

Implementing IFRS 16

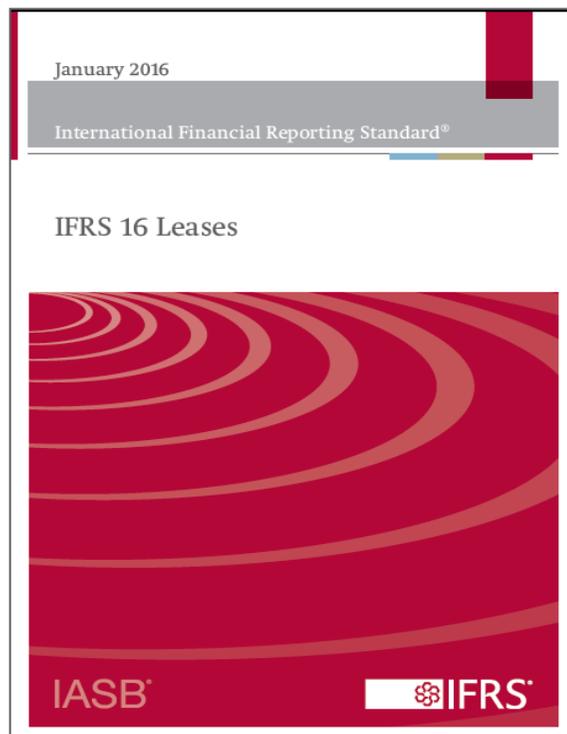
Seminario ABEL 'A Implementacao do IFRS 16 no Brasil'

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- **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?

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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

Different effects by company / industry

Industry sector	Long-term financial liabilities to equity ratio			EBITDA (in billions of US\$)		
	Reported on balance sheet (IAS 17)	If all leases on balance sheet (IFRS 16)	Increase (percentage points)	Reported on balance sheet (IAS 17)	If all leases on balance sheet (IFRS 16)	Increase
Airlines	123%	251%	1.28	51.6	73.8	43%
Travel and leisure	118%	191%	0.73	50.3	63.3	26%
Retailers	48%	103%	0.55	270.4	347.7	29%
Transport	54%	84%	0.30	71.2	87.6	23%
Telecommunications	79%	96%	0.17	399.3	434.5	9%
Distributors	91%	104%	0.13	29.4	35.0	19%
...	
Total sample⁽¹⁾	59%	74%	0.15	3,394	3,722	10%

(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

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Determine Lease term

- Extension options
 - Termination options
- } 'Reasonably certain' assessment

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

Apply Discount rates

- Rate implicit in lease, if readily determinable
- Otherwise, incremental borrowing rate

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?

For example:

- ***Favourable terms*** compared to market rates
- Significant ***leasehold improvements***
- Termination or relocation ***costs***
- ***Specialised asset*** or lack of available alternative assets

Other considerations:

Interaction with other contract terms

Past practice

Length of non-cancellable period

Identify lease payments

Variable lease payments

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

For example:

- Consumer Price Index (*CPI*)
- Benchmark interest rate (eg *LIBOR*)
- Payments that vary with *market rentals*

Initially measure based on index or rate at commencement date

do not forecast future changes in the index or rate

Remeasure only when cash flows change

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

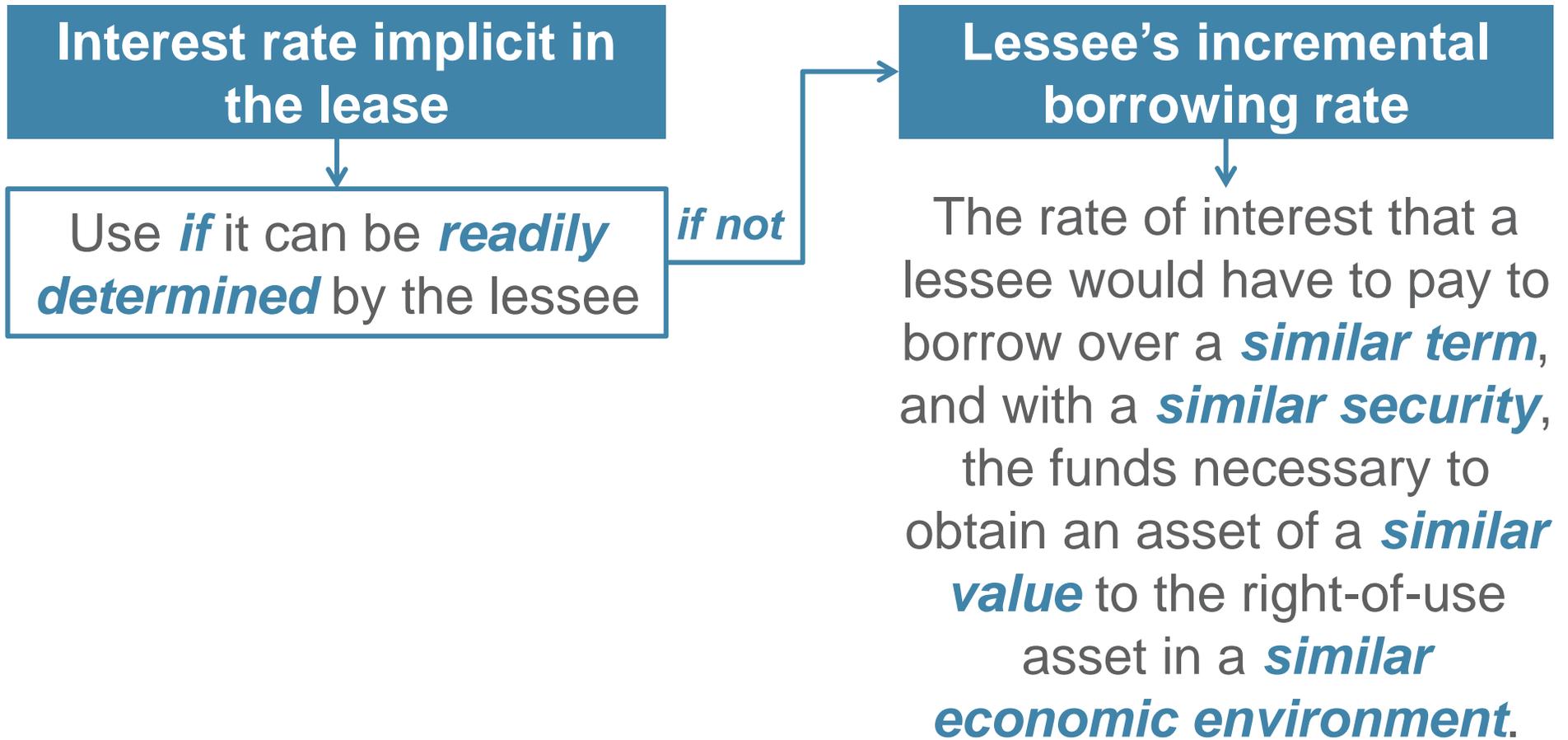
E.g. if sales
are less than
CU100, rent
is CU5

In-substance fixed lease
payments of CU5p.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



Areas of interest: Disclosure

- 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

- 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

- Considerations

What information
is **monitored**
and **reported**
internally?

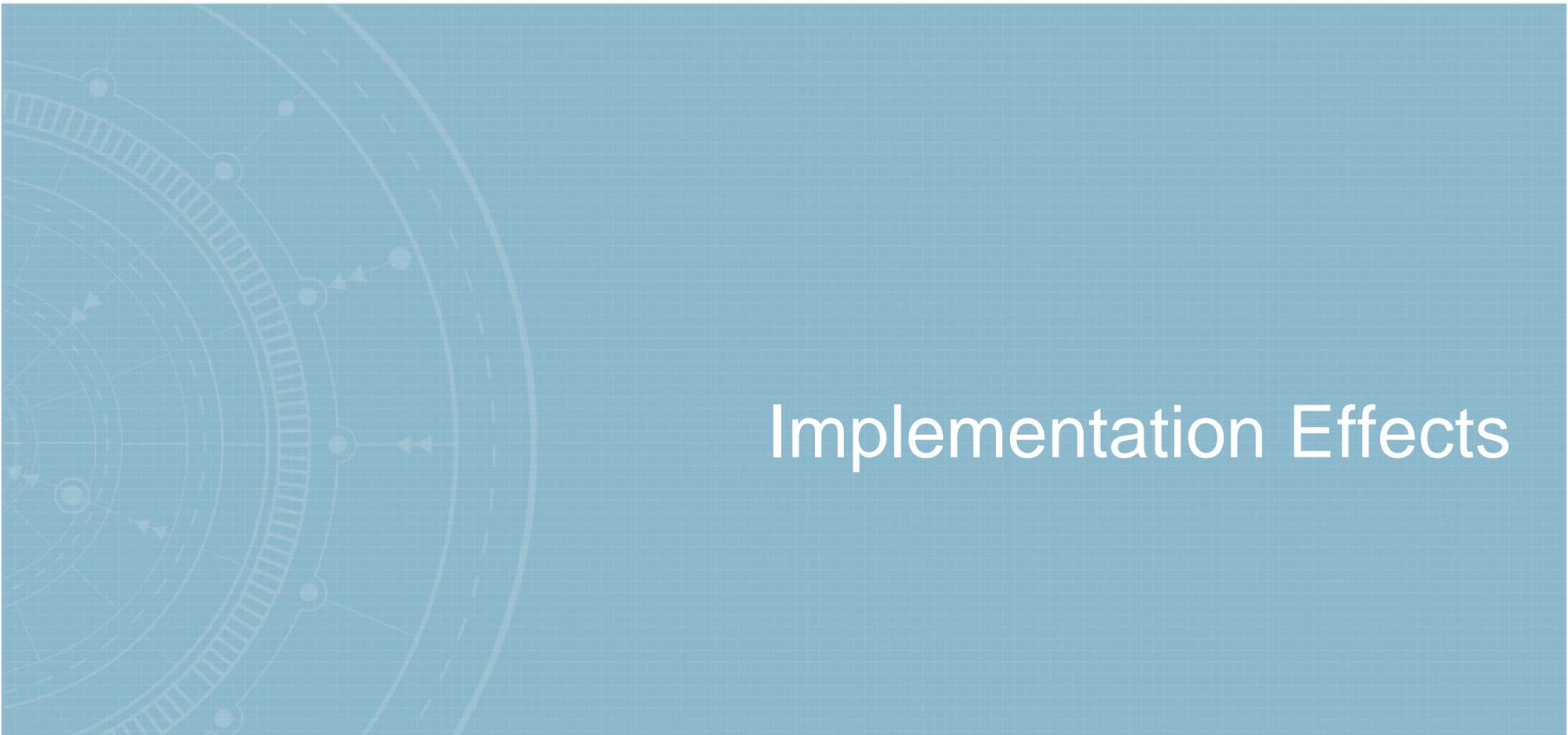
What information
is used in
decision
making?

Additional Entity-Specific Information

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- Lessee to apply judgement about what is relevant:

Extension and termination options	Variable lease payments	Residual value guarantees	Sale & leaseback transactions
<p>For example....</p> <ul style="list-style-type: none">• Why have them?• Prevalence within lease portfolio• Relative magnitude of optional payments vs committed payments• Exercise of options not recognised on balance sheet	<p>For example....</p> <ul style="list-style-type: none">• Why have them?• Prevalence within lease portfolio• Relative magnitude of variable payments vs fixed payments	<p>For example....</p> <ul style="list-style-type: none">• Why have them?• Nature of relevant assets• Prevalence within lease portfolio• Magnitude of exposure to residual value risk	<p>For example....</p> <ul style="list-style-type: none">• Why use them?• Prevalence• Key terms and conditions• Payments not recognised on balance sheet• Cash flow effect



Implementation Effects

- Early adopters
- Disclosed information
 - Operating lease commitments
 - Pre-adoption disclosures

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

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.

Qualitative disclosures included....

Expected effect on financial ratios and KPIs (increase/decrease)

Accounting policy choices – eg whether entities will use the optional recognition exemptions

Information about the process undertaken to identify lease contracts, and any changes to the lease portfolio

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

Get involved

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