective approach include Publicis, SES and Nexity.

Key points to remember

- As from the 2019 interim financial statements (generally drafted at 30 June), it is necessary to give detailed information on the first application of IFRS 16. The amount of information required depends on the level of impact identified.
- The important information to be presented in the financial statements at 30 June 2019 is as follows:
  - A description of the accounting policies and methods for leases; the presentation option chosen (separate or in aggregate); whether the entity used the practical expedients for short-term leases or leases for which the underlying asset is of low value; and the key judgements made (assessing whether a contract contains a lease, determining the lease term and the discount rate, and separating out non-lease components).
  - The transition approach chosen, and the elections made for this approach:
    - Whether the entity has elected to use the practical expedient that permits it to apply the provisions of IFRS 16 to contracts identified as leases in accordance with IAS 17 and IFRIC 4 (rather than reassessing them in light of the new definition).
    - If the entity has elected to apply the modified retrospective approach, the method used to measure the right-of-use asset (at its carrying amount as if IFRS 16 had been applied since the commencement date or at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments recognised immediately before the date of initial application); any practical expedients that the lessee has used from the list in paragraph C10 (i.e. applying a single discount rate to a portfolio of leases with reasonably similar characteristics, relying on assessments made under IAS 37 immediately before the transition date rather than carrying out an impairment test, not restating leases with a remaining term of less than 12 months, excluding initial direct costs, etc.); and the key judgements made at the transition date (e.g. whether the incremental borrowing rate is calculated with reference to the remaining term or the original lease term).
  - Quantitative disclosures should make it possible to measure the extent of the change of accounting principle:
    - If the entity has elected to use the full retrospective approach: the effect of the change for the financial statements line items impacted by IFRS 16 in the comparative periods presented (i.e. for 2018 at a minimum);
    - If the entity has elected to use the modified retrospective approach: the effect of the change on the line items impacted by IFRS 16 at 1 January 2019, and all significant information relating to first-time application required by Appendix C, especially the lessee’s weighted average incremental borrowing rate applied to lease liabilities at the date of initial application and an explanation of the difference between (i) the amount of commitments disclosed applying IAS 17 immediately preceding the date of initial application, discounted using the average incremental borrowing rate at the date of initial application; and (ii) lease liabilities recognised at the transition date.

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