

2019

Statutory Reporting Quality

Information Note

Transition to IFRS 16 *Leases* – review of 2019 half-yearly disclosures

MISSION

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest

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INFORMATION NOTE

Transition to IFRS 16 Leases – review of 2019 half-yearly disclosures

1. Purpose of this Information Note

The purpose of this Information Note is to provide readers with:

- an analysis of the nature, extent and impact of the information disclosed by issuers in relation to the transition to IFRS 16 Leases in their 2019 half-yearly financial reports; and
- a comparison of the actual transitional impact of IFRS 16 as disclosed in the half-yearly financial statements with the estimated impact disclosed by the issuers in their prior year annual financial statements.

2. Introduction

IAASA, Ireland's accounting enforcer, has responsibility for the examination and enforcement of the periodic financial reports of certain listed entities ('issuers').

IFRS 16 is mandatory from 1 January 2019 and replaces IAS 17 Leases. IFRS 16 specifies how to recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases (unless the lease term is 12 months or less or the underlying asset has a low value).

IFRS 16 is required for annual reporting periods beginning on or after 1 January 2019. As such, the 2019 half-yearly financial reports were the first financial statements where the application of IFRS 16 was mandatory. In addition to applying the measurement principles of IFRS 16, these financial statements included the required IFRS 16 disclosures, such as information to enable users of the financial statements to understand the impact of transition.

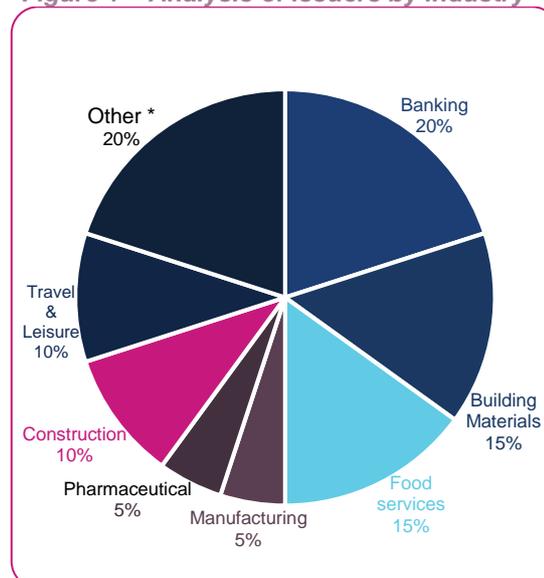
The most significant impact for issuers' reported results arising from transitioning to IFRS 16 is that leases previously defined as operating leases under IAS 17 and treated as "off-balance sheet" are now required to be recognised in the Statement of Financial Position as a "right of use" asset and a related lease liability.

We have completed a desk-top review on the 2019 half-yearly financial reports and 2018 annual reports of 20 equity issuers (see appendix) falling within IAASA's financial reporting examination remit. *Figure 1* shows the industry breakdown of our sampled issuers.

Our expectation is that:

- the disclosures in relation to the transition to IFRS 16 are detailed and clearly disclosed in the 2019 half-yearly financial reports; and
- if an issuer has provided known or reasonably estimable information in relation to the impact of transitioning to IFRS 16 in their 2018 annual reports, the actual impact stated in their 2019 half-yearly financial report should not be materially different to this estimate.

Figure 1 – Analysis of issuers by industry

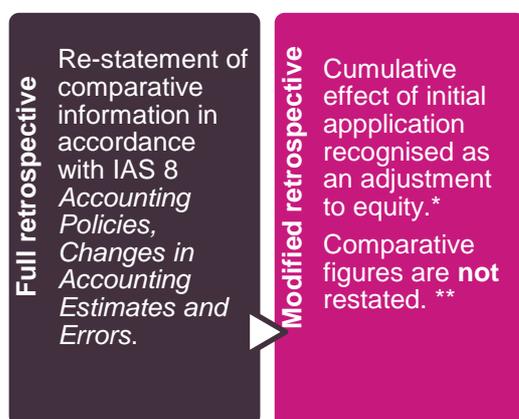


*includes exploration, insurance, healthcare and entertainment

3. Desktop review results

3.1 – Method of transition

IFRS 16 provides issuers with two transition methods when transitioning to IFRS 16 from IAS 17.



* Cumulative effect of initially applying IFRS 16 is recognised as an adjustment to equity at the date of initial application

** Comparative figures for the year ended 31 December 2018 are not restated to reflect the adoption of IFRS 16 but instead continue to reflect the lessee’s accounting policies under IAS 17

All 20 of the issuers disclosed in their half-yearly financial reports that the modified retrospective approach was applied when transitioning from IAS 17 to IFRS 16, meaning no changes to 2018 comparative figures were applied.

Furthermore, as all issuers chose the modified retrospective approach, the use of all available practical expedients under IFRS 16 is permitted for all issuers, to ease the transition from IAS 17 to IFRS 16 (see 3.3 below).

3.2 – Materiality of transition reported by issuers sampled

Figure 2 – Impact of transition to IFRS 16



Thirteen issuers disclosed that, in their 2019 half-yearly financial reports, the transitioning

to IFRS 16 had a material impact on their reported results.

Seven issuers stated that the transition to IFRS 16 did not have a material impact on their reported results. Those issuers that stated an immaterial impact were predominately in the banking and construction sectors (57%) with the remainder being from the exploration, insurance and healthcare industries.

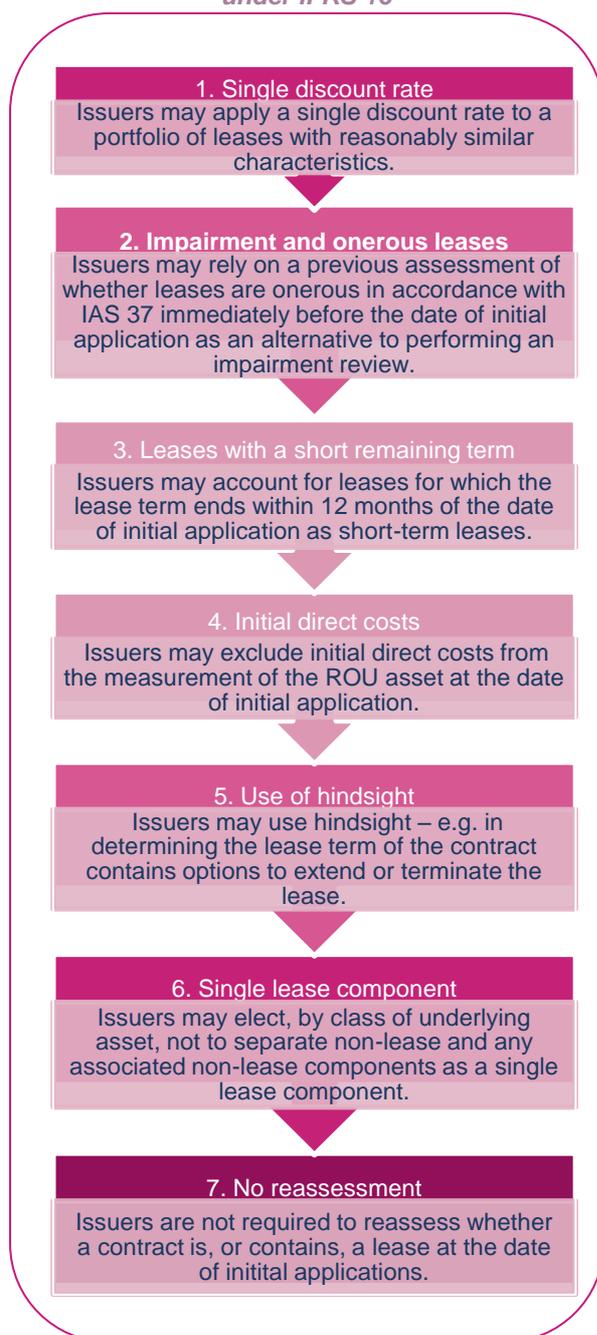
3.3 – Use of practical expedients

When applying a modified retrospective approach to leases previously classified as operating leases, IFRS 16 outlines that issuers may use one or more available practical expedients.

The use of each practical expedient, or combinations thereof, could have a significant impact on an issuer’s financial results on transition, as well as in subsequent years, until the leases are no longer in effect. If an entity chooses any of the practical expedients outlined, IAASA’s expectation is that the issuer would disclose that fact in their half-yearly financial report.

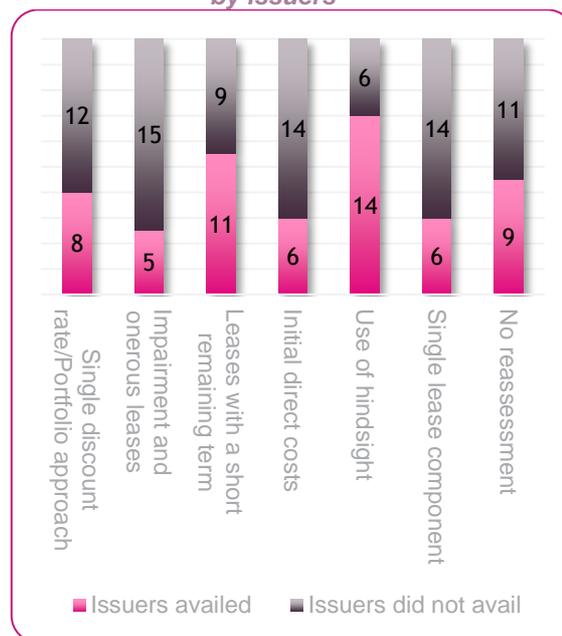
Figure 3 below shows the seven practical expedients available under IFRS 16. Practical expedients listed 1 – 5 in the table are permitted on a lease-by-lease basis. Practical expedients 6 and 7 are permitted but, if availed of, must be applied to all lease contracts.

Figure 3 – Practical expedients available under IFRS 16



Fifteen of the issuers stated in their 2019 half-yearly financial reports that they had availed of one or more of the available practical expedients within IFRS 16. The average number of practical expedients used per issuer was 3, with the use of hindsight being the practical expedient availed of by most (14 out of 20 issuers). See figure 4 below for further breakdown of the practical expedients availed of and not availed of by the issuers.

Figure 4 – Practical expedients availed of by issuers



Five issuers did not disclose whether or not they had availed of any practical expedients. However, two of these five issuers had stated that the assessment of the impact of transitioning to IFRS 16, including the use of practical expedients, was still ongoing. Two of the remaining issuers stated that the implementation of IFRS 16 had an immaterial impact on their reporting results.

3.4 – Impact of transition vs. estimated impact

As expected, the Statement of Financial Position was the area where the main impact of transition to IFRS 16 arose.

Issuers identified the minimum lease payments outstanding and applied an appropriate discount rate to calculate the present value of the lease liability and then calculated the corresponding right-of-use asset.

IAASA noted that any impact the issuers disclosed on the Statement of Profit and Loss, in relation to the reduction of operating lease interest and payment, was largely offset by the increased depreciation expense resulting from the additional right-of-use assets.

Eighteen of the issuers provided an estimate in their 2018 annual reports in relation to the transitional impact expected on the Statement of Financial Position and the

actual impact of transition in their 2019 half-yearly financial reports.

One issuer did not provide an estimate in their 2018 annual report; however, it disclosed the actual impact in their 2019 half-yearly report. One issuer did not provide an estimate in their 2018 annual report or disclose the actual impact in their half-yearly financial report. Both of these issuers stated that the transition to IFRS 16 did not have a material impact on their reported results.

For the 18 issuers that disclosed both the estimated impact in 2018 and the actual impact of transition in 2019, IAASA compared the actual impact on their 2019 half-yearly Statement of Financial Position to the expected impact stated in their 2018 annual report. See below for the results of the comparison.

Figure 5 – Comparison of expected impact and actual impact



The total difference between the expected impact and the actual impact, for both right-of-use assets and lease liabilities, is a €240 million decrease from the estimated figures reported, for the 18 issuers.

€183 million of this difference related to one issuer. The main reason for this difference is that the 2018 estimate was on a gross basis before the issuer had completed the discounting to present value. The issuer is a large issuer with net assets of €126 billion so the difference was immaterial for the issuer.

Overall, other than the €183m difference explained above, it can be seen from the analysis that the expected impact of transitioning to IFRS 16, which was

disclosed in the 2018 annual reports for the 18 issuers was reasonably estimated when compared with the actual impact disclosed in the 2019 half-yearly financial reports of the issuers.

3.5 – Other findings

IAASA noted that only six of the issuers disclosed that transitioning of IFRS 16 had a significant impact on the issuer's net debt figure. One issuer noted that the net debt figure had increased by as much as €1.95 billion. The increase occurred due to the increase in lease liabilities impacting the calculation. However, all six issuers stated that, even with the increase in net debt, bank covenants had not been breached.

4. Overall conclusion

Overall, IAASA noted that the disclosures in the half-yearly financial reports provided evidence of good quality disclosure in relation to the requirement in IAS 34 *Interim Financial Reporting* to disclose a description of the nature and effect of the change in accounting policies.

Some main positives to note were:

- ✓ clear disclosure of the transition method adopted;
- ✓ good quality explanations and disclosures of the practical expedients availed of when transitioning to IFRS 16;
- ✓ descriptive disclosure of the changes in accounting policies in relation to accounting for leases; and
- ✓ actual impact of transitioning as presented in the half-yearly financial reports not being materially different from the estimated impact stated in the 2018 annual reports.

However, further improvements could have been made in certain areas. For example:

- ✗ only 6 of the 20 issuers provided information on the impact that the implementation of IFRS 16 had had on net debt and other alternative performance measures; and
- ✗ further disclosure in relation to the key judgements made such as discount rates, recognition and measurement of

the right-of-use assets and liabilities would have been helpful to the users.

IAASA reminds preparers, auditors and users of financial statements of IAASA's expectation in relation to IFRS 16 disclosures in the 2019 annual reports, as outlined in our recently published 2019 observation document¹.

In particular, it is our expectation that issuers will disclose key judgements in their implementation of IFRS 16, including but not limited to:

- implementation and transition disclosures;
- the key judgements made in recognising and measuring right-of-use assets and liabilities;
- the determination of the discount rate(s) of leases; and
- determination of the lease term (i.e. lease term extensions, early termination options and lease modifications).

¹ <http://iaasa.ie/getmedia/8b9ddb07-4ad4-45cc-8abb-010912e17753/Obs-doc-2019-final-16sep19.pdf>

APPENDIX

ISSUERS INCLUDED WITHIN THIS REVIEW

	Issuer	2018 Annual Report	2019 Half-Yearly Report
1	AIB Group plc	31 December 2018	30 June 2019
2	Bank of Cyprus Holdings plc	31 December 2018	30 June 2019
3	Bank of Ireland Group plc	31 December 2018	30 June 2019
4	Cairn Homes plc	31 December 2018	30 June 2019
5	CRH plc	31 December 2018	30 June 2019
6	Dalata Hotel Group plc	31 December 2018	30 June 2019
7	FBD Holdings plc	31 December 2018	30 June 2019
8	Flutter Entertainment plc	31 December 2018	30 June 2019
9	Glanbia plc	31 December 2018	30 June 2019
10	Glenveagh Properties plc	31 December 2018	30 June 2019
11	Grafton Group plc	31 December 2018	30 June 2019
12	Greencore Group plc	30 September 2018	31 March 2019
13	Irish Continental Group plc	31 December 2018	30 June 2019
14	Kenmare Resources plc	31 December 2018	30 June 2019
15	Kerry Group plc	31 December 2018	30 June 2019
16	Kingspan Group plc	31 December 2018	30 June 2019
17	Mainstay Medical International plc	31 December 2018	30 June 2019
18	Permanent TSB Group Holdings plc	31 December 2018	30 June 2019
19	Smurfit Kappa Group plc	31 December 2018	30 June 2019
20	UDG Healthcare plc	30 September 2018	31 March 2019



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