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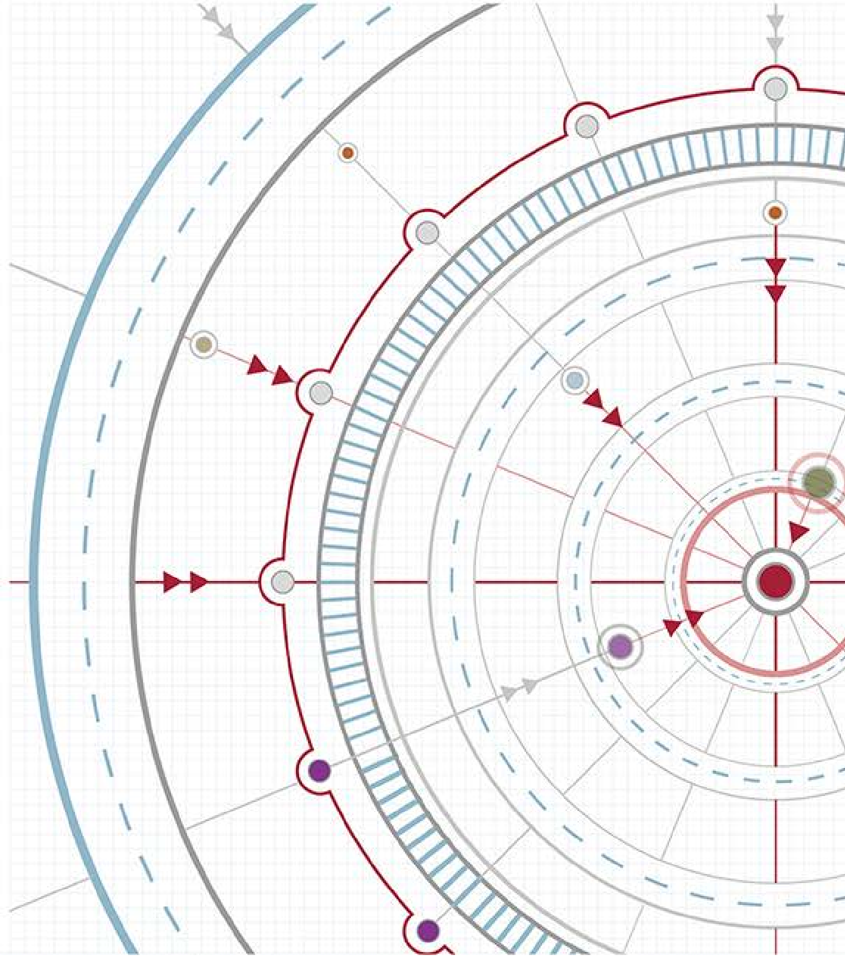

Guide to new Standards IFRS 9, IFRS 15, IFRS 16 and research opportunities

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Agenda

Introduction and objectives

IFRS 9 *Financial Instruments*: the basics

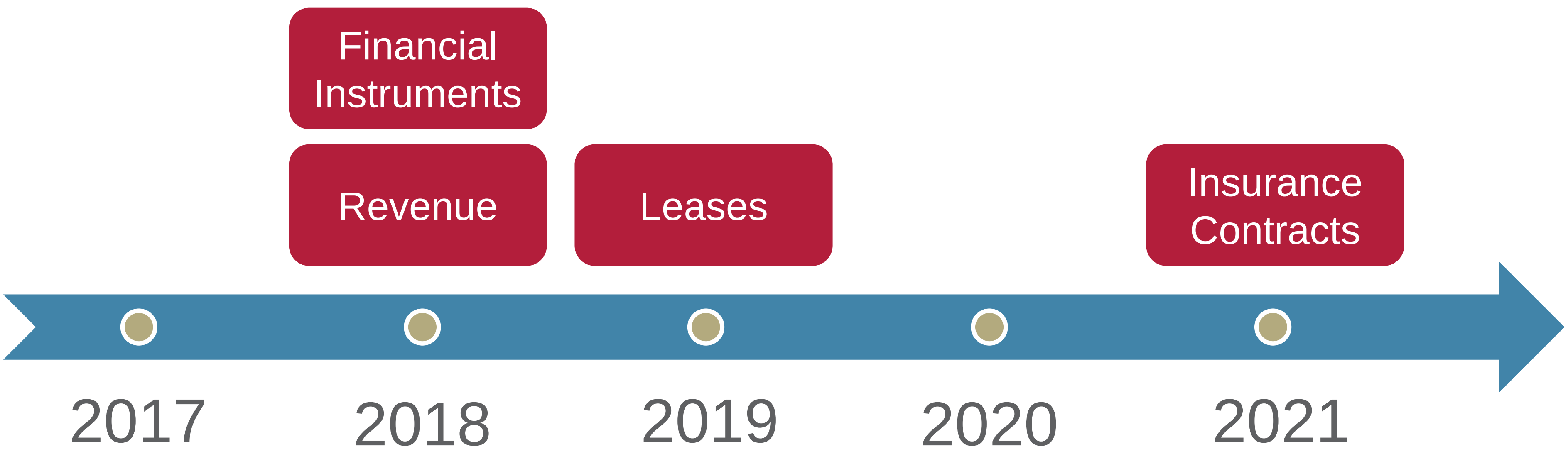
IFRS 15 *Revenue from Contracts with Customers*: the basics

IFRS 16 *Leases*: the basics

Wrap up

Introduction and objectives

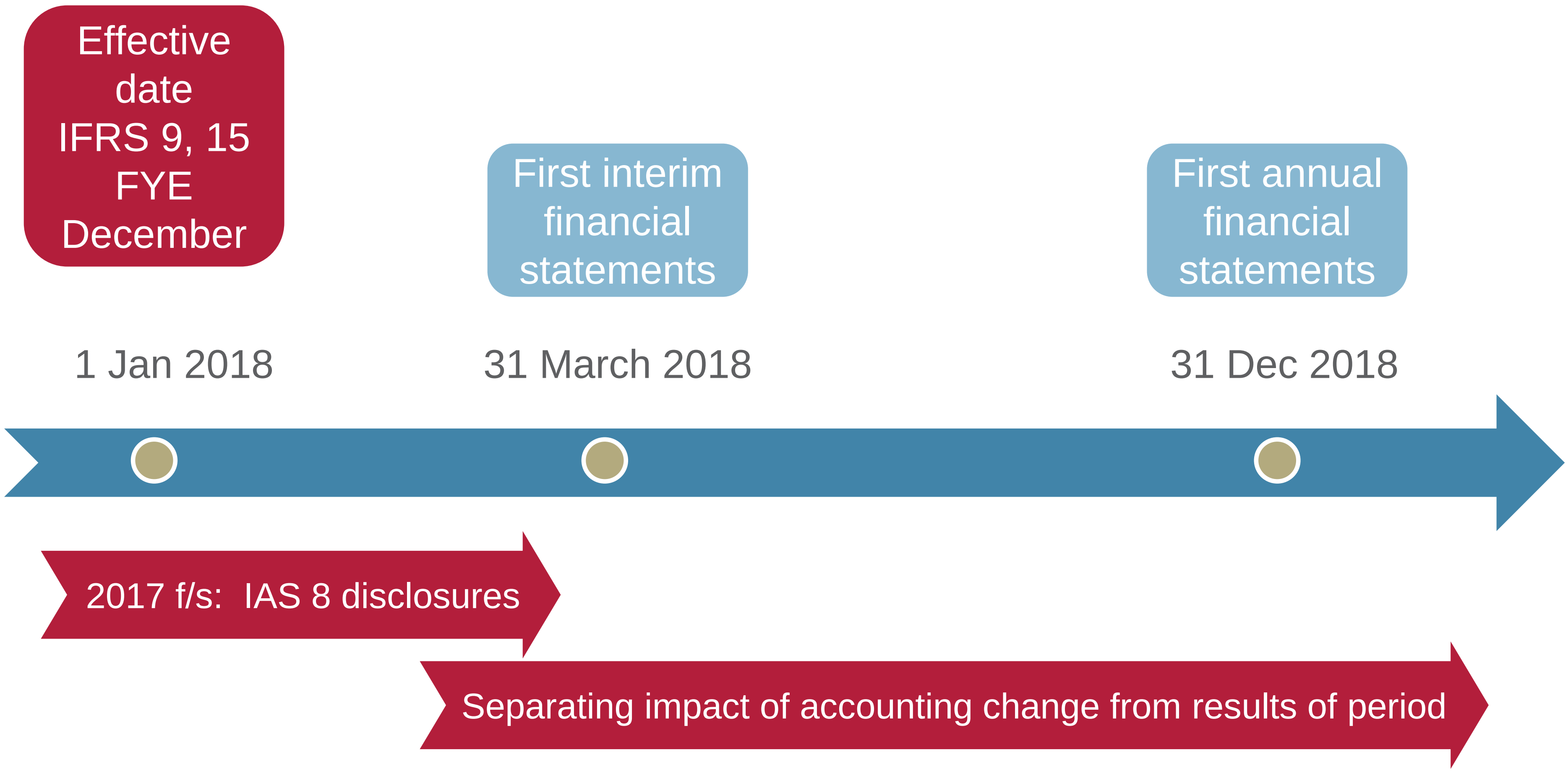
Changes ahead – are they worth it?



Messages on the new Standards

<table>
<tr><th colspan="2">Effective 2018</th><th>Effective 2019</th></tr>
<tr><th>Financial Instruments</th><th>Revenue</th><th>Leases</th></tr>
<tr><td colspan="2">Users disappointed in disclosure prior to effective date</td><td rowspan="6">Not many new questions</td></tr>
<tr><td colspan="2">Mixed news on visibility in first interims</td></tr>
<tr><td>Impairment
• Significant challenge, but some benefits for risk management & governance
• Generally manageable effect on regulatory capital</td><td>Greater awareness of accounting consequences of contract terms</td></tr>
<tr><td rowspan="2">Classification & Measurement limited changes in classification overall more practice questions than expected</td><td>Many may have limited quantitative impact</td></tr>
<tr><td>Disclosure should be a big gain</td></tr>
</table>

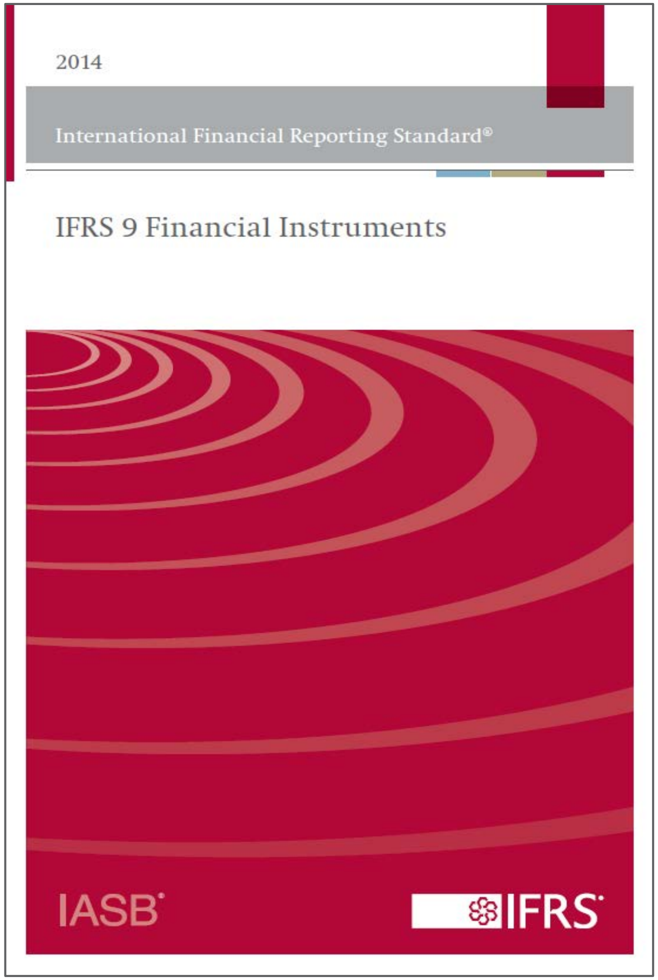
Don’t forget about disclosure



IFRS 9 *Financial Instruments*:

Overview of the basics

IFRS 9 at a glance



- Issued in 2014
- Effective annual reporting periods from 1 January 2018
- Replaces IAS 39

Key points:

- Classification and measurement
  - a logical, single classification approach driven by cash flow characteristics and how financial instruments are managed
- Impairment
  - forward-looking ‘expected loss’ model
- Hedge accounting
  - better aligns accounting with risk management

Classification and measurement

IFRS 9 *Financial Instruments*

Classification of financial assets

Useful information about the future cash flows

Approach

Business model + Contractual cash flows

IFRS 9 classification of financial assets

	Business model = hold to collect	Business model = hold to collect and sell	Other business models
Cash flows are solely payments of principal and interest (SPPI)	Amortised cost	FVOCI* Balance sheet: FV Profit or loss: AC	FVTPL
Other types of cash flows	FVTPL	FVTPL	FVTPL

* Different from OCI category for equity investments

Contractual cash flows characteristics

Why SPPI?

Amortised cost is calculated using the effective interest method.

Effective interest method allocates interest over the relevant time period

Amortised cost measurement provides useful information about the amount, timing and uncertainty of future cash flows, if…

Solely payments of principal and interest

Solely payments of

PRINCIPAL

Fair value at initial recognition

INTEREST

Time Value of Money

Credit risk

Other costs & profit

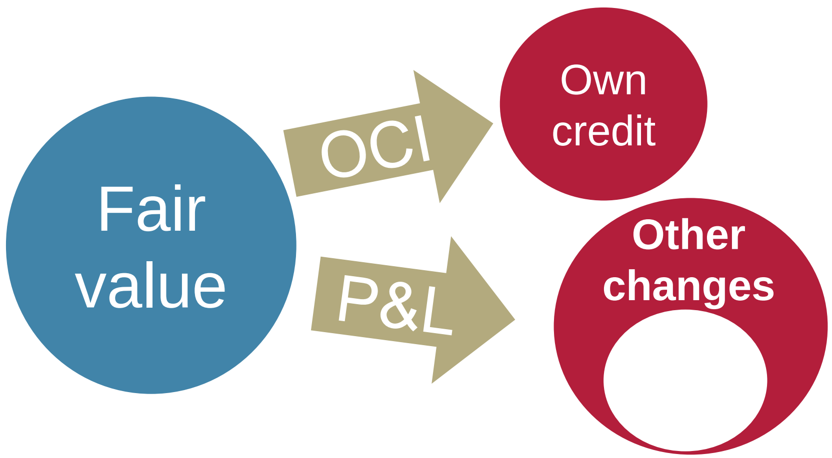
Other consideration

Alternative classification of financial assets

- Fair value option
- OCI election for particular equity instruments

Financial liabilities - own credit

- Required for all fair value option liabilities, unless doing so would create or enlarge an accounting mismatch



Impairment

IFRS 9 *Financial Instruments*

How accounting for credit losses improves

Addressing 'too little, too late'

- Broader range of information to consider
- Timely recognition of credit losses
- Addresses 'front-ending income, back-ending losses'

One impairment approach

- For all instruments in scope

Enhanced disclosures

- More information about credit risk and how it is managed

Overview of general model

Change in credit risk since initial recognition

	Stage 1 'performing'	Stage 2 'under-performing'	Stage 3 'non-performing'
Expected credit losses	'12-month' expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses
Interest revenue	Gross basis	Gross basis	Net basis

12-month expected credit losses (ECL)

Expected [lifetime] shortfall in all contractual cash flows given probability of default occurring in next 12 months

NOT:

- Expected cash shortfalls in next 12 months
- Credit losses on instruments expected to default in next 12 months

Example:

- Portfolio of 10m loans repayable over 5 years
- 2% probability of a default occurring in next 12 months
- Entire loss that would arise on default is 10%
- 12-month expected credit losses = 20,000 (2%x10%x**10m**)

Measuring Expected Credit Losses

ECLs need to reflect:

- Probability-weighted outcome
    - must consider possibility that default will/will not occur
- Time value of money
    - discount at effective interest rate or an approximation thereof
- Reasonable and supportable information
    - available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions

Particular measurement methods are not prescribed – designed to accommodate different information availability

Hedge accounting

IFRS 9 *Financial Instruments*

Accounting and risk management

Feedback on IAS 39

- Lack of an overarching principle; complex and rule-based
- Difficult for preparers to reflect hedging activities in financial statements
- Hard for users to understand risk management practices

Solutions in IFRS 9

- **Align accounting** treatment with **risk management activity**
- Enable preparers to better reflect hedging in financial statements
- Provide disclosures to help users understand risk management and its impact on the financial statements

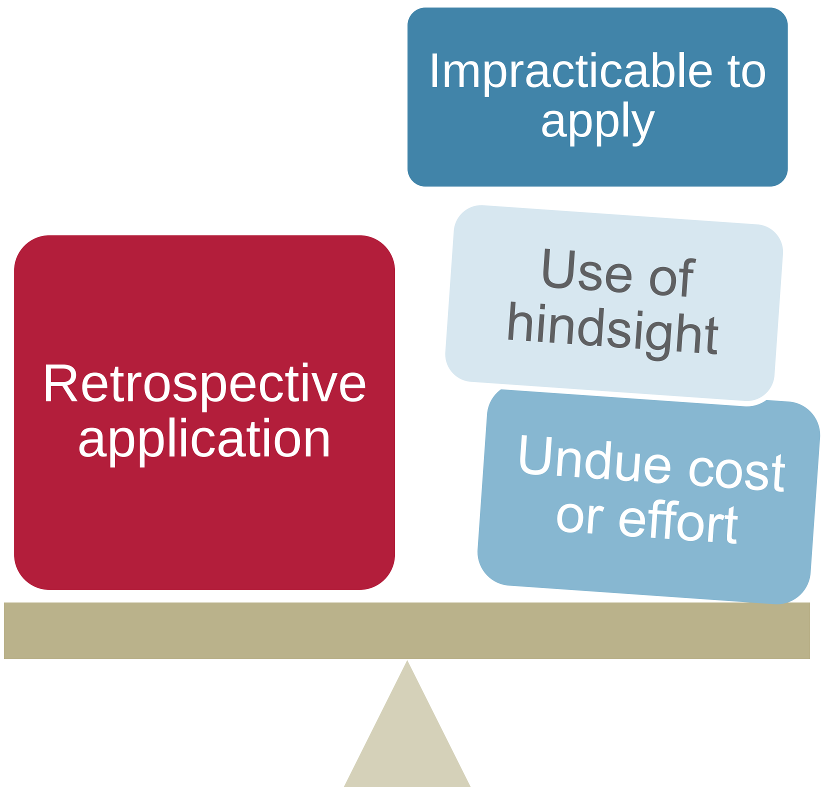
Major improvements

- A principle-based hedge effectiveness prospective assessment … and all ineffectiveness in P&L
- Designate risk components of non-financial instruments
- Ability to hedge aggregated exposures (combinations of derivatives and non-derivatives)
- Introduction of ‘costs of hedging’ to improve the transparency around some hedging instrument
- Disclosures that meet the objectives of understanding the hedged risks, how those are managed and the effect of hedging

For now, entities can choose to continue to apply IAS 39 hedge accounting

Dynamic Risk Management is a separate project

Transition to IFRS 9



Classification and measurement

- Assessment of business model as at date of initial application
- Impracticability alternatives

Impairment

- Undue cost or effort

Restatement of comparative reporting period not required

Investor considerations

- Must fundamental change– expected credit loss model
- Some changes to measurement of financial assets and use of OCI including ‘own credit’ effect for liabilities
- AFS accounting eliminated for equity investments. *Election* to use OCI (*with no recycling permitted*)
- Entities may continue to apply IAS 39 hedge accounting
- Application of hedge accounting likely to change for corporates
- Improved hedge accounting disclosures for all

Research Opportunities IFRS 9

- IFRS 9 brings many changes to accounting for FI. Studies that provide evidence about the impact of these changes will be helpful. Studies may use a range of methods.
- Pre and post application: what changes in accounting practice are observed. What are the financial impacts of the changes.
- What are the effects for market participants of the changes. What market outcomes are observed.
- Specific issues – see next slides

Research Opportunities IFRS 9

1. New expected credit loss model. What is impact on reported numbers and financial ratios. How do entities' calculations relate to economic fundamentals. How do entities, industries and countries compare in their application of the model. In the long term, how does better measurement of impairment contribute to goals such as financial stability.
2. There is no available for sale category. How many entities are affected by this change. What new policies are used. How many entities make use of the FVOCI election. What are the characteristics of these entities. How do investors respond to choices made.
3. What is the impact of new hedging requirements. Are any investor or market impacts observable. What is extent of adoption of new requirements compared to continuing to use IAS 39 requirements.

Research Opportunities IFRS 9

4. What transition arrangements have entities adopted – consider ECL and hedge/accounting risk management separately. What are characteristics of entities making various choices. Are any market impacts observable in relation to choices.

5. More disclosures are provided under IFRS 7. The Standards introduces more objective based disclosure requirements. Can researchers observe changes in entities' disclosures because the drafting of disclosure requirements are different. What factors are associated with better disclosures under IFRS 7. Are costs or benefits of better disclosure observable.

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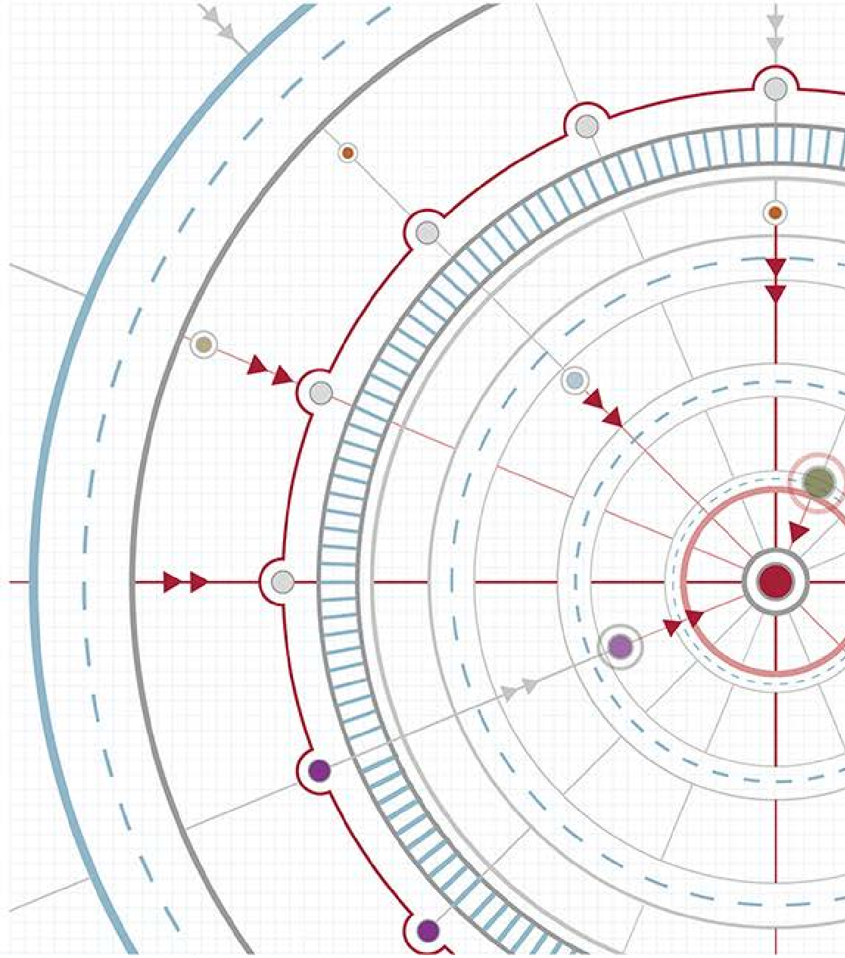

IFRS 15: Overview of the basics

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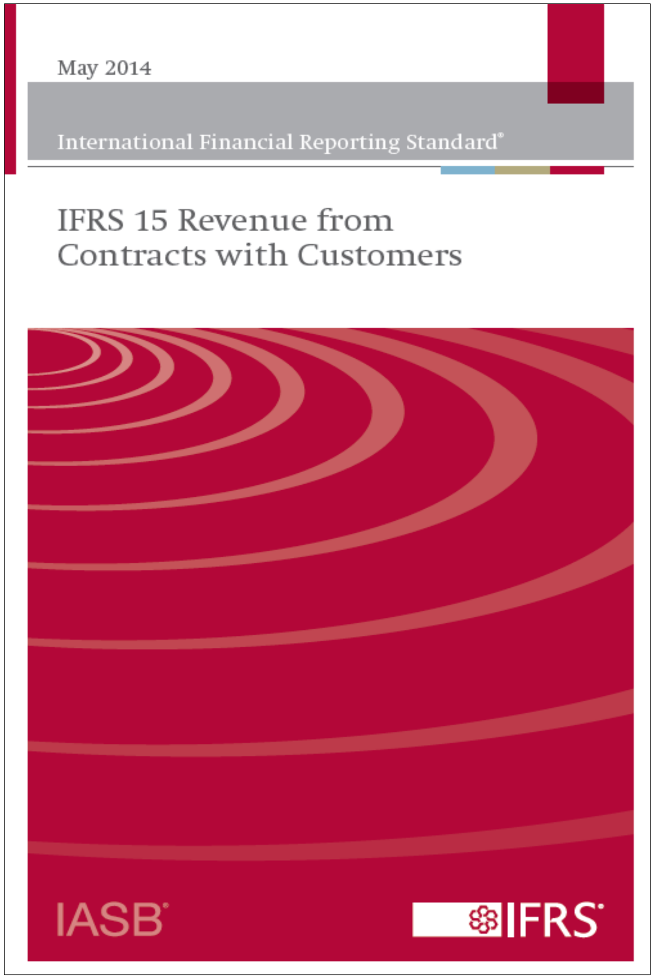
IFRS 15 at a glance



- Issued in 2014
- Effective 1 January 2018
- Replaces IAS 18 and IAS 11

Key points:

- Framework for all revenue recognition
- Developed jointly with FASB

The 5 steps to apply IFRS 15

Recognise revenue to depict transfer of goods or services in an amount of consideration to which the entity expects to be entitled

- Identify the contract(s) with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations
- Recognise revenue when (or as) the entity satisfies a performance obligation

Identify the contract

Existence of a contract

- Must meet specified criteria to apply the model, including collection of consideration is probable

Combine contracts

- Criteria to identify if legally separate contracts are in substance a single contract

Contract modifications

- Guidance to identify whether changes create additional new obligations or modify existing ones

Step 2

Identify performance obligations

Objective: To identify the promised goods or services that are distinct and should be accounted for separately

Promise to transfer a distinct good or service, or series of substantially similar distinct goods or services

Good or service is capable of being distinct

- Customer can benefit from good or service:
  - on its own; or
  - together with other readily available resources

Distinct within the context of the contract

- Is the entity's promise to transfer:
  - each of the goods or services separately; or
  - a combined item to which the goods or services are *inputs*

Step 3

Determine transaction price

- Transaction price is the amount to which the entity expects to be entitled in exchange for transferring goods or services
- Specific guidance on:

Variable consideration

Estimate using:
- Expected value
- Most likely amount

but 'constrained' (next slide)

Significant financing

Adjust promised consideration if timing provides customer or entity with significant benefit of financing

Non-cash consideration

Measure at fair value unless FV cannot be reasonably estimated

Consideration payable to customer

Reduction of the TP unless in exchange for a distinct good or service

When to recognise variable consideration

Include estimate of variable consideration in the transaction price only to extent it is *highly probable* a significant reversal of revenue will not occur when uncertainty is resolved

- Variable consideration is a broad term
  - includes rebates, refunds, price concessions
- Estimate of transaction price updated each period
- Expectations of revenue reversal assessed using 5 indicators

Variable consideration must be assessed – no default to nil

Step 4

Allocate the transaction price

Allocate to each performance obligation the amount to which entity expects to be entitled in exchange for satisfying that performance obligation

- Relative standalone selling price basis
  - estimate selling prices if not observable
  - residual estimation techniques may be appropriate
- Discounts and variable amounts allocated entirely to specific performance obligation if specified criteria met

Step 5

Recognise revenue when (or as) a performance obligation is satisfied

When is PO satisfied?

- As good or service is transferred
- Test: when does customer obtain control?

Satisfied over time?

- Percentage of completion
- Select single measure of performance that reflects progress

If not then point in time

- If fail criteria for POT then recognise point in time
- When entire PO is satisfied

Disclosure requirements

To enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

Revenue

- Disaggregation of revenue
- Amounts recognised relating to performance in previous periods

Contracts

- Information about contract balances and changes
- Information about performance obligations
- Amounts allocated to remaining performance obligations

Significant judgments

- Timing of and methods for recognising revenue
- Determining the transaction price and amounts allocated to performance obligations

Application guidance on…

- Performance obligations satisfied over time
- Methods for measuring progress
- Sale with a right of return
- Warranties
- **Principal versus agent considerations**
- Customer options for additional goods or services
- Customers’ unexercised rights
- Non-refundable upfront fees
- **Licensing**
  - Point in time versus Over time
  - Royalties
- Repurchase agreements
- Consignment arrangements
- Bill-and-hold arrangements
- Customer acceptance
- Disclosure of disaggregated revenue
- **Contract costs**

Principal versus agent

It’s all about control

Licensing intellectual property

Does the licenced IP change?

Right to *use* IP	Right to *access* IP	
IP has significant standalone functionality	Change in form or functionality of IP	Benefits substantially derived/dependent on licensor’s activities
Revenue at point in time	Revenue over time	

Sales-based or usage-based royalties for licence of IP

Exception applies if:

- Royalty relates only to a licence or
- Licence is the predominant item (eg licence to show a movie and additional promotional goods or services)

Contract costs

Contract costs

Acquire a contract	• Capitalise if incremental (except if contract <= 12 months)
Set-up costs	• No revenue recognition • Capitalise if create resource for future use
Fulfilment costs	• No WIP if PO satisfied over time

Transition

		PY (2017)		CY (2018)	CY Notes
Full retrospective	Cumulative catch-up	Contracts under new standard			
Modified retrospective		Contracts not restated	Cumulative catch-up	Contracts under new standard	Contracts presented under legacy IFRS

Optional reliefs that permit

- use of hindsight in restating modified contracts
- not to apply IFRS 15 to contracts that are completed contracts at the date of transition to IFRS 15

Completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with previous revenue Standard.

Explaining IFRS 15 transition

Revenue	Recognition of revenue over the life of major contracts and active software licences spread more evenly
Costs	Certain transformation spend, previously expensed, now capitalised as contract fulfilment assets and released over the contract life. Redundancies expensed upfront. Increased focus on cost reduction
Profit	Phasing of profits on major contracts may be shaped differently, with potentially lower profits or losses in the early years on contracts – but overall contract profitability unchanged – just the timing
Balance sheet	Net liabilities reflects increase in deferred income on contracts where we have been paid to undertake transformation prior to delivering planned outcomes for clients
Presentation	Underlying result further analysed to separately disclose results of significant new contract wins and restructuring
Cash	No change

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Investor considerations IFRS 15

- Changes can be complex: Transition disclosures are important and need to be communicated early
- Many investors struggled to understand the impact of IFRS 15
  - Confusion over revenue ‘double counting’ and ‘black-holes’
  - Annoyance with transition options
  - Suspicion if revenue shows greater divergence from cash
- The IFRS 15 disaggregation of revenue disclosure is key and unlikely to be met by preparers’ segment information
- Disaggregating revenue more than one way will often be necessary to satisfy the disclosure objective

Research opportunities IFRS 15

- Matters of interest are: pre/post application affecting recognition, measurement and disclosure – impact for preparers, auditors, investors and regulators.
- Specific to IFRS 15
  - What are the financial impacts of the new standard. How do industries and countries differ.
  - How does point in time and over time revenue recognition change pre/post application.
  - Expected industry impact regarding IP: What is observed. What is impact of change.

Research opportunities IFRS 15

- Specific to IFRS 15 (continued)
  - What choices were made on transition. How have transition disclosures benefited analysts and investors.
  - What is the quality of disclosure about the new policies and their impact. Is quality sufficient. Do ‘good’ disclosers benefit.
  - Does the standard get the right balance of disclosure objectives and disclosure requirements.

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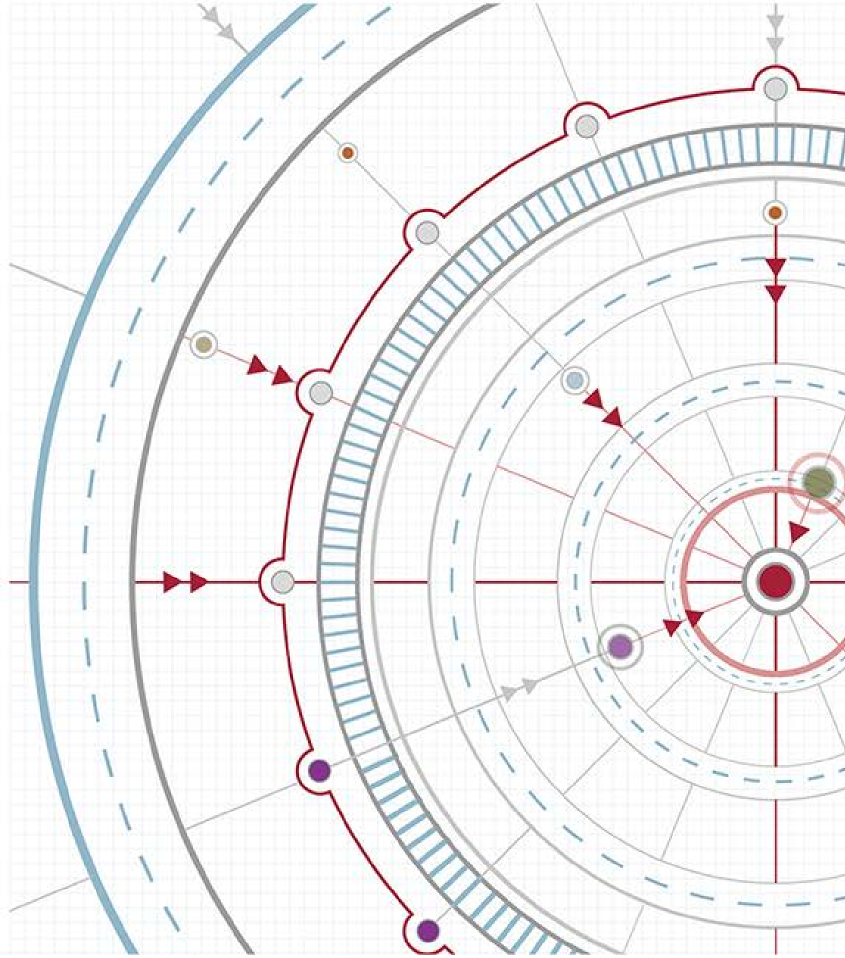

IFRS 16 *Leases*: Overview of the basics

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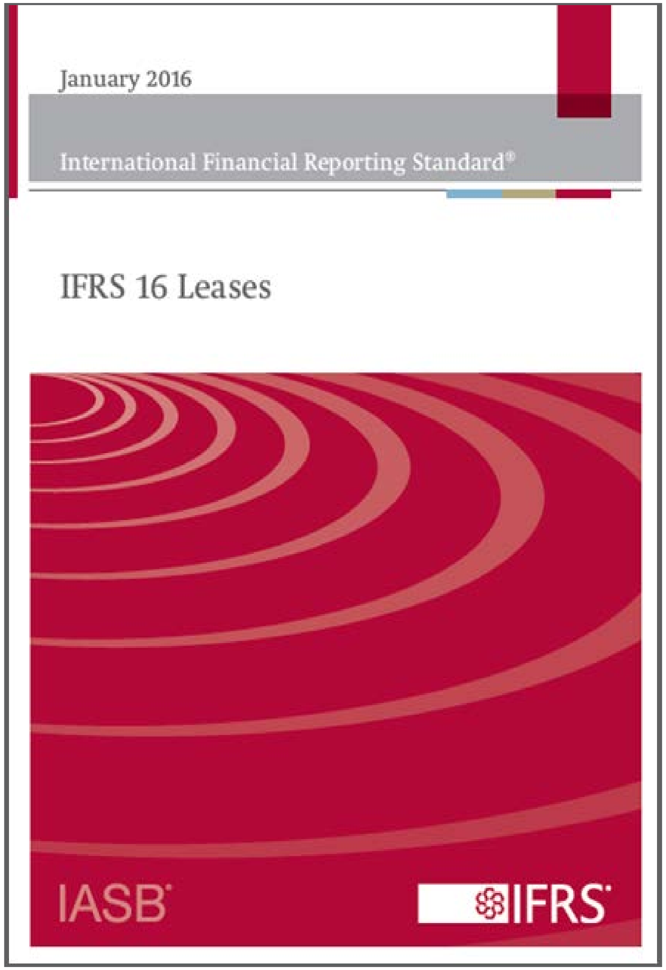
IFRS 16 at a glance



- Issued in January 2016
- Effective 1 January 2019
- Replaces IAS 17

Key points:

- Brings leases onto the balance sheet
- Changes lessee accounting substantially; little change for lessors
- Early application permitted (only with application of IFRS 15)

Why IFRS 16? The need for change

Leases are an important and flexible source of financing – listed companies using IFRS Standards or US GAAP estimated to have US$3.3trillion lease commitments

Over 85% of lease commitments **do not appear** on balance sheet today

This creates **challenges** for **users of financial statements**

The need for change: Currently a lack of information

- Six retail chains that ultimately went into liquidation

Retailer	Off balance sheet leases (undiscounted)[1]	Off balance sheet leases (discounted)[2]	On balance sheet debt[1]	Discounted leases as multiple of debt[3]
Borders (US)	$2,796M	$2,152M	$379M	5.68
Circuit City (US)	$4,537M	$3,293M	$50M	65.86
Clinton Cards (UK)	£652M	£525M	£58M	9.05
HMV (UK)	**£1,016M**	**£809M**	**£115M**	**7.03**
Praktiker (DEU)	€2,268M	€1,776M	€481M	3.69
Woolworths (UK)	£2,432M	£1,602M	£147M	10.90

[1] Based on averaged published financial statement data available for 5 years before company entered Chapter 11 (US), liquidation (UK) or bankruptcy (DEU).
[2] Estimated using (i) a discount rate of 5% and (ii) estimated average lease terms based on the information disclosed in the financial statements.
[3] Off balance sheet leases (discounted) as a multiple of on balance sheet debt

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What has changed for lessees?

Changes to lessee accounting

- Former operating leases capitalised
- All[1] leases accounted for similarly to today's finance leases
  - ROU asset and lease liability recognised
  - Depreciation of all ROU assets
  - Interest expense for all lease liabilities

[1] Exemptions for short-term leases and leases of low-value assets

What has changed for lessees?

Balance sheet

	IAS 17		IFRS 16
	Finance leases	Operating leases	All leases
Assets	✈ 🏛	---	✈ ✈ 🚗 🚌 🏛 🏛 🏛
Liabilities	$$	---	$$$$$$$
Off balance sheet rights / obligations	---	🚗 🚌 ✈ 🏛 🏛 $$$$$	---

Income statement

	IAS 17		IFRS 16
	Finance leases	Operating leases	All leases
Revenue	x	x	x
Operating costs *(excl. depreciation and amortisation)*	---	Single expense	---
EBITDA			⇧⇧
Depreciation and amortisation	Depreciation	---	Depreciation
Operating profit			⇧
Finance costs	Interest	---	Interest
Profit before tax			⇔

Definition of a lease

Based on which party **controls** the use of an **identified asset**

Customer has control →	**Lease**
Supplier has control →	**Service**

Optional recognition exemptions

Short-term leases

Leases of low-value assets

- If exemption is taken, account for these leases similarly to operating leases in IAS 17
- ie recognise **expense in P&L**

Balance sheet measurement: Lease liability

Lease liability = Lease payments during the lease term

x

Discount rate

- If readily determinable: rate implicit in the lease
- Otherwise: lessee's incremental borrowing rate

Balance sheet measurement: Lease liability

Lease payments:

Fixed payments

Variable payments (that depend on an index or rate OR that are in-substance fixed)

Optional payments (that are reasonably certain to occur)

Residual value guarantees (amounts expected to be payable)

Variable payments (that depend on **sales or use** of the underlying asset are **not included**)

Optional payments (that are not **reasonably certain** to occur are **not included**)

Lessor accounting

- Substantially retained the lessor accounting model in IAS 17
- Feedback on 2013 ED
  - Lessor accounting in IAS 17 is not broken
  - Concerns about cost and complexity

Subleases

Enhanced disclosures

Investor considerations IFRS 16

- Awareness of impact of changes to assets, liabilities, equity, income and expenses as well as cash flows, financial ratios and KPIs
- Entities need to communicate with banks, lenders, investors and others regarding financial impacts
- Understand the judgements and estimates made (eg lease vs service; lease terms; discount rates) and choices made on transition
- Additional disclosures will be provided, including for complex features (eg variable lease payments, extension options and residual value guarantees)

Research opportunities IFRS 16

- Impact of IFRS 16 – it's been a long time coming!
- On transition: What is the financial impact, observable in the financial statements, of the capitalisation of leases. What are the impacts on financial ratios. How do observed effects compare with expected effects.
- What is observed about choices on transition and the usefulness of transition disclosures. What are the attributes of entities making various choices and providing more useful disclosures.

Research opportunities IFRS 16

- In what ways are IFRS 16 disclosures useful for investors. How are companies meeting the disclosure *objectives* of the Standard.
- What are investor reactions/capital market benefits of the changes to recognition and disclosure.
- In what ways has the comparability of lease accounting improved for IFRS adopting entities in different industries and countries.
- Long term: do investors benefit from more capitalisation of leases.

In conclusion…

- The new IFRS Standards 9, 15 and 16 bring many changes
- IASB is seeking evidence of impact
  - Impact for preparers, auditors, investors, regulators
  - Capital market impact; also application issues
  - Post implementation reviews around 3 years after implementation
  - Range of research methods will be useful
- Researchers can benefit from the experience of investigating 2005 adoption effects

Relevant materials

- *IFRS 9*
- Overview: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-9-financial-instruments/
- List of supporting materials: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-9/#webcasts
  - Project Summary: https://www.ifrs.org/-/media/project/financial-instruments/project-summaries/ifrs-9-project-summary-july-2014.pdf
  - Articles: https://www.ifrs.org/-/media/feature/resources-for/investors/investor-perspectives/investor-perspective-jul-2014.pdf
- https://www.ifrs.org/-/media/project/financial-instruments/features/article-by-sue-lloyd-big-changes-ahead-march-2015.pdf
-

Relevant materials

- *IFRS 15*
- Overview: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-15-revenue-from-contracts-with-customers/
- List of supporting materials: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-15/#education
  - Project Summary and Feedback Statement: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-15/#education
  - Articles: https://www.ifrs.org/-/media/feature/resources-for/investors/investor-perspectives/investor-perspective-jun-2014-1.pdf
- https://www.ifrs.org/news-and-events/2016/04/ian-mackintosh-amendments-revenue-standard/
-

Relevant materials

- *IFRS 16*
- Overview: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-16-leases/
- List of supporting materials: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-16/
  - Effects Analysis*: https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf*
  - Project Summary and Feedback Statement: https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-project-summary.pdf
  - Articles: https://www.ifrs.org/-/media/feature/resources-for/investors/investor-perspectives/investor-perspective-jan-2016.pdf
- https://www.ifrs.org/news-and-events/2016/03/hans-hoogervorst-article-shining-the-light-on-leases
- https://www.ifrs.org/-/media/project/leases/ifrs/educational-materials/ifrs16-leases-article-jan2017.pdf
- https://www.ifrs.org/news-and-events/2016/01/gary-kabureck-article-little-to-fear-in-new-world-of-lease-accounting/

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individual comments
questions
comment
expressions of
individual views
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questions
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