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PwC's survey on quarterly reporting for listed companies and transition to IFRS 16

Will Q1 and Q3 IAS 34 reporting be market practice going forward?

How prepared are listed companies for the new IFRS 16 leasing standard?

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Introduction

In October 2017 PwC conducted a survey on whether the listed companies on Oslo Børs will continue to report quarterly in the future, as this is no longer a strict requirement. In the same survey, PwC also inquired the companies about their transition to the new lease standard - IFRS 16 - which takes effect from January 2019. The results are based on responses from about 100 companies listed on Oslo Børs, which represents a response rate above 50% of the listed companies.

The main purpose of our survey was to clarify if quarterly reporting will continue as the dominant market practice for the listed companies. We found that current market practice for reporting also of Q1 and Q3 interim financial reports, in general will continue.

The purpose of asking the listed companies about their status of the transition to IFRS 16 is the potential effect this standard may have on their balance sheets. Just as important is the amount of time and resources needed to review leasing contracts, set up new systems, do proper calculations, processing both new and comparable/historical figures and review loan contracts etc, in order to be compliant with the new standard. The status of the transition process to IFRS 16 by the companies is discussed below.

More on the companies' periodic financial reporting

Since 1999, listed companies have been required to publish periodic, financial information for the first, second, third and fourth quarter. This information has been perceived as an important status report for shareholders, helping them assess how companies have performed over the period. Quarterly reporting has also been key to analysts covering the companies and other stakeholders in the Norwegian capital market[1]. Such quarterly reporting has also been a temperature reading of how Norwegian businesses in general are doing, on a macro level.

In December 2016, Oslo Stock Exchange, however, removed the requirement for quarterly reporting for the companies listed on Oslo Børs and Oslo Axess[2], as a consequence of Ministry of Finance terminating such reporting.

The change is a consequence of EU lifting the requirements for quarterly reporting. The reasons for the revised EU-rules[3] were that EU considered that quarterly reporting may lead to an excessive focus on short-term results and performance of the issuers, furthermore that such reporting may be an impediment for small and medium sized issuers to access regulated markets.

As a consequence of the new rules, Oslo Børs now only requires companies to report a half-year report (no later than 2 months after 30 June) and the annual accounts (before the end of April)[4].

1. See further about PwCs view on quarterly reporting here (in Norwegian): *http://blogg.pwc.no/styringogkontroll kravet-om-kvartalsrapportering-bortfaller-likevel-godt-ir-arbeide-%C3%A5-rapportere-q-1-og-q-3*
2. Here is PwC's description (in Norwegian) of Oslo Børs circular 4/2016, which lifted the requirements to report Q1, Q3 and Q4: *https://www.pwc.no/no/pwc-aktuelt/oslo-bors-ikke-lenger-krav-om-kvartalsrapportering.html*
3. The Revised Directive on transparency requirements for listed companies (Transparency Directive)
4. Here is the Exchange's new, adjusted requirements for periodic, financial information: *https://www.oslobors.no/ob_eng/Oslo-Boers/Regulations/Circulars/4-2016-Changes-to-the-Oslo-Boers-issuer-rules-for-issuers-of-shares-and-equity-certificates* Note that for financial institutions it is still mandatory to report quarterly going forward.

However, with a nearly 20 year history of quarterly reporting, many players in the Norwegian capital markets believe that continued financial quarterly reporting is preferable as this is what investors are accustomed to, and more importantly that such reporting represents a valuable investor relations service.

In its Investor Relations guidelines, Oslo Børs therefore recommends that listed companies continue reporting interim reports in accordance with IAS 34[5] (or equivalent accounting policies) for the first and third quarter. However, this is only a recommendation, and is by no means binding on companies. It should be noted that there is no recommendation to report a Q4 stand-alone report, in Oslo Børs' IR guidelines.

In light of these regulatory changes, PwC contacted in October 2017 all companies listed on Oslo Børs[6] to investigate whether the companies will voluntarily report the first, third and possibly the fourth quarter in addition to the required reporting of half-yearly and full-year accounts. Below we present our findings.

5. The companies listed on Oslo Børs or Oslo Axess will need to report in line with IFRS – International Financial Reporting Standards (or equivalent GAAP). International Accounting Standards 34 is the IFRS-standard covering the companies' interim reporting, regardless of whether it is half year or quarterly reporting. Here is also the Oslo Børs` IR recommendation: *https://www.oslobors.no/ob_eng/Oslo-Boers/Listing/Shares-equity-certificates-and-rights-to-shares/Oslo-Boers-and-Oslo-Axess/Code-of-Practice-for-IR*
6. PwC has not contacted the financial institutions; for these entities the reporting requirements are unchanged.

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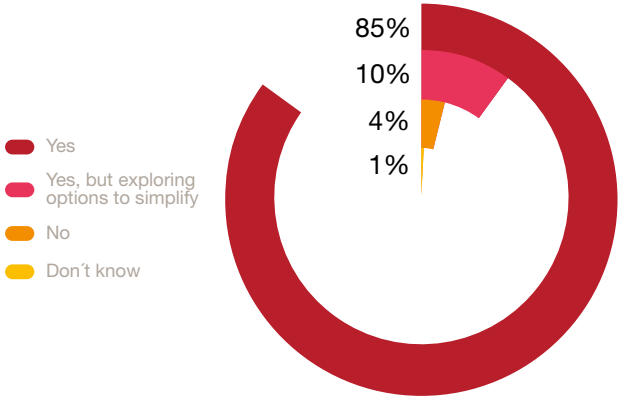
Summary of the survey on quarterly reporting

85% of the listed companies surveyed responded that they will continue to report first and third quarter accounts in accordance with IAS 34 (or similar accounting languages) going forward.

10% of the companies surveyed responded that they will instead be reporting other financial information for Q1 and Q3. (This would be a financial reporting that is not in accordance with IAS 34 financial interim reporting - presumably a more light version of financial reporting[7]). Furthermore, a minority of only 5% will either not report Q1 and Q3, or have not made any firm decision on this as the date of the survey.

Of the respondents, 39% had been encouraged by shareholders, analysts and other stakeholders to continue reporting quarterly information, while 45% had not been asked to report quarterly (but will to a large extent do it anyways). A minority of 16% had no comment («did not know») to the question whether they had been encouraged by the market to report quarterly, or not.

Will your company report Q1 and Q3 in accordance with IAS 34 in 2018 and onwards?



85% Of the companies on Oslo Børs will report Q1 and Q3 going forward

We saw no clear differences in the response from smaller or larger companies ("smaller" or "larger" in terms of capital market values), both groups seemed just as positive to quarterly reporting (of Q1 and Q3), hence the argument by EU that quarterly reporting may be an impediment for smaller companies may not be so relevant in reality, at least not after listing. However, some companies - due to few shareholders - reported that they would not report Q1 and Q3 going forward.

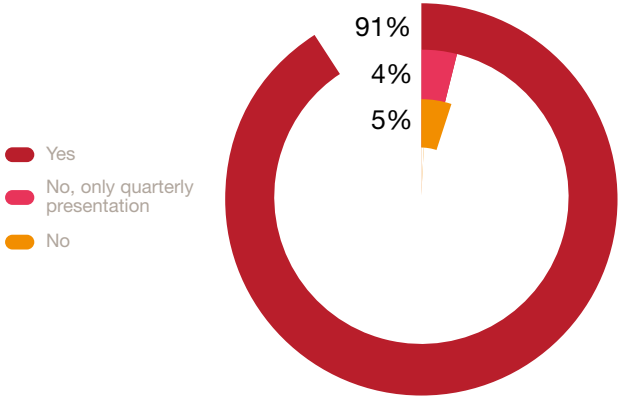
With regards to reporting of Q4 interim (stand-alone) report, the result is not so clear cut. 91% of the companies who responded will report Q4 (for 2017) next year. The companies we contacted, however, indicated some uncertainty as to whether their company would continue to report Q4 stand-alone in the future, or if the reporting of Q4 2017 will be the last one[8]. The reason for this uncertainty seems to be that since the full, annual financial statement is reported anyways shortly after a stand-alone Q4 report, some companies may decide to report only annual accounts the next years. Due to this uncertainty, our survey cannot draw any conclusions on the future of reporting of stand-alone Q4 reports.

7. Such a report with financial figures - while not strictly adhering to all the IAS 34 reporting requirements - should be set up in accordance with the same accounting principles as the full annual financial statement. Hence, it may be specifically set out in the report that while it is not fully in line with IAS 34, the accounting principles applied are the same as for the audited, financial statement.
8. Note that our question was specifically focused on whether the companies would report Q4 2017, while our question for Q1 and Q3 was not specifically in relation to FY 2017.

As an appendix to this report please find a break-down of the results by industry.

In summary, a large majority - 85% of the companies on Oslo Børs - will continue reporting in accordance with IAS 34 (or equivalent accounting standards) for the first and third quarters, at least for the foreseeable future. Apparently this is considered as good IR-work, as a substantial part of the companies had received indications from the market (analysts, shareholders) that such reporting was desired. The investors and the companies apparently believe that the benefits of such reporting outweighs the potential drawbacks of an excessive focus on short-term results and performance that was set forth as rationale for the revised EU-requirements.

Will your company report Q4 17 stand alone (i.e. not as part of the annual report for 2017) in accordance with IAS 34?



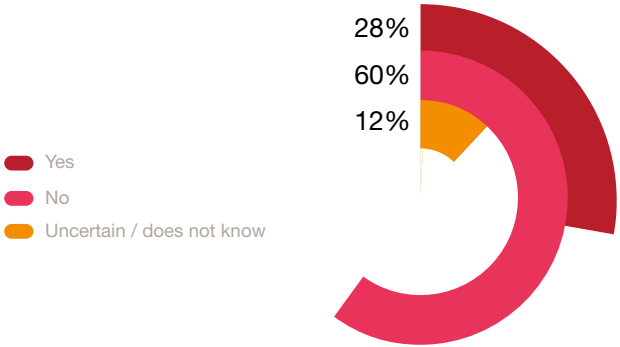
91% Of the companies on Oslo Børs will report Q4 2017

So, why do the companies opt for continued quarterly reporting?

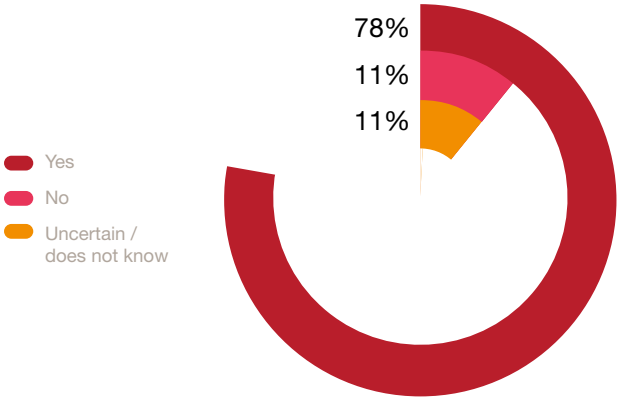
A large majority (85%) of companies will continue to report Q1 and Q3 voluntary at least for the foreseeable future. Why is that the case? After all, a NFF survey[9] indicated that while analysts and investors wanted the companies to report quarterly, the CFOs (representing the companies) supported a decision to abolish quarterly reporting:

NFFs survey 2015: «Do you support the proposal to remove the requirement for quarterly reporting?

Financial analysts

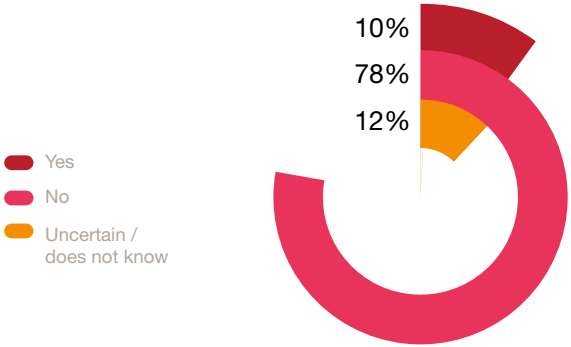


CFOs

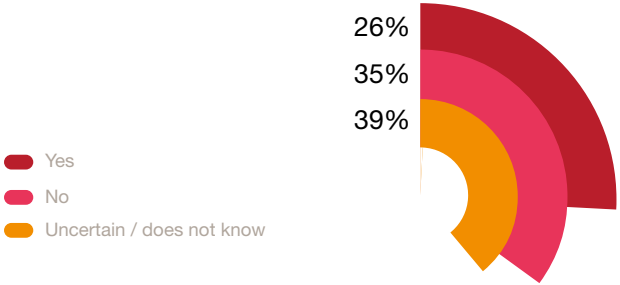


9. *http://www.finansanalytiker.no/innhold/bibl_pdffiler/KFI/KFI-uttalelse_2017.pdf*

Investors



Other



The short answer to why the companies will still report Q1 and Q 3, appears to be that the market wants it (represented by investors and finance analysts - see figure above) and that such reporting cater to their needs as part of keeping up good IR.

However, it is not entirely clear why the market wants quarterly reporting.

Below we have tried to indicate reasons for continued reporting.

Go with the flow - long practice

The practice of quarterly reporting is well established, and the market seems accustomed to this kind of regular updates.

Abroad the picture is a bit more mixed, as indicated by Oslo Børs consultation paper[10] (prior to the revised rules), which sets out how companies in the EU are reporting.

In the Norwegian market (as mentioned above) several CFOs in our survey indicated that they would report quarterly as long as other companies did so, and did not want to be the first not to report Q1 and Q3. So apparently there is some level of peer pressure to continue quarterly reporting.

Investors want it...the agency theory

We do see that the investors want regular updates. This is clear from the NFF chart set out above. Large investors like Folketrygdfondet has also indicated that they prefer quarterly reporting and has stated on their website that "*Folketrygdfondet is, however, concerned with transparency and orderly processes for publishing information to the capital market. Relevant information should be made available to all at the same time. It is also an important principle that significant information about the company's financial position should be published as soon as it is available.*"

10. Here is Oslo Børs consultation paper, also setting out what other exchanges require of quarterly reporting: *https://www.oslobors.no/ob_eng/Oslo-Boers/Regulations/Consultations/Consultation-on-new-requirements-on-the-publication-of-inside-information-and-the-submission-of-announcements-of-large-shareholdings*

"*Folketrygdfondet therefore encourages companies to continue publishing quarterly reports*". See their website for the full text[11].

Investors want it presumably due to the principal - agent theory, which can be summed up as follows: The company and its management ("the agent") is managing the capital on behalf of the shareholders ("principals"). But the interest of the principal and agents may not be fully aligned, and hence the principal needs to monitor that management cater not only to its own interests. Thus, the shareholders want to have regular updates on (i.e. monitoring) how the management stewards the principal's capital[12], and periodic, quarterly reporting provides such monitoring.

We also see the same trend with bonds. For bonds listed on Oslo Børs and Nordic ABM there is no requirement for quarterly reporting - only full and half year. Still, bond investors usually demand the bond issuers to report quarterly (based on the loan agreements), presumably in order to monitor the company's financial situation.

Our experience with bank loan financing is the same; the banks want regular, quarterly updates (compliance reporting) on how the companies are doing financially.

Analysts want it....good for IR

As is clear from NFF's presentation, also analysts prefer regular updates. To follow a company and do proper financial analyses is difficult if the company only reports financials twice a year. In theory it can take up to 8 months between financial reports from the company, and this would make the analyst's job very difficult.

It is also likely that the capital markets interest in a stock will wane if there is no interesting information (like financials) being reported. Hence, in order to keep up the interest for the company and its stock, it is apparently important to provide the market with news releases now and then, and financial figures are always especially noteworthy for the shareholders.

11. *http://www.folketrygdfondet.no/nyheter/behold-kvartalsrapporteringen-article660-176.html (In Norwegian).*
12. Here is a brief explanation of the agency theory: *https://www.investopedia.com/terms/a/agencyproblem.asp*

Increased transparency, reduced volatility and probably lower cost of capital

Another issue is that frequent reporting may disseminate relevant information better.

In NFFs survey it was reported that less regular financial reporting increased somewhat the volatility of the share price: "*Few reports = Higher Stock Price Volatility*"[13].

It seems that with more frequent, regular financial reporting the companies will be less prone to hold back sensitive - even inside information. This is also the point made by Folketrygdfondet: The risk "*is that less frequent reporting will lead to increased pricing uncertainty, increased volatility and less well-functioning capital markets. In addition, it may involve an increased risk of information leakage*".

Furthermore, financial information is prepared and reported internally by the companies. Some of this information is also reported as compliance reporting to the company's bank associates. Banks customarily require reporting of quarterly information, and it would be an unsustainable situation if such information is available but not shared with the capital market at large. Less frequent reporting of quarterly information may lead to a climate where sensitive/inside information is available, but not being reported. Which could result in more insider trading.

Reduced share price volatility associated with more frequent reporting will also have the consequence that cost of capital for companies may be somewhat lower, as the beta (in financial theory[14]) will be reduced. Which is also good for the companies.

13. *http://www.finansanalytiker.no/innhold/bibl_pdffiler/KFI/KFI-uttalelse_2015.pdf* (see slide no 15).
14. Please refer to the Capital Asset Pricing Model - CAPM. The beta reflects the volatility of the share price, a reduced volatility will reduce the cost of capital in principle.

In more practical terms one may phrase the impact on cost of capital as follows: When a company desires to do a capital market transaction (paying with its shares in an M&A, raise equity or bonds…), how will this work if the latest financial report/update is several months old? It seems that the investors in such a setting will demand some kind of rebate in order to put up their money for the company. Hence, frequent, regular financial reporting should in general facilitate the company's capital market transactions by reducing the uncertainty around their financial health, and therefore lower the cost of capital.

Coping with quarterly reporting

Advances in accounting systems allow most of the companies to report financial figures (internally) monthly, and also quarterly to banks and the board. The additional work of preparing a full quarterly report to the market seems manageable. There was no indication among the companies surveyed that smaller listed companies will reduce their quarterly reporting.

PwC's view

PwC work with a number of listed companies, we assist them with capital market transactions, valuations, share/ bond issues, M&As etc. We see that investors want to make informed decisions, based on available and relevant financial information.

While many - if not most - of the listed companies are exposed to volatility from fluctuations on exchange rates and/or commodity prices, some companies still enjoy a more stable income. Hence, while quarterly reporting should be relevant for companies with cyclical business, companies with very stable earnings may not have the same impetus for quarterly reporting.

In short we believe that quarterly reporting:

- Keeps the shareholders better informed (ref the agency theory), also in line with the companies' compliance reporting to financial institutions
- Such reporting is good IR-work as it keeps up the interest for the company and ensures better coverage by analysts
- It also increases transparency and reduces the opportunity for insider trading, and this is crucial for the credibility of the company and the capital market

Due to the above reasons such regular reporting reduces share price volatility and may also reduce the cost of capital, and facilitates capital market transactions.

As we see it, quarterly reporting is generally the hallmark not only for good IR, but also for an efficient and sophisticated capital market, which enables the companies to raise capital efficiently and to a lower cost of capital. To resort to only half and full year reporting would be a step back. Hence we believe that what appears to be market practice - reporting also of Q1 and Q3 - is a sound practice for the stakeholders in the capital market, also benefiting the society at large.

Status of the IFRS 16 implementation

In January 2016, the IASB published its new standard for leases; IFRS 16. The new standard was endorsed by EU on 9 November 2017 and takes effect no later than 1 January 2019. A majority of Norwegian IFRS reporting companies apply leases to control and use assets, a large number of the listed companies will therefore be affected by the new standard.

The new standard requires that the company (as a lessee) should capitalise most leases as a "right to use"-asset, with a corresponding leasing liability. Many of these lease payments (operational leases) were previously expensed as incurred[15.]. The change in accounting will affect a number of key figures for the companies, such as debt ratio and EBITDA. Lessors on the other hand, will only be marginally affected, as for these the new standard is largely similar to today's accounting standard; IAS 17 Leases.

Comparability between companies will increase with the new standard, as the way a company finances its assets does not create large differences in measurement and presentation. For some, the changes may potentially affect loan terms and borrowing costs as the perception of the company may change due to a weaker equity ratio following the new standard[16].

15. While operating leases have been expensed over P&L according to the current standard, financial leases have always been capitalised in the balance shee
16. Here is PwC's publication of the new standard: *https://www.pwc.no/no/publikasjoner/ifrs/regnskapsforing-av-leieavtaler.pdf*

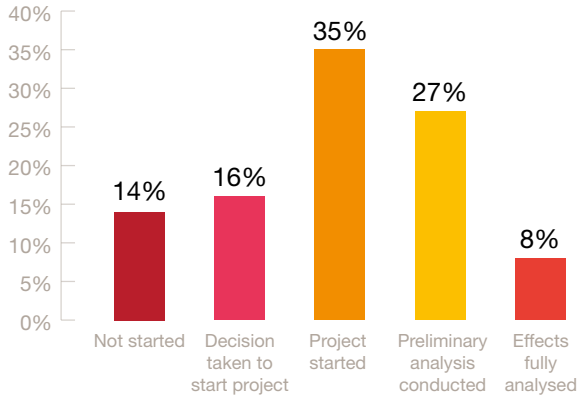
Summary of the companies' IFRS 16 implementation

PwC asked around 100 listed companies whether the company had quantified the effect of IFRS 16 Leasing, on EBITDA, equity ratio, debt/equity ratio or other relevant key figures. About 14% had not started assessing the effect, 16% had decided to start a project for assessing the impact, 35% had a project underway, 27% had prepared a preliminary analysis, and only 8% had effects fully analysed.

Hence, 2 out of 3 companies have not yet quantified the effect of the new leasing standard.

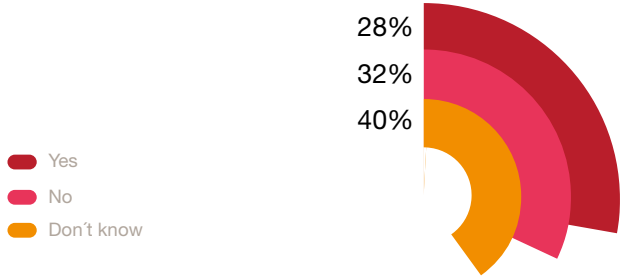
On the question of whether the companies will restate previous financial history to IFRS 16, in order to show comparable figures (across several years), 28% responded they would do so, while 32% would not do this. For 40% of the companies, they did not know or no decision had been made. Hence, there is no clear consensus among the companies on how the new standard will be implemented.

How far into the process of assessing and quantifying the effects from IFRS 16 are you?



The majority of the companies with leasing have not yet quantified the effect on the financial statements.

Will you restate historical financial statements metrics to show comparable figures to illustrate the retrospecitve effect of IFRS 16?



It should be noted that these are the companies' subjective assessment of their status for the transition to IFRS 16. Furthermore, some companies indicated that they do not have leases at all. In view of the fact that also very minor leasing contracts have to be capitalised, it may be the case that a number of companies are underestimating the impact the new standard will have on their balance sheets or/and their organisational systems.

The main conclusion drawn from this survey is that for the majority of companies (65%), no quantitative analyses had been performed. Furthermore, there is no clear consensus among the companies on how the new standard will be implemented with regards to historical information.

There is no clear consensus around how the standard will be implemented.

Briefly on the choice of transition methods for IFRS 16

The company can choose between:

(a) full retrospective application of IFRS 16 with restatement of comparative figures, including effects on the opening balance of equity; or

b) modified retrospective application of IFRS 16 without restatement of comparative figures. The right of use assets may on the day of initial application, on a lease by lease basis, be set as either being equal to (i) the lease liability or (ii) its carrying amounts as if IFRS 16 had been applied fully retrospective, but calculated using the lessee's incremental borrowing rate at the date of initial application. Each option (a), (b) (i) or (b) (ii) will affect the equity as of 1 January 2019 differently.

PwC's view

Given that the consequences on the balance sheets of many companies is likely to be significant, and that the implementation also will impact other parts of the company (the organization, loan contracts/terms, etc.), it is a question whether the companies are really fully on track with the transition to IFRS 16. A number of listed companies will likely also do various capital market transactions before the effect of the new standard has been adopted, meaning that the investors will to some degree be kept in the dark on the transitional effects of the standard. It remains to be seen whether this can negatively affect the pricing of such capital market transactions.

For further reading and assistance with the IFRS 16 transition, please refer to our *PwC IFRS 16 publications*.

PwCs IFRS 16 Readiness assessment
PwC introduced in 2017 a specific service, IFRS 16 readiness assessment, where PwC efficiently can assess the status of the IFRS 16 transition for the company, estimate the likely impact on the balance sheet, and provide action points/timeline for the company to transpose to the new standard. This can be the first easy, but crucial step towards a successful IFRS 16 implementation for the company.

Any questions regarding IFRS 16 can be addressed to:

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Appendix: Survey results per sector

Will your company report Q4 17 stand alone (i.e. not as part of the annual report for 2017) in accordance with IAS 34?

Sector	Yes	No, only quarterly presentation	No
Industry	91%	5%	5%
Oil & Offshore	73%	14%	14%
Seafood	100%	0%	0%
Shipping	89%	0%	11%
Technology, media and telecom	100%	0%	0%
Retail	100%	0%	0%
Health/life science	100%	0%	0%
Real estate and financial services	100%	0%	0%

Will your company report Q1 and Q3 in accordance with IAS 34 in 2018 and onwards?

Sector	Yes	Yes, but exploring options to simplify	No	Don't know
Industry	91%	0%	5%	5%
Oil & Offshore	59%	27%	14%	0%
Seafood	100%	0%	0%	0%
Shipping	89%	11%	0%	0%
Technology, media and telecom	94%	6%	0%	0%
Retail	100%	0%	0%	0%
Health/life science	83%	17%	0%	0%
Real estate and financial services	92%	8%	0%	0%

Have you quantified the expected effect of IFRS 16 Leasing? (EBITDA, D/E ratio and/or other financial statement metrics)

Sector	Yes	No	Don't know
Industry	43%	57%	0%
Oil & Offshore	19%	75%	6%
Seafood	20%	80%	0%
Shipping	43%	43%	14%
Technology, media and telecom	38%	62%	0%
Retail	80%	20%	0%
Health/life science	33%	67%	0%
Real estate and financial services	43%	57%	0%

On a scale from 1 to 5, how far into the process of assessing and quantifying the effects from IFRS 16 are you?

Sector	Not started	Decision taken to start project	Project started	Preliminary analysis conducted	Effects fully analysed
Industry	14%	10%	43%	29%	5%
Oil & Offshore	7%	27%	40%	20%	7%
Seafood	40%	0%	40%	0%	20%
Shipping	0%	17%	17%	50%	17%
Technology, media and telecom	23%	15%	31%	31%	0%
Retail	0%	20%	20%	40%	20%
Health/life science	0%	33%	33%	33%	0%
Real estate and financial services	17%	17%	33%	17%	17%

The Survey on financial reporting for companies listed on Oslo Børs

PwC surveyed companies listed on Oslo Børs in October 2017, 100 companies have contributed.

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