



EY IFRS 16 leases survey

March 2018



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Foreword

Dear reader,

During 2017, we saw a significant mobilization in the efforts to prepare for the implementation of the new lease accounting requirements introduced by International Financial Reporting Standard (IFRS) 16 *leases*. Recognizing the magnitude of the change in the accounting model for lessees, many entities have started with a detailed analysis of the current state of their leasing activities and quantitative impact assessment.

While it is generally expected that financial services firms will mostly be affected by the capitalization of their operating leases of real estate, the information technology (IT) and corporate vehicles leases may also result in a significant impact. Additionally, the extent of enhancements required to data models, reporting processes and controls are among the key attention points in preparing for the implementation of IFRS 16.

In November 2017, we discussed the status of implementation of the new standard with 36 of our financial services clients. We asked questions covering a range of areas, from project setup, status and expected challenges, to the selection of transition options and practical expedients.

While many of our clients continue with their implementation projects, this publication contains a summary of the answers provided and the project status at that date. With less than 12 months to the effective date of the standard, we hope you find this document helpful as you continue with your IFRS 16 implementation project.

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EY IFRS 16 leases survey: methodology and approach

- ▶ We conducted the *EY IFRS 16 leases survey* with 36 European banks and insurers, in order to understand their current progress with IFRS 16 implementation, expected costs and operational impacts on the business. The survey covered questions around:
 - ▶ Gap analysis; financial and operational impact assessments
 - ▶ Resource requirements
 - ▶ Structure and leadership of implementation
 - ▶ Impact, complexity and cost of implementation
 - ▶ Anticipated challenges
 - ▶ Planned application of the policy and transition options
- ▶ Budget and cost questions were included in the survey; however, most entities have yet to undertake a full cost-impact analysis and cannot fully understand the expected costs of a full IFRS 16 implementation at this stage.
- ▶ In order to analyze responses in accordance with the relevant size of the respondents, we have split them into the following size categories:
 - ▶ Over US\$1t total assets (bulge bracket)
 - ▶ US\$500b – US\$1t total assets (large)
 - ▶ US\$250b – US\$500b total assets (medium)
 - ▶ Under US\$250b total assets (small)



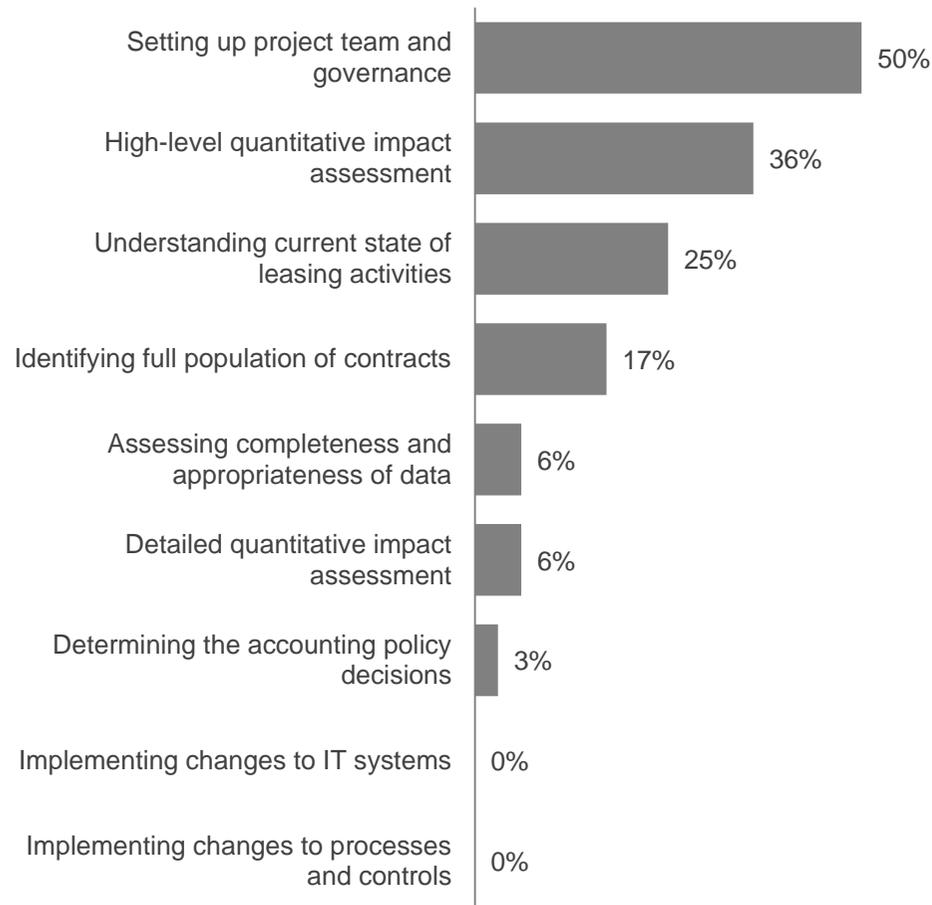
Section 1

Governance and current implementation status

Current status of IFRS 16 implementation projects

Data

Completion status by project phase



Commentary

- ▶ Most preparers who participated in the survey initiated their IFRS 16 implementation projects during 2017. Half of the respondents have already completed the initial planning and governance phase of the project and a further 45% are in an early or advanced phase.
- ▶ With approximately one year until the effective date of IFRS 16, only 36% of respondents have completed a high-level quantitative impact assessment and a further 47% are either in an early or advanced stage of this project phase.
- ▶ The status of completion significantly decreases for the more advanced phases in the project life cycle (e.g., completeness of contracts, data, accounting policies), showing that most of the effort on implementing IFRS 16 will occur during 2018.
- ▶ Focusing on the key phases of the leases implementation project, the table below shows an indicative status by size of the respondent:

	Understanding current state of leasing activities	Assessing completeness and appropriateness of data	Detailed quantitative impact assessment
Bulge	Advanced stages		Early stages or not started
Large	Advanced stages		Early stages or not started
Medium	Early stages or not started		
Small	Advanced stages	Early stages or not started	

- Early stages or not started
- Advanced stages
- Completed

Project governance

Data

Do you have a clear IFRS 16 implementation plan?



Which function leads the IFRS 16 project?



How is the leases project managed?

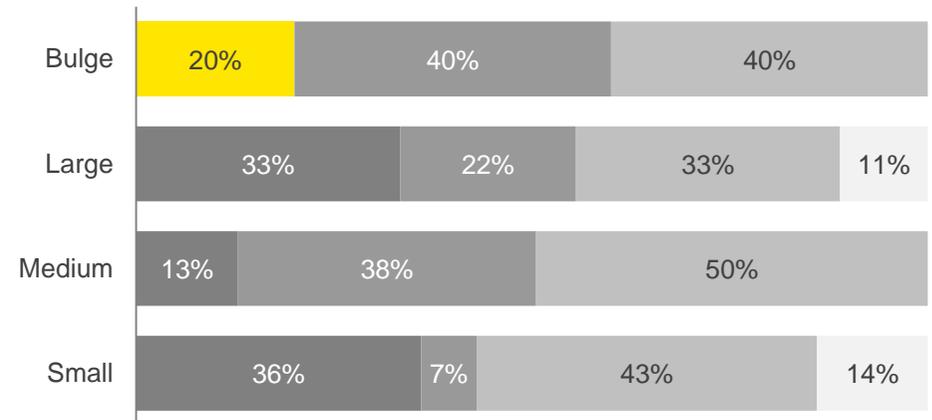


- Exclusively centralized
- Exclusively decentralized
- Centralized with a few exceptions
- Centralized coordination, decentralized implementation
- Other

Commentary

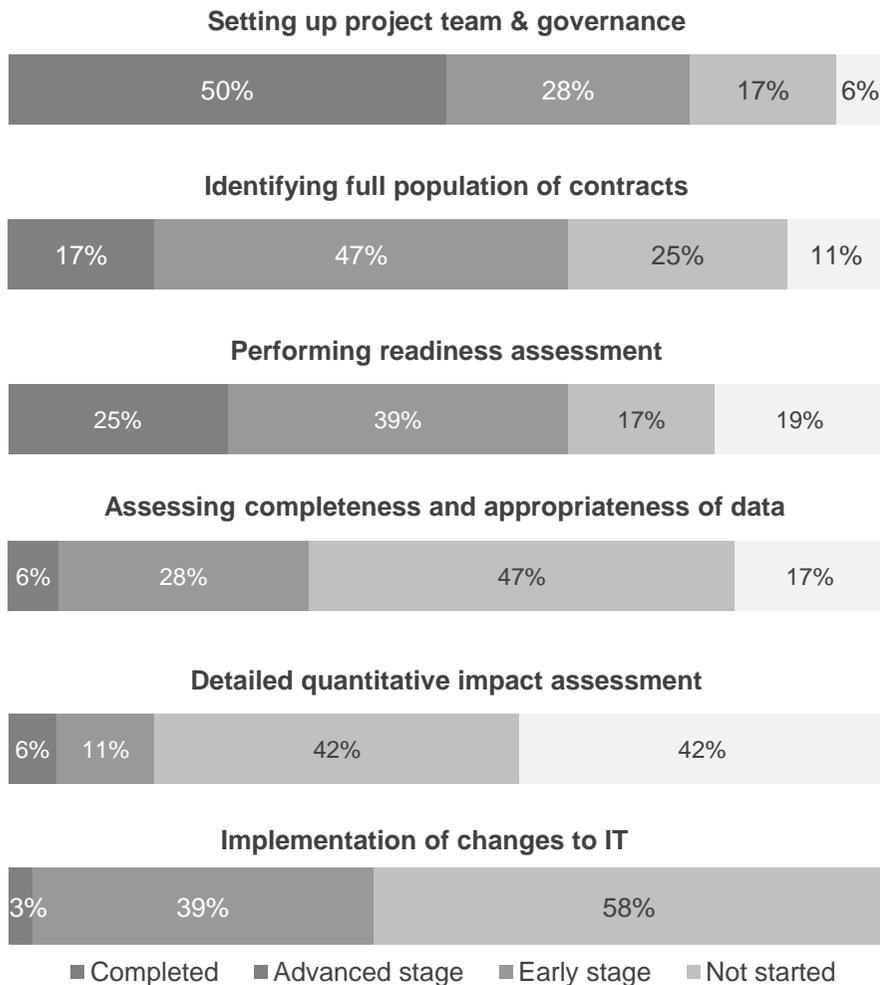
- ▶ While the advancement of projects varies across the entities, most respondents have developed an IFRS 16 implementation plan and have a general understanding of the amount of additional resources needed to support the implementation of new lease accounting requirements.
- ▶ Smaller entities tend to be further behind in planning for IFRS 16 and are less likely to have a fully developed implementation plan than their larger counterparts.
- ▶ Most IFRS 16 implementation projects are being led centrally by the finance team but almost a third of respondents are running an implementation programme that is jointly led, usually by the finance and accounting policy teams, with significant involvement of the property team or another function responsible for the commercial real estate management.
- ▶ Banks reporting under IFRS and US GAAP (dual reporters) are implementing IFRS 16 and ASC 842 leases by running one project covering both standards.

How is the leases project managed (by size of respondent)



Current status of IFRS 16 implementation projects

Data



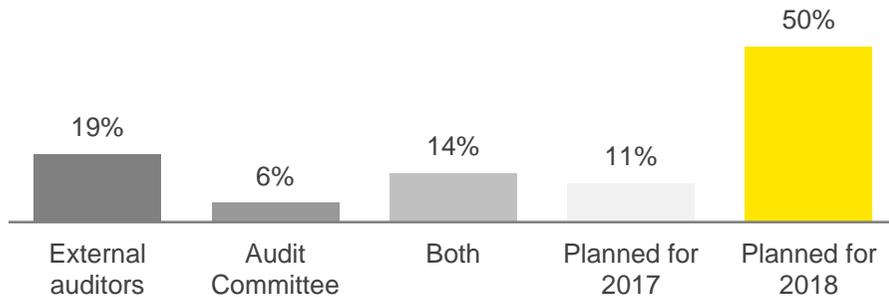
Commentary

- ▶ When discussing the detailed status of projects, it is important to note that progress often varies depending on the level of centralization of the lease administration activities and type of the asset. For example, preparers who have a central commercial real estate team responsible for property management tend to be more advanced as they are able to rely on a single source of data.
- ▶ Only 17% of respondents have identified a complete population of leases and many are still busy with the review of contracts and identification of leases embedded in the service. Similarly, the assessment of the completeness and accuracy of data, which is an area expected to have a significant impact on the IFRS 16 implementation, has only been completed by 6% of respondents.
- ▶ Small- and medium-sized entities are less likely than their larger peers to have started or reached an advanced stage of the project.
- ▶ Only some of the largest entities have completed a detailed quantitative impact assessment, with most of the medium and smaller size respondents yet to advance to that phase.
- ▶ While approximately 42% have started working on the changes to their IT systems, 58% have yet to start this process. Considering the time and effort required in choosing and embedding the new IT solution in the reporting process, we expect this to be one of the key focus areas in the first half of 2018.

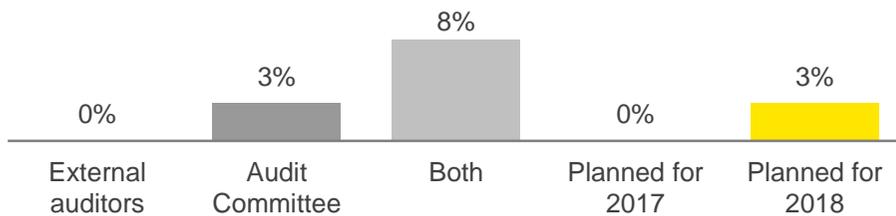
Current status of IFRS 16 implementation projects

Data

Respondents who have engaged with broader stakeholders



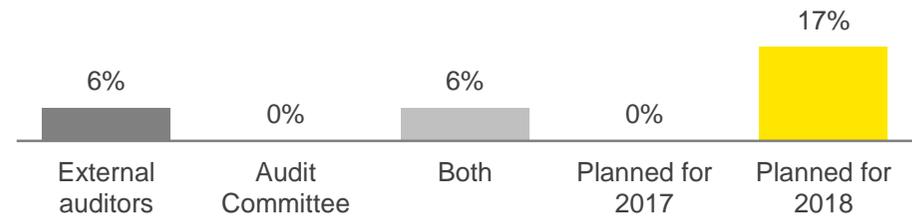
Bulge



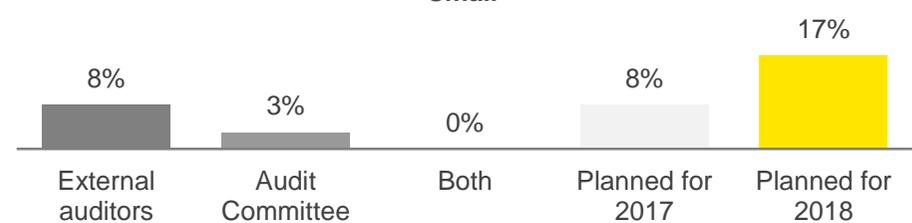
Medium



Large



Small



Commentary

- ▶ Only 14% of the largest preparers involved both the Audit Committee and external auditors in the discussion regarding the implementation of IFRS 16, and a further 25% discussed this topic with one of the stakeholders.
- ▶ While 11% of respondents expected to discuss the impact and implementation process with their Audit Committee or external auditors before the end of 2017, half of the respondents intend to do that during 2018.
- ▶ Engagement with broader project stakeholders is directly linked with the status of implementation programme; preparers who have reached the advanced stage are more likely to have engaged the Audit Committee and external auditors.

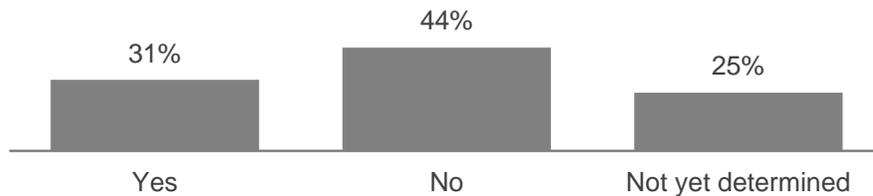
Section 2

Impact, complexity and cost of the IFRS 16 implementation

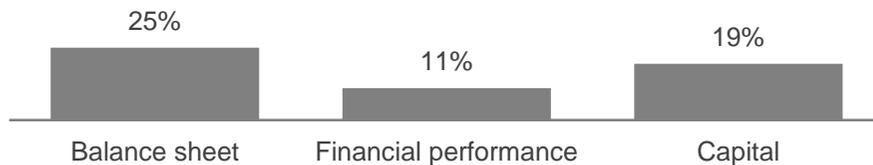
Significant areas of impact

Data

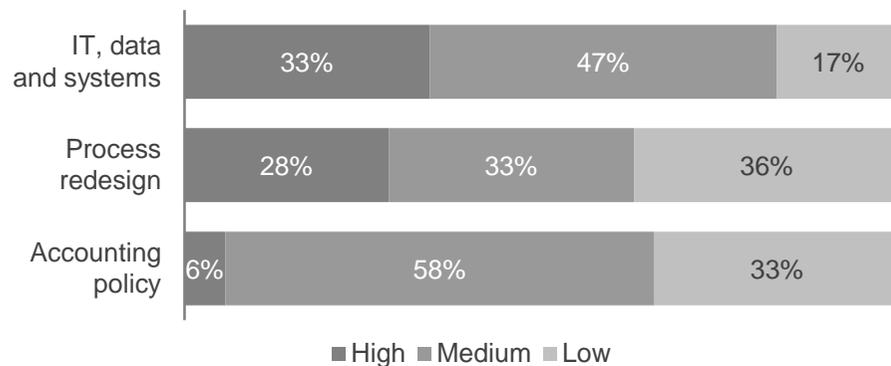
Is the impact of IFRS 16 expected to be material?



If yes, on which financial measure?



Expected impact by area



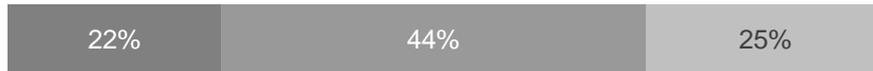
Commentary

- ▶ Almost a third of respondents consider the impact of IFRS 16 to be material, mostly because of balance sheet gross up (25%) and capital consequences (19%).
- ▶ Only 11% consider changes in the presentation of items in the income statement (financial performance) material to the financial statements as a whole.
- ▶ A quarter of the preparers have yet to determine whether the impact of the new lease accounting requirements is material.
- ▶ Given the expected complexity of some of the lease arrangements and the number of additional data points needed, respondents expect the highest impact from IFRS 16 to be on IT, data and systems.
- ▶ As a result of the significant impacts on IT systems, 25% of respondents plan to buy a new system in order to comply with the new requirements and a further 36% plan to extend or adapt an existing system.
- ▶ Larger preparers generally plan to extend or update the current lease system or develop a bespoke IT platform but almost a third remain undecided and have yet to evaluate the IT options.
- ▶ Most respondents recognize that processes and controls necessary to capture financial and non-financial data, and to apply the new accounting requirements, will require strengthening and more formal governance.

Significant areas of impact

Data

Data gap analysis



Identifying complete population of leases



Gathering all required data



Implementing changes to processes, controls and accounting policies



Managing differences between IFRS and US GAAP



Expect significant effort required
 Expect moderate difficulty
 Not expected to be difficult

Commentary

- ▶ Almost 70% of respondents expect a moderate or significant level of difficulty in performing a data gap analysis and identifying a complete population of leases.
- ▶ Most preparers also expect a significant level of effort in gathering all the data necessary to support the measurement and disclosure requirements of the new standard.
- ▶ Almost 70% of respondents expect a moderate or significant level of difficulty in developing and implementing new processes, controls and accounting policies.
- ▶ Commonly discussed accounting judgements include determining whether a contract contains a lease, lease terms and discount rates.
- ▶ It is expected that most challenges in managing the IFRS and US GAAP conversion are due to different presentation and transition requirements; the latter may be simplified by the recent FASB decision to provide certain transition relief not to apply ASC 842 to comparative periods.
- ▶ The table below shows an indicative level of impact (in terms of the effort required) by size of the respondent:

	Data gap analysis	Identifying complete population of leases	Gathering all required data	Implementing changes to processes, controls and accounting policies	Managing IFRS and US GAAP differences
Bulge	Medium impact	Medium impact	High impact	Medium impact	Medium impact
Large	Medium impact	Medium impact	High impact	Medium impact	Medium impact
Medium	Medium impact	Medium impact	High impact	Medium impact	Medium impact
Small	Medium impact	Medium impact	Low impact	Medium impact	Medium impact

High impact
 Medium impact
 Low impact

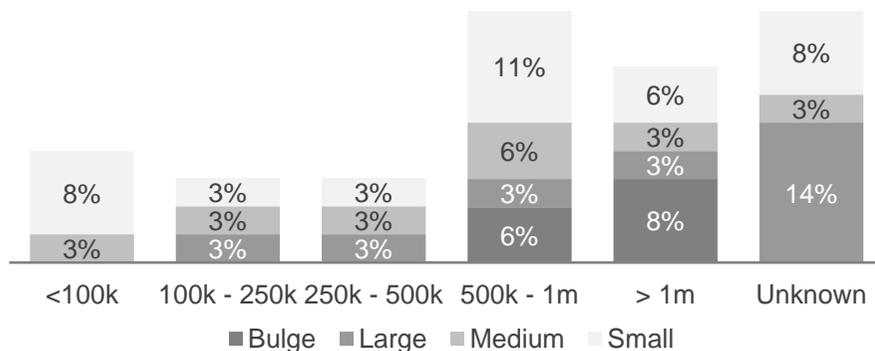
IFRS 16 implementation project costs

Data

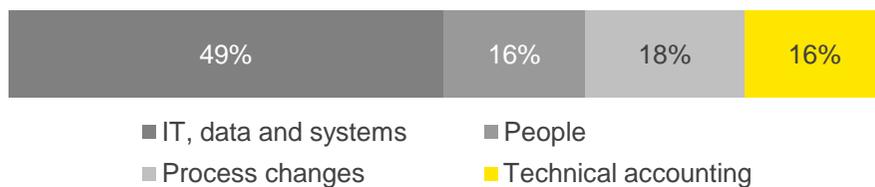
Total expected implementation cost (in EUR)



Expected cost of implementation by size (in EUR)



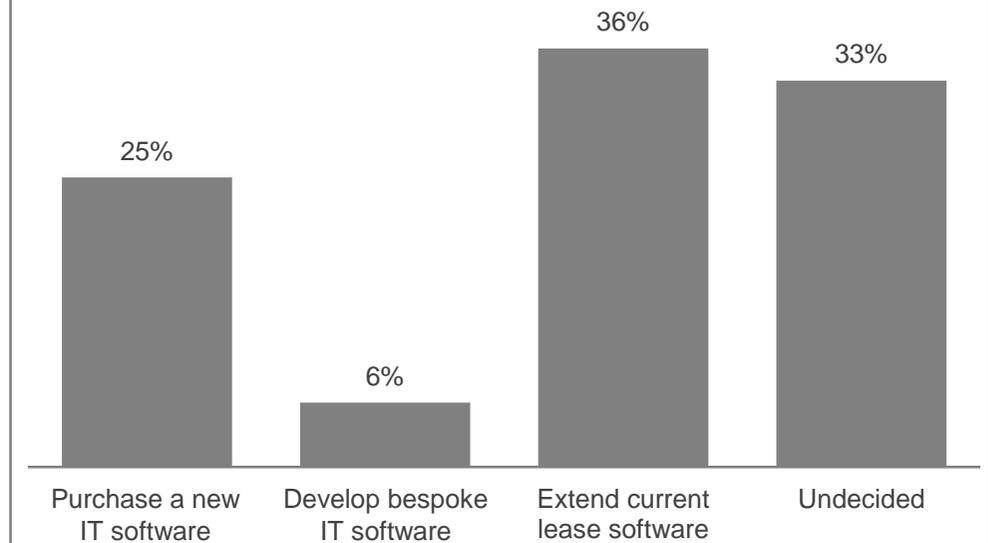
Expected budget split



Commentary

- ▶ Preparers expect to spend a significant part of their IFRS 16 implementation budget on IT, data and systems – small banks indicate that 65% of the budget will be spent in this area.
- ▶ Significant part of the IFRS 16 implementation budget is also expected to be spent on data remediation, gathering and cleansing, as well as introduction of new reporting processes and controls.
- ▶ 25% of respondents plan to buy a new IT system in order to comply with IFRS 16 requirements and further 36% plan to extend or adapt an existing system.
- ▶ Almost a third remain undecided and have yet to evaluate their IT options.

Type of IT software that will be implemented



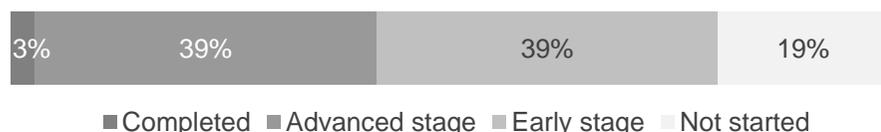
Section 3

Accounting policy and transition

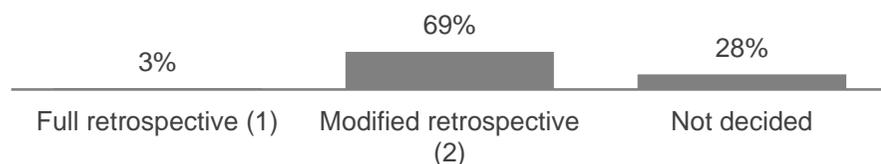
Status of work, preliminary view on transition approach and timing of disclosure

Data

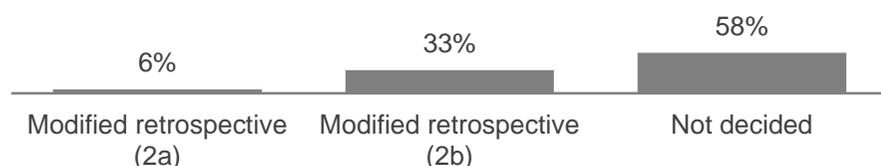
Status of work on IFRS 16 accounting policy workstream



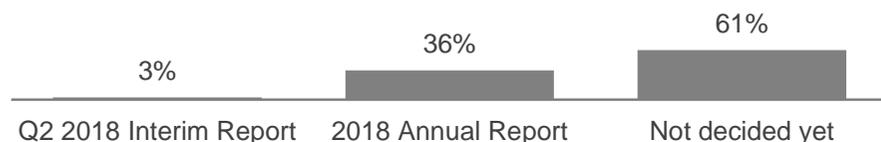
Preferred IFRS 16 transition method (1)



Preferred modified retrospective transition method



Expected timing of quantitative impact disclosure



Commentary

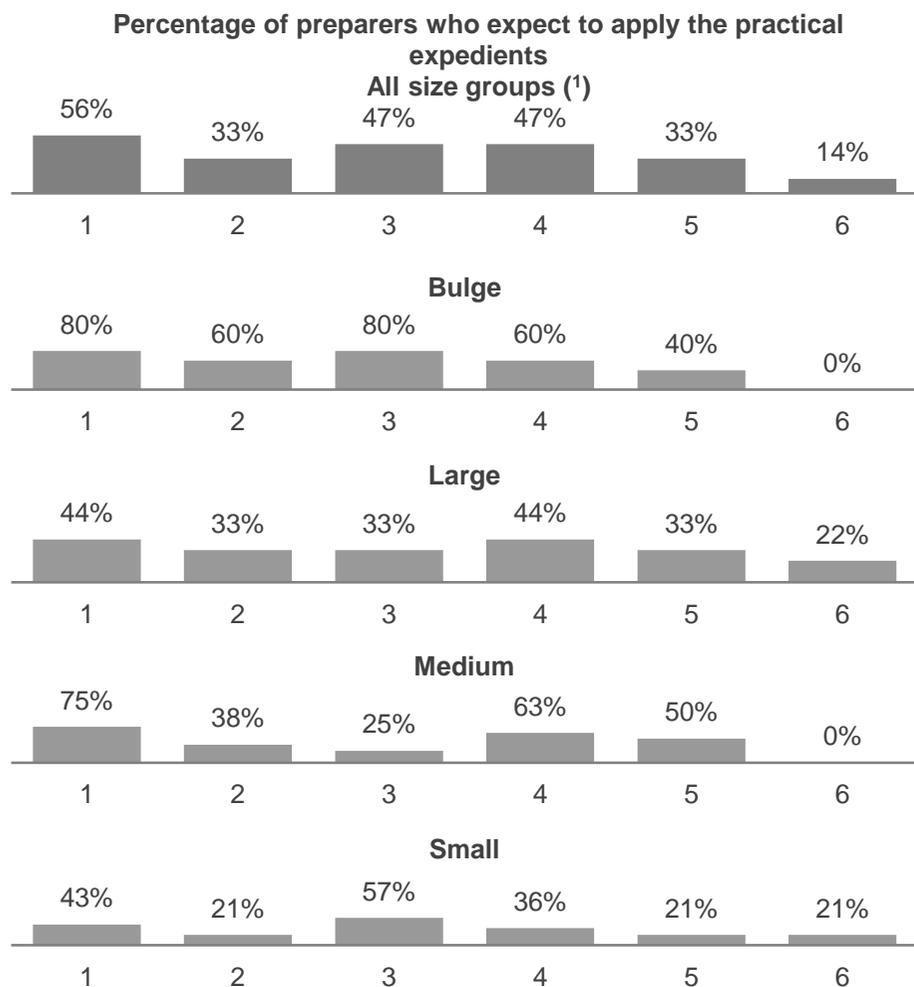
- ▶ None of the participants are considering an early application of IFRS 16 and most respondents intend to implement the new lease accounting requirements using a modified retrospective method (option 2b, as explained below).
- ▶ In applying that, most expect to measure the ROU asset at an amount equal to the lease liability, which requires significantly less effort compared with the full retrospective application.
- ▶ While in most instances option 2b minimizes the day-one capital impact, it also tends to result in the highest value of the ROU asset, potentially leading to the highest impact on future profitability.
- ▶ Modified retrospective application requires significantly less effort compared with full retrospective.
- ▶ Considering the current status of the implementation process, 36% of respondents plan to provide public quantitative disclosures of estimated impact of IFRS 16 in their 2018 annual report, and 61% have yet to decide on the appropriate timing.

(1) IFRS 16 transition methods:

- ▶ Full retrospective approach in accordance with IAS 8 (**option 1**)
- ▶ Modified retrospective approach with ROU assets measured as if the standard were applied since the lease commencement (**option 2a**)
- ▶ Modified retrospective approach with ROU assets measured at an amount equal to the lease liability subject to certain adjustments (**option 2b**)

Use of IFRS 16 practical expedients

Data



Commentary

- ▶ While most preparers intend to apply one or more of IFRS 16 practical expedients, we expect some of the responses may change as entities advance in their implementation process.
- ▶ Almost 60% expect to use the so called “portfolio approach” and determine a single discount rate for leases with reasonably similar characteristics. Many users also expect to apply the following:
 - ▶ Non-recognition of lease terms shorter than 12 months (47%)
 - ▶ Exclusion of the initial direct costs from the measurement of the ROU asset (47%)
- ▶ Most respondents will apply the low value asset exemption. While 45% intend to apply the US\$5k threshold referred to in the basis for conclusions to IFRS 16, 17% plan to apply a threshold on the basis of the overall assessment of materiality. The remainder of the participants have yet to decide what thresholds to apply.

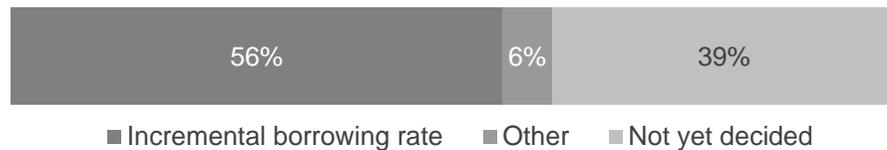
(1) IFRS 16 practical expedients:

1. Apply a single discount rate to a portfolio of leases with reasonably similar characteristics (portfolio approach).
2. Rely on the onerous lease assessment immediately before the date of initial application as an alternative to performing an impairment review.
3. Not to apply the requirements to leases with the lease term shorter than 12 months from the date of initial application.
4. Exclude initial direct costs from the measurement of the right-of-use asset at the date of the initial application.
5. Use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.
6. Not decided yet.

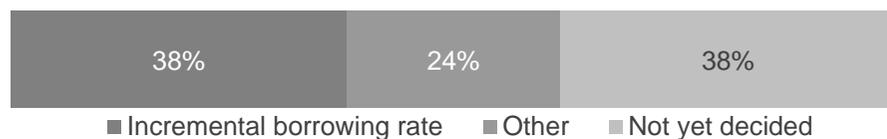
Discount rate

Data

Discount rate for property leases



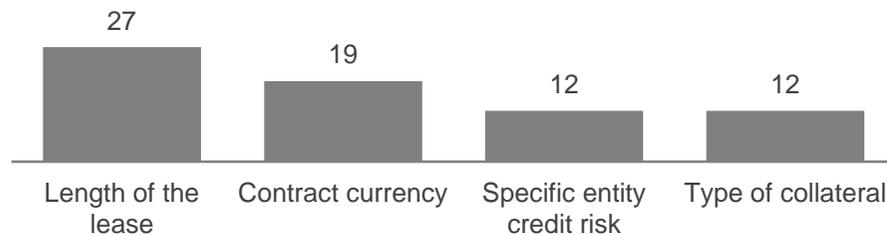
Discount rate for non-property leases



Approach to determining the IBR



Factors considered in determining the IBR



Commentary

- ▶ While approximately 40% of respondents have yet to determine the type of the discount rate used to measure lease liabilities, most respondents (56%) indicated they intend to use the entity's incremental borrowing rate (IBR) to determine the present value of the property lease liability.
- ▶ Of those who have decided on the approach, 33% expect to use the same discount rate for all or most of entities within the group and 17% of respondents intend to calculate the discount rate for each of the group entities, reflecting their individual circumstances and economic environment.
- ▶ Length of lease and contract currency are the two most commonly used factors in determining the incremental borrowing rate, with respectively 80% and 56% of respondents considering them as an input.
- ▶ Determination of the incremental borrowing rate is a significant judgmental area, debated across the industry. We expect this discussion to continue as preparers advance in their implementation projects.

Section 4

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EY survey contacts



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