IFRS 16: Current implementation challenges
Overview of IFRS 16

Lessees
- Single on-balance sheet accounting model for most leases
- New presentation and disclosure requirements
- Optional exemption for short-term leases and leases of low-value items

Lessors
- Dual lease accounting model substantially unchanged
- Lease classification test based on IAS 17 criteria

New standard is effective for annual periods beginning on or after 1 January 2019
Lessee accounting:
Presentation

<table>
<thead>
<tr>
<th>Balance sheet</th>
<th>Income statement</th>
<th>Cash flow statement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ROU asset:</strong> Separately from other assets (e.g., owned assets), or with corresponding underlying assets and disclose line items containing ROU assets</td>
<td><strong>Depreciation expense</strong> (separate from interest expense)</td>
<td><strong>Principal payments</strong> within <strong>financing activities</strong></td>
</tr>
<tr>
<td><strong>Lease liability:</strong> Separately from other liabilities, or together with other liabilities and disclose line items containing lease liabilities</td>
<td><strong>Interest expense</strong> (separate from depreciation expense)</td>
<td><strong>Interest payments</strong> consistent with policy election in IAS 7 <em>Statement of Cash Flows</em></td>
</tr>
<tr>
<td><strong>Present or disclose:</strong></td>
<td></td>
<td>Lease payments for low-value assets, short-term leases and variable lease payments (not included in the lease liability) within operating activities</td>
</tr>
<tr>
<td>► Variable lease expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>► Short-term lease expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>► Low-value asset lease expense</td>
<td></td>
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</tr>
</tbody>
</table>
Current implementation challenges

1. Identification of a lease
2. Determining the lease term
3. Determining the discount rate
4. Transition Considerations
5. Operational aspects
Identification of a lease

**Identified asset** + **Right to control the use of the asset throughout the period of use** = **Lease**

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

WHO BENEFITS?

Reassess only if the terms and conditions of the contract change.
Identification of a lease

Questions

In your implementation project, have you identified contracts that contain a lease that was not previously classified as such?

If yes, what was the triggering factor that changed your previous assessment?
Lease term

Non-cancellable periods + Periods covered by options to extend the lease (*) + Periods covered by options to terminate the lease (**)

(*) if the lessee is reasonably certain to exercise

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

Reasonably certain

- Assessed at commencement date
- Consider all facts and circumstances that create an economic incentive
Lease term

Questions

What was your experience with analyzing the terms of your lease contracts? What **types of options** were identified in your lease contracts?

What is the approach you followed to **assess the probability of them being exercised**? What key factors have you taken into account?
Determining the Discount rate

- Lessors use the interest rate implicit in the lease that causes the following:

\[
\text{The present value (PV) of lease payments} + \text{The PV of the unguaranteed residual value} = \text{Fair value of the underlying asset} + \text{Any initial direct costs of the lessor}
\]

- Lessees use their incremental borrowing rate (IBR) when the interest rate implicit in the lease cannot be readily determined.

- Lessee's IBR is 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 (ROU) asset in a similar economic environment.
Determining the Discount rate (cont.)

- Determining the Incremental Borrowing Rate

**Readily observable starting point**

**Consider:**
- Recent borrowings
- Hypothetical loan rates
- Property yield (property leases)

**Adjustments**

**May include:**
- “Security” – Start from unsecured rate
- Repayment profile
- Lessee credit risk
- Currency
Determining the Discount rate

Questions

Are there any cases where the \textit{implicit rate in the lease} was readily available to your company? What type of contracts?

For other cases, what methodology have you followed to determine the \textit{incremental borrowing rate of the lessee}, as defined in the standard? What are the key elements captured and main challenges faced?
Transition to IFRS 16

**Approaches**

1. **Full retrospective approach**
   - In accordance with IAS 8:
   - Do not restate comparative information
   - Adjust opening retained earnings on transition
   - Provide line by line comparison disclosure

2. **Modified retrospective approach**
   - Do not transition leases ending within 12 months
   - Simplified right-of-use asset measurement
   - Optional practical expedients, including:
     - Do not transition leases ending within 12 months
     - Simplified right-of-use asset measurement

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

**Cumulative catch up**

**Fully retrospective**
Transition Considerations

Questions

How did you approach the different transition options available by the new standard?

Which are the key factors that mainly affected your decision above?
What else could be challenging?

- Disclosure requirements
- Lease Modifications / Reassessments
- Data Collection & Validation
- Robust Processes & Controls
- Technology