

A person wearing a red beanie and a dark jacket is sitting on a rocky shore, looking out over a large body of water towards a sunset. The sun is low on the horizon, casting a golden glow across the sky and reflecting on the water. The sky is filled with soft, colorful clouds. The foreground is a rocky, mossy bank with some sparse vegetation. The overall scene is peaceful and scenic.

International Accounting (22E00400)

20.4-03.6.2021

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Course schedule

Date		Time	Topics	Standards
20.4.2021	Tuesday	17.15-20.00	Welcome! Introduction to IFRS Conceptual Framework Fair value measurement Operating segments	Conceptual Framework IAS 1 - Presentation of financial statements IFRS 13 - Fair value measurement IFRS 8 - Operating segments
22.4.2021	Thursday	17.15-20.00	Revenue and Leases	IFRS 15 - Revenue from Contracts with Customers IFRS 16 - Leases
27.4.2021	Tuesday	17.15-20.00	Assets	IAS 38 - Intangible assets IAS 36 - Impairment of assets IFRS 5 - Discontinued operations
4.5.2021	Tuesday	17.15-20.00	Liabilities	IAS 37 - Provisions, contingent liabilities and contingent assets IAS 19 - Employee benefits IFRS 2 - Share based payments
11.5.2021	Tuesday	17.15-20.00	Business combinations, Associates and Joint Arrangements	IFRS 3 - Business Combinations IFRS 10 - Consolidated financial statements IAS 12 - Income taxes IFRS 9 - Financial instruments
18.5.2021	Tuesday	17.15-20.00	Financial instruments and income taxes Cash flow statement Exam preparation	IAS 7 - Statement of Cash Flows IAS 28 - Investments in associates and joint ventures IFRS 11 - Joint arrangements
20.5.2021	Thursday	17.15-20.00	Term Paper presentations & discussion	
25.5.2021	Tuesday	17.15-20.00	Term Paper presentations & discussion	
3.6.2021	Thursday	09.00-10.30	Exam 1	

Attendance is mandatory
Guest speaker from PWC
Guest speaker from EY
Attendance is mandatory
Attendance is mandatory



IFRS 16 Leases

Textbook: Chapter 9

Learning objectives

- New model for recognising leases
 - IFRS 16 impacts on lessee's financial statements, ratios and key performance indicators
- Explain and apply the requirements of IFRS 16
 - Determining whether an arrangement contains a lease
 - Recognition and measurement of right-of-use assets & lease liability
 - Lease term & Discount rate
 - Presentation and disclosure

An aerial photograph of a lush green forest. A river flows through the forest from the top left towards the bottom center. To the right of the river, a large body of water, likely a lake, is visible under a clear blue sky with scattered white clouds. The text "New model for recognising leases" is overlaid in white, bold, sans-serif font across the center of the image.

New model for recognising leases

New IFRS 16 Leases standard

Overview

IFRS 16

Released in January 2016 and superseded IAS 17 Leases for reporting periods on or after 1 January 2019

Finance lease/operating lease distinction is no longer relevant for lessees but has been retained for lessors









The impact of IFRS 16 depends on an entity's relative number of operating lease contracts and across varies industries

Single on-balance sheet accounting model for most leases.
Scope exemptions include e.g. short term leases, low value leases

Under IFRS 16 a lease is defined as 'a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'

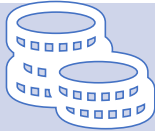
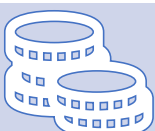
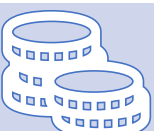
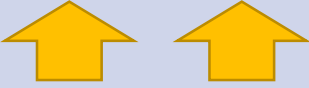


New IFRS 16 Leases standard

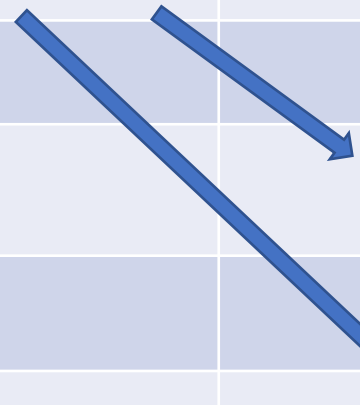
Balance sheet impact

	IAS 17 Finance leases	IAS 17 Operating leases	IFRS 16 All leases
Assets		_____	 
Liabilities			 
Off balance sheet rights/obligations	_____		
			

New IFRS 16 Leases standard

Income statement impact

	IAS 17 Finance leases	IAS 17 Operating leases	IFRS 16 All leases
Revenue			
Operating costs		Single lease expense	
EBITDA			
Depreciation and amortization	Depreciation		Depreciation
Operating profit			
Finance costs	Interest		Interest
Profit before tax			



New IFRS 16 Leases standard

What has changed?

Classification of
leases

Identifying a lease
contract

Identifying and
accounting for
separate
components

Lease term

Accounting
treatment for
leases

Lease
modifications

Subleasing

What constitute
the transfer of an
asset as a sale

Disclosures

**What have been
the driving
factors behind
the change?**



The need for a change

Benefits

Lack of transparency
of information
about lease
obligations

The reason behind the new standard is to e.g.

- Give a more faithful representation of lessees' assets and liabilities and greater transparency of lessees' financial obligations and leasing activities
- Increase visibility of companies' lease commitments and better reflect economic reality
- Make it easier for users of financial statements to compare companies that lease their assets with companies that borrow money to buy their assets

The need for a change

Costs

Financial
statements and
metrics

Data collection
and ongoing data
management

Accounting
policies and
manuals

IT systems,
processes and
controls

Lease
procurement and
negotiation

Tax consideration

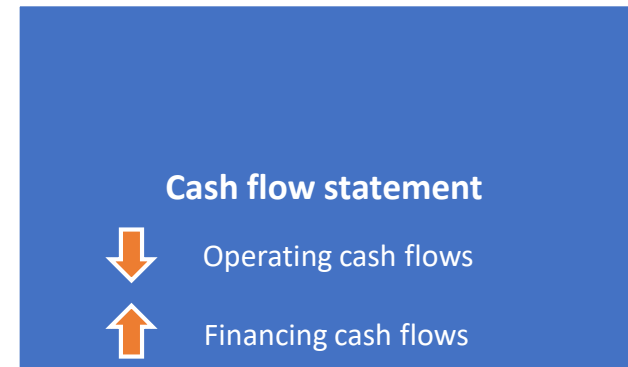


**What needs to be
considered in financial
statement analysis?**

Key impacts in financial statement analysis

Equity ratio, ROCE, EBITDA, Operating Cash Flows

- Increased assets and liabilities impact balance sheet derived KPIs such as (equity ratio, ROCE, etc.)
- EBITDA and Operating cash flows impacted significantly although impact to EBIT and Results was normally minor and impact to total cash flows was zero



What are the most affected sectors?

Please choose 3

<input checked="" type="checkbox"/>	Retailer	<input type="checkbox"/>
<input checked="" type="checkbox"/>	Entertainment	<input type="checkbox"/>
<input checked="" type="checkbox"/>	Transport (airlines)	<input type="checkbox"/>
<input checked="" type="checkbox"/>	Telecommunication	<input type="checkbox"/>
<input checked="" type="checkbox"/>	Hospitality (hotels)	<input type="checkbox"/>
<input checked="" type="checkbox"/>	Health care	<input type="checkbox"/>
<input checked="" type="checkbox"/>	Wholesale	<input type="checkbox"/>
<input checked="" type="checkbox"/>	Professional services	<input type="checkbox"/>

What are the most affected sectors?

TOP 3

Retailer

Airlines (transport)

Hotels (hospitality)

IFRS 16 Implementation Finnair Stock Exchange Release

Finnair's restated financials 2018 resulting from new IFRS 16 standard, changes in accounting principles relating to aircraft components and renewal of Chart of Accounts

Finnair Plc Stock Exchange Release 21 March 2019 at 9.00 a.m. EET

As of 1 January 2019, Finnair has adopted the new IFRS 16 Leases standard using the full retrospective method. Finnair has also changed its accounting principle relating to aircraft frame components, including cabin components and frame overhauls, and made structural changes in its financial reporting chart of accounts, including income statement, balance sheet and cash flow reporting line item changes. Finnair's financial reporting for 2018 has been restated to account for the new reporting practices.

Key impacts of these changes

- Assets at 31.12.2018 increased by 996.3 million euros, of which 992.3 million euros was due to the adoption of the IFRS 16 standard ("IFRS 16"); 4.0 million euros was due to the change in the accounting principle of aircraft frame components ("change in accounting principle").
- Liabilities as of 31.12.2018 increased by 1,099.5 million euros, of which 1,091.6 million euros was due to the implementation of IFRS 16 and 7.9 million euros resulted from the change in accounting principle.
- Equity decreased 103.2 million euros, of which 99.3 million euros resulted from the implementation of IFRS 16 and 3.9 million euros due to the change in accounting principle.
- The comparable operating result 2018 improved by 49.0 million euros, of which 54.7 million euros was due to IFRS 16 and -5.7 million euros resulted from the change in accounting principle. Operating result improved by 48.8 million euros.
- The net result 2018 decreased by 49.0 million euros, of which -44.3 million euros was due to IFRS 16 and -4.7 million euros resulted from the change in accounting principle.
- The equity ratio at 31.12.2018 decreased by 11.5 points to 23.3%, of which -11.3 points was due to the implementation of IFRS 16 and -0.2 points resulted from the change in accounting principle.
- Gearing will replace adjusted gearing as a key figure. Gearing at 31.12.2018 increased by 115.5 points to 76.9%, of which 115.6 points were due to the implementation of IFRS 16 and -0.1 points resulted from the change in accounting principle.

Both IFRS 16 and the change in accounting principles related to aircraft frame components have an effect on the presentation of cash flow. Structural changes in financial reporting did not have effect on the figures, but rather the line items in income statement, balance sheet and cash flow.

IFRS 16 Implementation Finnair Stock Exchange Release

Key impacts of IFRS 16:

- The change increased assets by 992.3 million euros due to the recognition of right-of-use assets, of which approximately 80% are aircraft.
- Liabilities increased in total by 1,091.6 million euros due to the recognition of the present value of qualifying operating lease liabilities.
- The comparative information was restated, and the cumulative effect of initially applying IFRS 16 was made as an adjustment to opening equity of 2018. The change decreased Finnair's equity at 31.12.2018 by 99.3 million euros.
- Depreciation increased due to the depreciation of the right of use fleet. The qualifying operating lease payments were transferred to lease liability repayments and financial expenses, which improved comparable operating result. The effects combined increased 2018 comparable operating result by 54.7 million euros and operating result by 54.8 million euros.
- The net result decreased by 44.3 million euros due to interest expenses (related to lease liabilities) and foreign exchange losses associated with USD denominated aircraft lease payments and liabilities. The majority of the decrease in net result was derived from unrealized foreign exchange losses caused by the translation of the USD denominated liability. In the future, the effect and amount of the foreign currency exchange could be positive or negative, depending on the USD-rate at the closing date. As at January 2019, Finnair aims to mitigate the foreign exchange volatility introduced by this difference by using hedges. The annual effect in net result going forward is dependent on the size of the qualifying operating lease portfolio and the duration of the leases.
- In the cash flow statement, repayments of lease liabilities were moved from operating cash flow to financing cash flow, which improved cash flow from operating activities by 111.9 million euros and reduced cash flow from financing activities.
- The change also impacted Finnair's 2018 key figures as described above.

An aerial photograph of a lush green forest. A river flows through the forest from the top left towards the bottom center. To the right of the river, a large body of water, likely a lake, is visible under a clear blue sky with scattered white clouds. The text 'IFRS 16 requirements' is overlaid in white, bold, sans-serif font across the middle of the image.

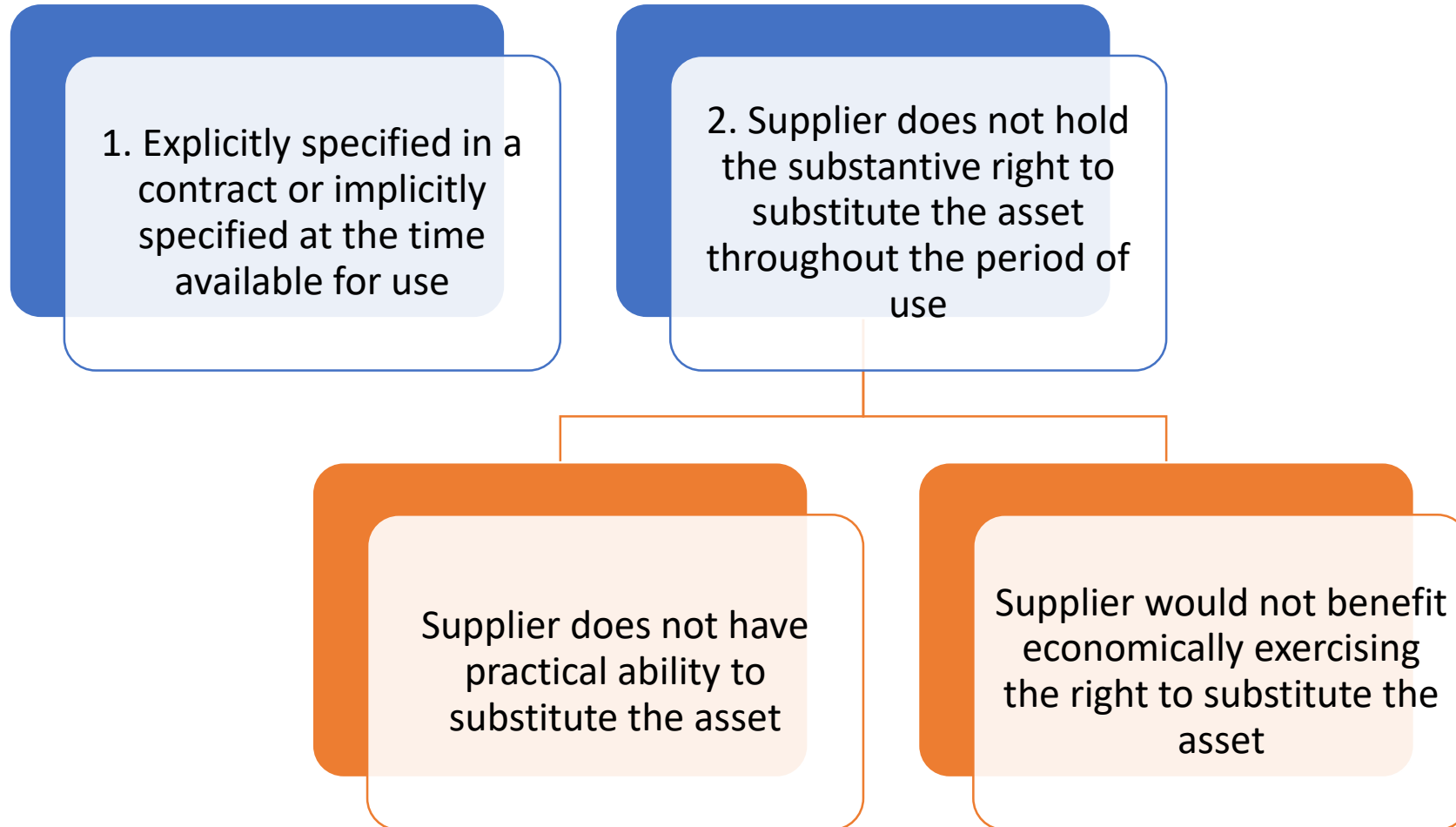
IFRS 16 requirements

How to identify a lease?

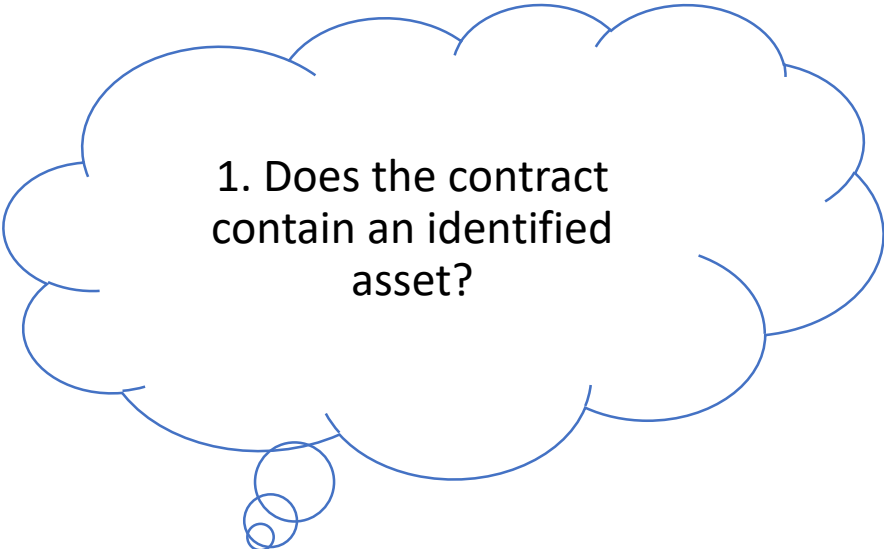
A lease is a contract that conveys the right to use an asset for a period of time in exchange for consideration



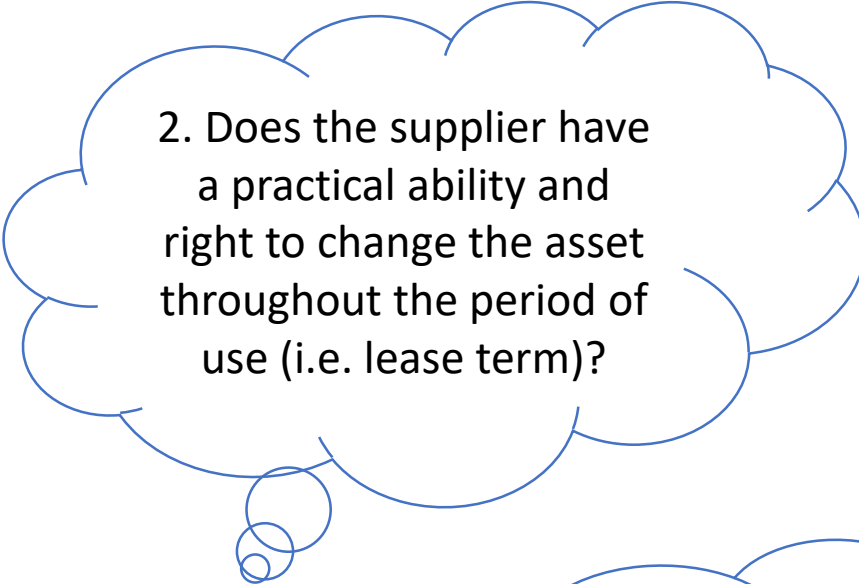
Identified asset



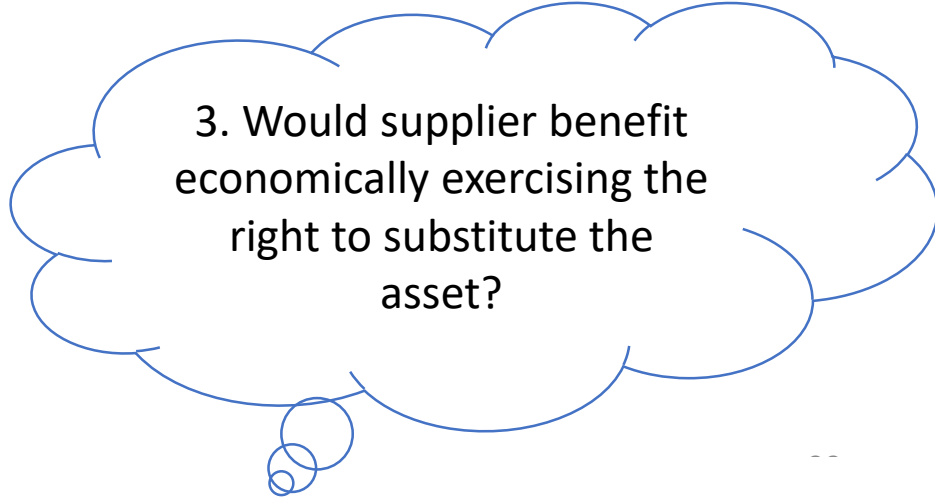
Identified asset

A blue-outlined thought bubble with a small tail at the bottom left.

1. Does the contract contain an identified asset?

A blue-outlined thought bubble with a small tail at the bottom left.

2. Does the supplier have a practical ability and right to change the asset throughout the period of use (i.e. lease term)?

A blue-outlined thought bubble with a small tail at the bottom left.

3. Would supplier benefit economically exercising the right to substitute the asset?

A capacity portion of an asset

- An identified asset can be a physically distinct portion of a larger asset.
- A capacity portion of an asset is an identified asset if:
 - ✓ The portion it is physically distinct or
 - ✓ The portion represents substantially all of the capacity of the asset

	Identified asset?	
	Yes	No
Warehouse	The contract gives the entity the right to use a specific area of the warehouse for the full contract period or entity's storage requirement accounts for substantially all of the capacity of the warehouse (e.g. 95 %)	The contract gives the right to a certain capacity (e.g. 40%) of storage area. The supplier has a right to direct where the goods are stored. → The entity does not have exclusive use of a specified portion of the warehouse and the portion is not substantially all of the warehouse capacity

Right to control the use of the identified asset

1. Right to obtain substantially all the economic benefits

2. Right to direct the use

Right to direct how and for what purpose the asset is used

Decisions are **predefined**
The lessee has the right to operate the asset, without the lessor having the right to change those operating instructions

Decisions are **predefined**
The lessee designed the asset in a way that predetermines how and for what purpose the asset is used

Right to control

1. Is entity entitled to almost all of the output of the asset, or are there other customers involved?

2. Does entity make the relevant decisions on when, where and how the asset is used? (type/amount of output, scheduling, etc.)

3. If relevant decision-making rights are predefined in the contract or otherwise, does entity operate the asset? Or is the asset designed for entity?

Case

Right to direct the use of an asset?

Entity enters into a contract with Supplier to use a vehicle for a three year period. The vehicle is identified in the contract. Supplier cannot substitute another vehicle unless the specified vehicle is not operational (e.g., it breaks down). Under the contract:

- ✓ Entity operates the vehicle (i.e., drives the vehicle) or directs others to operate the vehicle (e.g., hires a driver).
- ✓ Entity decides how to use the vehicle (within contractual limitations, discussed below). For example, throughout the period of use, Entity decides where the vehicle goes as well as when or whether it is used and what it is used for. Entity can also change these decisions throughout the period of use.
- ✓ Supplier prohibits certain uses of the vehicle (e.g., moving it overseas) and modifications to the vehicle to protect its interest in the asset.

DOSE THE CONTRACT CONTAIN A LEASE?

Case

Right to direct the use of an asset?

SOLUTION

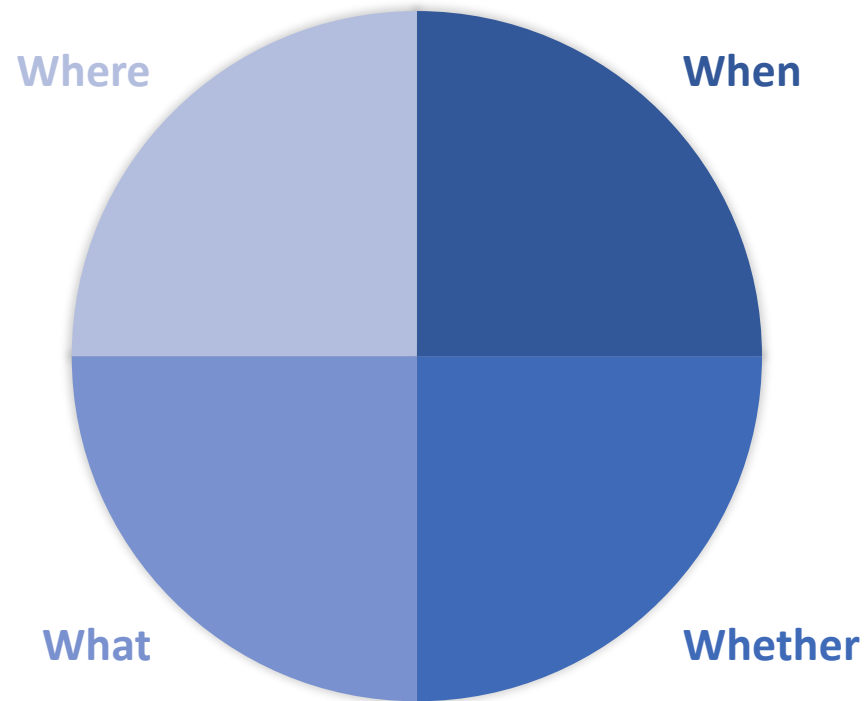
Entity has the right to direct the use of the identified vehicle throughout the period of use.

Entity has the right to direct the use of the vehicle because it has the right to change how the vehicle is used, when or whether the vehicle is used, where the vehicle goes and what the vehicle is used for.

Supplier's limits on certain uses for the vehicle and modifications to it are considered protective rights that define the scope of Entity's use of the asset but do not affect the assessment of whether Entity directs the use of the asset.

Decision-making rights subject to the arrangement

DECISION MAKING RIGHTS



Decisions about maintaining and operating the asset do not result in the right to change how and for what purpose the asset is used throughout the period of use (unless all the decision-making rights are predefined).

Case

Identifying a lease

Customer enters into a contract with a ship owner (Supplier) for the transport of cargo from Rotterdam to Sydney on a specified ship. The ship is explicitly specified in the contract, and Supplier does not have substitution rights. The cargo will occupy substantially all of the capacity of the ship. The contract specifies the cargo to be transported on the ship and the dates of pickup and delivery.

Supplier operates and maintains the ship and is responsible for the safe passage of the cargo onboard the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract.

DOES THE CONTRACT CONTAIN A LEASE?

Case

Identifying a lease

SOLUTION

- The contract does not contain a lease.
- There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.
- Customer has the right to obtain substantially all of the economic benefits from use of the ship over the period of use. Its cargo will occupy substantially all of the capacity of the ship, thereby preventing other parties from obtaining economic benefits from use of the ship.
- However, Customer does not have the right to control the use of the ship because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the ship is used. How and for what purpose the ship will be used (that is, the transport of specified cargo from Rotterdam to Sydney within a specified time frame) are predetermined in the contract. Customer has no right to change how and for what purpose the ship is used during the period of use. Customer has no other decision-making rights about the use of the ship during the period of use (for example, it does not have the right to operate the ship) and did not design the ship. Customer has the same rights regarding the use of the ship as if it were one of multiple customers transporting cargo on the ship.

Case

Identifying a lease

Customer enters into a contract with Supplier for the use of a specified ship for a five-year period. The ship is explicitly specified in the contract, and Supplier does not have substitution rights.

Customer decides what cargo will be transported and whether, when, and to which ports the ship will sail, throughout the five-year period of use, subject to restrictions specified in the contract. Those restrictions prevent Customer from sailing the ship into waters at a high risk of piracy or carrying hazardous materials as cargo.

Supplier operates and maintains the ship and is responsible for the safe passage of the cargo onboard the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract.

DOES THE CONTRACT CONTAIN A LEASE?

Case

Identifying a lease

SOLUTION

- There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.
- Customer has the right to control the use of the ship throughout the five-year period of use because:
 - Customer has the right to obtain substantially all of the economic benefits from use of the ship over the five-year period of use. Customer has exclusive use of the ship throughout the period of use.
 - Customer has the right to direct the use of the ship. The contractual restrictions about where the ship can sail and the cargo to be transported by the ship define the scope of Customer's right to use the ship. They are protective rights that protect Supplier's investment in the ship and Supplier's personnel. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the ship is used throughout the five-year period of use because it decides whether, where, and when the ship sails, as well as the cargo it will transport. Customer has the right to change these decisions throughout the five-year period of use.
- Although the operation and maintenance of the ship are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used. Instead, Supplier's decisions are dependent on Customer's decisions about how and for what purpose the ship is used.

Recognition and measurement of right-of-use assets & lease liability

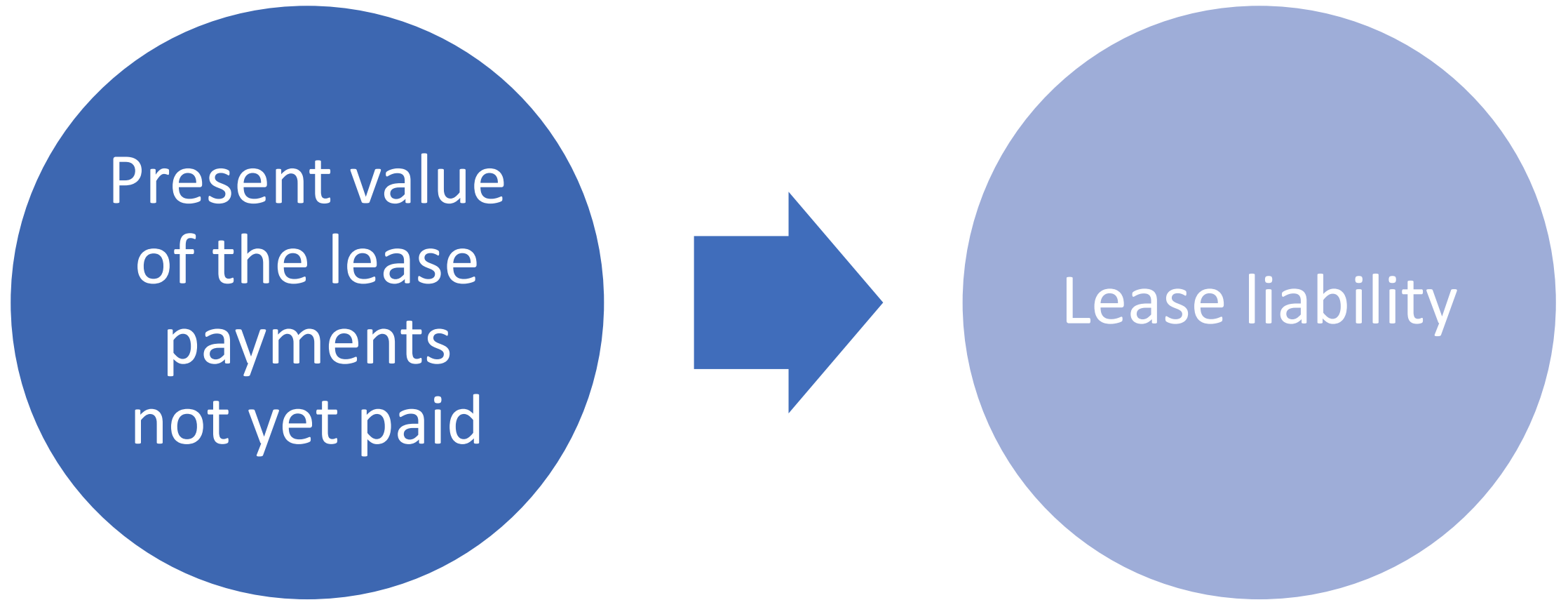
IFRS 16 requires lessees to recognise a liability to make lease payments and an asset representing the right to use the underlying asset (i.e., the right-of-use asset) during the lease term for all leases, except for short-term leases and leases of low-value assets if they choose to apply such exemptions.

Short-term lease: a lease that, at the commencement date, has a lease term of 12 months or less and does not include an option to purchase the underlying asset

Low value lease: At the time of reaching its decisions about the exemption, the IASB had in mind leases of underlying assets with a value, when new, of US\$5,000 or less. Examples of low-value assets include desktop and laptop computers, small items of office furniture, telephones and other low-value equipment.

The lessee recognizes the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis.

Initial measurement of lease liability



Initial measurement of lease liability

Lease payments are payments, made by a lessee to a lessor, relating to the right to use an underlying asset during the lease term and include the following amounts:

Fixed payments	Purchase options (exercise price)	Residual value guarantees	Termination penalty	Variable lease payments based on index or rate
<ul style="list-style-type: none">• Including in-substance fixed payments	<ul style="list-style-type: none">• Include if reasonably certain of exercise	<ul style="list-style-type: none">• Expected payments entity has to make under guarantee	<ul style="list-style-type: none">• Include if reasonably certain of exercise	<ul style="list-style-type: none">• Variable lease payments that do not depend on index or rate are excluded from lease payments

Amounts excluded from lease payments (lease liability)

Variable lease payments linked to future performance or use of an asset

- Examples include lease payments based on x% of annual sales, hours used, units delivered, usage of warehouse etc.

Amounts allocated to non-lease components

- Entities may separate non-lease components from lease components in every asset class

Components of contracts

Entity enters into a three-year lease of building, with fixed annual payments of EUR120,000. The contract itemises the fixed annual payments as follows:

- EUR90,000 for rent,
- EUR30,000 for maintenance

Analysis: The contract contains two components - one lease component (lease of building) and a non-lease component (maintenance). Therefore, the total consideration in the contract of EUR360,000 is allocated to the lease component (building) and the non-lease component (maintenance).

Initial measurement of right-of-use asset

- A lessee initially measures the right-of-use asset at cost, which consists of all of the following

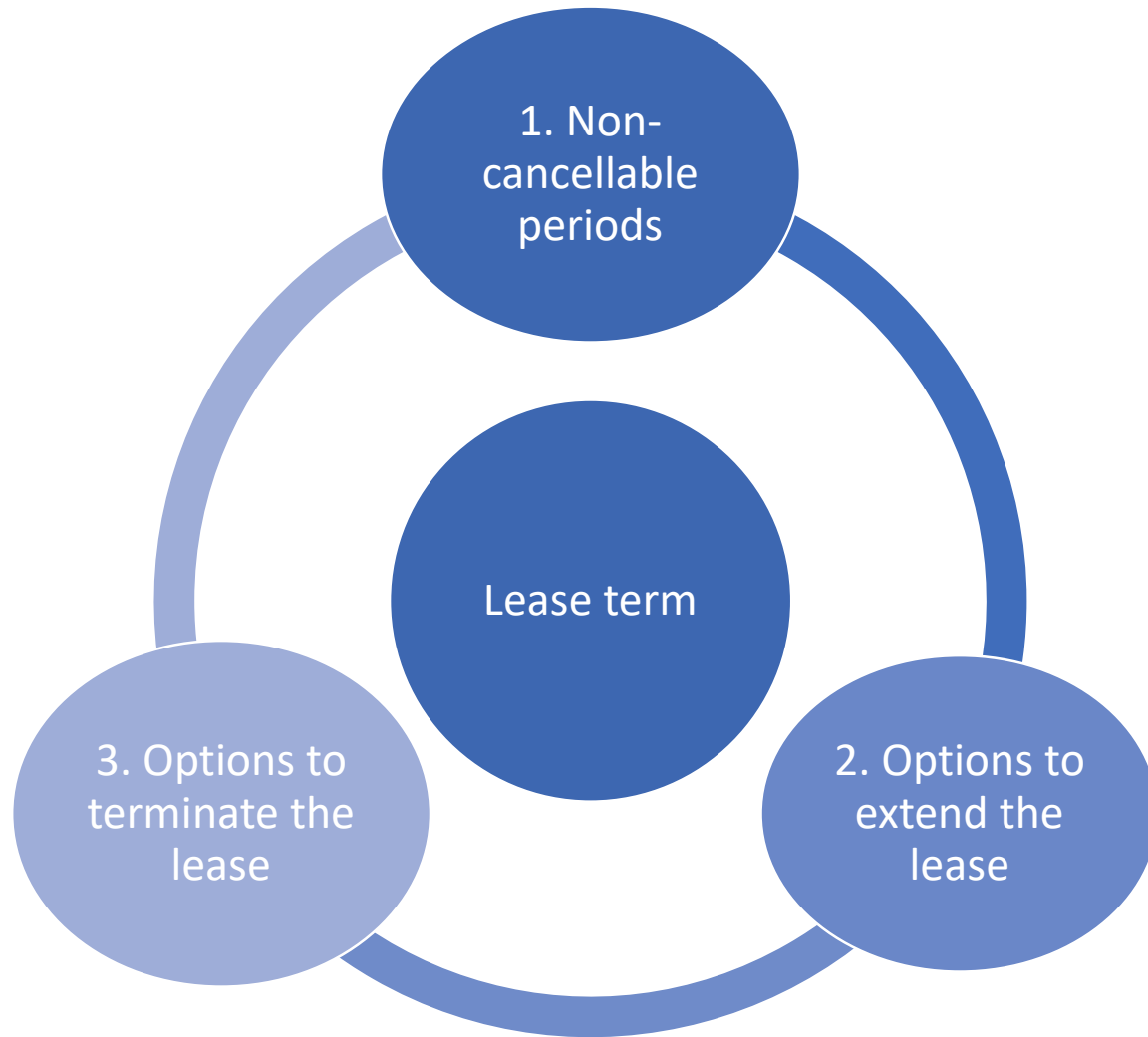
The amount of the initial measurement of the lease liability

Any prepayments at or before the commencement date, less any lease incentives received from the lessor

Any initial direct costs incurred by the lessee

Any cost to be incurred by the lessee in dismantling and remove the underlying asset

Lease term



Entity needs to consider all relevant facts and circumstances that create an economic incentive for entity to exercise the option when determining the lease term.

Reassessment of lease term

- ✓ Reassessment of lease term upon occurrence of a significant event or a significant change in circumstances, including:
- ✓ Lease term needs to be revised if there is a change in the non-cancellable period of a lease.

Significant leasehold improvement not anticipated at commencement date

Significant modification to underlying asset not anticipated at commencement date

Business decision of the lessee that is relevant to exercising (or not) an option

Case

Example A

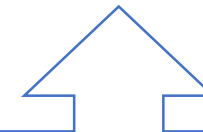
Assume that entity enters into a lease for equipment that includes a noncancelable term of four years and a two-year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception. There are no termination penalties or other factors indicating that entity is reasonably certain to exercise the renewal option.

Analysis: The lease term is four (4) years

Example B

Assume that entity enters into a lease for a building that includes a noncancelable term of four years and a two-year, market-priced renewal option. Before it takes possession of the building, entity pays for leasehold improvements. The leasehold improvements are expected to have significant value at the end of four years, and that value can only be realised through continued occupancy of the leased property.

Analysis: The lease term is six (6) years.



At lease commencement, entity determines that it is reasonably certain to exercise the renewal option because it would suffer a significant economic penalty if it abandoned the leasehold improvements at the end of the initial non-cancellable period.

Discount rate

- ✓ Discount rates are used to determine the present value of the lease payments, which are used to measure a lessor's net investment in the lease and a lessee's lease liability.
- ✓ For a lessee, the discount rate for the lease is the interest rate implicit in the lease and, if that rate cannot be readily determined, its incremental borrowing rate. For a lessor, the discount rate for the lease is the interest rate implicit in the lease.

Lessee's incremental borrowing rate: The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.



IFRS 16 Disclosures &
Presentation
FINNAIR ANNUAL REPORT 2019

Changes in Accounting Principles

Note! Finnair applied the standard using the full retrospective method, i.e. restated the comparatives.

Changes in accounting principles and restated financials 2018

As of 1 January 2019, Finnair has adopted the new IFRS 16 Leases standard using the full retrospective method. Finnair has also changed its accounting principle relating to aircraft frame components, including cabin components and frame overhauls, and made structural changes in its financial reporting chart of accounts, including income statement, balance sheet and cash flow reporting changes. The comparable financial reporting periods presented in the consolidated financial statements have been restated to account for the new reporting practices.

Finnair has published a separate Stock Exchange Release on 21 March 2019 related to the changes, which encloses the restated financials, including tables for each quarter of 2018 with the combined effect of all three restatements. Tables are also available in excel-format on Finnair's investor relations website at <https://investors.finnair.com/en>

Below is presented the summary of changes to figures and accounting principles as well as the restatement effects tables, where the different restatement effects to 2018 financials are specified separately for each restatement.

Impact of the IFRS 16 implementation on the prior period 2018 financials

The new leasing standard IFRS 16 is effective from 1 January 2019 onwards. It replaces the previous standard IAS 17 Leases. Finnair has adopted the new standard from 2019 onwards and has applied the full retrospective method to each prior reporting period presented.

The new standard has a significant impact on the Finnair Group financial statements and key ratios. The present value of the future operating lease payments for aircraft, real estate and other qualifying operating lease arrangements

are recognized as right-of-use assets (named as 'right-of-use fleet' and 'right-of-use other fixed assets' on Finnair's balance sheet) with corresponding interest-bearing lease liabilities. Previously, future operating lease payments were presented in the notes as off-balance sheet commitments.

Assets at 31.12.2018 increased by 992.3 million euros due to the recognition of right-of-use assets, of which approximately 80 % are aircraft. Liabilities increased by 1,091.6 million euros due to the recognition of the present value of qualifying operating lease liabilities. The comparative information was restated, and the cumulative effect of applying IFRS 16 was recognized as an adjustment to the opening equity of 2018. The change decreased Finnair's equity at 31.12.2018 by 99.3 million euros.

The change had a significant impact on Finnair's 2018 reported key ratios. The increase of interest-bearing net debt was also reflected in the gearing ratio, which increased by 115.6 p.p. due to the implementation of IFRS 16. The equity ratio decreased by 11.3 p.p. Due to the implementation of IFRS 16, Finnair also ceased reporting two alternative key performance indicators from 1st January 2019 onwards. Adjusted net debt and adjusted gearing, which previously included adjustments for operating lease payments on aircraft, are no longer presented. Interest-bearing lease liability is now recognized on the balance sheet and therefore already included in the calculation of interest-bearing net debt and gearing, without the need for separate adjustment.

The leasing standard is also impacting Finnair's income statement. Based on the IFRS 16, operating lease expenses are divided into a depreciation of the right-of-use asset and interest costs on the lease liability. The interest costs for the liability are at their highest in the beginning of the lease term, decreasing towards the end of the term as the lease liability is amortized. Previously, operating lease expenses were accrued over the lease term on a straight-line basis and recognized in the operating result as lease payments for aircraft and other rents.

Finnair's 2018 comparable operating result improved by 54.7 million euros and operating result improved by 54.8 million euros due to the implementation of the new standard. Finnair's net result in 2018 however decreased by 44.3 million euros due to interest expenses and foreign exchange losses associated with USD denominated aircraft lease payments and liability. The majority of the decrease in Finnair's net result is derived from unrealized foreign exchange losses caused by the translation of the USD denominated liability.

The majority of Finnair's existing lease agreements and lease payments for aircraft are denominated in USD. In the future, the effect and amount of foreign currency exchange rate changes on the value of the right-of-use asset and lease liability recognized in the balance sheet may either be positive or negative, depending on the USD-rate at the balance sheet date. The annual effect in net result going forward is dependent on the size of the qualifying operating lease portfolio and the duration of the leases. Finnair aims to mitigate the foreign exchange volatility by using hedges.

In the cash flow statement, repayments of lease liabilities are moved from operating cash flow to financing cash flow in accordance with IFRS 16. Operating cash flow increased by 111.9 million euros in the comparison period 2018, with a corresponding reduction in financing cash flow.

IFRS 16 impacts in Finnair accounting policies

The leases recognized as right-of-use assets under IFRS 16 at Finnair are comprise of leased aircraft and spare engines, real estate, cars and ground equipment. Aircraft account for the majority (~80%) of the balance sheet value of the right-of-use asset and lease liability. The majority of the remaining right-of-use assets (~20%) comprise of real estate contracts.

Finnair uses the exemption provided by the standard not to account for lease liability for operating leases which have a term of 12 months or less, and which do not include an option to purchase the underlying asset. In addition, Finnair does not account for IFRS 16 lease liability for leases for which the underlying asset is not material to Finnair. The assessment of whether the underlying asset is material and is within the scope or excluded from the recognition requirements of IFRS 16 is based on the concept of materiality in the Conceptual Framework and IAS 1. Finnair recognizes the lease payments associated with such short-term and immaterial leases as an expense on a straight-line basis.

Aircraft

Lease term: For the aircraft operating lease contracts, the lease term corresponds to the non-cancellable duration of the contracts signed except in cases where the Group is reasonably certain of exercising either an extension option or an early termination option that is included in the contract. At the initial measurement of the lease, Finnair does not normally include any option period in the lease term as there is significant uncertainty whether Finnair will continue the lease term, even if the lease allows for extensions. The negotiation of possible extension typically begins 12-18 months prior to the initial operating lease term expiry. Finnair remeasures the lease liability when it decides to use the extension option or when there is some other significant indication that the lease period will be extended. For example, major modifications to leased aircraft may be considered as indications of extending the lease, especially if done close to the end of the leasing period.

Discount rate: Aircraft lease agreements do not clearly define the interest rate implicit in a lease. Since the fair values of the aircraft are provided publicly by third parties, Finnair is able to calculate the implicit interest rate for each qualifying aircraft operating lease. The rate implicit in the lease is defined as the rate that causes the sum of the present value of the lease payments and the present value of the residual value of the underlying asset at the end of the lease to equal the fair value of the underlying asset.

Maintenance costs: Finnair recognizes provisions for leased aircraft to maintain the aircraft during the period of the lease. For owned aircraft, provisions are not recognized because the cost is avoidable, by for instance selling the asset. IFRS 16 requires including restoration costs in the right-of-use asset. Finnair uses the criteria of whether the maintenance cost is avoidable or unavoidable in determining whether the maintenance cost is capitalised to the right-of-use asset or not.

Finnair is obliged to return leased aircraft and their engines according to redelivery conditions set in the lease agreements. If at the time of redelivery, the condition of the aircraft and its engines differs from the agreed redelivery condition, Finnair needs to either maintain the aircraft so that it meets the agreed redelivery condition or settle the difference in cash to the lessor. The maintenance costs can be divided into two main groups:

- 1) costs that are incurred independent of the usage of the aircraft / leasing period and
- 2) costs that are incurred dependent on the usage of the aircraft / leasing period

The final check and painting required at redelivery are considered unavoidable maintenance costs that realize when the aircraft is redelivered to the lessor, irrespective of the time or flight hours. The counterpart of the provision is recorded in the book value of the right-of-use asset at the commencement of the lease in accordance with IFRS 16 (IFRS 16:25). Respectively, costs depending on the usage of the aircraft are not considered as part of the right-of-use asset cost.

Excluded contracts: Excluded, non-qualifying, aircraft lease contracts include wet leases and spare engines that have been mainly excluded based on short-term exemption. Finnair analyses the lease term separately for each lease contract based on the contract term and possible extension or early termination options. When the lease term is 12 months or less and Finnair does not intend to continue the lease period after that, the lease agreement is excluded from lease liabilities.

Wet lease agreements are made to lease airline capacity typically on a short-term basis, for example when there are shortages in resourcing. The lease term of a typical wet lease agreement can vary from one day to one year.

Spare engines that have been leased on a short-term basis in exceptional cases (e.g., when the owned engine is unusable), are excluded from the lease liability. The lease term is usually only few days up to few months and Finnair does not intend to lease the spare engines for a longer period of time than they are needed.

Real estate

Lease term: The lease term corresponds to the non-cancellable duration of the contracts signed, except in cases where Finnair is reasonably certain of exercising either an extension option or an early termination option included in the contract.

Discount rate: Since facility agreements do not clearly specify the implicit interest rate in the lease contracts, Finnair uses an estimate of the incremental borrowing cost for a portfolio of facilities, meaning that all of the facilities'

(land and real estate) lease contracts are discounted using the same discount rate. A management estimate of the incremental borrowing cost is used in determining the interest rate.

Excluded contracts: Based on Finnair's evaluation, service contracts that relate to the usage of airports and terminals (HEL hub) do not qualify as lease arrangements for IFRS 16 purposes. In the contracts, the lessor has a substitution right to substitute the leased area with another area, which leads to classifying the contracts as non-leases. As an exception from this principle, there are specific lounge areas at Helsinki-Vantaa airport that are dedicated for Finnair's use, and these are therefore included in lease contracts.

Finnair has analyzed lease contracts where the lease term is not fixed but both the lessor and lessee have an option to terminate the lease within 1-12 months' notice and has concluded that these contracts are not material and termination of these contracts is practically realistic within the time of the notice (e.g. small storage space). Therefore, these contracts have been mainly excluded from the lease liability.

Other leases (cars and ground equipment)

Other leases are comprised mainly of company cars and ground equipment, where the lease is considered long term and therefore are qualified as IFRS 16 leases.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. Finnair has used this practical expedient for those company car and ground equipment leases that include service components.

The lease term corresponds to the non-cancellable duration of the contracts signed except in cases where Finnair is reasonably certain of exercising either an extension option or an early termination option included in the contract. Current lease contracts do not include such options that would be reasonably certain to be exercised, so the lease term of the current contracts corresponds to the lease duration of the signed contract.

Finnair uses an estimate of incremental borrowing cost for each portfolio of cars and ground equipment, meaning that all of the lease contracts are discounted using the same discount factor. A management estimate is used to determine the incremental interest rate. Lease contracts that individually (or by asset class) are not material to Finnair have been excluded from the lease liability. These contracts include small IT-equipment and office equipment.

Subleases

IFRS 16 did not change substantially how a lessor accounts for leases. Under IFRS 16, a lessor continues to classify leases as either finance leases or operating leases and account for those two types of leases differently. Under IFRS 16, an intermediate lessor is required to classify the sublease as a finance or operating lease by reference to the right-of-use asset arising from the head lease (and not by reference to the underlying asset as was the case under IAS 17). Because of this change, Finnair has reclassified certain of its sublease agreements as finance leases as at 1st January 2019.

Finnair subleases 9 (nine) aircraft and a small amount of ground equipment, whereby reference to the head lease, the lease term is for the majority of the remaining economic life arising from the right-of-use asset and therefore these are classified as finance leases in accordance with IFRS 16. The right-of-use asset arising from the head lease is derecognized and a net investment corresponding to the discounted lease payments is recognized on the Finnair balance sheet.

In accordance with IFRS 16, for subleases where Finnair is the lessor and are reclassified from operating subleases to finance leases due to IFRS 16, contracts ongoing at 1.1.2019 (date of initial application) are accounted for as new finance leases and the gain arising on the subleases is included in the cumulative catch-up adjustment in retained earnings.

Notes

2.2 Leasing arrangements

A The Group as lessee

Finnair assesses whether a contract that relates to tangible assets is, or contains, a lease in accordance with the IFRS 16. Lease agreements for tangible assets, where the contract conveys the right to use of an identified asset for a period of time in exchange for consideration, are classified as leases.

The lease term is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both periods covered by an option to extend the lease if Finnair is reasonably certain to exercise that option; and periods covered by an option to terminate the lease if Finnair is reasonably certain not to exercise the option.

The lease recognition requirements are not applied to short-term leases, where at the commencement date, the lease term is 12 months or less and does not contain a purchase option. Finnair considers the lease period to be the period that is enforceable. Hence, for contracts where the contract term is non-fixed and Finnair has the right to terminate the contract without the permission from the other party with no more than an insignificant penalty and there are no other indications that the contract is enforceable, Finnair classifies these contracts as short-term. The lease recognition requirements are also not applied to leases that are not material to Finnair.

For short-term leases and to immaterial leases to which these exemptions are applied, the lease payments are recognised as an expense on either a straight-line basis over the lease term, or on another systematic basis if that basis is more representative of the pattern of Finnair's benefit.

At the commencement date of a lease, Finnair recognises both a right-of-use asset, and a lease liability.

The lease liability is the present value of future lease payments. At Finnair, lease payments for aircraft leases contain typically payments that depend on interest rates and indices, that are included in the measurement of the lease payments included in the measurement of the lease liability, using the interest or index rate at the commencement date of the lease.

The right-of-use asset is measured at cost, comprising

- the amount of the initial measurement of the lease liability;
- any lease payments made at or before the commencement date, less any incentives received;
- any initial direct costs incurred by Finnair; and
- an estimate of costs to be incurred by Finnair in restoring the assets to the condition required by the terms and conditions of the lease.

Finnair is obliged to return leased aircraft and their engines according to the redelivery condition set in the lease agreement. If at the time of redelivery, the condition of the aircraft and its engines differs from the agreed redelivery condition, Finnair needs to either maintain the aircraft so that it meets the agreed redelivery condition or settle the difference in cash to the lessor.

The maintenance costs can be divided into two main groups:

- 1) costs that are incurred independent of the usage of the aircraft / leasing period and
- 2) costs that are incurred dependent on the usage of the aircraft / leasing period

The final check and painting required at redelivery are considered unavoidable maintenance costs that realise when the aircraft is redelivered to the lessor, irrespective of the time or flight hours. The counterpart of the provision is recorded in the book value of the right-of-use asset at the commencement of the lease.

Respectively, costs depending on the usage of the aircraft are not considered as part of the right-of-use asset cost.

Finnair remeasures the lease liability when there is a lease modification that changes the scope of a lease or the consideration for the lease, that was not part of the original terms and conditions of the lease, including changes in lease payments resulting from a change in indices and rates used in variable aircraft lease payments. The amount of the remeasurement of the lease liability is generally recognised as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, the remaining measurement is recognised in profit or loss.

After initial recognition, right-of-use assets are measured at cost less any accumulated depreciations and impairment losses. The assets are depreciated with a straight-line method from the commencement date to the shorter of end of useful life of the right-of-use asset and the end of lease term. However, if the lease transfers ownership of the asset to Finnair by the end of lease term or if the cost of the right-of-use asset reflects that Finnair will exercise a purchase option, the right-of-use asset is depreciated from the commencement date to the end of useful life of the asset.

At Finnair aircraft lease contracts contain the interest rate implicit in the lease, even if the aircraft lease agreements do not clearly define the interest rate implicit in the lease. Since the fair values of the aircraft are provided publicly by third parties, Finnair is able to calculate the implicit interest rate for each qualifying aircraft operating lease. The rate implicit in the lease is defined as the rate that causes the sum of the present value of the lease payments and the present value of the residual value of the underlying asset at the end of the lease to equal the fair value of the underlying asset. The implicit interest rate is determined by each aircraft lease contract separately.

For other lease contracts at Finnair, implicit interest rate cannot be usually determined. The incremental borrowing rate is therefore used and it is determined by each class of assets separately, based on management estimate.

Aircraft lease contracts are usually denominated in foreign currency (US dollars) and the foreign currency lease liabilities are revalued at each balance sheet date to the spot rate. The lease payments (lease payments made) are accounted for as repayments of the lease liability and as interest expense.

The Group as lessor

Agreements, where the Group is the lessor, are accounted for as operating leases, when a substantial part of the risks and rewards of ownership are not transferred to the lessee. The assets leased under operating lease are included in the tangible assets and they are depreciated during their useful life. Depreciation is calculated using the same principles as the tangible assets for own use. Under the provisions of certain aircraft lease agreements, the lessee is required to pay periodic maintenance reserves which accumulate funds for aircraft maintenance. Advances received for maintenance are recognised as liability, which is charged, when maintenance is done. The rents for premises and aircraft are recognised in the income statement as other operating income over the lease term.

Agreements, where the Group is the lessor, are accounted for as finance leases, when a substantial part of the risks and rewards of ownership are transferred to the lessee. Finnair recognises assets held under a finance lease in its statement of financial position and presents them as a receivable at an amount equal to the net investment of the lease.

Finnair subleases aircraft and a small amount of ground equipment, where by reference to the head lease, the lease term is for the majority of the remaining economic life arising from the right-of-use asset (i.e. the lease term of the sublease corresponds closely to the lease term of the head lease) and therefore these are classified as finance leases. At the commencement date, for the subleases, a net investment (lease receivable), equaling to the present value of lease payments and the present value of the unguaranteed residual value, is recognised. The proportion of the right-of-use asset subleased is derecognised from the balance sheet and the difference between the right-of-use asset and the net investment is recognised in the profit or loss, in sales gains and losses. Subsequently, the lease payments (lease payments received) are accounted for as repayments of the lease receivable and as interest income.

Sale and leaseback

In sale and leaseback transactions, where Finnair sells and then leases back aircraft, Finnair measures the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right-of-use retained by the Group. Accordingly, Finnair recognises only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor. **A**

A Critical accounting estimates and sources of uncertainty

The classification of all leasing arrangements in the Group, determining the interest rate and lease term used in discounting the lease payments and estimating the redelivery obligations of aircraft leases require management discretion in interpretation and application of accounting standards. **A**

Right-of-use assets 2019

EUR mill.	Aircraft	Buildings and land	Other equipment	Total
Book value 1 Jan 2019	834.3	153.6	10.7	998.6
Additions	10.0	5.3	13.9	29.2
Changes in contracts	-1.8	-3.4	-0.5	-5.6
Disposals		-15.1		-15.1
Depreciation for the financial year	-106.1	-16.4	-6.9	-129.5
Book value 31 Dec 2019	736.4	124.0	17.1	877.5

Additions to right-of-use aircraft in 2019 are related to two new lease agreements for spare engines and the increase in other equipment relates to renewal of company car agreements. The changes in contracts relate to changes either in the scope, or consideration, of leases. Disposals of buildings and land comprise of sublease agreement of land which was recognised at the beginning of the year 2019.

Right-of-use assets 2018

EUR mill.	Aircraft	Buildings and land	Other equipment	Total
Book value 1 Jan 2018	881.8	170.9	15.5	1,068.3
Additions	109.3	0.5	3.3	113.1
Changes in contracts	12.4	-0.6		11.8
Disposals	-56.3			-56.3
Depreciation for the financial year	-112.9	-17.2	-8.2	-138.4
Book value 31 Dec 2018	834.3	153.6	10.7	998.6

Lease liabilities

EUR mill.	Aircraft		Buildings and land		Other equipment	
	2019	2018	2019	2018	2019	2018
less than one year	118.9	102.3	15.8	16.2	5.7	6.6
1-5 years	507.0	584.3	58.9	61.1	11.6	4.1
more than 5 years	275.7	297.8	60.3	87.0		
Total	901.7	984.4	135.0	164.2	17.3	10.7

The Group leases aircraft, premises and other fixed assets, for which the lease liability is recorded on the balance sheet. The lease agreements have different terms of renewal and include index-linked terms and conditions. The Group was operating 27 leased aircraft at the end of the year with lease agreements of different tenors. The leased aircraft, that Finnair is subleasing to other operators is shown in note Finance lease receivables, Group as a lessor.

Finance lease receivables, Group as lessor

EUR mill.	Aircraft		Other equipment	
	2019	2018	2019	2018
less than one year	13.2	11.0		0.3
1-5 years	33.7	47.0		
more than 5 years				
Total	47.0	58.0		0.3

Subleases include sublease arrangements of 9 aircraft, as well as subleased ground equipment, that have been reclassified as finance leases at the time of IFRS 16 implementation.

Leasing arrangements in profit and loss

EUR mill.	2019	2018
Depreciation expense of right-of-use assets	-129.5	-138.4
Interest expense on lease liabilities	-68.5	-69.3
Interest income on sublease receivables	3.7	
Exchange rate differences	-18.7	-40.1
Hedging result of lease liabilities	31.1	
Short-term wet leases	-26.6	-15.8
Short-term office rents	-3.7	-5.1
Variable purchase traffic and cargo capacity rents	-103.2	-107.0
Total	-315.4	-375.7

Operating expenses include costs related to short-term and capacity based rental agreements, for which a lease liability and right-of-use asset is not recognised. In the income statement, the short-term wet leases and variable purchase traffic and cargo capacity rents are included in capacity rents and the short-term office rents are included in property, IT and other expenses. Total cash outflow relating to leases was -317.5 million euros (-315.7).

Off-balance sheet lease commitments, Group as lessee, Group as lessee

EUR mill.	Premises rents		Other rents	
	2019	2018	2019	2018
less than one year	3.0	2.9	2.3	3.6
1-5 years	6.5	6.6	0.8	2.2
more than 5 years	7.8	11.7		0.1
Total	17.2	21.1	3.1	5.8

The irrevocable lease agreements include short-term and other lease contracts that are not included in lease liabilities. The most significant item in the premises rents is the right-to use a test cell, which is excluded from the lease liability on the basis that it is not for the exclusive use of Finnair. Other rents include IT equipment leases, that are not material.

Off-balance sheet lease assets, Group as lessor

EUR mill.	Aircraft		Buildings and land	
	2019	2018	2019	2018
less than one year	27.0	27.1	2.1	2.1
1-5 years	36.8	63.8	8.4	8.3
more than 5 years			11.9	14.0
Total	63.8	90.9	22.4	24.4

The Group has leased 15 owned aircraft as well as premises with irrevocable lease agreements. These agreements have different terms of renewal and other index-linked terms and conditions.

A photograph of a man with a beard and sunglasses, wearing a yellow shirt, leaning out of the open window of a car. He is smiling and looking towards the camera. The car is on a road, and the background shows a sunset or sunrise with a warm, golden glow. The text "IFRS 15 Revenue from Contracts with Customers" is overlaid in white on the image.

IFRS 15 Revenue from Contracts with Customers

Textbook: Chapter 13

Learning objectives

- Explain the scope of IFRS 15
- 5-step model
- Main presentation and disclosure requirements

KONE publishes restated information on 2017 financials as a result of adaption of new IFRS 15 and IFRS 9 accounting standards

● STOCK EXCHANGE RELEASE PUBLISHED 19/03/2018

In 2018, KONE has adopted new accounting standards issued by the International Accounting Standards Board, IFRS 15, Revenue from Contracts with Customers, and IFRS 9, Financial Instruments, effective on January 1, 2018.

The most significant impact from the implementation of the IFRS 15 is the application of the percentage of completion revenue recognition method also in the volume new equipment and modernization businesses. In these businesses, revenue has previously been recognized upon the handover of the project to the customer, while long-term major projects have already been recognized under the percentage of completion method. With the new IFRS 15 principles, revenue is gradually recognized for all construction contracts at KONE based on the progress from the point when materials arrive at the customer site until the handover of the project. The implementation of IFRS 9 did not have a material impact in KONE's consolidated financial statements.



The five step
model

The five-step model

Core principle

Recognise revenue to describe the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

Step 1:

Identify the contract(s) with a customer



Step 2:

Identify the performance obligations in the contract



Step 3:

Determine the transaction price



Step 4:

Allocate the transaction price to the performance obligations



Step 5:

Recognise revenue when (or as) the entity satisfies a performance obligation

Step 1: Identify
the contract

1



Definition of a contract

A contract is defined as an agreement between two or more parties that creates enforceable rights and obligations

- Can be written, oral or implied, but must meet specific criteria
- Does not exist if both parties can cancel a wholly unperformed contract without penalty

Parties have approved the contract and are committed to perform

Each party's rights are identifiable

Each party's payment terms are identifiable

Contract has commercial substance

It is probable the entity will collect the consideration it is entitled to in exchange for the transfer of goods/services to the customer

Case

- Tech Co. enters into an arrangement with a customer in a new region for networking products for promised consideration of CU1 million
- The new region is experiencing economic difficulty; however, Tech Co. expects the economy to recover over the next two to three years
- Tech Co. expects that it may not be able to collect the full amount from the customer
- Tech Co. determines it may have to grant the customer a price concession, and it is willing to do so up to CU200,000

IS COLLECTABILITY PROBABLE?

SOLUTION

At contract inception, Tech Co. expects that it may not be able to collect the full amount from the customer. Tech Co. considers whether the customer has the ability and intent to pay the estimated transaction price, which may be an amount less than the contract price.

Tech Co. determines at contract inception that it may be forced to grant the customer a price concession, and it was willing to do so up to CU200,000, if necessary.

The amount to which Tech Co. is entitled is CU800,000 and, Tech Co. performs the collectability assessment based on that amount rather than the CU1 million contract price.

Combining contracts

Two or more contracts entered into at or near the same time with the same customer (or related parties) are combined and accounted for as a single contracts if any of the following conditions are met:

Contracts are negotiated as a package with a single commercial objective

Consideration in one contract depends on the price or performance of the other contract

Some or all of the goods and services promised in the contracts are single performance obligation

Contract modifications

A contract modification is an approved change in the scope or price (or both) of a contract that creates new or changes existing enforceable rights and obligations of the parties to the contract

Scope of the contract increases due to added goods or services that are distinct

Price of the contract increases by the stand-alone selling price of the added goods or services

Separate contract

All other modifications

Part of original contract

Case – Scenario A

- The entity enters into an arrangement to sell 120 products to a customer for CU12,000 (CU100 per product).
- The products are transferred to the customer over a six-month period
- After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products to the customer (a total of 150 identical products)
- When the contract is modified, the price of the contract modification for the additional 30 products is an additional CU 2,850 or CU 95 per product (stand-alone selling price)

HOW SHOULD THE CONTRACT MODIFICATION BE ACCOUNTED?

Case – Scenario A

- The entity determines:
- The additional products are distinct from the original products and
- The pricing for the additional products reflects the stand-alone selling price of the products at the time of the contract modification
- The contract modification is considered a separate contract for the additional products, and it would not affect the accounting for the existing contract

SEPARATE CONTRACT

Case – Scenario B

- When the contract is modified, the price of the contract modification for the additional 30 products is an additional CU 2,400 or CU 80 per product (not a stand-alone selling price)
- The entity determines:
- The additional products are distinct from the original products
- The negotiated price of CU 80 per product does not reflect the stand-alone selling price of the additional products
- Due to the pricing, the contract modification does not meet the conditions to be accounted for as a separate contract

PART OF ORIGINAL CONTRACT

Case – Scenario B

- Consequently, the amount recognised as revenue for each of the remaining products is a blended price calculated as follows:

$$\begin{aligned} & \text{(CU100}\times\text{60 products not yet transferred under the original contract)} \\ & \quad + \\ & \text{(CU80}\times\text{30 products to be transferred under the contract modification)} \\ & \quad \div \\ & \text{90 remaining products} \\ & \quad = \text{CU93.33} \end{aligned}$$

PART OF ORIGINAL CONTRACT

Step 2: Identify
performance
obligations

2



Overview

Performance obligation

A performance obligation is a promise (explicit or implicit) to transfer to a customer either:

- ▶ A distinct good or service
- ▶ A series of distinct goods or services that are substantially the same and have the same pattern of transfer

Determining performance obligations

Performance obligations are identified at contract inception and determined based on:

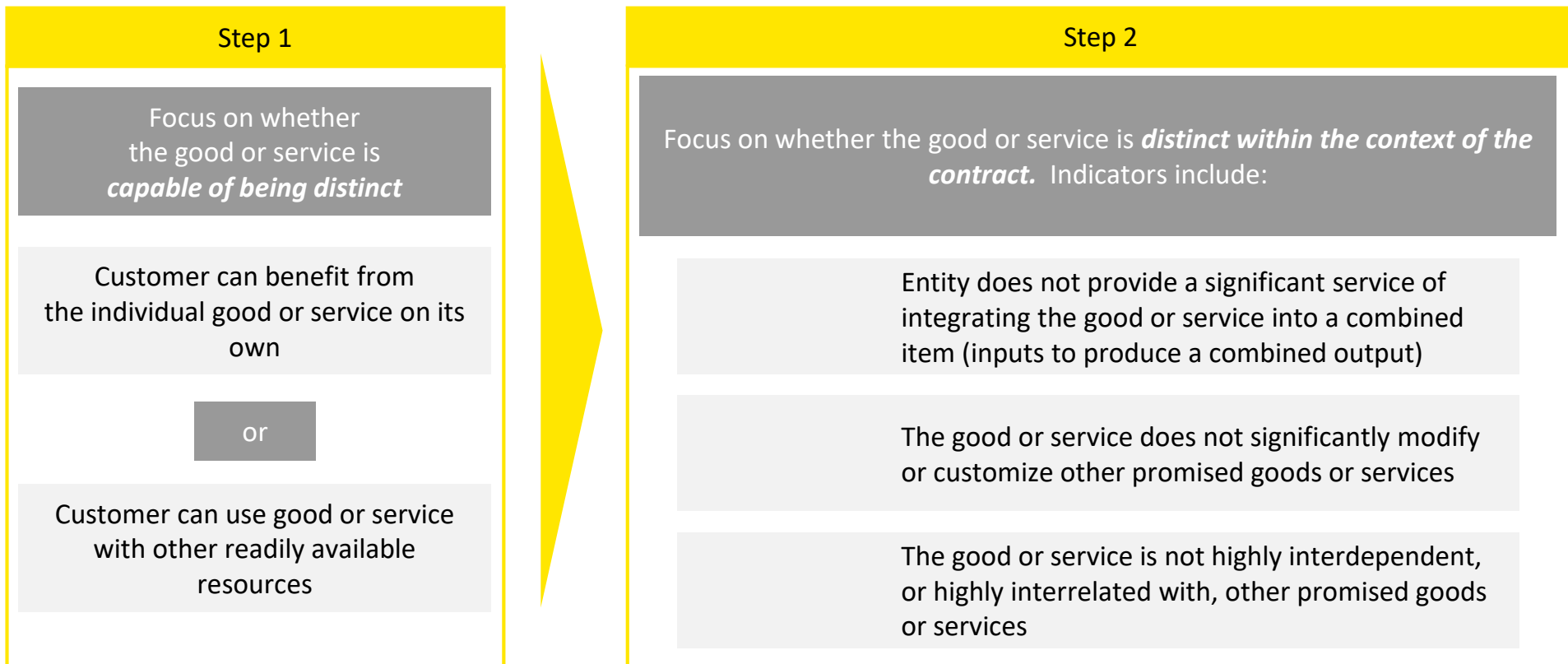
- ▶ Contractual terms
- ▶ Customary business practices

Marketing incentives

Incidental obligations or marketing incentives may be performance obligations (e.g., “free” maintenance provided by automotive manufacturers, loyalty points provided by a hotel)

Distinct goods or services

Two-step model to identify which goods or services are distinct

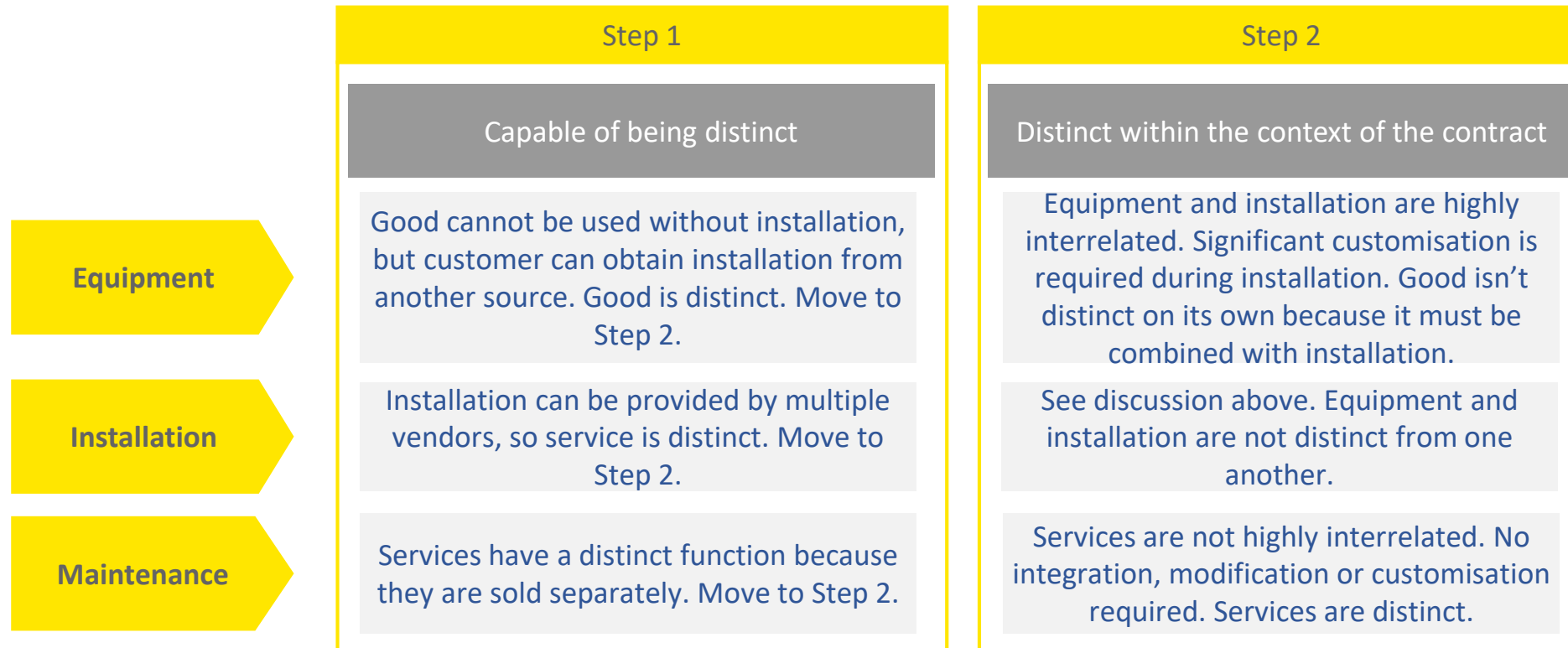


Case

- Entity enters into a contract to manufacture and install customized equipment and provide maintenance services for a five-year period.
- Installation services include the integration of multiple pieces of equipment at the customer's facility in order for the equipment to operate as a single unit. Equipment cannot operate without installation.
- Entity sells equipment and installation services together, and does not sell installation separately.
- Other vendors can provide the installation services. The maintenance services are sold separately.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Case



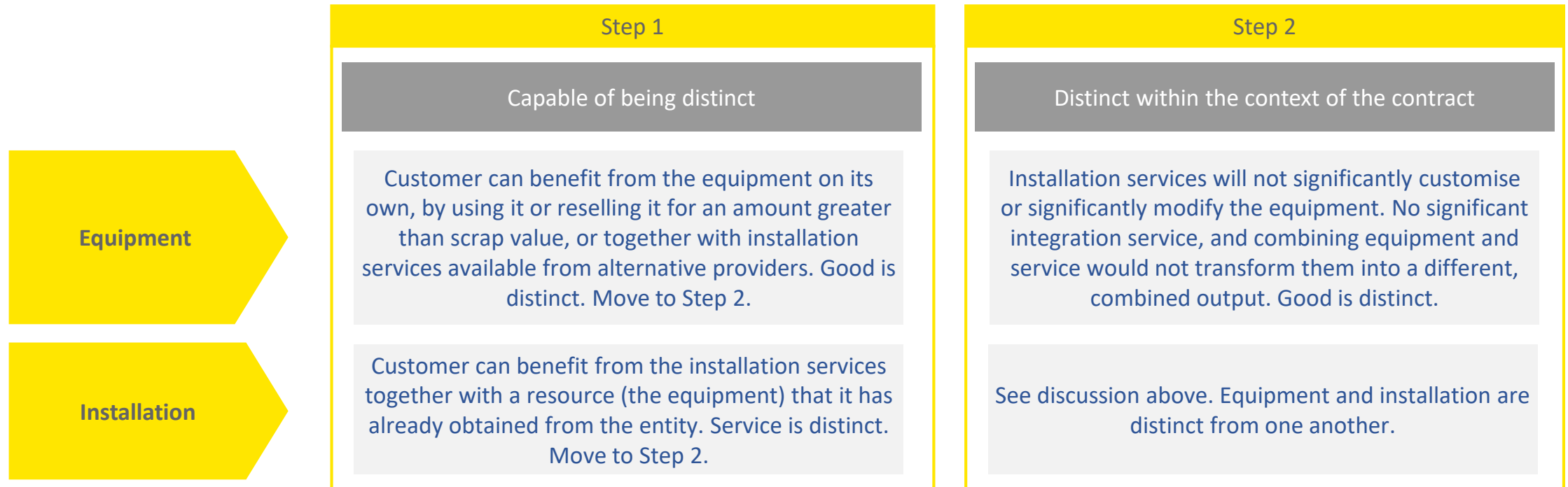
There would be two performance obligations: (1) the equipment and installation because they are not individually distinct; (2) maintenance services because they are distinct services in the contract.

Case 2

- An entity enters into a contract with a customer to provide an item of equipment as well as to provide installation services.
- The equipment is functional without any customization or modification.
- Installation will not significantly modify or customize the equipment.
- The installation required is capable of being performed by other service providers.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Case 2



There would be two performance obligations: (1) the equipment and 2) installation because they are distinct in the contract.

Principal versus agent consideration

- Determining whether an entity acts as a principal or an agent in a specific arrangement affects the amount of revenue recognised (gross versus net recognition).
- Appropriately identifying the entity's performance obligation is fundamental to the principal or agent determination.

PRINCIPAL

Provides goods or services itself

An entity is a principal if it controls a specified good or service before that good or service is transferred to a customer

AGENT

Arranges for the goods or services to be provided by another party

Principal versus agent consideration

- Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal) include, but are not limited to, the following:

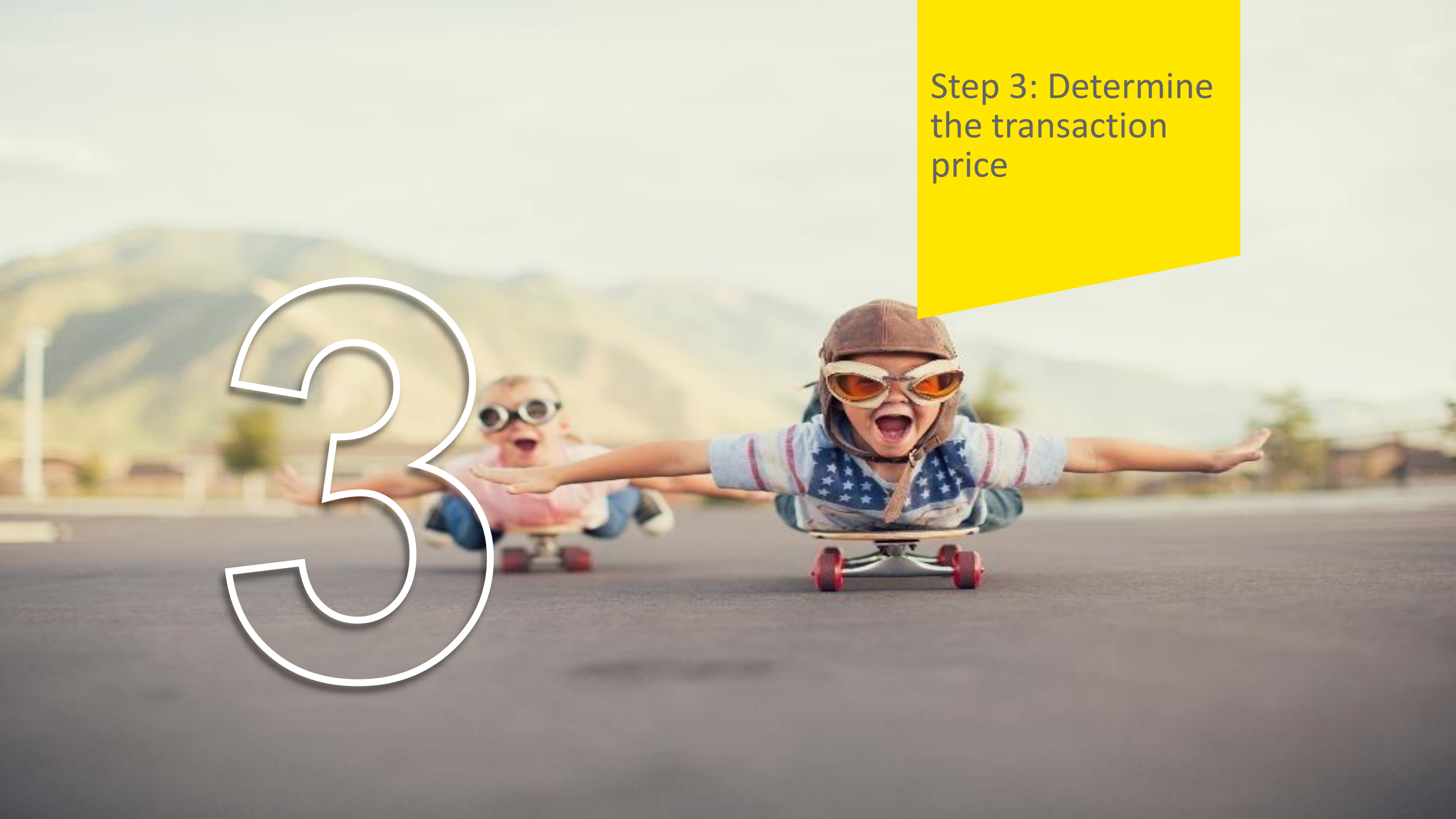
Entity is primarily responsible for fulfilling the promise to provide the specified good or service

Entity has inventory risk before the specified good or service has been transferred to a customer

Entity has discretion in establishing the price for the specified good or service

Step 3: Determine
the transaction
price

3



Overview

- Transaction price is the **amount of consideration to which an entity expects to be entitled** in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties
- When determining the transaction, an entity shall consider the effects of the following:

Variable consideration

Significant financing component

Non-cash consideration

Consideration payable to a customer

Variable consideration

- Transaction price may vary because of variable consideration
- Definition of “variable consideration” is broad
- Identifying variable consideration is an important step in the new model because the constraint has to be considered for each type of variable consideration

Common types and events that cause consideration to be variable

Bonuses	Incentive payments	Penalties
Refunds	Market-based fees	Discounts
Returns	Money-back guarantees	Price concessions
Volume rebates	Service level agreements	Liquidating damages

Variable consideration

- Variable consideration is estimated using the approach that better predicts the amount to which the company is entitled based on its facts and circumstances (i.e., not a “free choice”)
- The approach should be applied consistently throughout the contract and for similar types of contracts

EXPECTED VALUE

Sum of the probability-weighted amounts in a range of possible outcomes

Most predictive when the transaction has a large number of possible outcomes

Can be based on a limited number of discrete outcomes and probabilities

MOST LIKELY AMOUNT

The single most likely amount in a range of possible outcomes

May be appropriate when the transaction will produce only two outcomes

Case

- The entity enters into a contract to construct a building for a customer for CU25 million
- The entity will also receive a bonus or pay a penalty of CU25,000 for each day that project is completed before or after 30 June 2018, respectively
- The entity uses [the expected value approach](#) with the following possible outcomes:

Possible outcomes	Probability	Calculated amount
Ten days early - CU250,000	50%	CU125,000
On schedule - CU0	25%	CU0
Five days late – (CU125,000)	25%	(CU31,250)
Probability-weighted estimate		CU93,750

The entity would include CU93,750 in the transaction price, assuming that the amount is not limited by the constraint

Case

- Assume the same facts from Example before. The entity will also receive a bonus of CU200,000 if the building achieves a green building certification level specified in the contract
- The entity uses [the most likely amount approach](#) to determine whether the bonus should be included in the transaction price because there are only two possible outcomes
- Based on its history of completing projects that achieve the certification specified in the contract, the entity determines that the bonus should be included in the transaction price
- At contract inception, the total transaction price is:

Base contract price	CU25,000,000
Completion bonus	CU93,750
Green certification bonus	<u>CU200,000</u>
Transaction price	CU25,293,750

Constraint on variable consideration

Constraining
amounts of
variable
consideration

An entity should include an amount of variable consideration in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is resolved

IFRS constraint
threshold

Highly probable

Significant

“Significant” is relative to cumulative revenue recognised



An entity should update its estimate of the transaction price that includes variable consideration at each reporting date

Step 4: Allocate the transaction price

4



Overview

- Transaction price is allocated to each separate performance obligation in “an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer”
- Transaction price is [generally allocated based on relative stand-alone selling prices](#)

Case

- Entity A enters into an agreement to sell hardware, professional services and maintenance services for CU200,000
- Entity A determines that each of the promised goods or services represents a separate performance obligation
 - Because Entity A frequently sells professional services and maintenance on a stand-alone basis, it uses those transactions to determine stand-alone selling prices of CU25,000 and CU15,000, respectively
 - Entity A rarely sells the hardware on a stand-alone basis, so it estimates the stand-alone selling price at CU185,000 based on the hardware's underlying cost, Entity A's targeted margin and the amount of margin Entity A believes the market will bear (i.e., the expected cost plus a margin approach)

How would you allocate transaction prices for each performance obligations?

Case

Performance obligation	Estimated stand-alone selling price	% of relative selling price	Allocation of transaction price
Hardware	CU185,000	82.2	CU 164,400
Professional services	25,000	11.1	22,200
Maintenance services	15,000	6.7	13,400
Total	CU225,000	100.0	CU 200,000

Step 5: Recognise
revenue

5



Overview

Transfer

- ▶ Revenue is recognised upon satisfaction of a performance obligation by transferring the promised good or service to a customer. A good or service is considered to be transferred when (or as) the customer obtains control.

Performance obligations

- ▶ Performance obligations are either satisfied over time or at a point in time
 - ▶ To help make this determination, the standard includes criteria for determining when control transfers over time
 - ▶ If a performance obligation does not meet any of those criteria, control transfers at a point in time

Apply consistent method for similar performance obligations in similar circumstances

Performance obligations satisfied over time

Control of goods and services is transferred over time if one of the following three criteria is met:

The entity creates or enhances an asset that the customer controls as it is created or enhanced

The entity's performance does not create an asset with alternative use and the entity has a right to payment for performance completed to date

The customer is receiving and consuming the benefits of the entity's performance as the entity performs

If none of the criteria are met, control transfers at a point in time

Another entity would not have to re-perform work completed to date

Performance obligation satisfied over time

- Revenue is recognised over time by measuring progress toward completion
 - The objective is to most faithfully depict an entity's performance
 - Apply a single method of measuring progress for each performance obligation satisfied over time



Output methods



Input methods



Apply consistent method for similar performance obligations in similar circumstances



- ▶ If unable to reasonably estimate progress, revenue should not be recognised until progress can be estimated
- ▶ However, if an entity expects to recover the costs, the entity should recognise revenue up to costs incurred

Control transferred at a point in time

The following are indicators of when control is transferred.

(None of the indicators are individually determinative, and none are more important than others. Note that other factors could be relevant.)



The entity has a present right to payment for the asset



The customer has legal title to the asset



The customer has physical possession of the asset



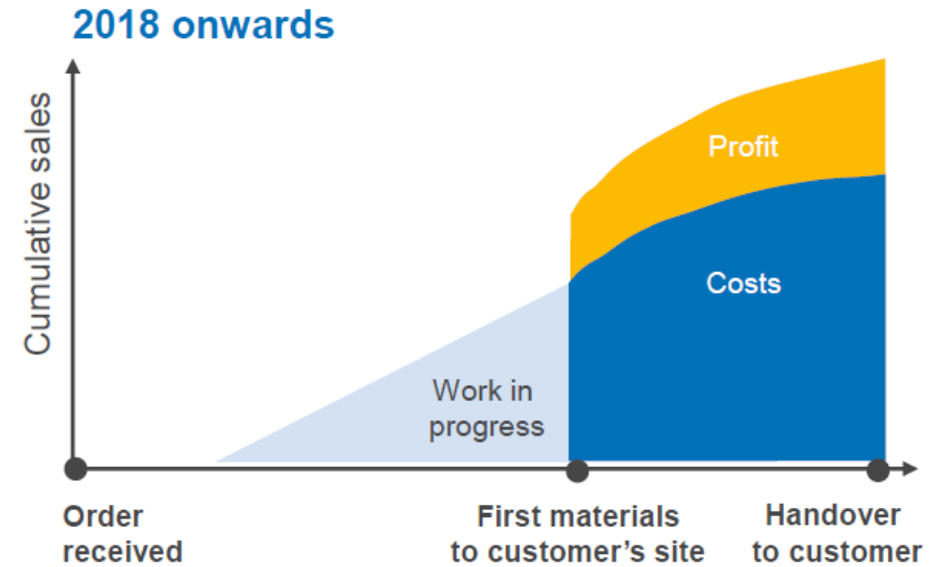
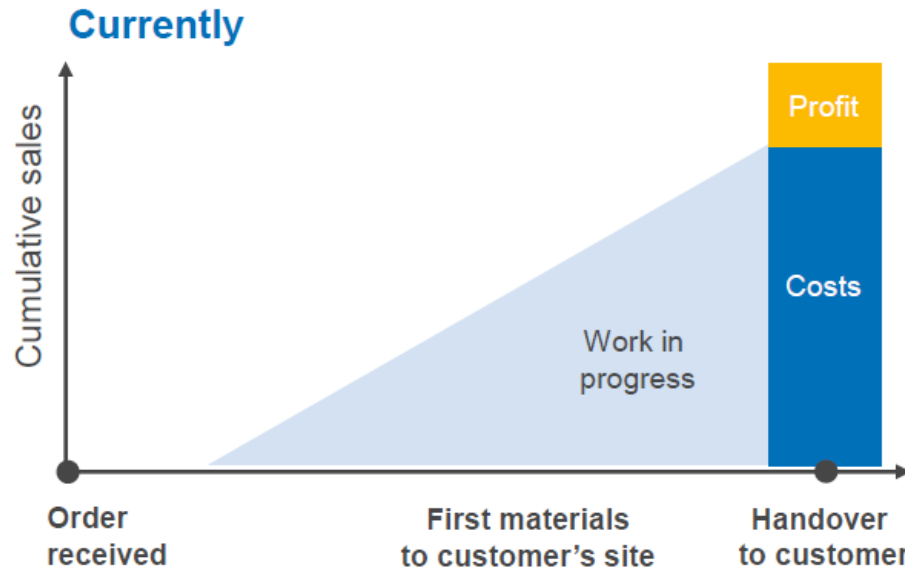
The customer has the risks and rewards of ownership of the asset



The customer has accepted the asset

Example case: volume new equipment order worth 100

(numbers are illustrative)



Balance sheet	Order book	100	100	-
	Inventory	-	45	-
	Advances received	5	50	-
	Accounts receivable	-	-	10
P&L	Cumulative sales	-	-	100
	Cumulative costs	-	-	85
	Cumulative profit	-	-	15

	Order book	100	47	-
	Inventory	-	-	-
	Advances received	5	-	-
	Accounts receivable	-	3	10
	Cumulative sales	-	53	100
	Cumulative costs	-	45	85
	Cumulative profit	-	8	15

A man in a dark suit stands with his back to the camera, looking at a wall covered in a dense, chaotic pattern of white scribbles. He has his right hand on his head, suggesting confusion or frustration. The wall is a dark, textured grey, and the floor is made of dark grey tiles. A bright yellow rectangular area is in the top right corner, containing the text 'Presentation and disclosure'.

Presentation and
disclosure

KONE Annual Report 2020

2.1 SALES

Due to KONE's business model, the nature of its operations and its governance structure, KONE has one operating segment.

Sales by business

MEUR	Jan 1–Dec 31, 2020	%	Jan 1–Dec 31, 2019	%
New equipment	5,340.2	54	5,318.8	53
Services	4,598.4	46	4,663.0	47
Maintenance	3,215.6	32	3,192.0	32
Modernization	1,382.8	14	1,471.0	15
Total	9,938.5		9,981.8	

Sales by geographical area

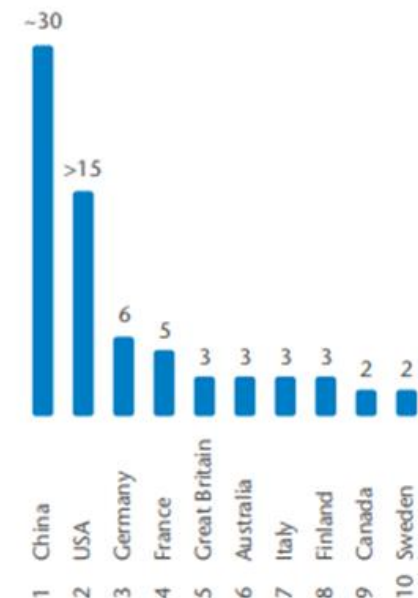
MEUR	Jan 1–Dec 31, 2020	%	Jan 1–Dec 31, 2019	%
EMEA ¹⁾	3,916.2	39	4,045.4	41
Americas	1,939.5	20	2,046.7	21
Asia-Pacific	4,082.8	41	3,889.7	39
Total	9,938.5		9,981.8	

¹⁾ EMEA = Europe, Middle East, Africa

Sales by customer

KONE's customer base consists of a large number of customers in several markets areas and no individual customer represents a material share of its sales.

Top 10 countries by sales, %



KONE Annual Report

Accounting principles

Revenue recognition

Revenue from contracts with KONE's customer is recognized at an amount that reflects the consideration to which KONE expects to be entitled in exchange for promised goods or services to a customer.

KONE recognizes revenue when or as it satisfies a performance obligation by transferring control on the promised goods or services (performance obligation) to a customer.

A performance obligation is a distinct good or service within a contract that a customer can benefit from on a stand-alone basis. For KONE's new equipment and modernization contracts, a performance obligation typically means delivery and installation of a single unit, i.e. an elevator, an escalator or other People Flow™ solutions. For KONE's maintenance contracts, maintenance of a single unit is considered as a distinct performance obligation and for repairs business, typically a service order is a performance obligation for KONE.

In new equipment and modernization contracts, KONE transfers the control of a single unit to the customer over time and, therefore, satisfies the performance obligation and recognizes revenue over time.

The transfer of control occurs when KONE delivers the unit to a customer site as then the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, a unit constructed by KONE. Upon this milestone and onwards up to the project handover, revenue is recognized under the percentage of completion method using a cost-to-cost input method as based on KONE's assessment it best depicts the transfer of control to the customer. Percentage of completion is defined as the proportion of an individual performance obligation's cost incurred to date from the total estimated costs for that particular performance obligation.

The percentage of completion method requires accurate estimates of future revenues and costs over the full term of the contracts. These significant estimates form the basis for the amount of revenue to be recognized and include the latest updated total revenue, cost and risks adjusted by the typical estimation revisions for similar types of contracts. These estimates may materially change due to the stage of completion of the contract, changes in the contract scope, cost estimates and customer's plans and other factors.

Revenues from the rendering of maintenance services and repairs are recognized when the services have been rendered or over the contract term when the work is being carried out. For maintenance services the performance obligation is satisfied over time because the customer simultaneously receives and consumes the benefits provided as KONE performs the services.

Most of KONE's revenue is derived from fixed-price contracts and, therefore, the amount of revenue to be earned from each contract is determined by reference to those fixed prices. KONE customer contracts do not contain any significant financing components. In new equipment and modernization contracts payment terms are typically based on either performance according to specific contractual milestones or progress of work performed. In maintenance services contracts the customer generally pays based on a fixed payment schedule.

When customer contracts contain multiple performance obligations the transaction price is allocated to each performance obligation based on the standalone selling prices. Where these are not directly observable, they are estimated based on estimated costs plus margin approach.

Fiskars Annual Report 2020

2.1 Segment information

Accounting principles

Fiskars Group's organizational structure features three Business Areas (BA): Vita, Terra and Crea. As of January 1, 2020 Fiskars Group's four primary reporting segments are Vita, Terra, Crea and Other. In addition, Fiskars Group reports net sales for three geographical areas: Europe, Americas and Asia-Pacific.

The performance of the reporting segments is reviewed regularly by the chief operating decision-maker, Fiskars Group's Board of Directors, to assess performance and to decide on allocation of resources. The operating segments, BA Vita, Terra and Crea, are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The performance of the segments is reviewed based on segments' operating profit (EBIT). The accounting principles of the segments are the same as those used in the preparation of the financial statements. Financial income and costs and income taxes are managed on group basis and accordingly not allocated to operating segments.

NET SALES AND REVENUE RECOGNITION

Net sales are shown net of indirect taxes, rebates, and exchange differences on trade receivables denominated in foreign currencies. Revenue from

the sale of goods is recognized when performance obligation is satisfied, i.e. when "control" of the good or service underlying the particular performance obligation is transferred to the customer, i.e. when a product has been delivered to the client in accordance with the terms of delivery. There are no such long-term projects in the group for which the revenue would be recognized using the percentage-of-completion (POC) method.

OPERATING PROFIT

IAS 1 Presentation of Financial Statements does not give a definition for operating profit. In Fiskars Group the operating profit (EBIT) is the net of revenues and other operating income, material purchases and change of inventories, production for own use, employee benefits, depreciations, amortizations and possible impairments and other operating expenses. The operating profit includes operating results of Fiskars' primary reporting segments Vita, Terra, Crea and Other. EBITA is calculated from EBIT by adding back amortization. Change in fair value of biological assets is presented as a separate line item below EBIT in the income statement.

A forest scene with several transparent bubbles containing green particles. The bubbles are scattered throughout the frame, some overlapping the text. The background consists of tall, thin tree trunks and a forest floor with green moss and small plants. The lighting is soft, suggesting a dappled sunlight effect.

NEXT TIME: IFRS 5, IAS 36, IAS 39