



IFRS 16 Leases Technical Update

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Date: July 2017

IFRS 16

Effective 2019

Background

Project history



March 2009
Discussion
paper

August 2010
1st Exposure draft

May 2013
2nd Exposure
draft

January 2016
IFRS 16 issued



Introduce a
**right-of-
use** concept

786
comment
letters

643
comment letters

IASB and
FASB reach
different
decisions on
expense
recognition
and other
areas...

*"One of my great
ambitions before I
die is to fly in an
aircraft that is on
an airline's
balance sheet."*

Sir David Tweedie,
Chairman,
International
Accounting Standards
Board

Joint document:
IASB and FASB

Joint document:
IASB and FASB

Major **concern**:
Cost and
complexity,
measurement,
lessor accounting
and scope

Major
concern:
lessor
accounting

**Carry
forward**
of previous
lessor
accounting

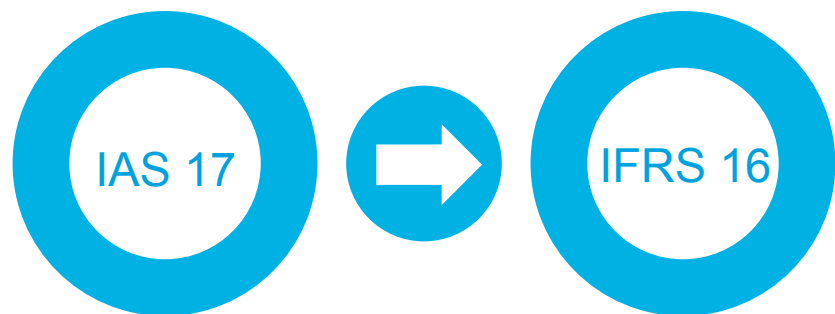
In a nutshell

The changes

Effective date: 1 January 2019

Limited changes to scope of IAS 17
Enhanced guidance on identifying a lease

Lessee accounting



Lessor accounting



Your impact

	2015	R m*
Balance sheet	Old	New
Total existing assets	xxx	xxx
Lease assets		xxx
Total existing liabilities	(xxx)	(xxx)
Lease liabilities for shipping		(xxx)
Income statement	Old	New
Lease payments	(xxx)	
Low-value/short-term		xxx
EBITDA	(xxx)	(xxx)
Depreciation		xxx
Finance cost for shipping		(xxx)
Profit before tax	xxx	xxx

Key ratios

EBITDA
 Net Debt: EBITDA
 Interest cover
 Debt:Equity

*Note we have assumed a discount rate of 10% to estimate the present value of the lease liability and the finance cost in the year of adoption.



New disclosures

Flexibility leases provide
 Deviations from industry practice

Sensitivity & risks analysis
 Increased impact analysis

Lessee impact

All leases come on balance sheet, except



Short-term leases
 (12 months or less)



Low-value
 leases

Lessor impact

Mainly unchanged – operating & finance leases

Potential mismatch for subleases



Lessee may require new
 information around non-
 lease components

Discussions to have now



Investors & Analysts

- Impact on financial report, key ratios and disclosures
- Impact on business valuation and free cash multiples
- Ability to access desired information
- Cost of implementation



Lenders

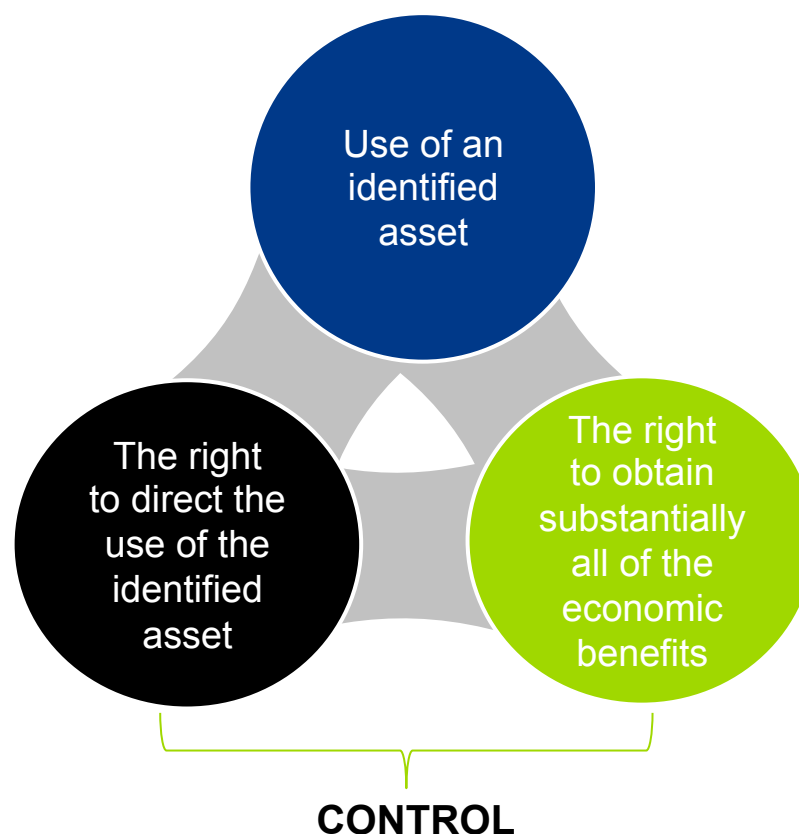
- Impact of covenants and debt renegotiations

Definition of a lease

When does a contract contain a lease

A contract is, or contains a lease if it meets **both** of the following criteria:

- Fulfilment of the lease depends on the use of an **identified asset**; and
- The contract conveys the right to **control** the use of the identified asset for a period of time in exchange for consideration.

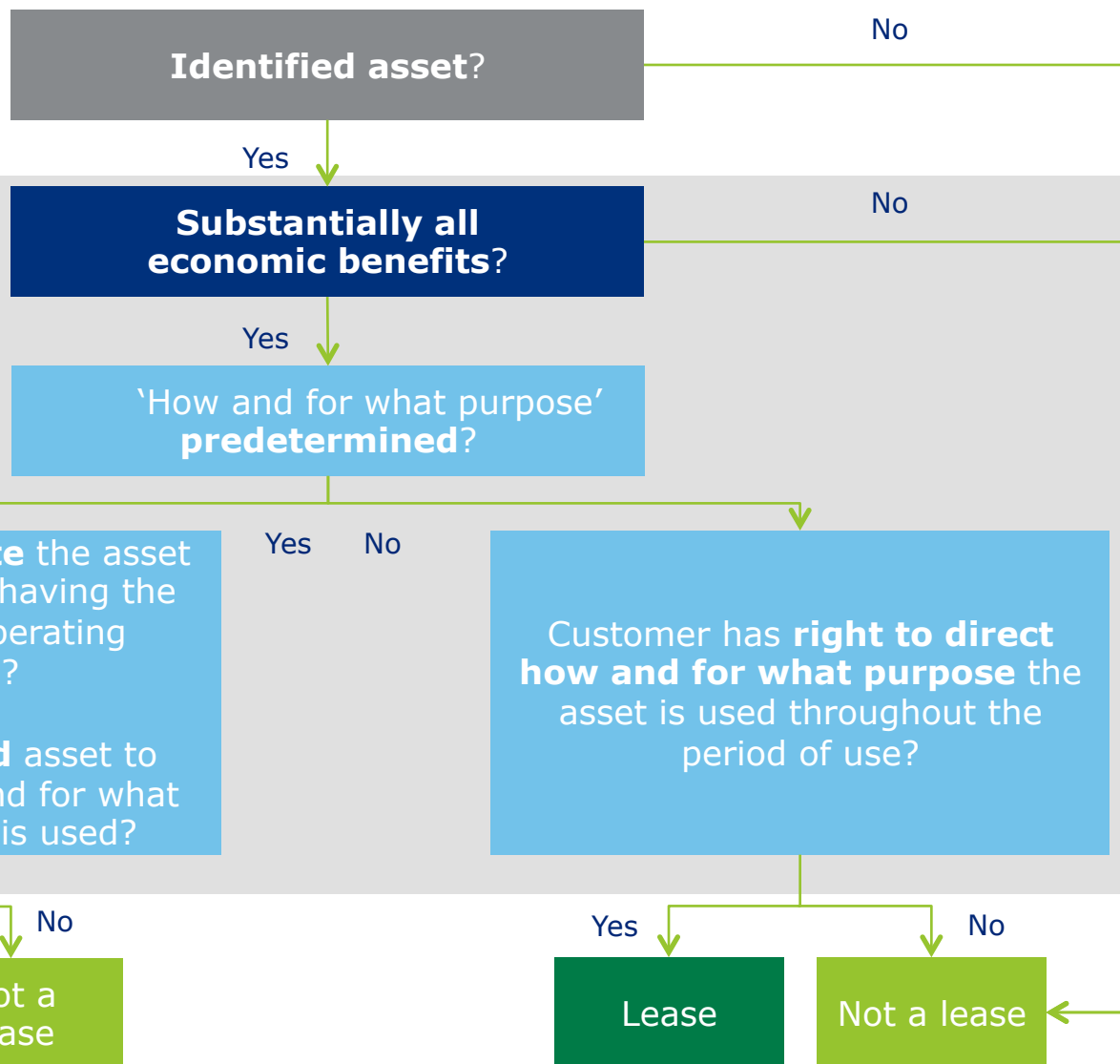


Identifying a lease

A decision tree

Fulfilment of the contract depends on the use of an identified asset

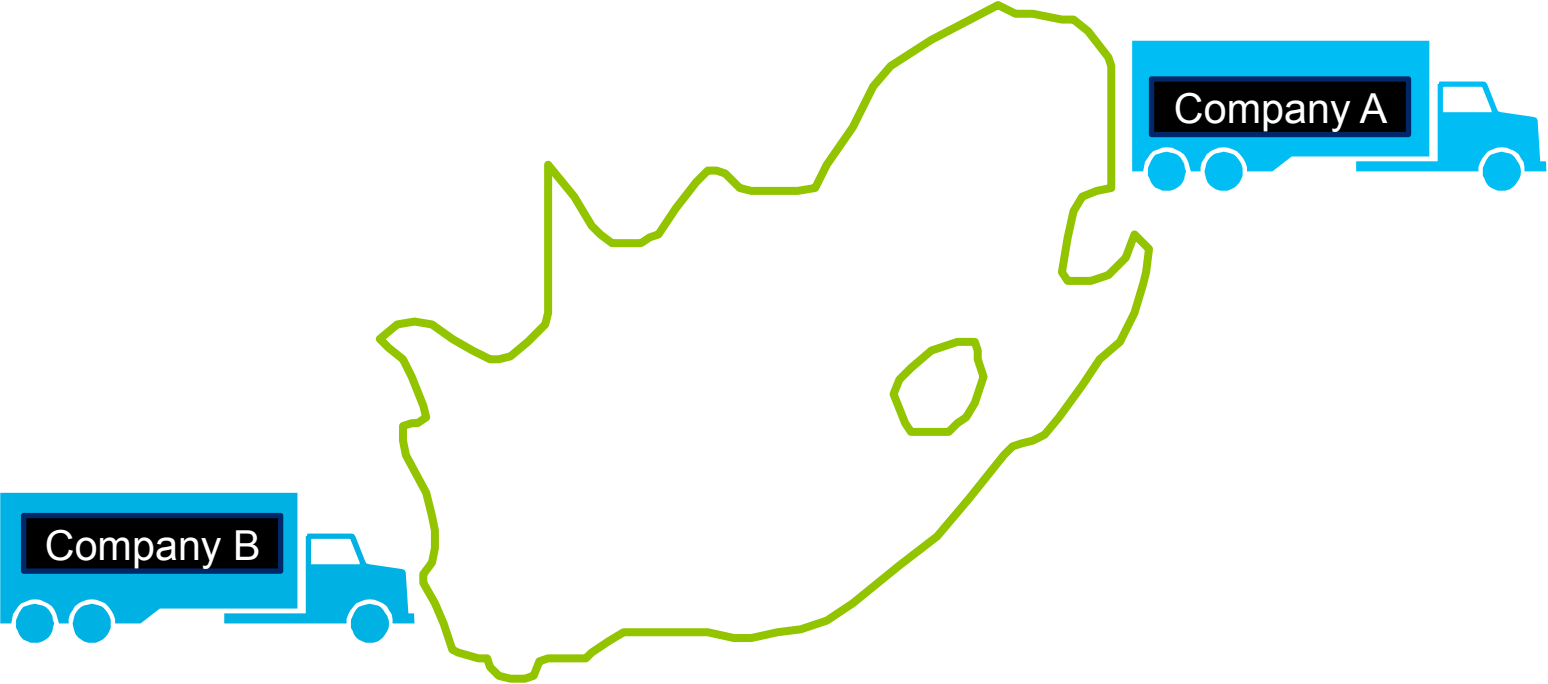
The contract conveys the right to control the use of the identified asset





Substantive substitution rights

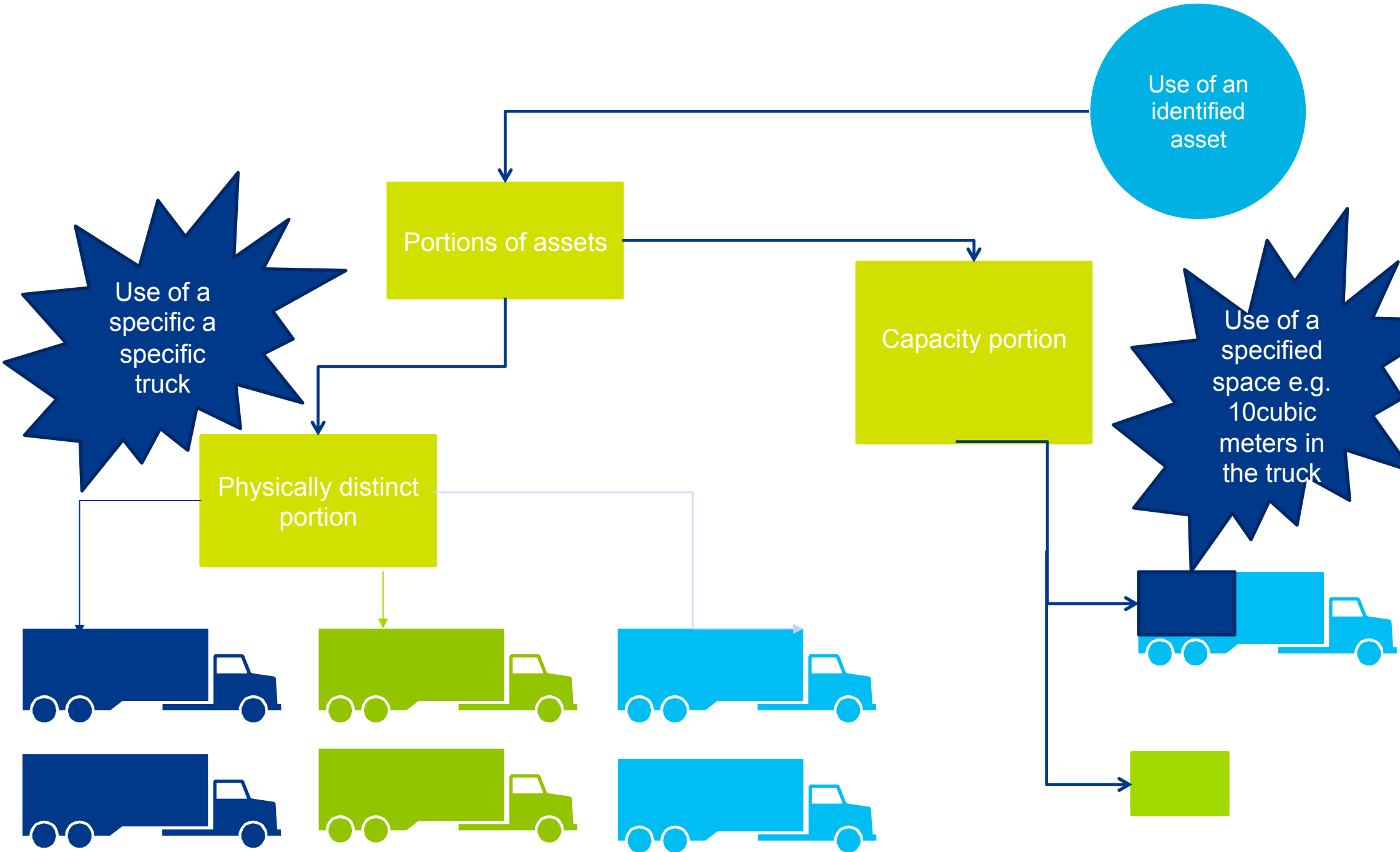
- Does the supplier have the **practical ability** to substitute alternative assets?
- and
- Would the supplier **economically benefit** from exercise of right to substitute?



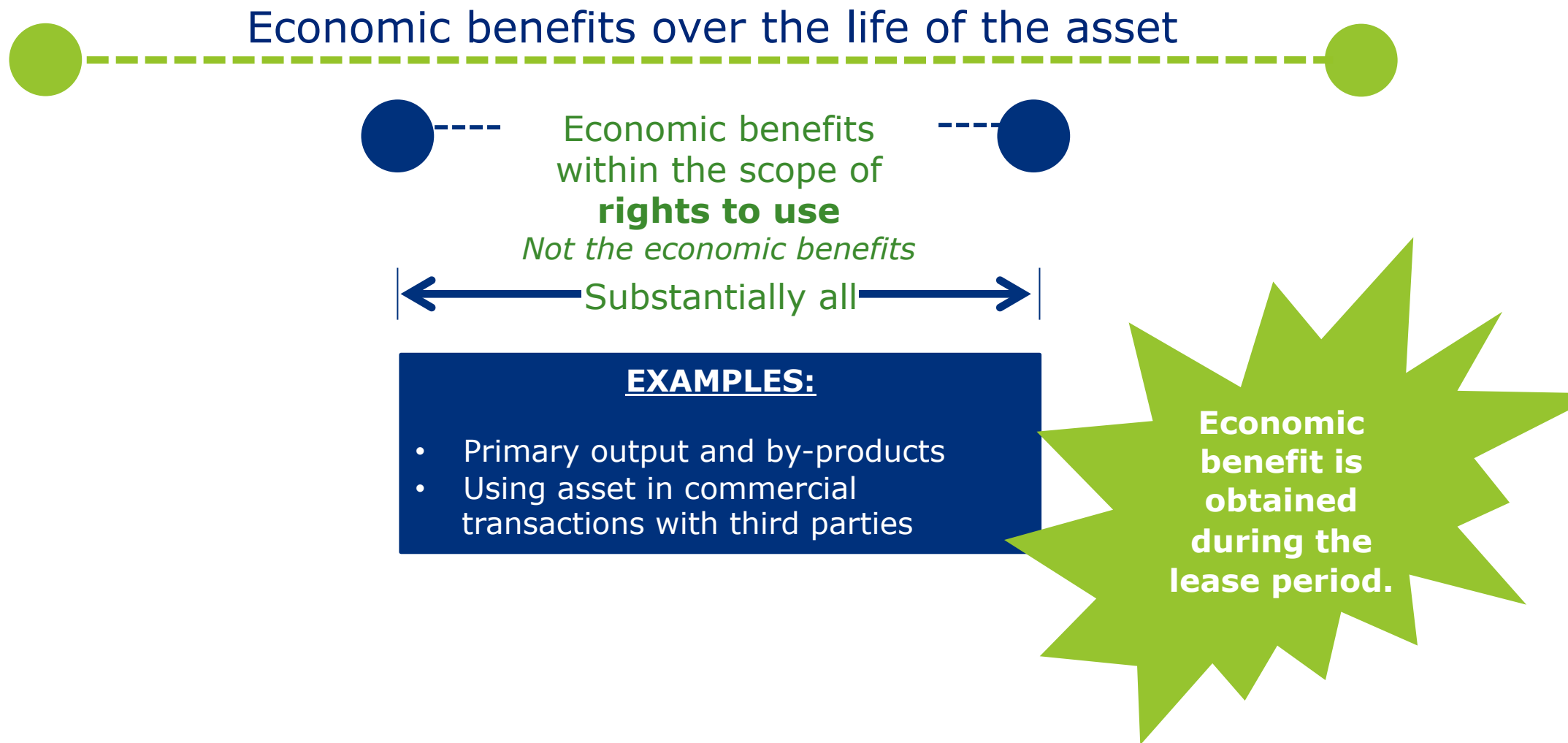
Dedicated truck vs fleet of trucks



Instead of having a dedicated truck if clients opt for the use of a truck from a fleet of the supplier, then the supplier does have an economic benefit to substitute the asset and this would no longer be a lease.



Control the use of the identified asset
Right to obtain economic benefits



Control the use of the identified asset

Right to direct the use



Are decisions predetermined?

Yes

No

Does customer have right to **operate** the asset without the supplier having the right to change operating instructions?
Or
Did the customer **design** the asset to predetermine how and for what purpose?

Does the customer have the right to direct **how and for what purpose** the asset is used throughout the period of use?

- **Relevant decisions?**
 - **Type, when, where, whether output is produced?**
 - **Decisions determined during and before the period of use?**
- (this is not about rights to operate and maintain the asset)*

Lease contracts

Combining or separating contracts

Combine two or more contracts



Account for as a single contract

Identify separate lease components



Account for each component separately

Identify separate lease components



Account for separately from non-lease components of a contract

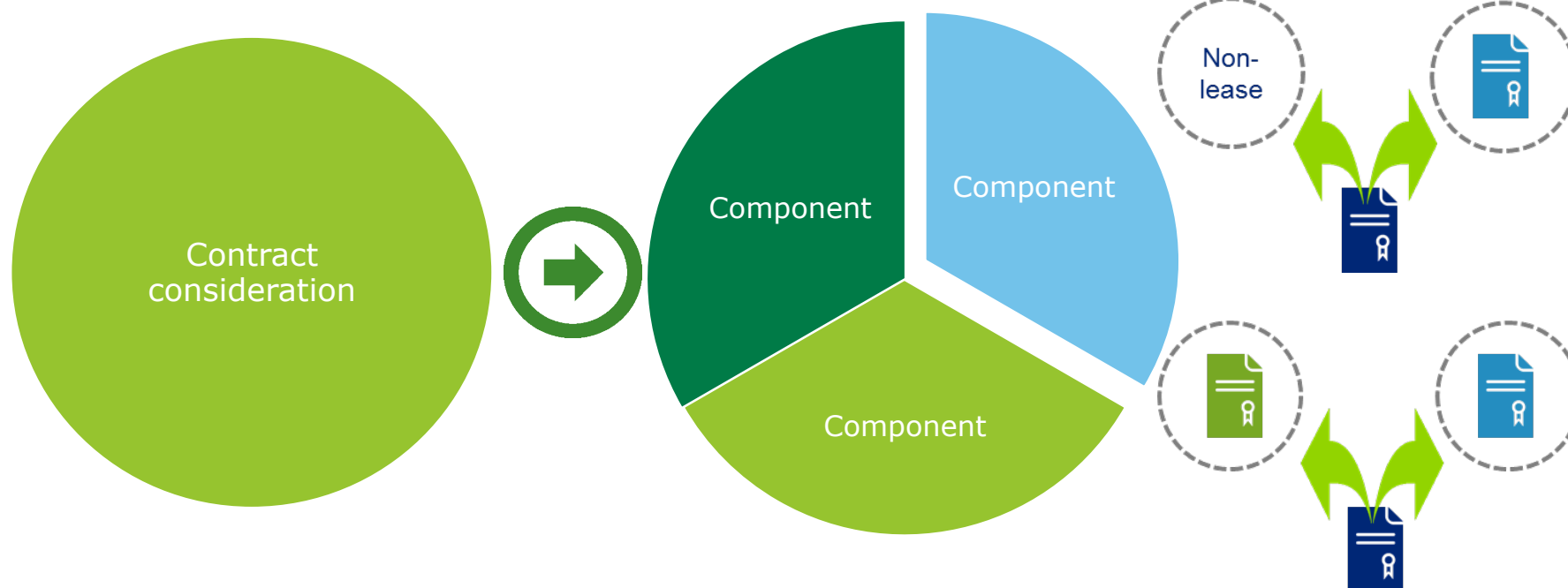
or

Elect not to separate (by class)

Lease contracts

Allocation of consideration

Lessee:



Lease component: Relative stand-alone price

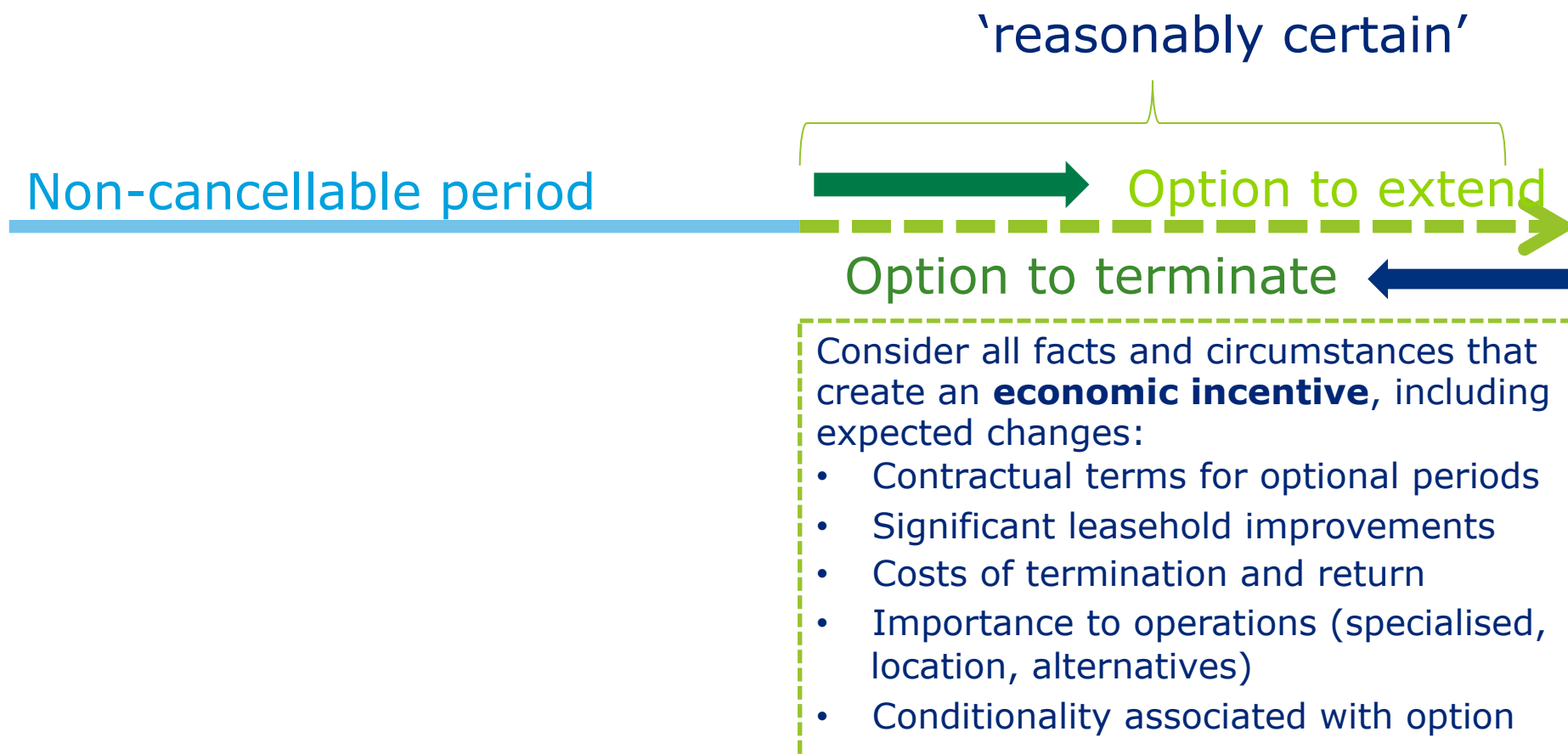
Non-lease component: Aggregate stand-alone price

If no observable data, estimate maximising the use of observable information

Lessor: allocate consideration in accordance with IFRS 15

Lease term

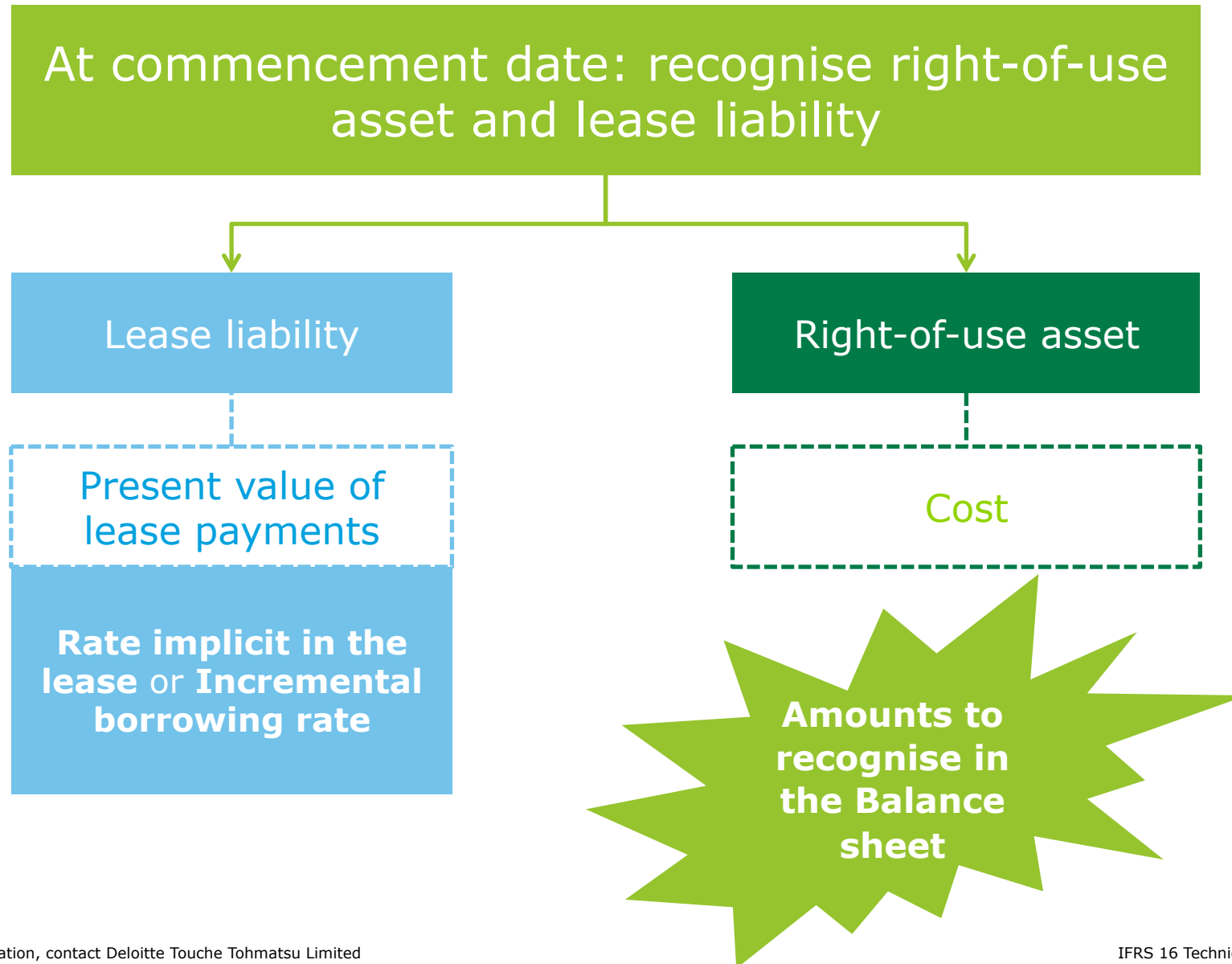
Extension and termination options



Reassess significant event or change in circumstances that lessee controls and affects whether exercise `reasonably certain` .
Revise: change in non-cancellable period.

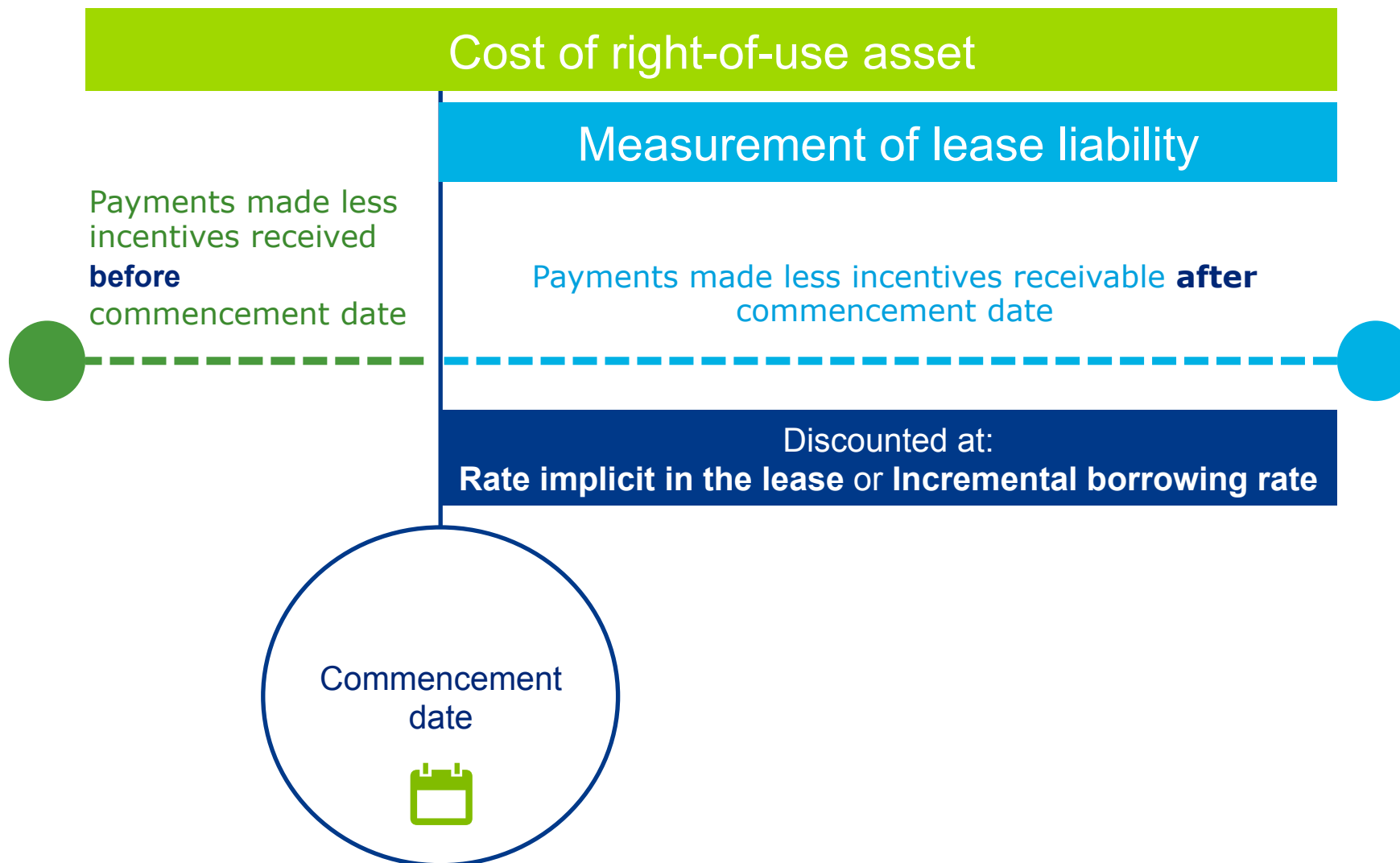
Measurement

Initial measurement



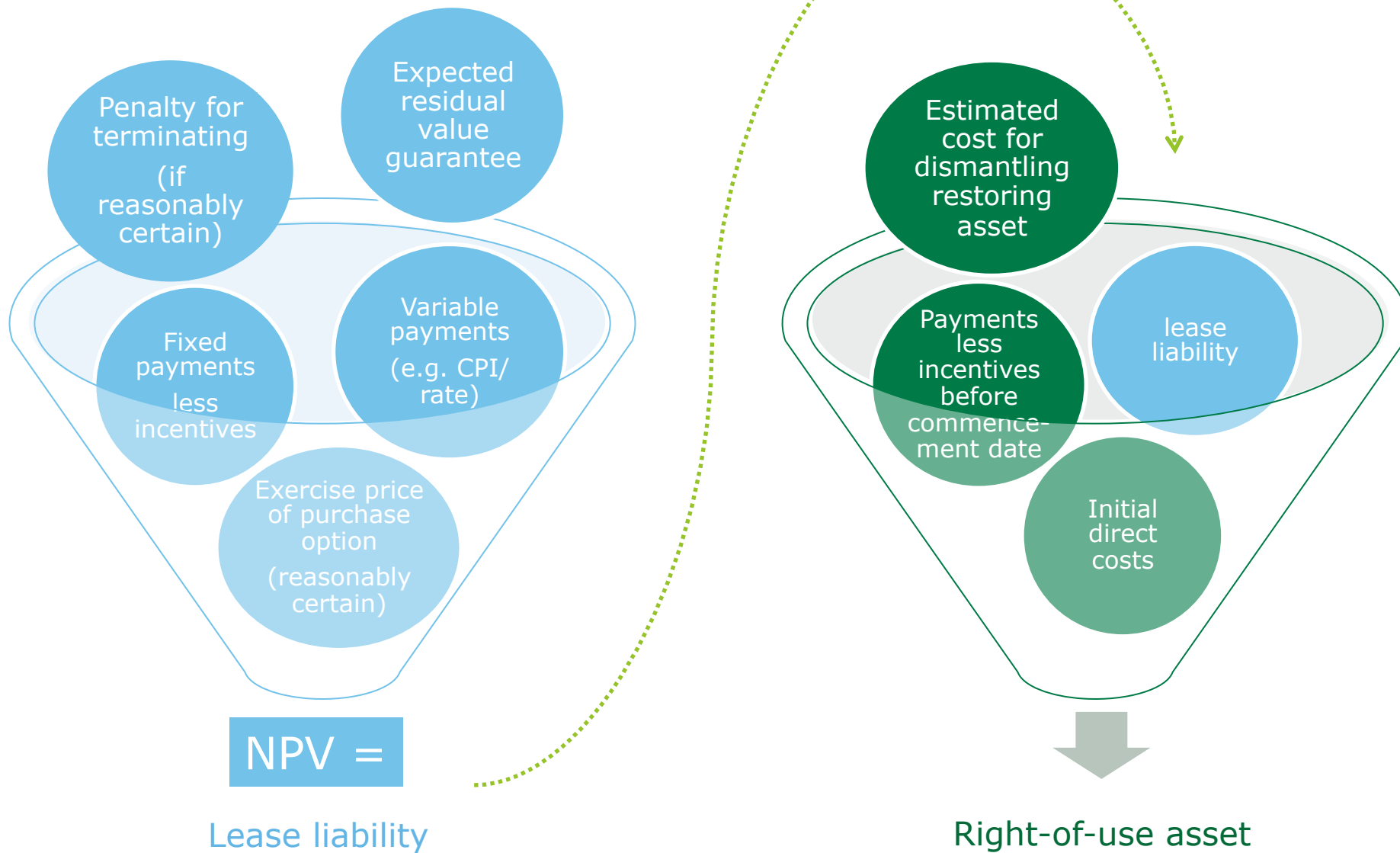
Measurement

Initial measurement



Measurement

Initial measurement



Measurement

Initial measurement example

Initial direct costs	T ₁	T ₂	T ₃	T ₄	T ₅
100	250	300	350	400	450



Lease term: 5 years

Discount rate: 5%

Present value = 1 494

Lease liability 1 494

Right-of-use asset 1 594 (1 494 + 100)

Measurement

Subsequent measurement

IFRS 16:

Year	Lease liabilities Amortisation table		
	Principal	Interest	Rental
T1	1,494	75	250.00
T2	1,319	66	300.00
T3	1,085	54	350.00
T4	789	39	400.00
T5	429	21	450.00

Year	Assets Depreciation table		
	Opening balance	Amortisation	Closing balance
T1	1,594	319	1,275
T2	1,275	319	956
T3	956	319	638
T4	637	319	319
T5	319	319	0.00

IAS 17:

$$(250+300+350+400+450)/5 = \mathbf{350} \text{ p.a.}$$

Lease term: 5 years

Discount rate: 5%

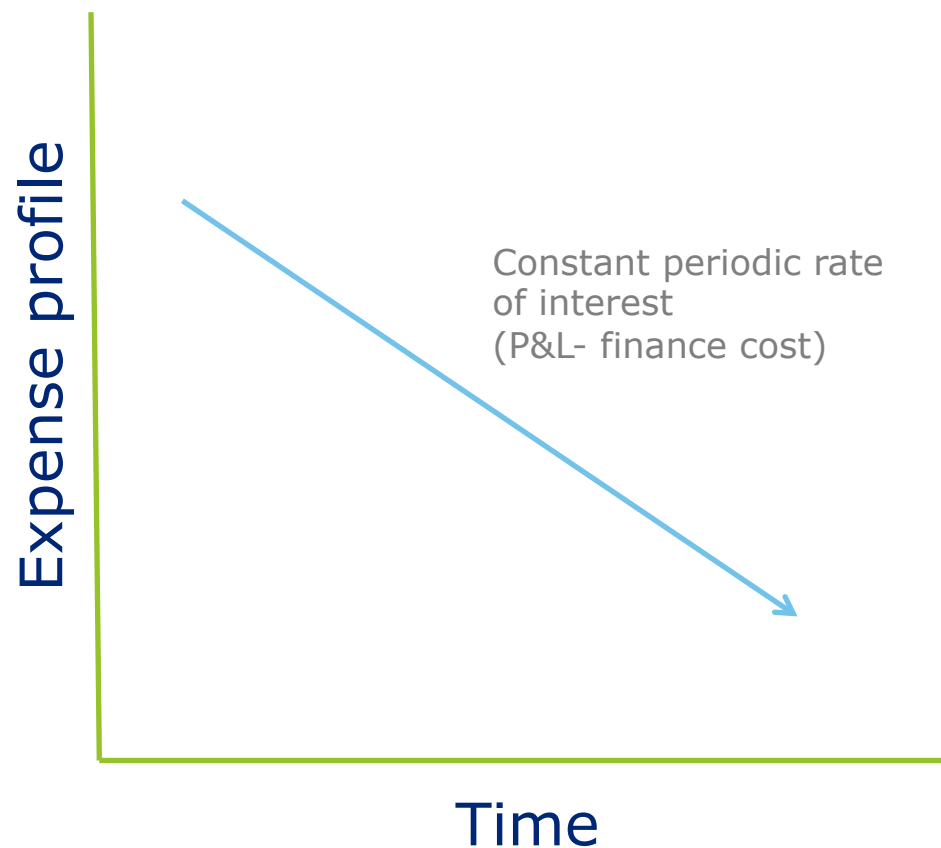
Present value = 1 494

Lease liability 1 494

Right-of-use asset 1 594 (1 494 + 100)

Measurement

Subsequent measurement: lease liability



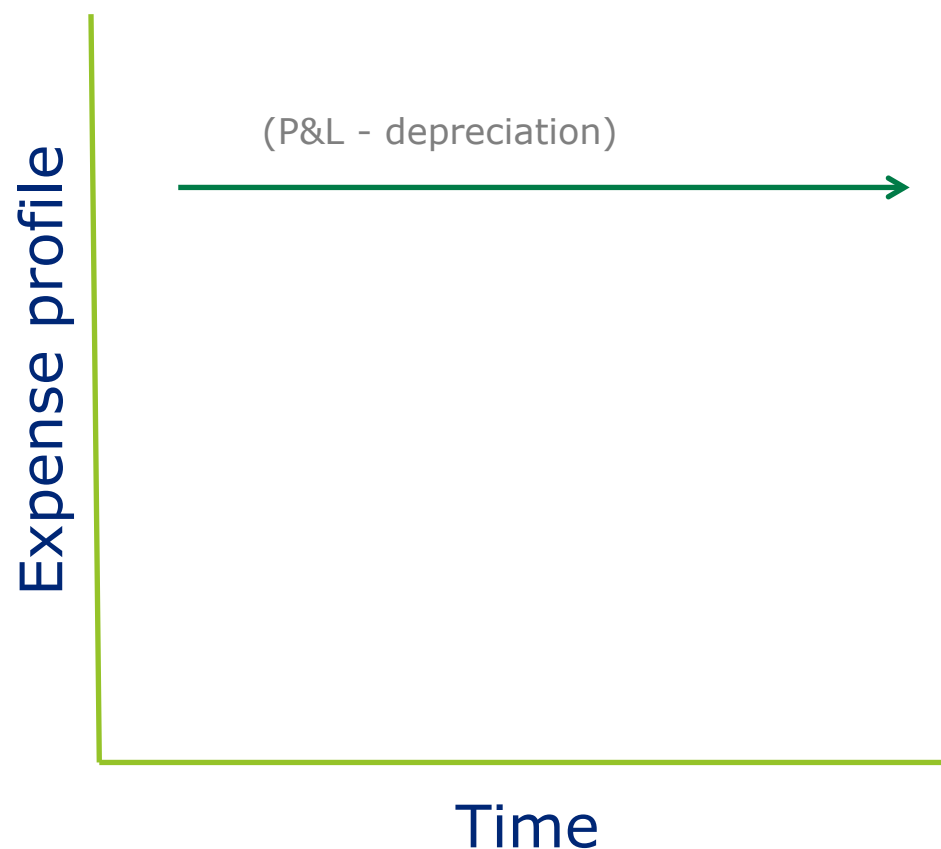
Increase the lease liability to reflect the interest



Decrease the lease liability to reflect payments made

Measurement

Subsequent measurement: right-of-use asset



Apply depreciation requirements in IAS 16



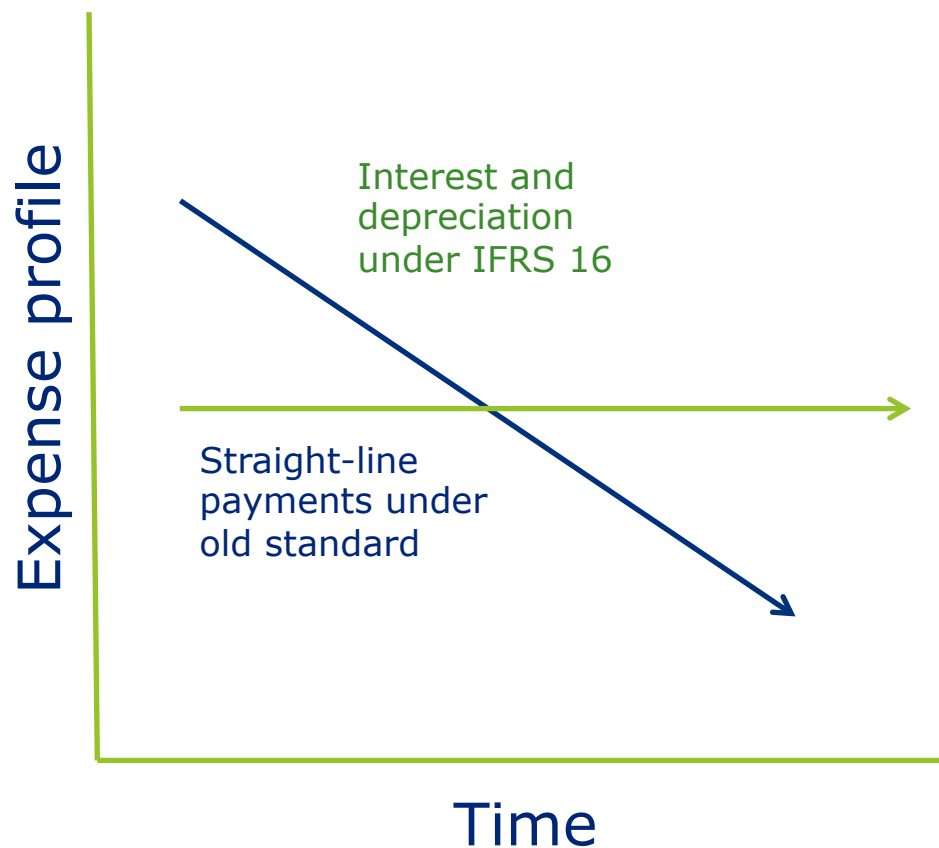
Depreciate over the useful life (taking extension options into consideration)



Impairment under IAS 36

Measurement

Old standard vs new standard



IFRS 16 results in front-loading of expense

Old standard 'smoothed' the impact on P&L

Measurement

Subsequent measurement: re-assessments

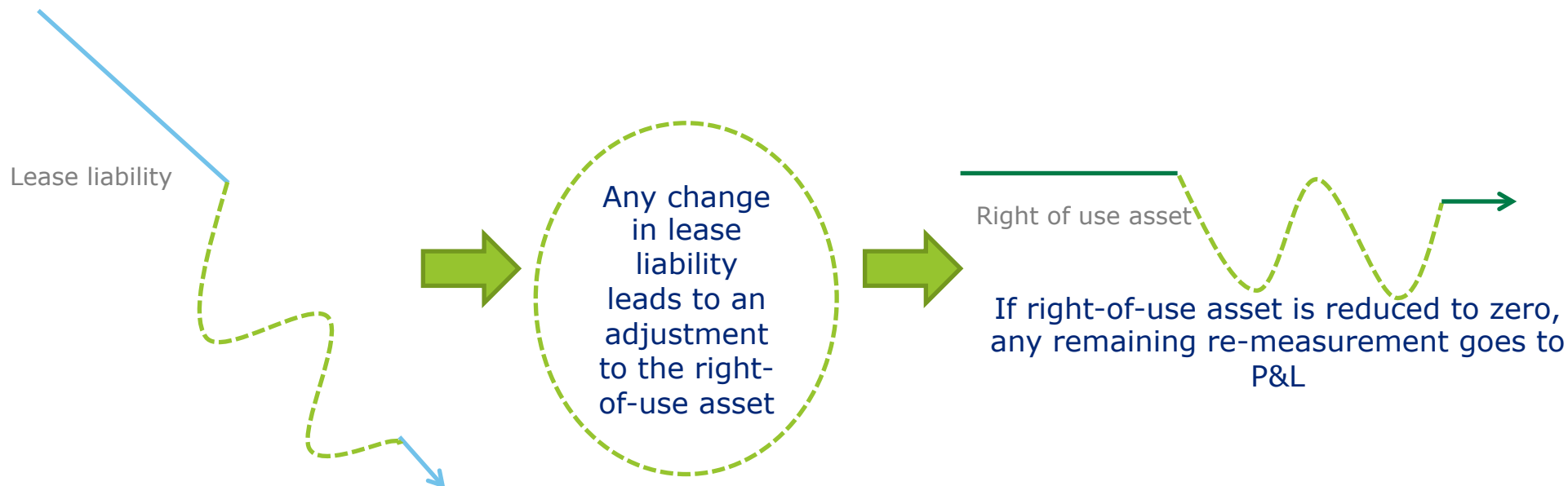
Re-measurement of lease liability

Original discount rate (unless changes result from floating interest rates) if changes in:

- Residual value guarantees expectation
- Payments due to changes in an index or rate (when they take effect)

Revised discount rate if:

- Change in the lease term
- Significant change in circumstances within the control of the lessee regarding an option to purchase



Accounting policy choice:
Apply IFRS 16 or straight-line the expense
(if applying the exemption: Apply IAS 37 to assess onerous contracts)



Short-term
leases (12
months or less)

A lease that contains a purchase option is not a short-term lease

Election by class of underlying asset



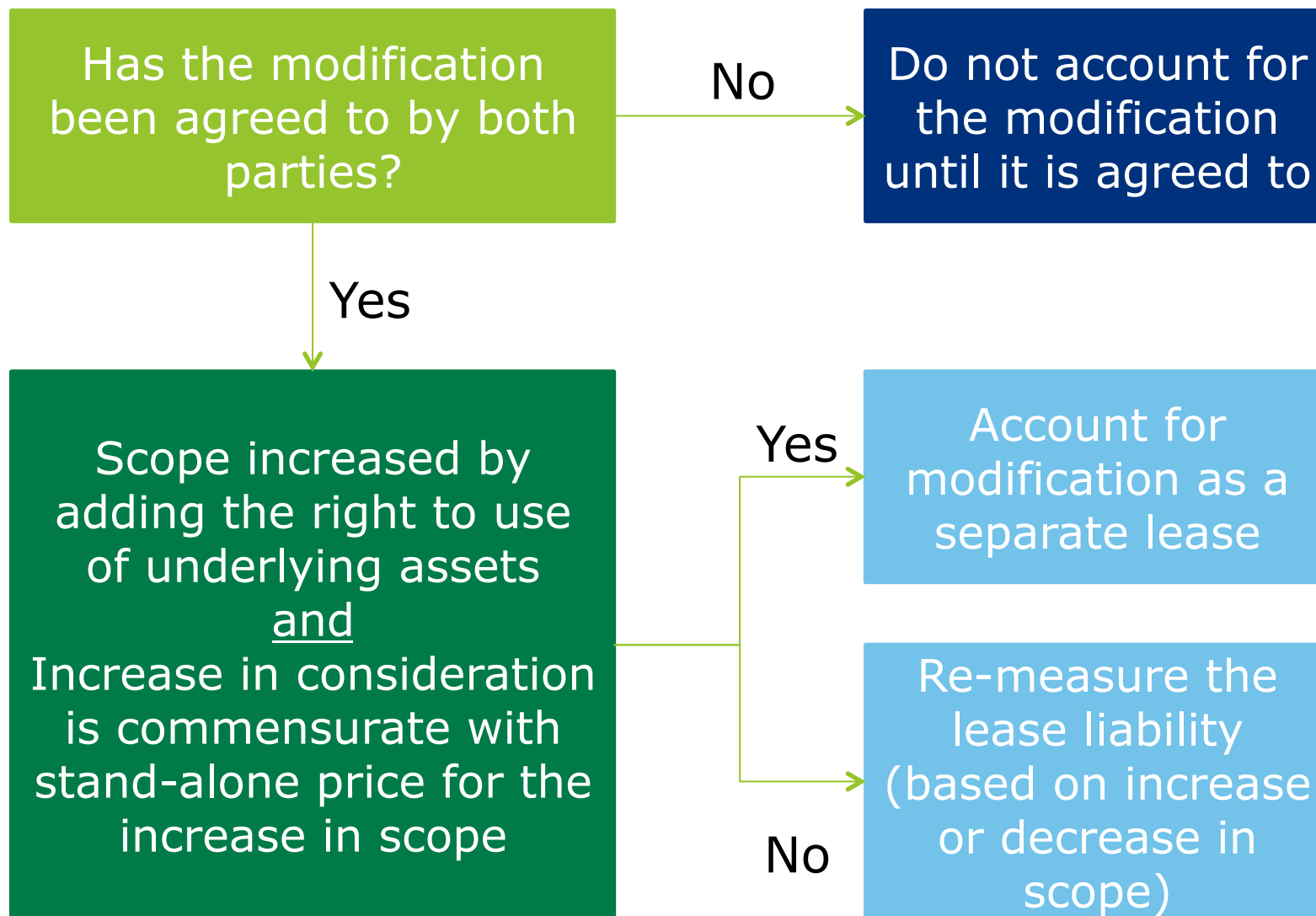
Low-value
leases

Assessment on an absolute basis

Election on a lease-by-lease basis

Measurement

Lessee modifications



Measurement

Lessee modifications

Account for lease modification as a separate lease

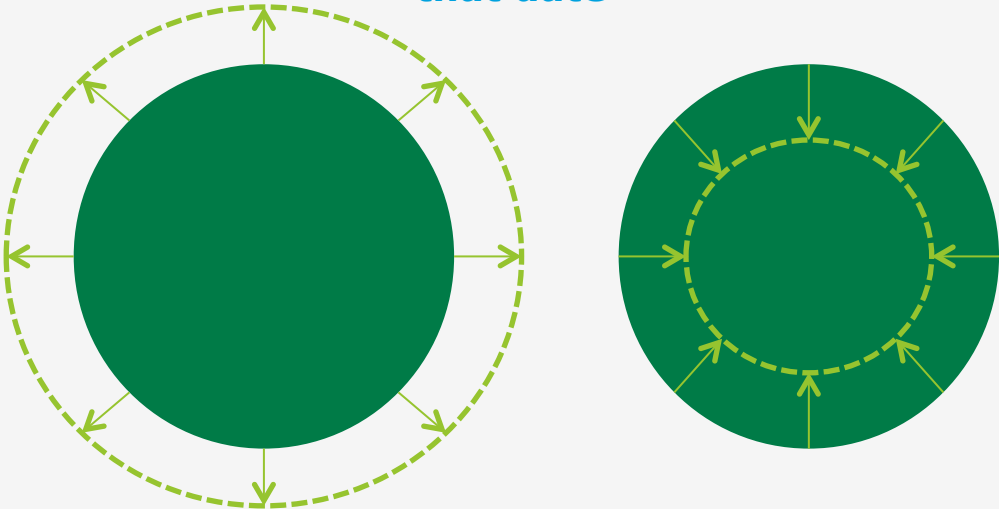


Original lease Modification

Only when:

- Modification increases scope; and
- Consideration is commensurate to stand-alone price for increase in scope

Account for lease modification by remeasuring the lease liability using the discount rate at that date



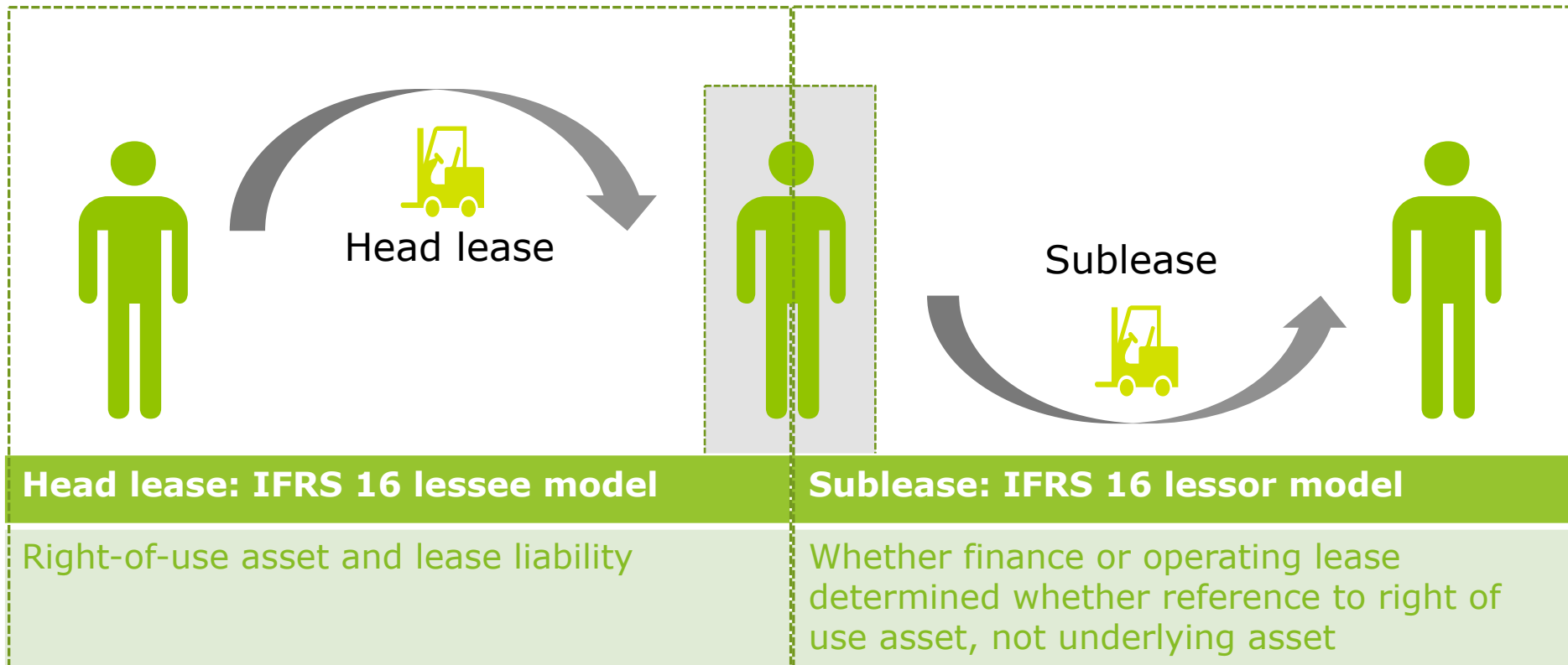
Modification increases scope Modification decreases scope

Corresponding adjustment to right-of-use asset

Decrease right-of-use asset to reflect partial termination and gain/loss to reflect the decrease

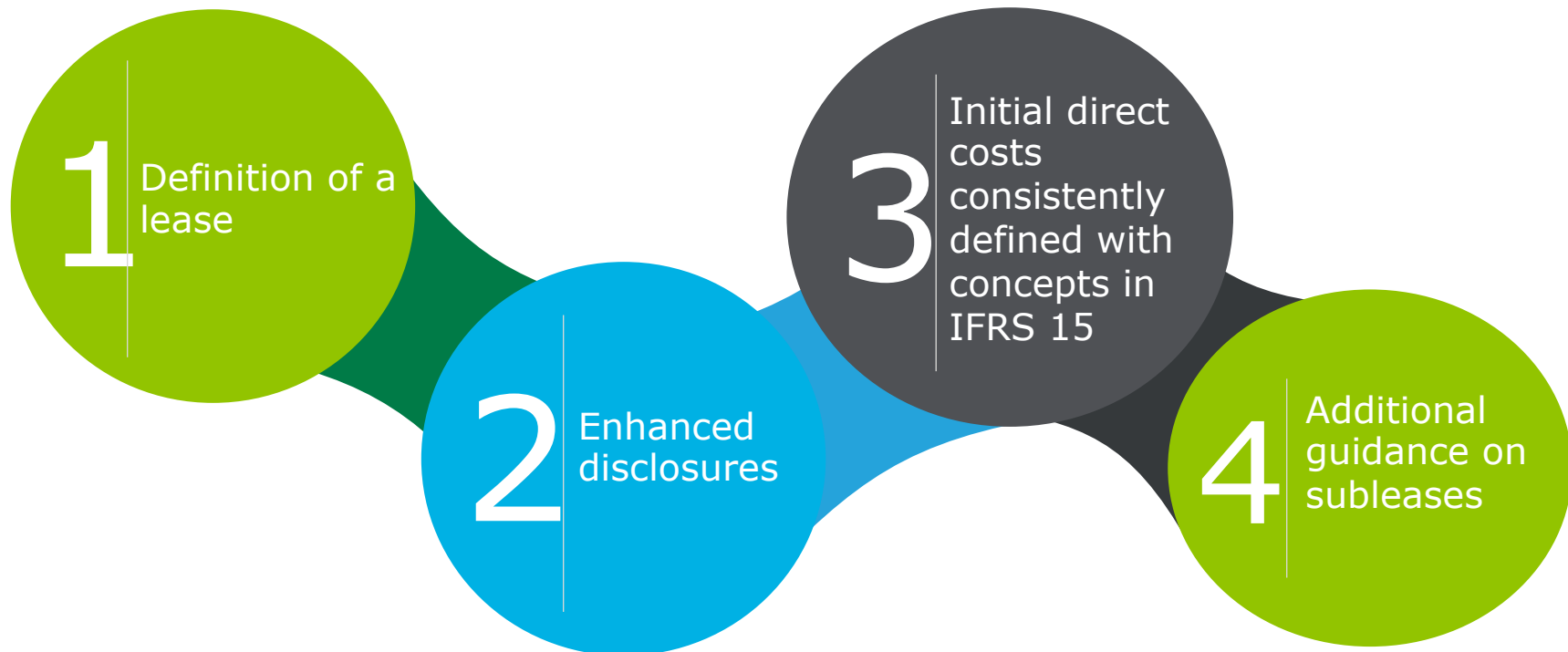
Subleases

Intermediate lessor accounting



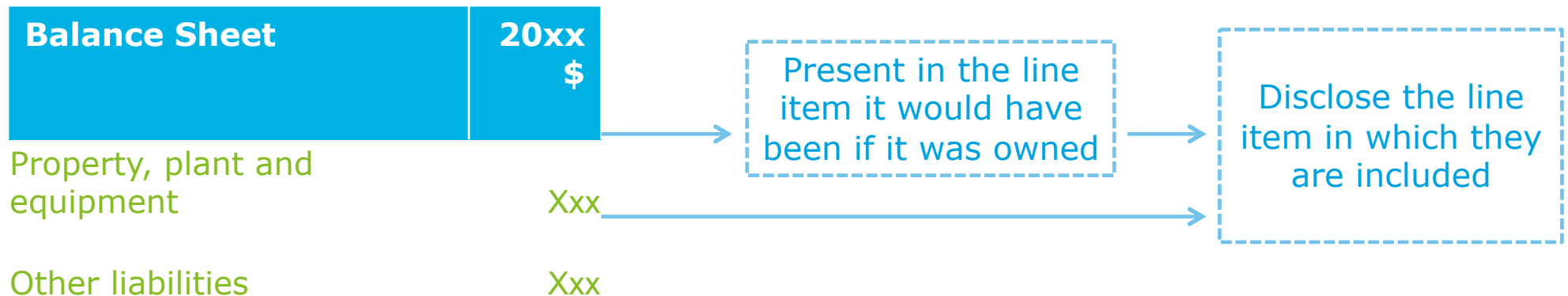
Lessor accounting largely unchanged

Main changes are...



Presentation and disclosure

Balance sheet



Presentation and disclosure

Income statement

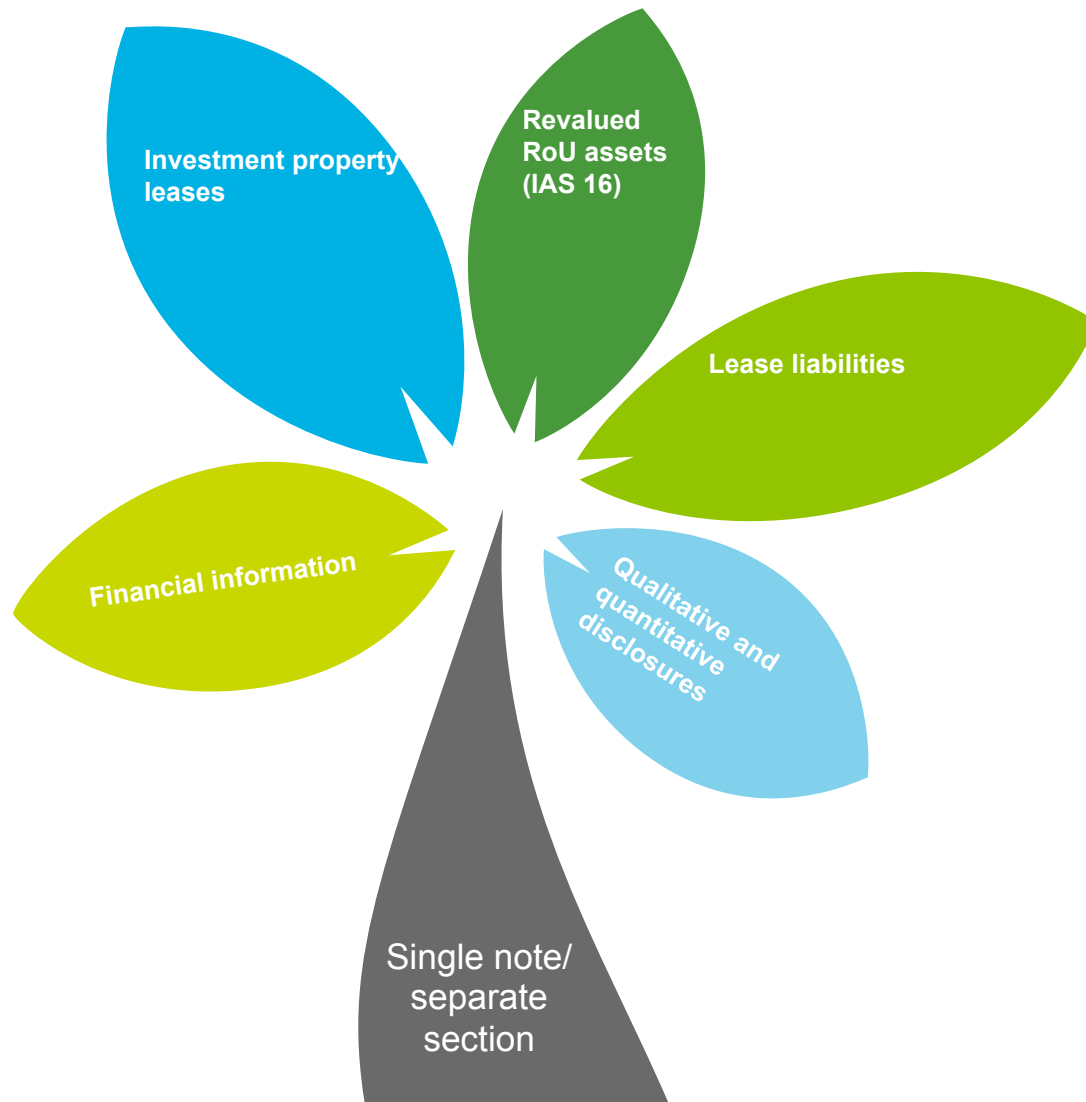
Income statement	20xx
	\$
Variable lease payments, re-measurement gains/losses, short term, low value leases	Xxx
Depreciation	Xxx
Finance cost	Xxx
Profit before tax	Xxx

Present interest expense separate from depreciation

(interest is a component of finance cost under IAS 1)

Presentation and disclosure

In the notes



Financial information

- Depreciation by class, interest expense
- Low-value or short-term lease expenses (not < 1 month)
- Variable lease payments
- Income from subleases
- Total cash flow
- RoU asset: additions, carrying amount at end
- Gain or losses on sale and leasebacks
- Fact: low-value or short-term lease exemption



Investment property leases

- Some IAS 40 disclosures



Revalued RoU asset (IAS 16)

- Effective date of revaluation
- Whether independent valuation expert involved



Lease liabilities

- Separate IFRS 7 maturity analysis

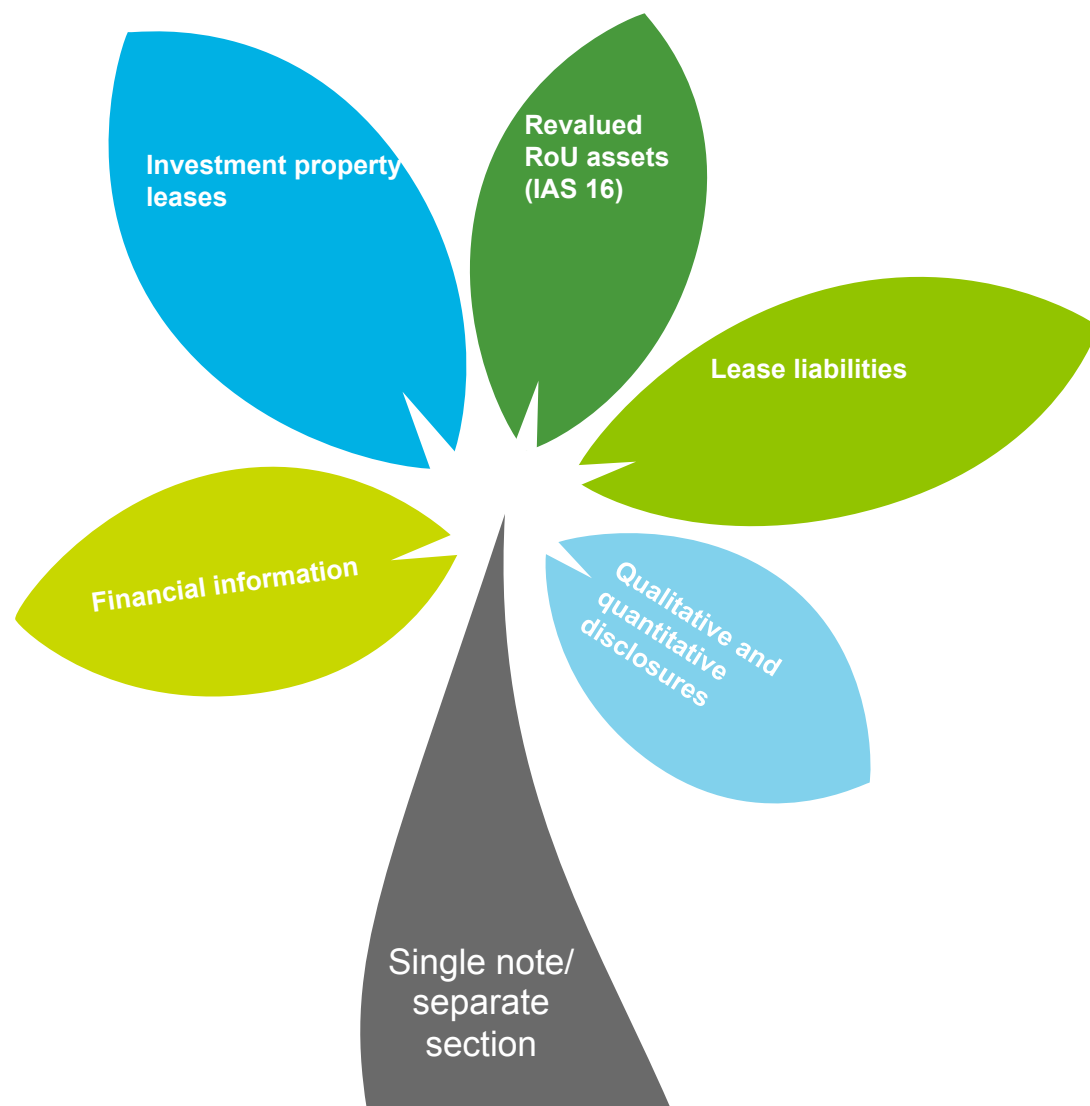


Qualitative and quantitative disclosures

- Nature of leasing activities,
- Exposure to possible future cash outflows
- Restrictions or covenants
- Sale and leaseback transactions

Presentation and disclosure

In the notes

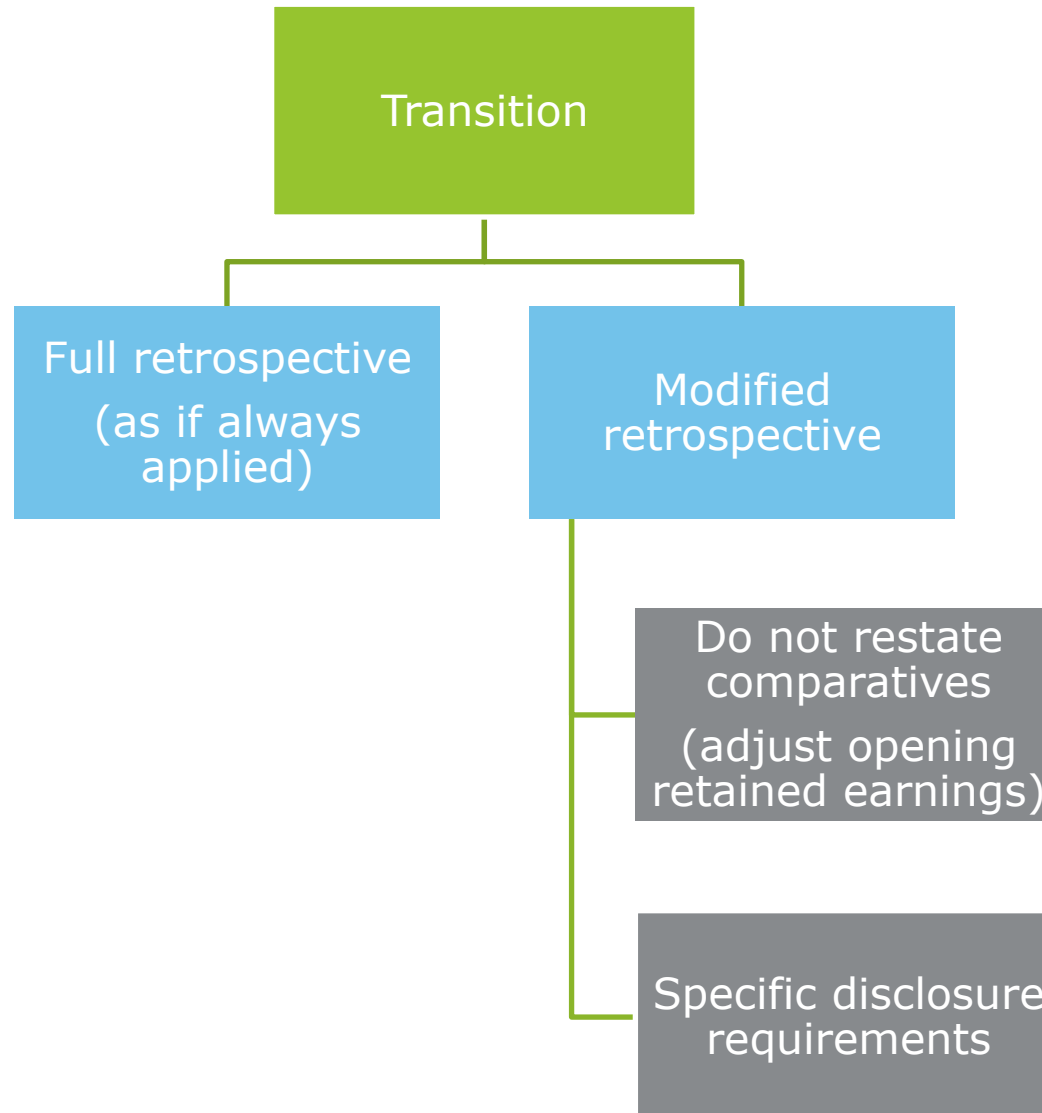


Qualitative and quantitative disclosures

- Nature of leasing activities so users can understand:
 - Flexibility leases provide
 - Restrictions imposed by leases
 - Sensitivity of reported key variables (eg future variable lease payments)
 - Other risks arising out of leases
 - Deviations from industry practice
- Exposure to possible future cash outflows (variable lease payments, options, residual value guarantees)
 - Reasons why used
 - Magnitude of exposure
 - Key variables exposure
 - Other operational and financial effects

Transition

Approaches: Lessees



Summary

Key judgements, policy choices and exemptions

Judgement, policy choice or exemption	Topic
Judgement: identifying a lease will sometimes require a significant amount of judgement based on the elements of the definition of a lease	Identifying a lease
Judgement: determining whether it is reasonably certain whether an extension or termination option will be exercised	Lease term
Judgement: identifying the appropriate rate to discount the lease payments will require significant judgement	Incremental borrowing rate
Exemption: Short-term leases (by class of asset) or low-value leases (lease-by-lease basis)	Recognition

Summary

Key judgements, policy choices and exemptions

Judgement, policy choice or exemption	Topic
Policy choice: Full retrospective approach or modified retrospective approach, definition of a lease - choice to grandfather all or not, initial direct cost in measurement of RoU asset - choice lease by lease and other practical expedients on transition	Transition
Policy choice: Lessee may elect not to separate non-lease components from lease components by class of asset	Components
Policy choice: Lessee may, but is not required to, apply IFRS 16 to leases of intangible assets	Scope

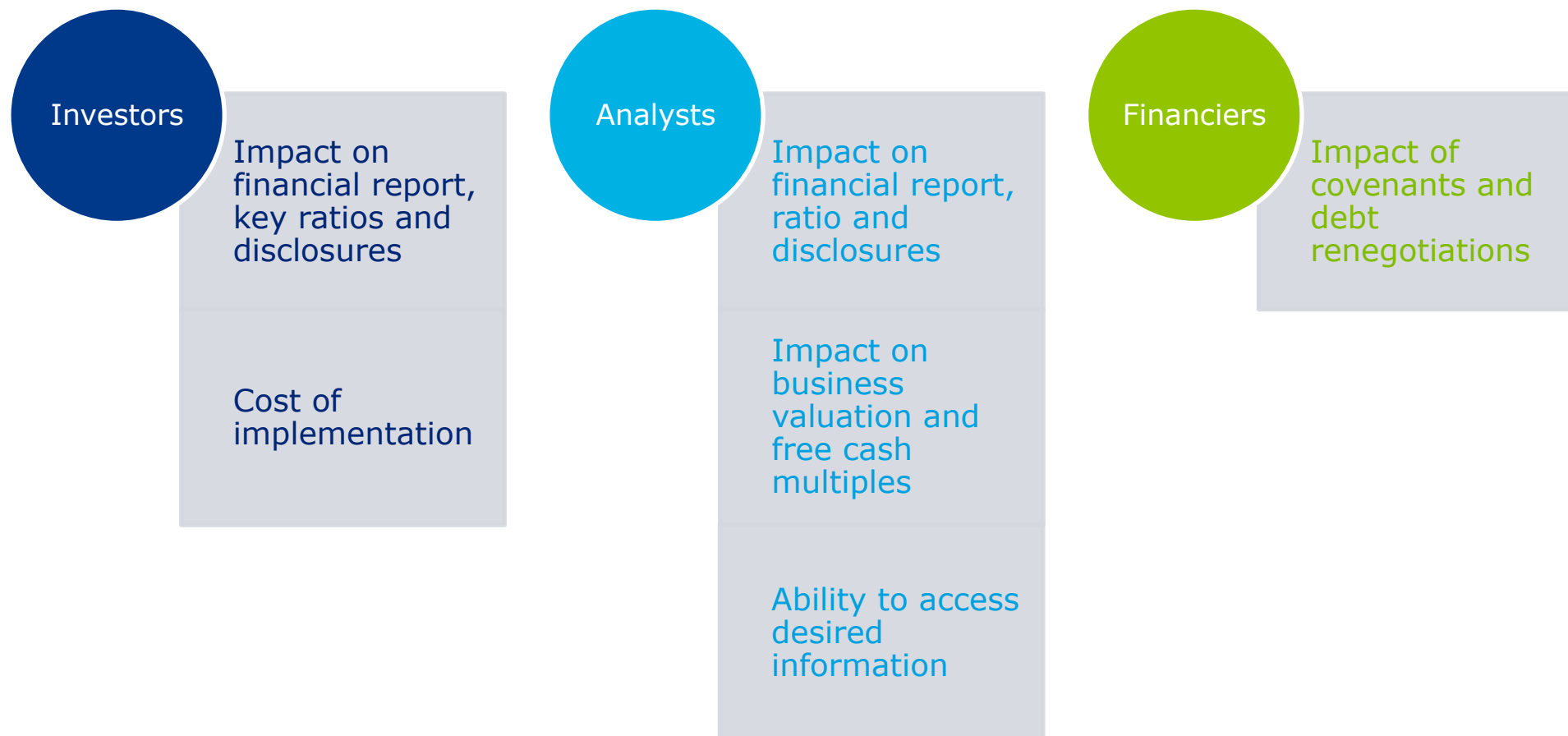
Wider business considerations

Internal



Wider business considerations

External



Presenter

Presenter



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