IFRS 16 Lease overview and EY’s enabling toolkit
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Section I
IFRS 16 overview
Executive summary

- Leased subjects are recognised on the lessee's balance sheet -> impact on balance sheet structure and financial ratios (leverage, EBITDA, ROA)
- Lessees have a single accounting model for all leases.
- Exemptions: short-term leases up to 12 months, underlying asset is of low value
- Lessor accounting is substantially unchanged compared to IAS 17
- Disclosure of new information about leases required
- Main risk being completeness of identified leases
- Impact on many activities across organisation, including procurement, commercial, IT and finance functions
- Effective for periods beginning on or after 1 January 2019 with limited early application permitted
- The most significant impact on the following industries:
  - Retail - Leases, now classified as operating (rent of retail space), will be recognized on BS
  - Finance - Many operating lease contracts under IAS 17 will be recognized on BS. Change in financial ratios may impact client risk assessment and financial covenants
  - Real-estate - Landlord accounting is substantially unchanged. However, there is impact on tenants
Definition of Lease

**Identified asset**

- Explicitly or implicitly identified in the contract
- No substantive substitution rights

The right is substantive, if the supplier (assess at inception):
- has the practical ability to substitute
- benefits > costs
- Physically distinct

**Right to control the use of the asset throughout the period of use**

Right to obtain substantially all the economic benefits from use
AND
Right to direct the use of the asset throughout the period of use

**Lease**

Reassess only if the terms and conditions of the contract change

**Right to direct the use throughout the period of use**

- Customer has the right to direct how and for what purpose the asset is used
- Relevant decisions about how and for what purpose the asset is used are predetermined
  - The customer has the right to operate the asset, without the supplier having the right to change those operating instructions
  - The customer designed the asset in a way that predetermines how and for what purpose the asset is used
Lease term

Non-cancellable periods

Periods covered by options to extend the lease (*)

(*) if the lessee is reasonably certain to exercise

Periods covered by options to terminate the lease (**) 

(**) if the lessee is reasonably certain not to exercise

Commencement date

Rent-free period

Reasonably certain
- Assessed at commencement date
- Consider all facts and circumstances that create an economic incentive
  - Including any expected changes in facts and circumstances between the commencement date and until the exercise date

Contractual terms and conditions for the optional periods compared to market rates

Conditionality associated with the option

Significant leasehold improvements

Costs related to termination

Importance of underlying asset to lessee's operations
<table>
<thead>
<tr>
<th>Fixed payments(^{(1)})</th>
<th>Purchase options(^{(2)}) (exercise price)</th>
<th>Residual value guarantees(^{(3)})</th>
<th>Termination option penalties(^{(4)})</th>
<th>Variable lease payments that depend on index or rate</th>
</tr>
</thead>
</table>

1. Including in-substance fixed payments. Note that there may be both lease and non-lease components, which need to be separated or practical expedient is applied.
2. Include only if reasonably certain of exercise.
3. Lessees use the amounts they expect to pay. Lessors include any guarantee.
4. Include unless reasonably certain not to be exercised.

- In-substance fixed payments are payments that may, in form, contain variability but that, in substance, are unavoidable.
- Variable lease payments that do not depend on an index or rate (e.g., based on usage or performance) are excluded from lease payments.
Lease accounting | Initial measurement of lease liability

Lease liability = Present value of lease payments

Discount rate

Interest rate implicit in the lease

If this cannot be readily determined

Lessee’s incremental borrowing rate

Present value of lease payments

Present value of unguaranteed residual value

Fair value of the underlying asset

Initial direct costs of lessor
Lease accounting | Measurement of right-of-use (ROU) asset

\[
\text{ROU asset} = \text{Lease liability} + \text{Prepaid lease payments} - \text{Lease incentives received} + \text{Lessee's initial direct costs (IDCs)} (*) + \text{Dismantling costs (**)}
\]

(*) Incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained
(**) Restoration, removal and dismantling costs: similar to IAS 16 requirements for dismantling costs recognised and measured according to IAS 37

(-) accumulated depreciation
(-) impairment losses
(+/-) remeasurements of lease liability

Cost model

OR

Fair value model in certain circumstances

OR

Revaluation model in certain circumstances
Appendix I

EY Lease enabling technology suite
EY Tools | EY Lease Enabler - Basic facts

The EY Lease Enabler Tool is an intuitive programme that process standard contract input and generate KPI impact and selected disclosures ready to be reported.

**BASIC FACTS**
- On-premises MS Access based tool
- Flexibility of customization
- Input of data either manually directly in tool or via input Excel file
- Can handle modifications and indexations of repayment schedules
- Calculate impact using both transition methods
- Supports currency conversion (from contract into functional currency)
- Run impact assessment of IFRS 16 in comparison to IFRS 17
- Required technology: MS Excel, MS Access, SQL - optional
- Limited to 10 000 contracts (dependent upon their complexity)
- No multi-user access
- Under IFRS 16 it calculates:
  - for short-term or low-value leases => monthly lease expense, monthly prepaid expense or deferred income
  - for other leases => present value of lease payments (used to determine the ROU asset and lease liability, allocation of monthly lease payments between principal and interest expense, depreciation (monthly and accumulated)
- Under IAS 17 it determines lease classification and calculates:
  - for operating leases => monthly lease expense, monthly prepaid expense or deferred income
  - for finance leases => present value of lease, allocation of monthly lease payments between principal and interest expense, depreciation

### Data entry area
- Input of contract data into tool
- Manual entry into the tool

### Processing area
- Data processing and simulation features
- Batch import using template
- Cash flow computation impact analysis of IAS17 vs. IFRS 16
- Ongoing import of the contract data directly from SAP (for example)

### Reporting area
- Output for GL
- MI reporting
- Scenario analysis
EY Tools | EY Lease Enabler - Basic facts

Financial statement impact assessment and simulations / sensitivity analysis.

### Modified retrospective transition from IAS 17 to IFRS 16

#### IAS 17

<table>
<thead>
<tr>
<th>Period</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>1,162,020</td>
<td>1,162,020</td>
<td>921,260</td>
<td>250,650</td>
</tr>
<tr>
<td>Cost</td>
<td>-1,162,020</td>
<td>-1,162,020</td>
<td>-821,260</td>
<td>-250,650</td>
</tr>
<tr>
<td>EBITDA</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Interest</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Operating</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Finance</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Pre-Tax</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Income</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Net Income</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

#### IFRS 16

### Lease payments

Future minimum lease payments under non-cancellable leases as at 31.12.2019 are, as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amounts (€)</td>
<td>2,200</td>
<td>3,200</td>
<td>2,200</td>
<td>3,200</td>
</tr>
</tbody>
</table>

### Lease interest

For the liabilities on leases interest has to be paid. For the following years the amounts are as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amounts (€)</td>
<td>3,200</td>
<td>3,200</td>
<td>3,200</td>
<td>3,200</td>
</tr>
</tbody>
</table>

### Carrying values by asset class

Asset carrying values of leased assets as of 31.12.2019 are, as follows:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>31.12.2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amounts (€)</td>
<td>1,877</td>
</tr>
</tbody>
</table>

### Depreciation by asset class

During the last fiscal year the group depreciated the following amounts per asset class:

- Plant and equipment: 630,000 €
- Manufactory equipment: 428,000 €
- IT equipment: 245,000 €

### Maturity analysis of lease liabilities as of 31.12.2019

- Within one year: 352,000 €
- After one year but not longer than five years: 210,000 €
- More than five years: 36,000 €
Processing steps can be adjusted on a client and modular basis.
## EY Tools | EY Lease Enabler - Project application

### Quick assessment
1. Support for preliminary analysis

### Prototyping
2. Support for preparing functional and IT concepts
3. Support for test management
4. Review during the project

### Sub ledger

- Preliminary analysis supported by templates and Access tool in order to estimate impact, cost and effort of conversion
- Subject-matter support for design and validation using Access tool as part of a review during the project
- Review of lease classification and evaluation
- Summary of impacts
BASIC FACTS:

► LAN is a web-based tool
► Supports lessee with navigating the lease accounting change journey
► Provides a guided evaluation of the new leases standards for both IFRS and US GAAP in order to evaluate the financial statement implications at transition and beyond
► A detailed dashboard provides a company with visibility of the contracts selected for assessment and the status of the analysis including workflow between preparers and reviewers (audit trail)
► Divided into parts: Configure, Contract Analysis, Report, Scenario
► The contract analysis questionnaire facilitates identification of embedded leases and evaluation of the terms of lease arrangements
► Enables documentation of accounting policies, judgments and estimates to comply with the new lease standards both: At transition and At post-effective date
► Analysis can be as detailed as an individual lease component level or summarized at the financial statement impact assessment level.
► Prepare proforma disclosures and scenario analysis to evaluate implications of changes to policy elections as well as management’s estimates and assumptions.
Prepare a comprehensive accounting analysis under both IFRS and US GAAP for measurement upon transition to the new standards and for lease arrangements after the effective date of the new standards. Analysis can be as detailed as an individual lease component level or summarized at the financial statement impact assessment level.

Prepare proforma disclosures and scenario analysis to evaluate implications of changes to policy elections as well as management’s estimates and assumptions.

Ability to transfer lease data collected into long-term lease applications.
EY Tools | EY Lease Enabler vs. EY Lease Accounting Navigator

**EY Lease Enabler**
- Tailored/bespoke
- On-premises Access based
- Time to deploy subject to configuration

**Benefits:**
- Highly customizable
- Enhanced validation rules in import template
- Covers calculations for current accounting under IAS 17
- Can do modifications and indexations

**EY Lease Accounting Navigator**
- Off the shelf
- Web-based
- Time to deploy 10-15 days

**Benefits:**
- Supports both IFRS and US GAAP
- Capable of managing all practical expedients
- Detailed dashboard available of selected contracts
Appendix II

EY Contacts
EY Contacts

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About EY
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