EFRAG
European Financial Reporting Advisory Group

EFFAS THE EUROPEAN FEDERATION OF FINANCIAL ANALYSTS SOCIETIES

Organismo Italiano di Contabilità

aiaf
Associazione Italiana degli Analisti e Consulenti Finanziari

JOINT INVESTOR OUTREACH EVENT

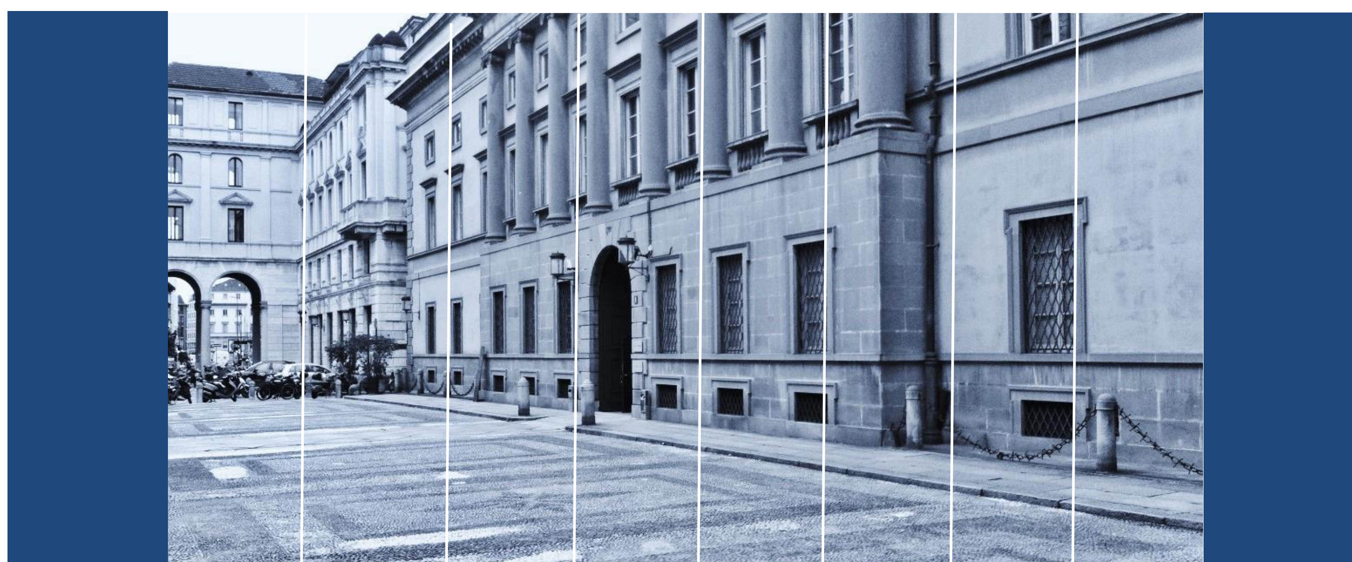
WHAT DO THE AMENDMENTS TO IFRS 4 MEAN FOR INVESTORS?

WHAT IS NEW IN ACCOUNTING FOR LEASES?

SUMMARY REPORT

MILAN

29 NOVEMBER 2016



This report has been prepared for the convenience of European constituents by the EFRAG Secretariat and has not been subject to review or discussion by neither the EFRAG Board nor the EFRAG Technical Expert Group. It has been reviewed by the speakers at the event and has been jointly approved for publication by representatives of EFRAG, EFFAS, OIC and AIAF who attended the outreach event.

Introduction

EFRAG together with the Associazione Italiana degli Analisti e Consulenti Finanziari (AIAF), European Federation of Financial Analysts Societies (EFFAS) and Organismo Italiano Di Contabilità (OIC) organised an investor outreach event in Milan on 29 November 2016 covering the amendments to IFRS 4 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* ("the Amendments to IFRS 4") and IFRS 16 *Leases*. This report has been prepared for the convenience of European constituents.

Paolo Balice (President of AIAF) opened the joint investor outreach event and welcomed EFRAG, EFFAS, the OIC, the speakers and participants.

At the conference, Fred Nieto (Head of Investor Engagement IASB) introduced the key elements of the Amendments to IFRS 4 issued in September 2016. Subsequently, Patricia McBride (EFRAG Technical Director) explained EFRAG's endorsement advice process on the Amendments to IFRS 4.

This was followed by a round table panel discussion led by **Angelo Casò**, President of the OIC Executive Board and EFRAG Board member. The panel comprised **Elena Perini**, AIAF, Intesa Sanpaolo and **Luca D'Onofrio**, EFFAS FAC, Bip who were joined by **Fred Nieto** and **Patricia McBride**.

Fred Nieto introduced the key changes and elements of IFRS 16 *Leases* and Saskia Slomp (EFRAG Director Governance & Admin) subsequently explained EFRAG's endorsement advice process on IFRS 16 and its Preliminary Consultation Document regarding the endorsement of IFRS 16.

This was followed by a round table panel discussion on IFRS 16 led by **Alberto Giussani**, member of the OIC Executive Board. The panel comprised **Chiara Del Prete**, AIAF, Mazars; **Marianna Sorrente**, AIAF; **Javier de Frutos**, Chairman EFFAS FAC; who were joined by **Fred Nieto** and **Saskia Slomp**.

The presentation slides can be found on EFRAG's Website (here)

Summary of observations on the Amendments to IFRS 4

Participants at the event expressed the following views:

- In general, panel members welcomed the Amendments to IFRS 4 as they reduced the accounting mismatches and volatility in reported results of insurance companies until the full implementation of IFRS 9 and forthcoming IFRS 17 *Insurance Contracts*.
- Insurers that are eligible for the temporary exemption from IFRS 9 are likely to use it while those that cannot use it are able to opt for the overlay approach. Still, some insurers may prefer the full implementation of IFRS 9 for different reasons.
- For investors, it will be difficult to distinguish economic volatility from accounting volatility if IFRS 9 is fully applied by insurers before the implementation of the forthcoming IFRS 17.

- Panel members preferred the temporary exemption from IFRS 9 as it solved the issues that arise from the misalignment of the effective dates of IFRS 9 and the forthcoming IFRS 17 *Insurance Contracts* and, at the same time, simplified the work of preparers and users.
- Panel members noted that IFRS 17 was a long-awaited standard and it was important to have the new standard ready as soon as possible so that investors could work together with insurers to understand what would change with the implementation of both IFRS 9 and IFRS 17.
- panel members noted that the deferral approach was the less costly approach for investors. Both the overlay approach and full implementation of IFRS 9 would involve additional costs for investors as they would have to change their models twice in a short period of time and understand how the changed requirements for financial instruments and insurance contracts would interact with each other.

Summary of observations on IFRS 16

Participants at the event expressed the following views:

- Panel members noted that IFRS 16 *Leases* represents a significant change to current accounting practice for lessees and some sectors are going to be more affected than others.
- Some panel members considered that, in general, IFRS 16 was an improvement over the existing accounting as it was going to increase the consistency, relevance and transparency of the accounting for leases contracts. One panel member also noted that it would reduce uncertainty for investors.
- Panel members considered that the lack of full convergence with US GAAP was a drawback of the new requirements. Lack of full convergence meant additional work for analysts as they would have to understand and measure the differences between IFRS and US GAAP.
- Panel members considered that companies' valuations were not going to be significantly affected by the new standard on leases, as an assessment of an entity's overall financial commitments (including operating leases) is already common, except for the financial industry where it would depend on the regulators' views on the regulatory capital treatment of the "right-of-use asset".
- One panel member noted that the debate around the nature of the "right–of-use asset" was important for the valuation of banks due to existing regulatory requirements on core capital.
- Panel members considered that the scope exception for leases of intangibles could reduce the relevance of information to users. In their view, the physical element should not prevent the lessee from retaining control of the asset.
- Optional recognition exemption for short-term leases and leases with low-value was considered a practical solution but there were concerns that the aggregation of small items could lead to material amounts and reduce comparability.
- Panel members acknowledged that IFRS 16 was likely to impact some non-GAAP measures, such as EBITDA and leverage indicators, but they noted that the calculation method of non-GAAP measures varies from entity to entity. Thus, they would continue to analyse carefully such measures.
- Although panel members considered that IFRS 16 brought greater comparability in terms of the balance sheet, there were mixed views on the impact on profit or loss, particularly on the

recognition of interest costs of lease contracts that were previously classified as operating leases.

- The new disclosure requirements in IFRS 16 were welcomed, particularly the disclosures related to lessors' risk exposure to residual value risk.
- Investors will incur one-off costs related to understanding the new requirements, updating their analysis and processes and developing comparable information. There will be no significant recurring costs once IFRS 16 is implemented.

Discussion on the Amendments to IFRS 4

Key elements of the Amendments to IFRS 4

At the conference, Fred Nieto introduced the key elements of the Amendments to IFRS 4 issued in September 2016. He highlighted that the IASB had issued the amendments to address the concerns arising from implementing the new financial instruments Standard, IFRS 9, before implementing the forthcoming insurance contracts Standard (IFRS 17). These concerns include temporary accounting mismatches and volatility in reported results.

He explained that the Amendments to IFRS 4 provided insurers with the option for a "temporary exemption from IFRS 9" (or the "deferral approach") until 31 December 2020 or to apply the "overlay approach" to designated financial instruments (i.e. adjust profit or loss for these financial assets so that it reports the same amount for these financial assets that it would have reported if IAS 39 had been applied) until the insurer first applies the forthcoming IFRS 17. Fred Nieto further detailed in which cases entities were eligible to use the options.

The IASB had acknowledged that the financial statements of insurers that opt to apply one of the two options will not be directly comparable with entities that apply IFRS 9. To mitigate this issue and improve comparability, the IASB gave particular attention to the scope of the options, presentation requirements on the face of the financial statements and related disclosures.

EFRAG's endorsement advice on the Amendments to IFRS 4

Patricia McBride explained EFRAG's endorsement advice process and provided some background information on the financial instruments and insurance contracts projects.

Patricia McBride recalled that EFRAG's conclusion on the endorsement of IFRS 9 had been positive, except for the impact on the insurance industry due to the misalignment of effective dates between IFRS 9 and the forthcoming IFRS 17.

The Amendments to IFRS 4 addressed many of the concerns raised in EFRAG's endorsement advice on IFRS 9. However, Patricia McBride noted that the temporary exemption option is not available to entities that have insurance activities but are not predominantly insurers, including entities that are conglomerates.

Patricia McBride further explained that EFRAG had already issued its draft endorsement advice letter on the Amendments to IFRS 4 in November 2016. EFRAG's overall preliminary assessment was that the Amendments to IFRS 4 satisfied the criteria for endorsement for use in the EU, including that the amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions. EFRAG had, therefore, recommended its endorsement.

Finally, Patricia McBride noted that EFRAG was seeking comments on all aspects of its analyses supporting its preliminary conclusions.

Main comments received

Do you welcome the IASB amendments to IFRS 4 in general?

Angelo Casò welcomed the panel members, conveyed Andrea Belluci's apologies, opened the debate and asked panel members whether they welcomed the IASB's amendments to IFRS 4.

In general, the Amendments to IFRS 4 were welcomed as they reduced the accounting mismatches and volatility in reported results of insurance companies.

The panel members were "generally in favour of the Amendments to IFRS 4" as they reduced the accounting mismatches and volatility in reported results of insurance companies until full implementation of IFRS 9 and forthcoming IFRS 17 *Insurance Contracts*.

One panel member welcomed the IASB and EFRAG's efforts and extensive consultations to address the concerns expressed by the European Insurance financial analysts on the misalignment of the effective dates of IFRS 9 and the forthcoming IFRS 17. He also welcomed the IASB's decision to include not only the overlay approach but also the deferral approach.

The panel members explained that the misalignment of the effective dates would lead to "accounting mismatches", particularly in the life insurance business. This is because some financial assets would start to be recognised at fair value through profit and loss under IFRS 9 (e.g. debt and equity instruments) while the liabilities for insurance contracts backed by those financial assets would remain measured at cost.

One panel member stated that these accounting mismatches could affect, for listed insurance companies in the Italian Market, approximately 27% of the pre-tax profit of the FTSE MIB[1]. This calculation took into consideration insurance companies, bancassurers and financial conglomerates.

[1] More detailed information can be found on the presentation slides (here)

In this panel member's view, major insurance companies were expected to opt for a "temporary exemption from IFRS 9". Therefore, the accounting mismatches were expected to be limited to 6% of the pre-tax profit of FTSE MIB and these would be mainly related to bancassurers and financial conglomerates.

In these cases, the insurance groups were likely to use IFRS 9 in their consolidated financial statements and the overlay approach in their individual financial statements.

This panel member also noted that based on the annual accounts, approximately 90% of the assets of the insurance companies were financial investments. These assets represented approximately 690 billion euros, from which 600 billion euros were related to life insurance.

Angelo Casò highlighted the importance of the concerns raised by the industry and observed that at a European level, approximately 75% of the assets of the insurance companies were financial investments.

Main comments received

Companies that can use the overlay approach and the deferral approach are expected to use the approach that provides the most relevant information to users. How do you expect them to decide?

Those that can use the temporary exemption from IFRS 9 are likely to use it while those that cannot are likely to opt for the overlay approach. Still, some may prefer full implementation of IFRS 9.

One panel member expected that the "overlay approach" was going to be applied by insurance companies that are part of financial conglomerates that cannot apply the "temporary exemption from IFRS 9" as they are not pure insurers. By contrast, this panel member expected that insurance companies that qualified for the temporary exemption from IFRS 9 were going to use the exemption.

Nonetheless, some insurance companies could still prefer the overlay approach or full implementation of IFRS 9 for different reasons. For example, some Scandinavian and British insurance companies were likely to apply IFRS 9 in full due to the use of unit-linked or indexed-linked insurance products.

It will be difficult to distinguish economic volatility from accounting volatility if IFRS 9 is applied without IFRS 17. Thus, it will also be difficult to understand insurers'

This panel member expressed concerns about the use of IFRS 9 by financial conglomerates, for their insurance activities, before the implementation of the forthcoming insurance contracts standard. In those cases, it would be difficult for users to distinguish the economic volatility inherent to the business from the artificial volatility introduced by the misalignment of the effective dates. This is because the users did not have, at that moment, detailed information about the duration mismatch between financial assets and liabilities, which is connected to the economic volatility.

asset liability management.

Without the amendments to IFRS 4, investors would have problems to understand insurers' asset liability management (ALM), particularly for life insurance products, including participating contracts.

This is because some debt instruments currently accounted for at amortised cost or at fair value through other comprehensive income (OCI) and most equity instruments currently accounted for at fair value through OCI with recycling are likely to be accounted for at fair value through profit or loss when applying IFRS 9. This would lead to an accounting mismatch because insurance liabilities backed by those assets remain measured at cost.

In terms of ALM, it would also be difficult for the management of financial conglomerates and bancassurers to establish a defined volatility and an investment strategy because of the noise created by accounting mismatches.

Main comments received

The overlay approach allows entities to mitigate artificial accounting fluctuations in profit or loss when using IFRS 9 before the forthcoming IFRS 17 is implemented. Will you make changes to your models? What companies do you expect will use the approach?

The overlay approach was considered a more complex option for investors when compared to the deferral approach.

Panel members considered that the overlay approach was a more complex option for investors in comparison with the deferral approach but better than the full implementation of IFRS 9 because they would have to understand how the requirements in IAS 39 would work together with the IFRS 9 requirements.

One Panel member stated that, for investors, the "overlay approach posed bigger problems than the deferral approach". Nonetheless, this panel member considered that additional disclosures on different sources of volatility, duration, interest rate movements and break down of asset classes would be very useful for investors to build up their models and estimate future cash flows.

Main comments received

If qualifying companies choose to defer the application of IFRS 9, what implications will this have for your work (models, comparability with other companies and industries)?

The deferral approach was the preferred approach as it solved the issues that arise from the misalignment of the effective dates and, at the same time,

Panel members were generally in favour of the deferral approach as it solved the issues related to the misalignment of the effective dates of IFRS 9 and the forthcoming IFRS 17 and, at the same time, simplified the work of preparers and users.

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One panel member added that he welcomed the alignment of the dates for the expiry of the temporary deferral from IFRS 9 and first-time adoption of the forthcoming IFRS 17 (1 January 2021). The deferral approach having a limited life demonstrated the IASB's commitment to finalise the new standard on insurance contracts and set a pace for the implementation of both IFRS 9 and IFRS 17.

If qualifying companies opt for a temporary exemption from IFRS 9, investors will not have to change their valuation models twice in a short period of time and would reduce comparability issues.

Panel members expected that major insurance companies, particularly in continental Europe, would opt for the deferral approach, which would reduce the comparability issues. In those cases, investors were not expecting to have to change significantly their valuation models and it would be easier for them to forecast future cash flows. Therefore, this was their preferred solution as they will not need to change their valuation models twice in a short period of time.

For conglomerates and bancassurers that are not eligible for the temporary exemption from IFRS 9, panel members noted that the disclosures will be key in terms of obtaining information that will enable users of financial statements to compare entities that apply the temporary exemption with those that apply IFRS 9 (with or without the overlay approach). The disclosures were also important to understand the entity's volatility.

At the same time, investors would also need to prepare themselves for the implementation of IFRS 9 by 2021. Therefore, it was important to have IFRS 17 published as soon as possible so that investors will be able to work with insurers to understand what will change with the implementation of both standards.

The forthcoming IFRS 17 is a long-awaited standard by investors and it is important to have the new standard ready and published as soon as possible.

Panel members explained that only with IFRS 17 will there be a better connection between assets and liabilities which will help investors to make comparisons and would bring more consistency for insurance contracts accounting. One panel member further explained that the forthcoming IFRS 17 was a long-awaited standard by investors, particularly in terms of disclosures which were expected to provide more insight about the different lines of businesses (e.g. life and non-life). He also expected a clear definition of duration of assets and liabilities in the forthcoming standard on insurance contracts.

In terms of alternative performance measures, this panel member considered that it would be useful to have risk management indicators such as Solvency II ratios for insurance companies.

Finally, this panel member expressed a concern about not having IFRS 17 finalised and implemented by 2021. He explained that the current low interest rate environment is affecting both sides of the balance sheet. As a consequence, insurance companies' investment portfolios have tended to change over time towards more risky investments (and less fixed rate bonds). This could lead to more instability in the insurance business. As IFRS 17 will play a key role for investors and the insurance industry, it is important that the insurance contracts standard be published and implemented as soon as possible.

Main comments received

The use of different options would raise comparability issues for investors and disclosures will have a key role in helping to promote comparability.

Are the disclosures in the amendments to IFRS 4 adequate?

The panel members stated that the use of different options raised comparability issues for investors.

To mitigate this issue, the panel members considered that disclosures would have a vital role in helping to promote comparability between different insurance companies, including those located in other jurisdictions.

For example, one panel member highlighted that the disclosures in the Amendments to IFRS 4 would provide users with information about the differences that arise from measuring designated financial instruments under IFRS 9 and IAS 39. This information would help users to make meaningful comparisons.

Main comments received

The deferral approach is the less costly approach for investors. Both the overlay approach and full implementation of IFRS 9 will involve additional costs for users as they will have to change their valuation model twice and understand how the different requirements interact.

What are the additional costs for users under each of the approaches?

Panel members considered that the deferral approach would not give rise to significant costs because investors would retain their models until both IFRS 9 and IFRS 17 are implemented.

Panel members stated that the full implementation of IFRS 9 by insurance companies was going to imply higher costs for investors, especially due to the fact that IFRS 17 has not yet been published. For them, the main cost was related to having to change their valuation models twice in a short period of time (when IFRS 9 is implemented and when IFRS 17 is implemented).

The overlay approach was considered the most costly option for investors as they would have to understand how the requirements in IAS 39 would work together with the IFRS 9 requirements.

One panel member would prefer to refer to this as an "investment" rather than a "cost", as these measures are necessary to provide useful information to users of financial statements and help preparers to implement the new set of requirements. He also highlighted the importance of having a common framework for accounting and regulatory disclosure requirements.

Discussion on IFRS 16

Key elements of IFRS 16

The new IFRS 16 Leases supersedes the requirements in IAS 17 Leases and companies are required to apply the new requirements from 1 January 2019.

Fred Nieto explained some key changes that investors would see with the new leases standard (IFRS 16) that had been issued by the IASB in January 2016. The new standard supersedes the requirements in IAS 17 *Leases* and companies are required to apply the new requirements from 1 January 2019.

He noted that IAS 17 had been criticised for failing to meet investors' needs because it did not require lessees to recognise the assets and liabilities for the rights and obligations that arise from their operating lease contracts, which are commonly used in in industries such as the airline, retail and transport sectors. To address this issue, the IASB and the FASB ("the Boards") had initiated a joint project in 2006 to develop a new approach for lease accounting. With the finalisation of the leases project and publication of IFRS 16, investors would no longer have to estimate the effects of a company's off balance sheet lease obligations that arise from operating lease contracts.

He further explained that the Boards had reached similar decisions regarding the measurement of lease liabilities and how to account for leases that were formerly classified as finance leases. They had also decided to provide more detailed guidance on specific topics such as the combination of contracts and leases with variable payments. Finally, the Boards had decided not to substantially change the accounting for lessors.

Nonetheless, the Boards had reached different decisions for leases that were formerly classified as operating leases with respect to the recognition of lease expenses and the reporting of lease-related cash flows for lessees.

EFRAG's endorsement advice on IFRS 16

EFRAG has already published a Preliminary Consultation Document regarding the endorsement of IFRS 16 and a questionnaire to users to obtain their views on the endorsement of the new leases standard.

Saskia Slomp explained EFRAG's endorsement advice process on IFRS 16. In October 2016, EFRAG published a Preliminary Consultation Document regarding the endorsement of IFRS 16 and in November 2016 issued a questionnaire to users to obtain their views on the new leases standard.

EFRAG's preliminary assessment on IFRS 16 had been, overall, positive in its Preliminary Consultation Document. However, EFRAG had not yet assessed whether IFRS 16 would reach an acceptable cost-benefit trade-off nor reached a preliminary conclusion as to whether IFRS 16 is conducive to European Public Good.

During the consultation period EFRAG was going to conduct additional work on a number of topics. In particular, it was going to obtain evidence and input for the European public good assessment through an economic study that had been commissioned on the effects of IFRS 16 and further work undertaken by the EFRAG Secretariat on small listed companies and SMEs using IFRS and on the behaviour of users.

Saskia Slomp finally highlighted that EFRAG expected to provide its final endorsement advice to the European Commission at the end of the first quarter of 2017.

Main comments received

Big change: all leases on the balance sheet. How do you react?

Alberto Giussani welcomed the panel members, opened the debate and asked how panel members reacted to the changes brought by IFRS 16.

IFRS 16 represents a significant change to current practice for lessees in Europe, still some sectors are going to be more affected than others.

Panel members acknowledged that IFRS 16 represented a significant change to current practice for lessees in Europe as it was going to eliminate the distinction between operating and finance leases for lessees and required all leases to be recognised on the balance sheet with related expenses split into depreciation and interest.

Some panel members highlighted that some sectors were going to be more affected than others by the introduction of the new single lessee accounting model, particularly entities that frequently used "operating leases" (as defined in IAS 17). With the implementation of IFRS 16, all companies with former "operating leases" were going to report higher amounts of assets and liabilities in their balance sheets.

In general, IFRS 16 will reduce uncertainty and increase the relevance and transparency of the information provided to users.

When discussing the lease standard more in general, some of the panel members welcomed IFRS 16 and considered that the new accounting model was an improvement as it was going to increase the relevance and transparency of the information provided to users. These panel members explained that the financial statements would better reflect the assets and liabilities that arise from lease contracts ("right-of-use or lease assets" and "lease liabilities"), users would have more information about the entity's leases obligations and all lease contracts would be accounted for on the same basis. Consequently, financial statements would give a more faithful representation of the economics behind the lease transaction and would bring more transparency.

One panel member added that one other significant advantage of IFRS 16 for investors was that it eliminated most of the judgements that analysts needed to make to estimate the lease liabilities related to operating leases. In his view, this would increase the accuracy of their analysis and reduce uncertainty, particularly in sectors that frequently used operating leases.

Another panel member considered that IFRS 16 was a “step forward for long-term commitments”. With the implementation of IFRS 16, companies would have to provide a more complete picture of their financial position. This panel member also welcomed the new disclosure requirements, including the information about different classes of assets being leased and different components of the lease contracts.

Nonetheless, this panel member noted that after initial recognition, the changes in the carrying amounts of leases assets and lease liabilities followed a different pattern. Therefore, changes in the net position would impact reported equity. This panel member questioned the meaning of such impacts on equity and on the valuation of entities.

Despite the Boards’ efforts, the lack of full convergence with US-GAAP was a drawback of the new requirements.

Two panel members noted that although convergence had been a priority for the IASB and FASB, they had reached different conclusions in some areas of the lease accounting, particularly on the recognition of expenses and exemption for small items for lessees.

One panel member explained that although both standards required lease assets and lease liabilities to be recognised on the balance sheet, the subsequent accounting for lease contracts was different: the FASB’s model retained a dual approach, in terms of presentation and recognition of expenses, while the IASB’s model introduced a single lessee accounting model.

One panel member explained that under the FASB model, companies would have to recognise a single expense in operating costs when accounting for “operating lease contracts”. In addition, the annual depreciation charges related to operating lease assets were going to be calculated differently from the finance lease assets. In particular, entities that applied the FASB model were going to recognise lower levels of depreciation charges in the first years of the “operating lease” contracts. As a consequence, entities’ reporting under IFRS will report higher depreciation, lower carrying amounts of lease assets and a lower level of equity in the first years. Therefore, the US standard could be considered more advantageous in the first years for entities that extensively used operating lease contracts.

Therefore, these two panel members considered that one of the limitations of the new lease standard was the lack of full convergence with US GAAP.

A participant referred to the loss of information about the distinction between operating and finance leases, particularly when referring to short term lease contracts. He noted that this could lead to some investors having to adjust EBIT or EBITDA and interest cost to reflect the short-term leases in operating results.

One panel member replied that the key objective of the standard was to have more leases on the balance sheet and he was not concerned about not having different classes of lease contracts.

Main comments received

Companies that are likely to be the most affected are those renting real estate and airlines. Will recognising leases in the balance sheet make a substantial impact on these companies' valuation? And in the cost of capital?

Companies' valuations are not going to be significantly affected by the recognition of leases in the balance sheet, except for the financial industry where it will depend on the regulators' views about "right–of-use asset ".

Some panel members considered that the recognition of all leases in the balance sheet was not going to substantially impact their valuations. Nonetheless, one panel member noted that investors would have to assess the impact of the new standard on their valuations on a case by case basis.

These panel members highlighted that the new standard could impact their computation of debt-like liabilities and EBITDA. One panel member indicated that the implementation of the new standard could also affect the calculation of the weighted-average cost of capital ("WACC") as investors would need to reconsider the entities' capital structure.

This panel member also explained that investors often used valuation multiples (e.g. multiples of EBITDA) in their valuation models and they were likely to keep using them in the future.

Finally, he noted that investors would continue to analyse the terms and conditions of the leases contracts.

The debate around the nature of "right–of-use asset" is important for the valuation of banks due to the existing regulatory requirements on core capital.

One of the panel members raised the debate around the nature of assets related to the "right–of-use asset". This panel member questioned whether these assets were an intangible or a tangible asset.

For the financial industry this was an important debate due to the existing regulatory requirements on core capital of financial institutions. For example, if the "right-of-use asset" was to be considered an intangible asset, then financial institutions would have to deduct them from core capital. Therefore, depending on how the "right-of-use asset" was considered by the regulators, the new

standard could have a significant an impact on the valuation of banks and on their cost of capital.

Main comments received

Under new US-GAAP and IFRS, leases are brought into the balance sheet but the cost is recognised differently. Do you expect this to be an issue?

Lack of full convergence means additional work for analysts as they will have to understand and measure the differences between the IFRS and US GAAP and make adjustments to improve comparability.

The panel members agreed that, in general, convergence was important for them and comparability across jurisdictions was key. They acknowledged that there were differences between the two models and this raised comparability issues.

Two panel members highlighted the comparability issues in respect to the accounting for operating leases expenses. Different requirements in IFRS and US GAAP meant that investors would have to understand and measure the differences between the two models and make their own adjustments to increase comparability. Consequently, this meant more work for analysts.

One panel member considered that the level of convergence between IFRS and US GAAP had decreased with publication of IFRS 16.

Nonetheless, the panel members expected that the enhanced disclosures would help them in obtaining the details that investors need.

Main comments received

Have all type of contracts been identified?

The scope exception for leases of intangibles could reduce the relevance of information provided to investors as the physical element does not prevent the lessee from having control of the asset.

Panel members noted that IFRS 16 included a scope exception for leases of intangible assets such as licensing agreements.

Two panel members considered that this scope exception could reduce the relevance of the information provided to investors and increase the need to make adjustments. The panel members highlighted that some sectors, such as the pharmaceutical and telecommunication sectors, regularly licensed their products. Such agreements could include the transfer of control of certain assets such as patents. They considered that the physical element did not prevent the lessee from retaining control of the asset. Thus, these panel members considered that there was a risk of omission of relevant information and considered that the IASB had not properly explained the scope exemption.

Optional recognition exemption for short-terms leases and leases of low-value assets was a practical solution, but

One panel member considered that the optional recognition exemption for short-terms leases and leases of low-value items was a practical solution, particularly when considering that there were small items, such as personal computers, that were subject to significant technological changes. Nonetheless, this panel member

there were concerns that the aggregation of small items could lead to material amounts.

noted that the aggregation of small items could lead to material amounts and highlighted the risk of not evaluating properly the assets and liabilities in such cases. Even though there are specific disclosures required for short term leases in terms of future lease commitments, it is not required for leases of low-value items.

One participant mentioned that gas suppliers use infrastructure to supply gas to their customers on a continuous basis. Usually gas suppliers have no issues with demonstrating that they control the use of the factory when it serves multiple clients. However, it was less obvious if the gas supplier built a factory to serve a single client in an isolated location where any transportation would be extremely onerous. In that case, as the client directs how and when the gas is supplied and it benefits from nearly all the capacity of the plant, questions arise as to who controls and recognises the infrastructure.

Main comments received

The new standard for leases contains guidance for modifications, recognising any gain or loss in P&L. This can affect a company's valuation. Is it an improvement for users?

IFRS 16 introduced detailed measurement requirements to address the intrinsic flexibility of leasing contracts but investors will have to consider whether profit or loss has to be adjusted when making their forecasts.

One panel member was uncertain how the accounting for lease modifications was going to impact valuations. For example, if there is an increase in the scope of the lease and the price is commensurate with market conditions, investors will not see immediate impacts on profit or loss. By contrast, if price changes are not in accordance with market price, then profit or loss is affected. This panel member considered that this was similar logic to the concept of onerous contracts in IAS 17.

However, when there is a decrease in the scope of the lease contract, both lease assets and liabilities would have to be adjusted. This would result in an impact on profit or loss. This panel member was unsure of the economic substance of such an impact on profit or loss. Investors would have to consider whether such items would have to be adjusted when projecting earnings and cash items.

Another panel member noted that IFRS 16 reflected the intrinsic flexibility of the leasing contracts and introduced detailed measurement requirements to address the issues that typically arise from leasing contracts (e.g. lease modifications). Thus, the lessee at each year end will have to reconsider the contract terms in order to evaluate whether the amounts reflected in the financial statements was still correct. She considered that this increased the relevance of the information. However, this would increase the volatility of the information and consequently, for users, it would be more difficult to make forecasts.

Main comments received

IFRS 16 may impact non-GAAP measures on financial performance (EBITDA) and position (leverage), particularly in some industrial sectors. Still, the calculation method of non-GAAP measures varies from entity to entity.

Does it matter that non- GAAP measures will change?

Panel members acknowledged that IFRS 16 was likely to impact some non-GAAP measures used by companies.

For companies that frequently used operating leases, the implementation of IFRS 16 would result in the increase of assets, liabilities, EBIT and EBITDA. Finance costs were also expected to be impacted with the implementation of IFRS 16.

Panel members expected that non-GAAP measures that use these elements would be affected with implementation of IFRS 16. For example, gearing ratios and multiples of EBITDA or EBIT were likely to be affected.

One panel member noted that depending on what will be the starting point of the entity and which sector the entity belongs to, companies might give a better picture of some financial indicators (e.g. EBITDA) but worse in others (e.g. interest costs).

This panel member also noted that non-GAAP measures were defined differently from company to company, which raised comparability issues. An additional issue was the need to make adjustments to historical information for comparability reasons. Thus, investors would have to make adjustments on a case-by-case basis.

Main comments received

Although IFRS 16 brought greater comparability in terms of balance sheet, there were mixed views on the impact on profit or loss, particularly on the recognition of interest costs on lease contracts that were previously classified as operating leases.

Lease liabilities are measured similarly to financial liabilities at amortised cost. What are your views on this measurement?

One panel member considered a lease contract was an investment decision that led to a long term commitment that should be discounted. In her view, it was necessary to separately recognise the interest component.

This panel member considered that IFRS 16 brought more comparability between companies that use lease contracts and those that borrow to acquire an asset.

Nonetheless, this panel member noted that these two transactions were not exactly the same and did not lead to the same results. The amount of assets and liabilities recognised in the balance sheet with the lease contract were not the same as those that arise with a loan. This is because leases did not include residual values.

By contrast, one panel member considered that the finance industry was used to the classification of leases by lessees as either operating or finance. This panel member struggled to consider the obligation that arises from an operating lease as a financial liability.

This is because, in her view, the lessee of an operating lease was not going to pay interest for that lease liability.

Fred Nieto clarified that conceptually, the lease asset recognised under IFRS 16 represented the right to use an asset and not the acquisition of the asset.

He also referred to the IASB's effect analysis study and explained that with IFRS 16 companies would provide information more aligned to the credit agencies methodology regarding their analysis of operating lease contracts.

In addition, Fred Nieto noted that in terms of cost of capital and cost of debt, many providers of debt finance were already looking at the economic substance of operating leases and incorporating that into their lending decisions and thinking about them as financing. This had been one of the reasons why the IASB had decided to change the requirements on leases.

In terms of convergence, Fred Nieto explained that despite the convergence efforts, there were a few areas for which the IASB and the FASB did not reach the same conclusions. The IASB reached different conclusions from the FASB only after carefully evaluating the implications of doing so and when, in its view, its conclusions represented a higher-quality solution.

Main comments received

Enhanced disclosures will provide more information about lessors' risks. Is this an element that will provide users with a more comprehensive understanding of the company?

The new disclosure requirements in IFRS 16 were welcomed, particularly the disclosures related to lessors' risk exposure to residual value risk.

Some panel members welcomed the enhanced disclosures in IFRS 16, particularly information about different classes of assets being leased, different components of the lease contracts and breakdown of the expense related to leases.

These panel members explained that although IFRS 16 brought little change for lessors, it increased the disclosure requirements for lessors. More specifically, IFRS 16 required lessors to provide more disclosures about the risk attached to the residual element of the assets (residual value risk) and how companies manage their exposure to residual value risk. They considered that this was an improvement in terms of transparency.

One panel member noted that IFRS 16 did not require disclosures about the fair value of the underlying assets, which would have been useful for investors.

Main comments received

Investors will incur one-off costs related to understanding the new requirements, updating their analysis and processes and developing comparable information.

What are the additional costs for users in applying IFRS 16?

Some panel members considered that the costs for investors were not significant. These panel members explained that investors would incur one-off costs related to understanding the new accounting model; updating their analysis and processes; and developing comparable information from the different transition options included in IFRS 16. That is, "investors will have to work with the numbers to get figures more comparable."

One panel member also noted that investors might also need to make additional adjustments if there are some lease contracts that are not within the scope of IFRS 16 (e.g. licensing agreements) or when the investor has to compare entities that apply US GAAP and IFRS. For that, investors will have to rely on the disclosures to obtain the necessary information.

Fred Nieto clarified that not all investors were making adjustments, and IASB believed that IFRS 16 would reduce the need for adjustments but would not eliminate them.

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2016

Joint Investor Outreach Event • Milan

What is new in accounting for leases?
What do the IFRS 4 amendments on applying IFRS 9 for insurance companies mean for investors and analysts?

Tuesday 29 November 2016 • 14:00-18:30
Sala Convegni Intesa Sanpaolo • Piazza Belgioioso,1 • Milan

PROGRAMME

13.30 – 14.00 **Registration and coffee**

14.00 – 14.10 **Opening and Welcome,** ***Paolo Balice****, President AIAF*

14.10 – 15.45 **What do the IFRS 4 amendments on applying IFRS 9 for insurance companies mean for investors and analysts?**

- **Introduction main elements amendments to IFRS 4, Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts**
  - ***Fred Nieto,*** *Head of Investor Engagement IASB*
- **EFRAG seeking input on endorsement advice on amendments to IFRS 4**
  - ***Patricia McBride,*** *EFRAG Technical Director*
- **Round table panel discussion**
  - *Facilitator:* ***Angelo Casò,*** *President of the OIC Executive Board and EFRAG Board member*
  - *User Panel:* ***Elena Perini,*** *AIAF, Intesa Sanpaolo -* ***Andrea Bellucci,*** *AIAF -* ***Luca D'Onofrio,*** *EFFAS FAC, Bip*

Issues suggested to be addressed:

- Do you welcome the IASB amendments to IFRS 4 in general?
- Companies that can both use the overlay approach and the deferral approach (temporary exemption from IFRS 9) are expected to use the approach that provides the most relevant information to users. How do you expect them to decide?
- The overlay approach allows entities to mitigate artificial accounting fluctuations in the profit or loss when using IFRS 9 before the new insurance contracts standard IFRS 17 being available. Will you make changes to your models? What companies do you expect will use the approach?
- If qualifying companies choose to defer the application of IFRS 9, what implications will this have for your work (models, comparability with other companies and industries)?
- Are the disclosures in the amendments to IFRS 4 adequate?
- What are the additional costs for users under each of the approaches?

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15.45 – 16.00 **Coffee break**

16.00 – 17.55 **What is new in accounting for leases?**

- **Introduction main elements IFRS 16 *Leases***
  - ***Fred Nieto***, *Head of Investor Engagement IASB*
- **EFRAG seeking input on endorsement advice on IFRS 16**
  - ***Saskia Slomp***, *EFRAG Director Admin & Governance*
- **Round table panel discussion**
  - *Facilitator:* ***Alberto Giussani***, *member of the OIC Executive Board*
  - *User Panel:* ***Chiara Del Prete,*** *AIAF, Mazars –* ***Marianna Sorrente***, *AIAF –* ***Javier De Frutos,*** *Chairman EFFAS FAC*

  Issues suggested to be addressed:
    - Big change: all leases on the balance sheet. How do you react?
    - Have all type of contracts been identified?
    - The new standard for leases contains guidance for modifications, recognising any gain or loss in P&L. This can affect a company's valuation. Is it an improvement for users?
    - Lease liabilities are measured similarly to financial liabilities at amortised cost. What are your views on this measurement?
    - Companies that are likely to be the most affected are those renting real estate and airlines. Will recognising leases in the balance sheet make a substantial impact on these companies' valuation? And in the cost of capital?
    - Enhanced disclosures will provide more information about lessors' risks. Is this an element that will provide users with a more comprehensive understanding of the company?
    - Under new US-GAAP and IFRS standards, leases are brought into the balance sheet but the cost is recognised differently. Do you expect this to be an issue?
    - Does it matter that non-GAAP measures will change?
    - What are the additional costs for users in applying IFRS 16?

17.55 – 18.00 **Wrapping up and closing of conference**

  - **Jesús López Zaballos**, *Chairman EFFAS*

18.00 – 18.30 **Drinks**

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JOINT INVESTOR OUTREACH EVENT

TUESDAY 29 NOVEMBER 2016

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SPEAKERS' BIOGRAPHIES

Fred Nieto

Fred joined the IASB in June 2013, and as of June 2016 is the Head of Investor Engagement. This role involves leading investor engagement activities, both maximizing the possibilities afforded by investor participation in the development of IFRS standards and acting as an advocate for investors' views internally. His previous role at the IASB was as the Investor Education Manager.

Prior to joining the IASB, Fred worked as an equity research analyst in London on the sell-side and on the buy-side. His experience includes having covered the European Insurance sector at UBS Investment Bank and Execution Limited, and having covered the global financial sector at a long/short equity hedge fund. Fred earned an MSc in International Accounting & Finance from the London School of Economics and is a holder of the CFA designation.

Patricia McBride

Patricia McBride joined EFRAG in April 2014 as Technical Director.

Although she is a UK citizen, she has spent most of her career working in Asia-Oceania. She is well known in the international IFRS arena for her technical roles supporting the standard setters in Australia, New Zealand and Hong Kong. Part of her career was spent in academia and in her earlier days she was Chief Accountant of a subsidiary of a large German corporate for eight years. She has written for textbooks, academic journals and newspapers and has extensive experience explaining technical accounting issues to non-accountants.

Angelo Casò

Angelo Casò graduated in Economy at the University "Luigi Bocconi" in Milano (Italy) in 1964 and has been "Dottore Commercialista" since 1965 and "Revisore Contabile" since 1970.

His professional experience covers audit, governance of companies, business evaluation, financial restructuring, forensic expert reports, insolvency.

Mr Casò was vice-President of FEE from its creation and President in 1993/1994 as well as a Member of the Board of IFAC and Chair of IFAC SMP Working Group in the years 2001-2005. He is currently a Member of the IFAC Compliance Advisory Panel.

He is currently President of the Executive Board of the "Organismo Italiano Contabilità -O.I.C." (the Italian National Accounting Standards Setter) since March 2008.

Elena Perini

Elena Perini graduated in Economics from the Catholic University of Milan in 1998. She is an AIAF member.

With previous experience as an auditor, Elena has worked as a financial equity analyst since 2001.

She joined Intesa Sanpaolo Research Department in 2012 as equity analyst specialised in the Italian Insurance and Asset Gathering sectors. She previously worked as Banking equity analyst at Centrobanca, Dresdner Kleinwort, RasBank and EptaSim.

Andrea Bellucci

Before joining University of Perugia as Associate Professor of Accounting, Andrea was head of Organization Department at Fondaria Group Companies and consultant for primary Insurance and Financial Companies.

He is also Senior Consultant in Business Integration Partners as well as author of several publications on financial reporting, local and international GAAP, value creation, governance of Insurance, Healthcare Companies and Utilities.

He is member of EFRAG User Panel, of Insurance OIC Commission and AIAF.

Luca D'Onofrio

Luca D'Onofrio is a Bip. Senior Manager in the Financial Services practise. He works mainly in areas like Accounting, Control and Risk Management with a focus on the organisational impacts and processes connected to compliance, reporting and financial analysis approach on topics like IFRS, etc.

As an AIAF board member, he represents the financial analysts in National and International working groups: EFFAS Financial Accounting Commission, EFRAG User Panel, EFRAG Insurance Accounting Working Group, OIC Insurance Contracts and Financial Instruments working groups.

He is also teacher in Accounting at the master in "Insurance and Risk Management" - "Collegio Carlo Alberto - Moncalieri (TO)"

Saskia Slomp

Saskia Slomp has been Governance and Admin Director at EFRAG since 1 January 2010.

She supports the various governance bodies of EFRAG and is responsible for the user activities and outreach events, in addition to her responsibilities for human resources.

Until the end of 2009, she was Technical Director at the Federation of European Accountants (FEE), one of the founding member organisations of EFRAG. She has been involved in EFRAG since its establishment. Within FEE, she was responsible for financial reporting, company law, corporate governance, capital markets, SMEs, sustainability issues and the public sector. In the beginning of her career, she worked with KPMG in The Netherlands.

Saskia is a member of the Dutch NBA.

Alberto Giussani

Alberto has a Degree in Economics by the Catholic University of Milano. He was a PricewaterhouseCoopers partner from 1981 to 2007, where he held internal senior positions and was auditor in charge of various Italian companies, quoted in Italy and in the USA.

A part from Italian Chartered Accountant and Authorized Italian Auditor, he is Professor of International Accounting at the Catholic University of Milano.

Alberto is currently the Vice Chairman of the OIC Board (Italian Accounting Standard Setter) after having been Member of the equivalent body (Commissione Principi Contabili) since 1981.

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Chiara del Prete

Chiara Del Prete is member of AIAF (Italian association of Financial Analysts) and partner at Mazars, focusing on financial services advisory.

Before joining Mazars in October 2016, Chiara has been Head of accounting principles and Disclosure at UniCredit Group for five years. Prior to that, she worked for approx. two years as Project Manager at EFRAG in charge of IAS 39 reform and IFRS 9. Chiara has also worked for eleven years in auditing and advisory services in the banking and financial services industry, initially at KPMG and after at PwC.

Chiara is currently member of EFRAG Financial instruments Working Group and of IFRS and Financial Instruments working groups of the Italian standard setter (OIC).

Marianna Sorrente

Marianna Sorrente is graduated in "Economics and Business Administrations" from the University of Florence in 1999 and earned a master's degree in Finance from IFAF Business school of Milan in 2007.

She is a Financial analyst at an Italian multinational pharmaceutical group, her professional experience covers auditing, consolidated financial statements, business valuation in pharmaceutical sector after previously experiences in Finance Department of medium size and multinational companies.

Marianna is author of publications on financial reporting, local and international GAAP and Integrated Reporting and also a member of research group promoted by AIAF related to the development of IFRS and the study of the impacts arising from the application of accounting standards on IAS-IFRS matters.

Javier de Frutos

Javier de Frutos is the Chairman of the Commission on Financial Reporting of the European Federation of Financial Analysts' Societies (EFFAS) and a member of the Spanish Society of Financial Analysts representing European analysts. Javier was a member of the EFRAG Board at inception and is a member of the User Panel. He was also a member of the Capital Markets Advisory Committee of the IASB.

He has worked for more than twenty years in investment banking for BBVA and participated in large private and public offerings and corporate transactions in Europe, North and Latin America.