Implementing IFRS 16
Seminario ABEL ‘A Implementacao do IFRS 16 no Brasil’

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The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.
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
What’s changed for lessors & lessees?

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

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Income statement</th>
<th>Cash flow statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>↑ Leased assets</td>
<td>↓ Operating expense</td>
<td>↓ Operating flows</td>
</tr>
<tr>
<td>↑ Financial Liabilities</td>
<td>↑ Finance cost</td>
<td>↑ Financing flows</td>
</tr>
<tr>
<td>↓ Equity</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

¹ Exemptions for short-term leases and leases of low-value assets
## Different effects by company / industry

<table>
<thead>
<tr>
<th>Industry sector</th>
<th>Long-term financial liabilities to equity ratio</th>
<th>EBITDA (in billions of US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Reported on balance sheet (IAS 17)</td>
<td>If all leases on balance sheet (IFRS 16)</td>
</tr>
<tr>
<td>Airlines</td>
<td>123%</td>
<td>251%</td>
</tr>
<tr>
<td>Travel and leisure</td>
<td>118%</td>
<td>191%</td>
</tr>
<tr>
<td>Retailers</td>
<td>48%</td>
<td>103%</td>
</tr>
<tr>
<td>Transport</td>
<td>54%</td>
<td>84%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>79%</td>
<td>96%</td>
</tr>
<tr>
<td>Distributors</td>
<td>91%</td>
<td>104%</td>
</tr>
<tr>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Total sample(1)</td>
<td>59%</td>
<td>74%</td>
</tr>
</tbody>
</table>

(1) 1,022 IFRS/US GAAP listed companies (excluding banks and insurance companies) each with estimated operating lease liabilities of >$300M (discounted basis). Data obtained from financial data aggregators that may contain errors; this information should, therefore, be used with a degree of caution.
Areas of interest: Measurement
Measurement of Lease Liability
Overview

Identify lease payments
- Fixed payments
  - including in-substance fixed payments
- Variable lease payments
  - based on an index or a rate
- Residual value guarantees
- Lease incentives
- Exercise price of purchase options
- Termination penalties

Determine lease term
- Extension options
- Termination options
  - ‘Reasonably certain’ assessment

Apply Discount rates
- Rate implicit in lease, if readily determinable
- Otherwise, incremental borrowing rate
Determine lease term

*Enforceable rights*

**IFRS 16; paragraph B34:**

….A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with **no more than an insignificant penalty**
Determine lease term
*Reasonably certain assessment*

Is there an *economic incentive* to lease for the longer lease term?

Other considerations:
- Interaction with other contract terms
- Past practice
- Length of non-cancellable period

For example:
- *Favourable terms* compared to market rates
- Significant *leasehold improvements*
- Termination or relocation *costs*
- *Specialised asset* or lack of available alternative assets
Identify lease payments
Variable lease payments

Include Variable Lease Payments that depend on an index or a rate

Initially measure based on index or rate at commencement date

Remeasure only when cash flows change

For example:
- Consumer Price Index (CPI)
- Benchmark interest rate (e.g., LIBOR)
- Payments that vary with market rentals

Do not forecast future changes in the index or rate

generally, do not change discount rate
Identify lease payments

*In-substance fixed payments*

Variable lease payments—how a lessor might cover their risk:

- **Example:** Minimum rent clause
  - E.g. if sales are less than CU100, rent is CU5
  - In-substance fixed lease payments of CU5 p.a. included in lease liability

- **Example:** Higher variable payments to compensate risk of zero return
  - E.g. variable payments based on 7% of sales
  - Genuine variability: variable payments not included in lease liability, recognise in P&L when incurred
Discount rate

Interest rate implicit in the lease

Use *if* it can be *readily determined* by the lessee *if not*

Lessee’s incremental borrowing rate

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 asset in a *similar economic environment*. 
Areas of interest: Disclosure
Overview

- Two main elements to IFRS 16 disclosures:

  - **Mandatory quantitative information**: Information that users want to see for all material lease portfolios.

  - **Additional entity specific information**: Companies apply judgement to determine whether and what further information is needed to meet the disclosure objectives.
Mandatory quantitative information

• To be disclosed whenever material:

**Information about lease costs, cash flows and assets**
- Breakdown of lease costs
- Total lease cash flows
- ROU assets by major class of leased asset
- Additions to ROU assets

**Maturity analysis**
- Maturity analysis of lease commitments
  - as for all other financial liabilities
  - apply judgement in determining time bands
Additional Entity-Specific Information

• Considerations

What information is monitored and reported internally?

What information is used in decision making?
**Additional Entity-Specific Information**

- Lessee to apply judgement about what is relevant:

<table>
<thead>
<tr>
<th>Extension and termination options</th>
<th>Variable lease payments</th>
<th>Residual value guarantees</th>
<th>Sale &amp; leaseback transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>For example….</td>
<td>For example….</td>
<td>For example….</td>
<td>For example….</td>
</tr>
<tr>
<td>• Why have them?</td>
<td>• Why have them?</td>
<td>• Why have them?</td>
<td>• Why use them?</td>
</tr>
<tr>
<td>• Prevalence within lease portfolio</td>
<td>• Prevalence within lease portfolio</td>
<td>• Nature of relevant assets</td>
<td>• Prevalence</td>
</tr>
<tr>
<td>• Relative magnitude of optional payments vs committed payments</td>
<td>• Relative magnitude of variable payments vs fixed payments</td>
<td>• Prevalence within lease portfolio</td>
<td>• Key terms and conditions</td>
</tr>
<tr>
<td>• Exercise of options not recognised on balance sheet</td>
<td></td>
<td>• Magnitude of exposure to residual value risk</td>
<td>• Payments not recognised on balance sheet</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Cash flow effect</td>
</tr>
</tbody>
</table>
Implementation Effects
Implementation effects

• Early adopters

• Disclosed information
  – Operating lease commitments
  – Pre-adoption disclosures
Early Adopters

**Industries**
- Technology
- Telecommunications
- Real estate
- Energy
- Airlines
- Logistics
- Food/Beverages

**Geographies**
- Europe
- US & Canada
- Africa & Middle East
- Asia Pacific
Pre-adoption disclosures—Increasing focus from regulators

“The common enforcement priorities for the 2017 year-end are... Disclosure of the expected impact of implementation of major new standards in the period of their initial application (i.e. IFRS 9 Financial Instruments, IFRS 15 Revenue from Contracts with Customers and IFRS 16 Leases)

ESMA, together with enforcers, will pay particular attention to these priorities when monitoring and assessing the application of all relevant IFRS requirements.”

ESMA 27/10/2017
Pre-adoPTION disclosures

For a sample of 100 IFRS reporting entities with significant lease portfolios†:

94 disclosed **qualitative information** about the effect of applying IFRS 16
(see slide 20)

11 disclosed **quantitative information** about the effect of applying IFRS 16
(see slide 21)

25 disclosed information about their transition approach

†Based on a sample of the 10 largest IFRS reporting entities by Operating Lease Commitment value in each of the following industries: Airlines; Retailers; Travel and leisure; Transport; Telecommunications; Energy; Media; Distributors; Information Technology; Healthcare. Information was obtained using financial data aggregators that compile financial information available in the financial statements of listed companies. The Board relied upon the information contained in those databases and did not independently verify the accuracy of such information for each company.
Pre-adoption disclosures

Qualitative disclosures included:

- Expected effect on financial ratios and KPIs (increase/decrease)
- Information about the process undertaken to identify lease contracts, and any changes to the lease portfolio
- Accounting policy choices – e.g., whether entities will use the optional recognition exemptions
- Information about judgements and estimates – for example, judgements made around lease term
Quantitative disclosures included estimated effects of IFRS 16 on....

- Lease expenses, depreciation, and interest in the Income Statement
- Values of ROU assets and lease liabilities that will come onto the Balance Sheet
- Deferred tax assets
- Profit measures
- Equity
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