European Securities and Markets Authority

Date: 27 October 2017
ESMA32-63-340

PUBLIC STATEMENT

European common enforcement priorities for 2017 IFRS financial statements

The European Securities and Markets Authority (ESMA) issues its annual Public Statement defining the European common enforcement priorities in order to promote consistent application of International Financial Reporting Standards (IFRS) as indicated in the ESMA Guidelines on enforcement of financial information.[1] ESMA, together with European national enforcers (hereafter "enforcers"), identified financial reporting topics which listed companies and their auditors should particularly consider when preparing and auditing their 2017 financial statements. In addition to these common priorities, enforcers might set additional national enforcement priorities focusing on other relevant topics. This statement also highlights other considerations related to the preparation of the 2017 annual financial reports.

ESMA, together with enforcers, will pay particular attention to these priorities when monitoring and assessing the application of all relevant IFRS requirements. Enforcers will continue to focus on material issues in the financial statements that are relevant for an individual issuer examined. Based on examinations performed, enforcers will take corrective actions whenever material misstatements are identified and ESMA will report subsequently on their findings. The common enforcement priorities for the 2017 year-end are:

1. Disclosure of the expected impact of implementation of major new standards in the period of their initial application (i.e. IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*);
2. Specific recognition, measurement and disclosure issues of IFRS 3 *Business Combinations*;
3. Specific issues of IAS 7 *Statement of Cash Flows*.

ESMA and enforcers selected these topics based on the expected significant changes that the new requirements will introduce to current accounting practices and issues identified when examining financial statements. In the light of their continuing relevance, ESMA and enforcers will continue to assess relevant issues monitored in previous years. These include, for instance, presentation of financial performance[2] as well as disclosure on the impact of the decision of the United Kingdom to leave the European Union (Brexit). With regards to the other sections of the annual financial reports, ESMA highlights the requirements with regards to the disclosure of non-financial information and the ESMA Guidelines on Alternative Performance Measures[3].

1. Disclosure of the expected impact of implementation of major new standards in the period of their initial application

[1] Guidelines: Enforcement of financial information, ESMA, 28 October 2014
[2] Statement: European common enforcement priorities for 2016 financial statements, ESMA, 28 October 2016
[3] Guidelines: Alternative Performance Measures, ESMA, 5 October 2015

ESMA • CS 60747 – 103 rue de Grenelle • 75345 Paris Cedex 07 • France • Tel. +33 (0) 1 58 36 43 21 • www.esma.europa.eu

ESMA highlights the need for high-quality implementation of the new standards issued by the International Accounting Standards Board (IASB), but not yet mandatorily applicable, and communication of their expected impact on the financial statements in the period of their initial application, as required by IAS 8 *Accounting Polices, Changes in Accounting Estimates and Errors*. This is likely to be particularly relevant for IFRS 9 and IFRS 15, which become applicable as of 1 January 2018 and for IFRS 16 as of 1 January 2019, with early application allowed subject to the EU endorsement.

ESMA published separate statements on the implementation of IFRS 9[4] and IFRS 15[5] in 2016, which should be taken into account for 2017 financial statements. In 2017 ESMA has undertaken a fact-finding exercise[6] on the 2016 annual financial statements and 2017 interim financial statements to assess the information issuers provided to users concerning the implementation of IFRS 9 and IFRS 15. While ESMA has identified a number of informative qualitative disclosures on the implementation of the new standards, practice has varied concerning the specificity of the information provided. ESMA expected a higher level of disclosure of the quantitative impact of the new standards. While this might reflect different stages of progress in implementation of the new standards and resulting lack of confidence in the precision of the information available, it might also indicate a low level of transparency on the implementation shortly before IFRS 9 and IFRS 15 are due to be applied, notably in the interim financial statements.

ESMA expects that entity-specific quantitative and qualitative disclosures about the application of the new standards will be provided in accordance with paragraph 30 of IAS 8. As the 2017 annual financial statements will be published after the requirements in IFRS 9 and IFRS 15 (and IFRS 16, if early adopted) will have become effective, ESMA expects that issuers will have substantially completed their implementation analyses. Therefore, ESMA expects that the impacts of the initial application of the new standards will be known or reasonably estimable at the time of the preparation of the 2017 accounts and thus should be disclosed. In ESMA's view, such disclosure should include sufficiently disaggregated information on both: (i) accounting policy choices expected to be applied, including those relating to the transition approach and the use of practical expedients; and (ii) the amount and nature of the expected impacts compared to previously recognised amounts. When explaining the impacts, issuers expected to be significantly impacted by the new standards are encouraged to provide financial communication enabling analysts and other users to update their models.

ESMA also highlights that paragraph 31 of IAS 8 states that issuers should consider disclosing the nature of the impending changes in accounting policy. When providing this disclosure, ESMA recommends that issuers focus on disclosing a concise entity-specific description of the changes introduced by the new standards and where specific choices are permitted by the standards what choices the entity has made thus enabling users to assess the impacts. In doing so, issuers should not merely repeat the requirements of the standards and should avoid the risk of overloading financial statements with boilerplate disclosures that do not fulfil the objective.

---

[4] Statement: Issues for consideration in implementing IFRS 9 Financial Instruments, ESMA, 10 November 2016
[5] Statement: Issues for consideration in implementing IFRS 15 Revenue from Contracts with Customers, ESMA, 20 July 2016
[6] Summary of Findings: Results of the fact-finding exercise on disclosure of the impact of the new accounting standards in the 2016 annual and 2017 interim IFRS financial statements, ESMA, 27 October 2017

Detailed recommendations on individual standards, and in case of IFRS 9 specific consideration for different types of entities, are included in the annex to this Statement. Finally, ESMA encourages issuers to monitor IASB/IFRS Interpretations Committee (IFRS IC) discussions regarding implementation issues relating to the new standards and specifically IFRS 9.

2. Specific measurement and disclosure issues stemming from IFRS 3 Business Combinations

In 2014 ESMA published its report[7] on the review of the application of the requirements in IFRS 3. The report highlighted some issues stemming from the application of IFRS 3 which, on the basis of recent enforcement activity, remain relevant. Therefore, ESMA draws issuers' attention to the treatment of the following aspects: intangible assets, adjustments during the measurement period, bargain purchases, mandatory tender offers (MTO), business combinations under common control (BCUCC), contingent payments and disclosures on fair value.

ESMA urges issuers to ensure consistency between the assumptions used to measure intangible assets at fair value for the purpose of a purchase price allocation (PPA) in a business combination and the assumptions applied for any impairment testing as well as for determining useful lives used for the amortisation. ESMA also reminds issuers of the importance of performing the analysis of the intangible assets in accordance with the separability criterion as provided for in paragraph B33 of IFRS 3 and to disclose, where relevant, the significant judgements underlying the conclusion whether separation of intangible assets was deemed necessary.

ESMA draws the issuers' attention to the requirements in IFRS 3 on the adjustments to fair value during the measurement period. When the initial accounting for a business combination is incomplete at the end of the reporting period in which the business combination occurs, paragraph B67 of IFRS 3 requires issuers to disclose that fact and provide the provisional amounts of assets, liabilities, non-controlling interests or items of the consideration paid. Additionally, issuers should disclose the reasons why the business combination accounting is incomplete and the nature and amount of any measurement period adjustments recognised during the reporting period.

ESMA highlights that another key area of the application of the IFRS 3 requirements relates to the existence of bargain purchases and the emergence of a related gain. IFRS 3 deems such situations as occasional and paragraph 36 of IFRS 3 provides guidance on the steps that need to be performed before a gain from a bargain purchase can be recognised. ESMA expects issuers to provide the disclosures required by paragraph B64(n) of IFRS 3, including information on the rationale for the transaction resulting in a gain. In providing this disclosure, ESMA encourages issuers to indicate how the assets and liabilities were reassessed, including information, if applicable, of the fact that the gain arises from the application of exemptions in IFRS 3 for measuring particular items (e.g. restructuring provisions) and why this is the case.

ESMA also draws the issuers' attention to the analysis needed to identify whether part of consideration received in a business combination qualifies as contingent consideration or as remuneration for post-combination services. Particularly, ESMA points out that paragraph B54 of IFRS 3 states that this depends on the

[7] Report: Application of accounting requirements for business combinations in IFRS financial statements, ESMA, 16 June 2014

nature of the arrangement. If it is not clear, paragraph B55 provides guidance to conclude whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions.

IFRS 3 does not address the accounting in cases where regulatory requirements oblige the issuer to offer to purchase the ownership interests of non-controlling interests (usually referred to as MTO)[8]. Similarly, IFRS 3 does not apply to BCUCC. Therefore, ESMA expects that, until the treatment of MTOs and BCUCC is addressed by the IASB, issuers should apply consistently the accounting policy selected in accordance with paragraphs 10-12 of IAS 8 and disclose it in accordance with paragraphs 117 and 121-122 of IAS 1.

Lastly, as indicated in its report[9] on the review of the application of IFRS 13 *Fair Value Measurement* requirements, ESMA notes that the disclosure requirements in IFRS 13 about non-recurring fair value measurements address only measurements subsequent to initial recognition and thus do not apply to assets and liabilities recognised at fair value in a business combination. However, ESMA reminds issuers that the information on the assumptions and measurement techniques used in the valuation of material assets, liabilities and non-controlling interests acquired in a business combination is relevant for investors. Therefore, ESMA encourages such disclosures to be provided in light of the requirements of paragraphs 125-129 of IAS 1. In this respect, ESMA notes that mere reference to the reliance on external valuations does not provide sufficient transparency on the methodologies and inputs used.

3. Specific issues of IAS 7 such as reconciliation of liabilities arising from financing activities

ESMA reminds issuers that paragraph 44A of IAS 7, applicable for the reporting periods starting on or after 1 January 2017, requires disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. Although there are various ways to provide the required information, ESMA encourages issuers to use the tabular format of reconciliation as shown in the Illustrative Example E to IAS 7.

Furthermore, ESMA highlights the need to provide an entity-specific accounting policy on which issuers' instruments or facilities meet the definition of cash and cash equivalents in accordance with paragraph 6 of IAS 7. In particular, where relevant, ESMA expects disclosure of whether, and to what extent, overdraft bank facilities (notably those repayable on demand) and balances resulting from cash pool facilities are considered as cash and cash equivalents.

Finally, ESMA recalls that the disclosure of cash and cash equivalents balances not available for use by the group required by paragraph 48 of IAS 7 is also required by paragraphs 13 and 22 of IFRS 12 *Disclosure of Interests in Other Entities* which refers to the disclosure of significant restrictions (e.g. statutory, contractual and regulatory) on the ability of an entity to access the assets of the group, including cash. Such disclosure might be particularly relevant in case of material balances held in a jurisdiction whose currency is subject to limited exchangeability or capital controls. However, ESMA emphasises that these are not the only circumstances in which cash is not available for use by the group.

[8] IFRS IC Update: IFRS 3 - Mandatory purchases of non-controlling interests in business combinations, IFRS IC, March 2013
[9] Report: Review of Fair Value Measurement in the IFRS financial statements, ESMA, 12 July 2017

Other considerations for the 2017 annual financial reports

ESMA reminds issuers that the 2017 year end will be the first time that the requirements of the amended *Accounting Directive*[10] (as transposed into the national law) to disclose non-financial and diversity information will be applied and ESMA will coordinate the enforcement activities related to both non-financial and corporate governance information. While different disclosure frameworks can be used to meet these requirements which are applicable to certain large groups and undertakings, ESMA is of the view that issuers should meet these requirements in a way that provides the most useful information to users. ESMA considers that *Guidelines of the European Commission*[11] describing a methodology for reporting non-financial information could be helpful for the issuers in this respect.

ESMA also reminds all issuers that the Accounting and Transparency Directives require that the management report includes a fair review of the development and performance of the business and the position of the issuer, together with a description of the principal risks and uncertainties that it faces. Such review shall provide a balanced and comprehensive analysis of the development and performance of the issuer's business, consistent with its size and complexity. In providing the analysis, the management report shall, where appropriate, include references to, and additional explanations of, amounts reported in the annual financial statements. When fulfilling these requirements, ESMA reminds issuers of the importance of providing entity-specific disclosure.

Furthermore, ESMA urges issuers to meet the principles in the *Guidelines on Alternative Performance Measures* (APMs) when including APMs in the annual financial reports. ESMA reminds issuers to evaluate whether APMs they use in the annual financial report contribute to a fair review of the development and performance of the business. ESMA also invites issuers to monitor development in this area as ESMA published a number of Questions and Answers[12] on this topic.

Finally, ESMA urges issuers potentially affected by the United Kingdom's decision to leave the European Union (EU) to assess and disclose the associated risks and expected impacts on their business strategy and activities as appropriate in the IFRS financial statements or in the management report. For example, within the IFRS financial statements, the recognition and measurement of deferred taxes in accordance with IAS 12 *Income Taxes* may be one area where issuers need to disclose any major sources of risks and uncertainties whose resolution will depend on the outcome of the Brexit negotiations.

[10] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

[11] Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information)

[12] Questions and answers: ESMA Guidelines on Alternative Performance Measures, ESMA, 12 July 2017

Annex: Detailed recommendations on the disclosure of the impact of the new standards

IFRS 9 *Financial Instruments*

ESMA reminds issuers the requirements introduced by IFRS 9 related to the accounting for a modification of a financial liability that does not result in de-recognition[13]. The accounting treatment under IFRS 9 differs from the predominant accounting treatment under IAS 39. Consequently, where material, ESMA urges issuers to provide a separate disclosure explaining the change of the accounting policy and its impact on the accounting for financial liabilities existing at 31 December 2017 that were previously modified under IAS 39.

Specific considerations related to application of IFRS 9 for corporates

ESMA expects corporate issuers to provide disclosure of implementation of IFRS 9 proportionally to the importance of financial instruments in their business operations and to describe and quantify the impact of the most significant effects of IFRS 9's introduction. ESMA also reminds corporate issuers that the new impairment model applies to all financial assets, including 'other financial assets' held such as investments in corporate bonds, not measured at fair value through profit or loss.

ESMA specifically highlights the need to properly assess the impact of the impairment requirements on receivables, notably when assessing whether a significant increase in credit risk (SICR) occurred[14]. For receivables whose contractual maturity is longer than 12-months, the lifetime expected credit loss (ECL) needs to be recognised if SICR occurred. However, in order to meet the disclosure requirement, SICR needs to be assessed for all receivables.

Finally, ESMA expects corporate issuers to provide disclosure on the impact of the application of the new hedge accounting model, where applicable. Such disclosure should provide users sufficient information on how the entity expects to change its use of hedge accounting, its alignment with the risk management policies and objectives and the expected impact on the financial statements.

Specific considerations related to application of IFRS 9 for credit institutions

ESMA welcomes the initiatives undertaken by the European Banking Authority (EBA)[15] and prudential supervisors to encourage high-quality, timely implementation of IFRS 9 by credit institutions and fostering its consistent implementation in Europe. With regards to the quantitative impact of the first time adoption of IFRS 9, ESMA expects that disclosures in the 2017 annual financial statements are sufficiently disaggregated, e.g. disclosing separately the quantitative impact from classification and measurement, impairment and hedge accounting and explaining main drivers of the most significant impacts. If a credit institution applies early the requirements related to presentation of gains and losses on financial liabilities designated as at fair value

[13] Application of paragraph B5.4.6 of IFRS 9 resulting in recalculation of the amortised cost of the modified financial liability by discounting the modified contractual cash flows using the original effective interest rate and recognition of any adjustment to the amortised cost of the financial liability in profit or loss as income or expense at the date of the modification or exchange.

[14] Unless the issuer applied the simplified approach for trade receivables, contract assets and lease receivables in paragraph 5.5.15 of IFRS 9 is applied

[15] Report: Results from the second EBA impact assessment of IFRS 9, EBA, 13 July 2017

through profit or loss in accordance with paragraph 7.1.2 of IFRS 9, ESMA expects separate disclosure of its quantitative impact as required by paragraph 28 of IAS 8.

ESMA notes that the European co-legislators are currently considering transitional arrangements[16] to mitigate the effects of IFRS 9 on prudential ratios and to mandate disclosure by institutions of their own funds, risk based capital ratios and leverage ratio on an IFRS 9 fully loaded basis. The finalisation by the co-legislators and by the EBA[17] of the disclosure requirements on IFRS 9 transitional arrangements in Pillar 3 reports will provide further clarity on the impact of the transitional arrangements and on the way they are implemented by institutions. In this context, ESMA also encourages credit institutions, where relevant, to disclose the impact on the fully loaded capital ratio and, to the extent applied, on the capital ratio calculated when applying the transitional relief.

ESMA expects that disclosures on applying judgement in some of the key areas of the standard are provided already in the 2017 annual financial statements. For example, ESMA expects credit institutions to provide disclosure about the judgments made on defining the business model, analysing which sales are expected to be consistent with their hold-to collect business models, the assessment of SICR, the definition of default and the incorporation of forward-looking information in the ECL model.

ESMA acknowledges that the implementation of the ECL model is the most complex part of IFRS 9 for credit institutions (e.g. assessment of SICR, incorporation of forward-looking information, data availability and governance) and therefore welcomes the initiatives to provide more consistency, e.g. the EBA Guidelines[18]. For example, ESMA highlights that the assessment of the SICR is a relative assessment, comparing the level of credit risk at the date of assessment with the credit risk at initial recognition. When making the assessment, ESMA understands that in practice, some issuers plan to implement a combination of absolute and relative triggers. However, ESMA reiterates that based on paragraphs B5.5.9 of IFRS 9, the SICR is a relative assessment and use of absolute triggers should not extend the use of the low credit risk exemption.

ESMA recommends that credit institutions for which the amendments to IFRS 9 related to prepayment features with negative compensation are expected to result in material impacts should provide an explanation of the expected impact, where practicable. Subject to the EU endorsement, ESMA encourages such credit institutions to consider applying these amendments early, as this would avoid changes to the initially reported IFRS 9 figures. In any case, ESMA expects these issuers to describe whether they plan to apply these amendments early or not.

Finally, ESMA highlights that the new standard will also add a significant amount of disclosures that might be material or require significant implementation efforts. Issuers are encouraged to gather the information and work in advance on the disclosures in order to provide specific, detailed and relevant disclosures on the first

[16] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the transitional period for mitigating the impact of the introduction of IFRS 9 on own funds
[17] Consultation Paper: EBA Guidelines on disclosure requirements on IFRS 9 transitional arrangements, EBA, 13 July 2017
[18] Guidelines: Credit institutions' credit risk management practices and accounting for expected credit losses, EBA, 12 May 2017

application of the standard in 2018. For instance, ESMA highlights the new disclosures related to credit impaired financial assets and hedge accounting[19] in IFRS 7 - *Financial Instruments: Disclosure*.

Considerations for measurement of credit-impaired financial assets (non-performing loans/NPLs[20])
ESMA supports a number of EU wide activities related to addressing the NPL issue in the EU banking sector[21]. ESMA considers that appropriate accounting for credit-impaired financial assets in accordance with IAS 39 and their disclosure in IFRS financial statements is an important step to foster increased transparency. ESMA believes that improvements in the accounting for credit-impaired financial assets and their disclosure brought by the introduction of the ECL model would further contribute to addressing the NPL issue in 2018.

ESMA urges issuers with material amounts of credit-impaired loans, to examine carefully their existing accounting policies for measurement of credit-impaired financial assets. In particular, ESMA expects credit institutions to evaluate critically whether their estimate of the expected cash flows from the NPL and where relevant from the related collateral are realistic and unbiased and what changes need to be implemented to them in order to be appropriate under the IFRS 9 ECL model[22].

Furthermore, ESMA strongly encourages credit institutions with high levels of NPLs to provide sufficient and specific disclosures. In this context, ESMA welcomes the work the EBA is carrying out on NPLs Pillar 3 disclosures and the initiative of the SSM[23] to harmonise further the disclosure of NPLs from a prudential perspective. ESMA notes that the Council of the European Union requested the EBA, in consultation with ESMA, to enhance the disclosure requirements on asset quality and non-performing loans to all banks by end of 2018[24]. In this context, ESMA encourages credit institutions to leverage on the data used for the prudential disclosure and improve transparency and comparability of their disclosures on credit-impaired financial assets in their financial statements.

Specific considerations related to application of IFRS 9 for insurance undertakings/conglomerates

ESMA notes that the amendments to IFRS 4 *Insurance Contracts*[25] permit a reporting entity to apply the overlay approach if certain conditions are met. ESMA highlights that these reporting entities need to apply IFRS 9 in full and expects these entities to disclose that they plan to use the overlay approach and explain to users the expected impact on financial performance in the period of its initial application.

ESMA notes that a reporting entity that is an insurer whose activities are predominantly connected with insurance is permitted to continue to apply IAS 39 rather than IFRS 9 until 2021. ESMA expects entities planning to use this option to explicitly disclose this fact in their 2017 accounts. Building on the principles in IAS 8, ESMA also expects that these issuers provide sufficient information on assumptions and judgments made

[19] The new disclosure in IFRS 7 related to hedge accounting apply whether the IAS 39 or IFRS 9 hedge accounting model is applied
[20] While the definition of non-performing exposures/loans (NPE/NPLs) for prudential purposes might be broader than for accounting purposes, many market participants use these terms interchangeably. When the term NPLs is used in the financial statements, ESMA encourages credit institutions to give a clear definition for users in order to enable them to understand the difference, if any, between this term and the credit-impaired financial assets under IFRS 9.
[21] See Action plan to tackle NPL in Europe, Council of the EU, 11 July 2017, Report: Resolving NPL in Europe, ESRB, 11 July 2017
[22] Changes might be required for example to fully incorporate forward-looking parameters, consider forbearance and re-defaults.
[23] Guidance: Guidance to banks on non-performing loans, Single Supervisory Mechanism (SSM), March 2017
[24] Council conclusions on the Action plan to tackle non-performing loans in Europe, Council of the European Union, 11 July 2017
[25] Amendments to IFRS 4: Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* issued in September 2016

when determining that they fulfil the requirements of paragraph 20D of IFRS 4 and thus qualify for the use of the deferral. Furthermore, ESMA highlights the additional disclosures to be provided by issuers deferring application of IFRS 9 based on the requirements of paragraph 39E and 39G of IFRS 4.

ESMA recalls that in the process of endorsement of aforementioned amendments to IFRS 4, the European co-legislators also allowed the use of the deferral option for legal entities in the insurance sector of a financial conglomerate[26]. The forthcoming Commission Regulation includes a ban on transferring financial instruments (other than those measured at fair value through profit or loss) between the insurance sector and any other sector of the financial conglomerate and requires additional safeguards and disclosures.

ESMA expects that issuers benefiting from this last option explicitly disclose this fact in the 2017 IFRS financial statements and indicate how the conditions of this option apply to them. Particularly, ESMA draws the issuer's attention to the importance of disclosing to the market the amount of financial assets for which application of IFRS 9 is deferred and the nature and extent of significant restrictions on the use of the group's assets subject to the transfer ban. Furthermore, for the group entities outside of the insurance sector not eligible for the deferral, pre-transition disclosure on IFRS 9 should be provided in accordance with IAS 8.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 replaces requirements in IAS 18 *Revenue* and IAS 11 *Construction Contracts* and related interpretations. While for some type of transactions the impact of the new requirements may be limited, for others significant changes in the timing and amount of revenue recognition and in the judgements affecting key policy decisions are expected, for example for some long-term contracts and multiple-elements arrangements. ESMA highlights some of the key areas of the application of the new model where, depending on the business model of the issuers and the existing practice, specific disclosures shall be provided.

ESMA observes that the application of the new requirements set out in paragraphs 22-30 of IFRS 15 for identifying performance obligations may give rise to the unbundling of contracts and to the identification of revenue recognition patterns that differ from current practice. In this respect, ESMA points out that the application of paragraphs B48-B51 of IFRS 15 would be critical in order to assess whether or not non-refundable upfront fees may relate to the transfer of goods and services and how the conclusion may affect the emergence of revenue over time compared to current practice.

ESMA also notes that changes in revenue patterns may also arise in connection to the application of the method to measure the progress towards the complete satisfaction of performance obligations under a contract. Particularly, ESMA urges issuers to consider the requirements in paragraph B15 of IFRS 15 to make sure that the method used is sufficiently granular to ensure that any work in progress or finished goods controlled by the customer are included in the measurement of the output at the reporting date.

ESMA reminds issuers that the guidance in IFRS 15 for the distinction between agent and principal is based on the concept of 'control' that differs from the currently applied notion of transfer of 'risks and rewards'.

[26] Defined in Directive 2002/87/EC of the European Parliament and of the Council ("FICOD")

ESMA notes that in some circumstances the analysis based on paragraphs B34-B38 of whether a party is an agent or principal involves judgement and might affect the amount and timing of recognition of revenues.

The new requirements for the determination of the transaction price in IFRS 15 require issuers to recognise any variable consideration at its estimated amount if it is highly probable that no significant reversal of revenue will occur once the uncertainty related to the variable consideration is resolved (and subject to the exception for sales-based or usage-based royalties). ESMA draws the issuers' attention to the fact that the application of paragraph 50 and 53 and 56 and 57 of IFRS 15 involves some degree of judgement. As IAS 18 did not include specific guidance on the recognition of variable consideration, ESMA notes that significant impacts may arise for issuers that either never recognised revenue arising from variable consideration until the moment in which the related amounts became certain or that recognised revenue on a basis that differs from the requirements in IFRS 15.

ESMA highlights that, in assessing the transaction price, the amount of revenue recognised may also depend on whether a contract includes a significant financing component. Paragraphs 61 and 62 set out the criteria and factors to assess whether the financing component is significant. ESMA notes that issuers need to put in place a specific policy to recognise and measure significant financing components. ESMA encourages issuers to assess whether a financing component exists for the different types of contracts it issues as such component may become relevant in response to future increases in interest rates.

ESMA draws the issuers' attention on the fact that IFRS 15 introduces specific guidance for the recognition of revenue arising from licences of intellectual property. ESMA specifically highlights that issuers need to pay particular attention in performing the assessment required by paragraph B58 of IFRS 15 in order to assess whether an entity's promise in granting a licence of intellectual property provides a right to access to the intellectual property.

Paragraph 91 and 95 of IFRS 15 provides new guidance on contract costs, which, under certain conditions, shall be capitalised. Particularly, ESMA reminds issuers that according to paragraph 96 of IFRS 15 the guidance in paragraph 91 does not apply to costs, incurred in fulfilling a contract with a customer, that are within the scope of another standard (such as IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets, e.g. staff training costs*).

Finally, ESMA highlights the importance of an issuer's entity-specific assessment as to which disclosures are most relevant to provide information on the expected possible impacts of IFRS 15 on all material aspects of the implementation of this new standard.

IFRS 16 *Leases*

IFRS 16 will replace the requirements in IAS 17 *Leases* and related interpretations and will become applicable as of 1 January 2019. However, subject to the endorsement in the European Union, issuers are permitted to early apply IFRS 16 at the same time as they apply IFRS 15.

ESMA expects that issuers that will early apply IFRS 16 will be able to provide in the 2017 annual financial statements disaggregated qualitative and quantitative disclosures regarding the significant expected impacts of the new standard, in a way that is relevant for a user's assessment of how the new standard will affect the financial statements. In this respect, ESMA recommends that issuers provide information on the transition

method chosen and explain how key judgements needed to apply the new requirements are expected to impact the accounting for leases, for example, the analysis of the lease term required by paragraph 19 of IFRS 16.

Finally, ESMA notes that once IFRS 16 is applied disclosures required by Appendix C of the standard relating to the initial application will need to be provided. Particularly, ESMA reminds issuers that when applying the simplified transition approach issuers are required by paragraph C12(b) to explain the difference between operating lease commitments disclosed applying IAS 17 and lease liabilities recognised as at the date of application of IFRS 16 and that, in accordance with paragraph C7, comparative information cannot be re-stated.