

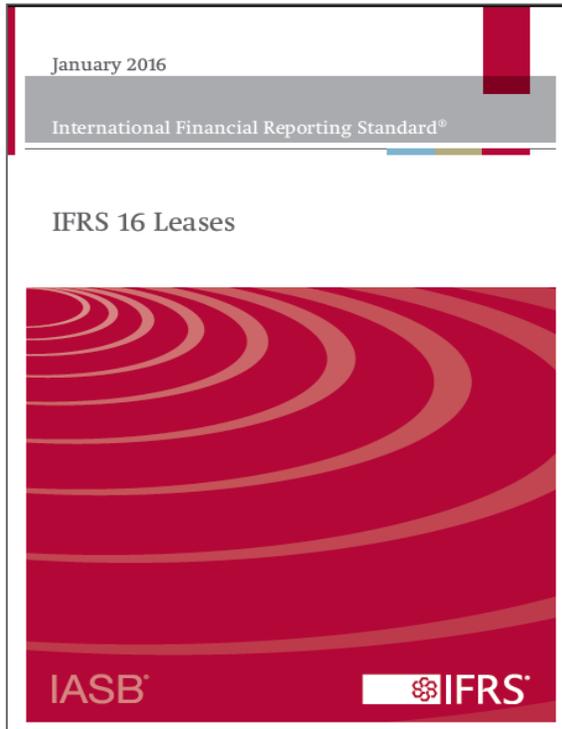
IFRS 16 *Leases*: Overview

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New Leases Standard



- **IFRS 16** Leases published in January 2016

- **replaces IAS 17** and related interpretations
- **changes lessee accounting** substantially
- little change for **lessors**

- Effective date **1 January 2019**
 - early application permitted (only with application of IFRS 15 Revenue from Contracts with Customers)

The need for change

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

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

Therefore, it is **difficult** for investors and others **to**:

- **Get accurate picture** of entity's lease assets and liabilities
- **Compare** companies that **lease** assets with those that **buy**
- **Estimate** the amount of off balance sheet obligations: often overestimated

The need for change

Currently a lack of information

- 6 retail chains that ultimately went into liquidation

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

¹ Based on averaged published financial statement data available for 5 years before company entered Chapter 11 (US), liquidation (UK) or bankruptcy (DEU).

² Estimated using (i) a discount rate of 5% and (ii) estimated average lease terms based on the information disclosed in the financial statements.

³ Off balance sheet leases (discounted) as a multiple of on balance sheet debt

The Changes

What's changed for lessors & lessees?

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Changes to lessor accounting

- **Substantially carry forward** IAS 17 accounting requirements; some additional disclosure requirements

Changes to Lessee accounting

- **Former operating leases capitalised.** All¹ leases accounted for similarly to today's finance leases

Balance Sheet

- ↑ Leased assets
- ↑ Financial Liabilities
- ↓ Equity

Income statement

- ↓ Operating expense
- ↑ Finance cost

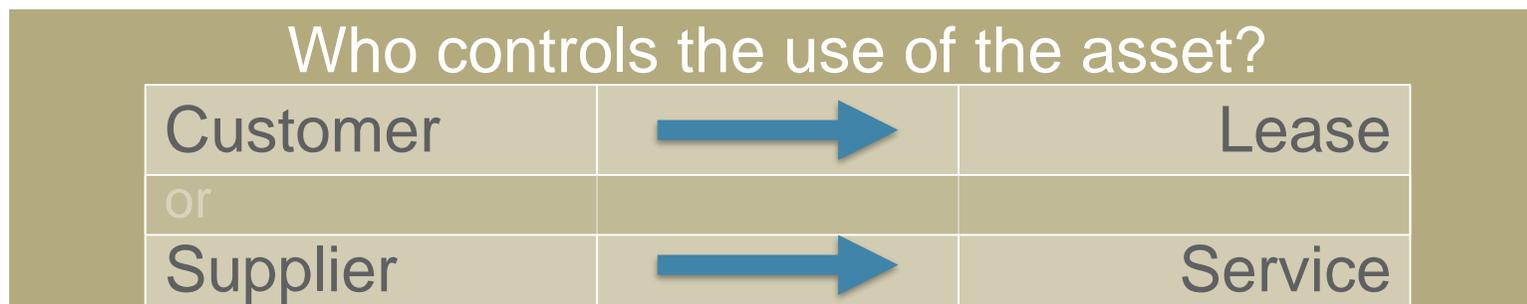
Cash flow statement

- ↓ Operating flows
- ↑ Financing flows

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

Definition of a lease

- **Similar** to previous definition, changed **guidance on control**
- Control = **directing the use** and **obtaining the benefits** from use
- Based on control of the **use of an identified asset**

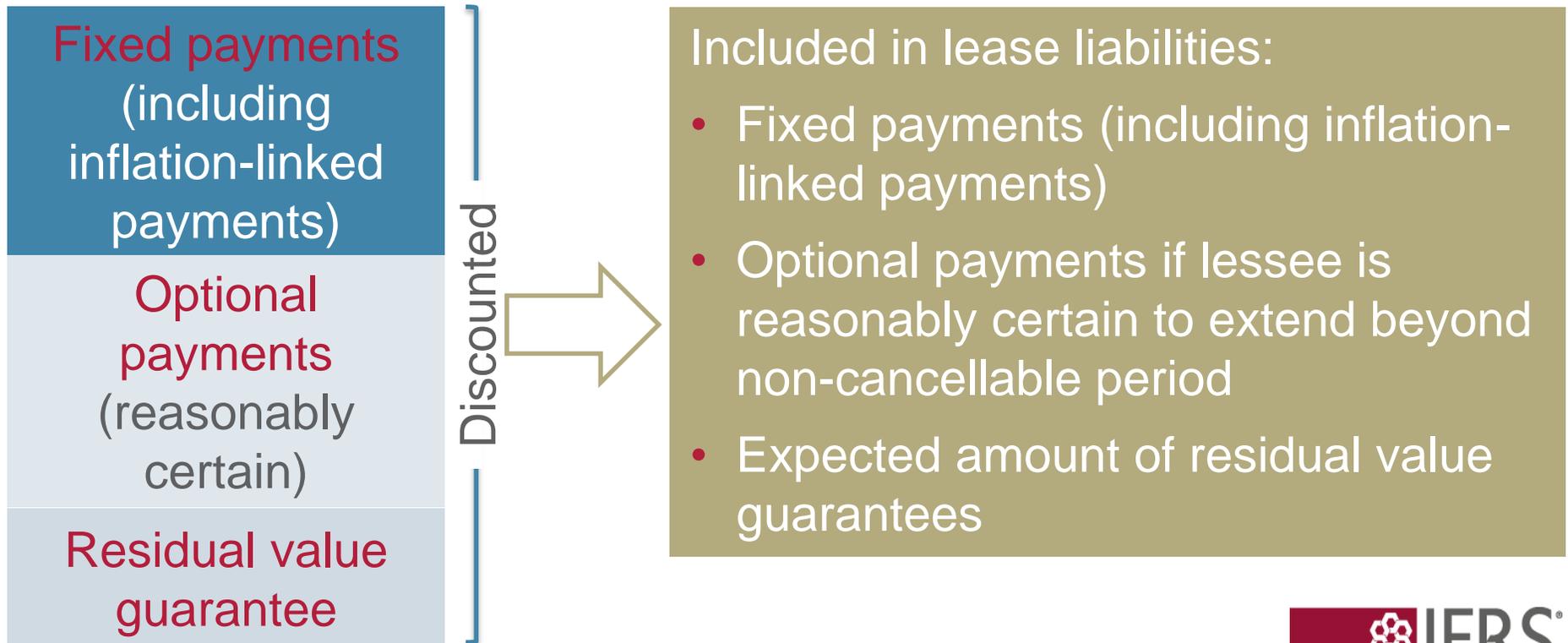


- **Separate services** provided with leases
 - Separate using available information (including estimates)
 - Option to not separate components

Lessee Accounting

Balance sheet: what's included?

- **Increase in lease assets and financial liabilities**—all leases reported on balance sheet (other than short-term leases and leases of low-value assets)



Lessee Accounting

Right-of-use model

- A lease conveys the right to use an asset for a period of time in exchange for cash payments
- Lessee reports **lease assets and liabilities on balance sheet**, except for short-term and for low-value asset leases, at **present value of future lease** payments
- **Discount rate**: the rate implicit in the lease, or, if rate implicit not available, lessee's incremental borrowing rate
- **Exclude variable payments** and most optional payments
- **Portfolio application**, simplified reassessment

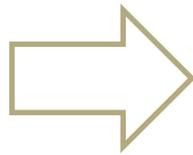
Lessee Accounting

Balance sheet: what's excluded?

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Leases of low-value assets

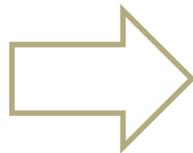
Short-term leases



Not required to be included in lease liabilities

Variable lease payments linked to sales or use

Optional payments (not reasonably certain)



Excluded from lease liabilities

Lessee Accounting

Optional recognition exemptions

- **Short-term** leases
 - Leases with lease term <12 months
- **Low-value** asset leases
 - Leased assets in order of magnitude of <\$5,000
 - Examples: laptops, office furniture, mobile phones

Lessee Accounting

Initial measurement

Right of use
asset
(at cost)



Lease
liability
(present value
of lease
payments)

Lessee Accounting

Right-of-use asset

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Initially measure equal to lease liability, adjusted for:



Prepayments



Lease incentives



Initial direct costs



Dismantling/restoration costs

Lessee Accounting

Initial measurement

- Assets and liabilities measured on a **present value basis**
- Lease payments
 - Those **payable during non-cancellable period plus optional periods** that the lessee is **reasonably certain to exercise**
 - Include **fixed payments and inflation-linked payments**
 - **Exclude variable payments** linked to future sales or use
- Discount rate
 - Rate in the contract or lessee's incremental borrowing rate

Lessee Accounting

Subsequent measurement

- **Right of Use (ROU) Asset**
 - Balance sheet presentation separately as an **asset**
 - **Depreciated** over the life of the lease
 - Depreciation carried **in profit and loss**
 - Reassessed for **impairment**
- **Liability**
 - Balance sheet presentation separately as a **liability**
 - **Interest expense** (discount unwind) through profit and loss as interest
 - **Simplified reassessment**

Lessee Accounting *Presentation*

Balance sheet

- **ROU assets** together with **PPE** or as own line item
- **Lease liabilities** in accordance with **IAS 1**

Income statement

- **Depreciation** of all leased assets
- **Interest** expense for all lease liabilities

Cash flow statement

- **Principal** within financing activities
- Interest within either operating or financing activities (**IAS 7 option**)

- **Subleases—Intermediate** lessor
 - Account for head lease and sublease as **two separate contracts**
 - Classify a sublease with **reference to the ROU asset** arising from the head lease
 - **Should not offset** lease assets and liabilities, or income and expenses, unless meets existing IFRS guidance for offsetting
- **Sale and leaseback transactions**
 - **Sale** must meet the **requirements in IFRS 15**
 - **Seller/lessee recognises only gain** related to rights transferred
 - Adjustment made for **off market terms**

- In essence, **no change to lessor accounting** in IAS 17
- Feedback on 2013 ED
 - **Lessor** accounting in IAS 17 is **not broken**
 - Concerns about **cost and complexity**
- IFRS 16: **enhanced disclosures**
 - Information about the **residual value risk**
 - Operating leases: separate disclosures for leased assets and assets used by a lessor for other than leasing

Quantitative disclosures

- Breakdown of **lease costs**
- Total lease **cash flows**
- **Maturity** analysis of undiscounted commitments
- Information about **ROU assets by major class** of leased asset

Entity-specific information

- Additional information, if relevant
- **Extension and termination** options
- **Variable** lease payments
- **Residual** value guarantees
- Sale and leaseback

Transition

Former operating leases

Fully retrospective approach

- In accordance with IAS 8:
- Restate as if IFRS 16 always applied
 - Provide line by line comparison disclosure

OR

Cumulative catch-up approach

- Do not restate comparatives
- Adjust opening retained earnings
 - Provide additional transition disclosure

Optional practical expedients:

- Do not transition if ending <12 months
- Simplified asset measurement
- Onerous lease provisions
- Portfolio application
- Use of hindsight

- Definition of a lease – **optional practical expedient**:
 - **Not required** to reassess contracts applying IFRS 16:
 - transition ongoing operating leases to IFRS 16
 - apply new definition requirements only to new contracts entered into after the date of initial application
- Subleases
 - Lessors **must reassess classification** of subleases
- Sale and leaseback transactions
 - **Do not reassess** whether a sale occurred
 - Transition the leaseback like any other lease

Who will be affected?

Lessee—who will be affected?

% of IFRS/US GAAP listed entities reporting material off balance sheet leases	
North America	62%
Europe	47%
Asia / Pacific	43%
Africa / Middle East	23%
Latin America and Caribbean	23%
Future minimum payments for off balance sheet leases ¹	US\$2.9tl
PV future minimum payments for off balance sheet leases ²	US\$2.2tl

- Off-balance-sheet lease financing numbers substantial
- About 50% of listed companies report material off balance sheet leases
- Use of off balance sheet leases is highly concentrated

¹ 2014 annual reports for the vast majority of companies.

² Estimate using the average cost of debt for these companies, that was 5%.

Key benefits

Key benefits of IFRS 16

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- Greater transparency about financial leverage and capital employed
- More level playing field for all market participants
- Reduce the need to make adjustments and to provide 'non-GAAP' information
- Improve comparability between those who lease and those who borrow to buy

Facilitate better capital allocation by enabling better credit and investment decision-making by both investors and companies

- Leases website

<http://www.ifrs.org/Current-Projects/IASB-Projects/Leases>

- Effects analysis

<http://go.ifrs.org/Leases/effects-analysis>

- Project summary and feedback statement

<http://go.ifrs.org/Leases/project-summary>

- Register for email alerts

<http://eifrs.ifrs.org/eifrs/Register>

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