A Closer Look

IFRS 16: Financial Reporting Still Limited at 30 June 2018

Just a few days ahead of the mandatory effective date of IFRS 16 – *Leases*, Mazars has attempted to see how far the information reported by issuers in their June 2018 interim financial statements had changed in comparison with the information reported in 2017 year-end financial statements on the progress towards the introduction of this standard and its expected impacts.

Readers will bear in mind that the interim statements are an update to the information provided in the last annual financial statements. Our analysis of the information reported has been conducted in both comparative and cumulative fashion, since some issuers published less information on this topic than in their annual financial statements.

The sample is the same as that used in our most recent study, and consists of 88 companies in the CAC 40, EUROSTOXX 50 and Next 20.

1. Main findings

The level of detail and the quality of the information on the introduction of the new standard reported by entities in the sample remain very diverse. In the particular case of interim disclosures, the information provided ranges from a total absence of detail on this topic to a qualitative and quantitative update of the information supplied in the 2017 financial statements.

However, despite this diversity, the great majority of entities again provided information with little informative value in June 2018 as to the implementation of the project and the expected impacts.

Consequently, disclosures on the last two reporting dates remain insufficient to an overall appreciation of progress towards implementing the standard, the structuring accounting choices and those requiring judgment, or the expected impact of the standard on the financial statements of these entities.

1.1. IFRS 16 implementation projects continue

Only 44% of the entities in the sample (or 39 issuers) supplemented their disclosures on the IFRS 16 transition in their half-yearly financial statements.

The qualitative aspects evoked, still fairly undeveloped, related to the type of leases identified, the practical expedients and exemptions adopted, the application difficulties encountered (lease term and discount rates, essentially) and the progress of the implementation project (identifying contracts, project management, etc.).

Two issuers also stressed the importance of taking into consideration the contractual and legal provisions proper to each country to determine the enforceable period of lease contracts. 20% of the entities in the sample also provided more or less detailed information about their progress in the choice of an IT solution to be adopted with a view to IFRS 16 compliance.

> Here again, action plans vary, and entities are not advancing at the same pace. While some report that they are developing tools (six entities) or adapting existing information systems (two entities), others have already launched plans for a dedicated software solution (ten entities).

1.2. Few entities have opted for early application of IFRS 16

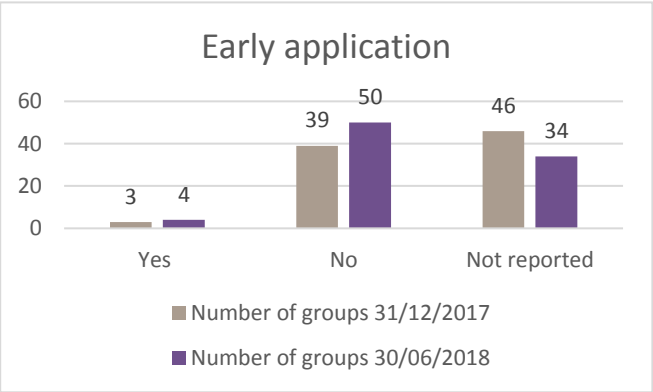
Publicis has joined the three entities in our sample (Air France – KLM, ASML and Deutsche Post) clearly stating at 31 December 2017 that they have decided to apply IFRS 16 early, with effect from 1 January 2018.

Deutsche Post provided very full information and is a good example for understanding the requirements when the modified retrospective method is applied.

The information these entities gave about their transitional arrangements is summarised in the table below.

	AIR FRANCE:	ASML	Deutsche Post	Publicis
Transition method	Yes (full retrospective)	Yes (modified retrospective)	Yes (modified retrospective)	Yes (modified retrospective)
Transition options	N/A	Yes (Definition of a lease, exclusion of initial direct costs from right-of-use measurement)	Yes (measurement of right-of-use, restatement of contracts with residual duration < 12 months)	Yes (measurement of right-of-use, restatement of contracts with residual duration < 12 months, determining the discount rate)
Quantified impact on statement of financial position	Yes	Yes	Yes	Yes
Impacts on cash flow statement (not quantified)	Yes	No	Yes	Yes
Impact on performance indicators	Yes (not quantified, but impact on the definition of the Return on Capital Employed and definition of a new indicator, Adjusted Operating Free Cash flow)	No	Yes (in particular Free Cash flow, EBIT after Asset Charge and explanations of the impact on indicators in the investor presentation)	Yes (In particular Free Cash Flow and Net Financial Debt)
Nature of leases and associated impacts	Yes (not quantified but distinction between impact of leases / maintenance contracts)	No	Yes (breakdown of right of use by asset type)	Yes (not quantified)
Other impacts	Yes (maintenance)	No	No	No

57% of entities in the sample (compared with 47% at the end of 2017) report that they will not apply IFRS 16 early, while the remaining companies (39% in 2018, compared with 52% at end 2017) have not stated 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.



1.3. More than half of entities in the sample still leave room for doubt as to the transition method to be used

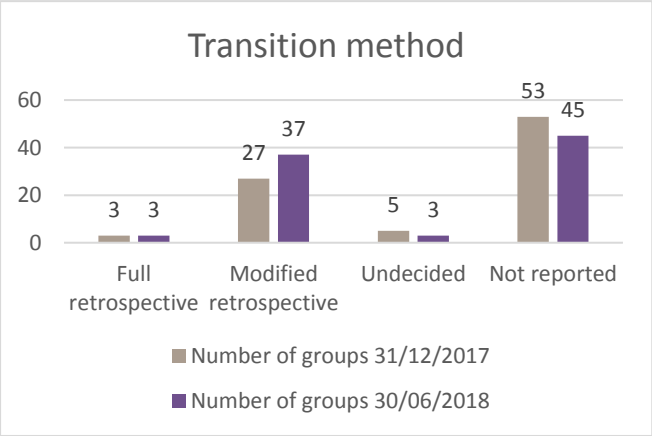
As a reminder, IFRS 16 offers entities two transition methods:

- 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 expedients when determining the amounts to be recognised at 1 January 2019.

Hence, the transition method remains one of the tricky aspects of the implementation of the new leases standard, because of the impact of the chosen method not only at the transition date but also in subsequent financial years. There are also considerations regarding the remaining works 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 45% of the entities in the sample (compared with 34% at end 2017) report their choice of transition method, and of these 93% (90% at end 2017) have opted for the modified retrospective method.



1.4. Limited additions to qualitative information

56% of the entities in the sample either included no information on IFRS 16 in their interim financial statements, or gave less or the same information as in their latest annual reporting.

The extra information provided by the rest of the sample (apart from the four entities that opted for early application of the standard, mentioned above) which consists of entity-specific (not generic) matters, is mainly focused on the classes of assets that are subject to leases (which have not been quantified). The proportion of entities providing this information has risen to 34% (compared with 11% at end 2017).

Few entities have provided a company-specific analysis of sensitive subjects such as the lease term, the variability of payments or the discount rate.

1.5. Accounting exemptions and options: some entities report their choices

70% of the entities in the sample (compared with 82% at end 2017) have still not reported which options and exemptions they intend to use when applying IFRS 16, whether these are:

- transition options and exemptions (apart from the choice of the transition method, see above)
- or those regarding the application of the standard under normal circumstances (short-term contracts, contracts for 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 mainly chosen one or another of the following:

a) application of IFRS 16 at the transition date only to contracts classified as leases under IAS 17 (option available for both transition methods): 8 entities (compared with 5 at end 2017);

b) valuation of the right of use for the amount of the lease liability (modified retrospective method only): 4 entities (compared with 2 at end 2017);

c) no application of IFRS 16 to short-term contracts (exemption applicable per asset class) and/or to low-value assets (exemption applicable asset by asset): 15 and 14 entities respectively (compared with 10 and 9 at end 2017); and

d) no separation of lease and service components in a contract: 5 entities (3 at end 2017);

e) no application of standard to leases of intangible assets: 3 entities (1 at end 2017);

f) no restatement of leases expiring within 12 months of the date of first application (modified retrospective method only): 2 entities (none at end 2017).

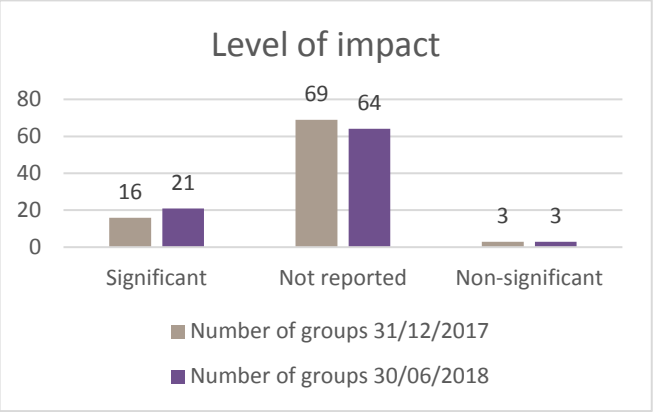
One entity stated that it will use some of the expedients where they are offered for application contract by contract, while another reported that it intends to use some expedients without saying which. Two other groups indicated that they had chosen one of the expedients offered but were still undecided about the rest.

1.6. Entities are still wary of reporting quantified expected impacts

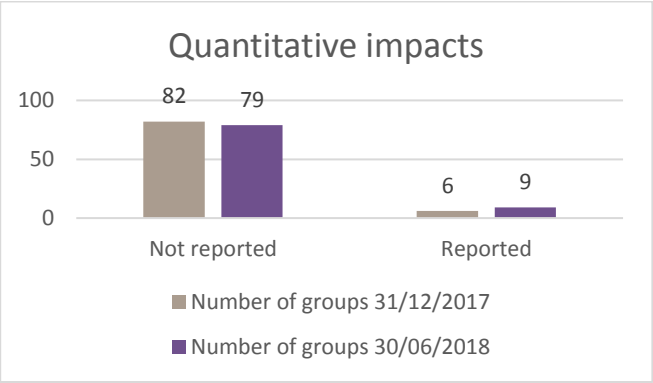
Whereas all the entities will be impacted by the standard, and some sectors will be very significantly affected, the impact is only expected to be significant[†] at this stage for 24% of entities in the sample (18% at end 2017).

73% of entities in the sample (77% at end 2017) provided insufficient information to say whether or not these impacts were significant[‡].

Only three entities (unchanged since the last annual financial statements), two of them in the real estate sector, have clearly indicated that the impacts expected as a result of the application of IFRS 16 will not be significant.



Apart from the four entities in our sample that say they will apply IFRS 16 early, as of 1 January 2018, five others (as against three at end 2017) have given a quantified estimate of the expected impact in terms of lease liabilities recognised on the statement of financial position, and two have reported a quantified estimate of the expected impact on performance indicators (EBITDA, net-debt-to-equity ratio), 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.



A quarter of the entities in the sample have updated the note on their minimum future operating lease payments in the interim accounts. Several went out of their way to point out 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.

2. Conclusion

The financial information at 30 June 2018 on IFRS 16 published by our sample remains (i) fairly varied in terms of the level of detail, (ii) still too general and insufficiently explanatory and (iii) essentially qualitative, with entities broadly reluctant to report the expected impacts.

This reluctance, common to almost all the issuers just a few months ahead of the effective date of IFRS 16, suggests the difficulties they are experiencing in predicting and rolling out the standard, which demands substantial resources.

As the implementation projects continue, more detailed qualitative information and the known or reasonably estimated quantified impacts are expected to be provided in the forthcoming annual financial statements, as emphasised in the regulator's recommendations for the 2018 year-end.

[†] The material impact of the application of the new standard by entities in the sample has been determined either on the basis of the information supplied by the issuer (where the impact is explicitly described as material) or using a materiality threshold (impact above 10% on non-current assets or on net debt).

[‡] This category includes (i) entities giving no indication of the level expected, (ii) those that had only determined that the impact on P&L would be immaterial (with no reference to the balance sheet impact) and (iii) those giving the amount of their operating lease commitments without indicating the level of lease liability expected under IFRS 16.

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