

# IFRS 16 *Leases*: Overview

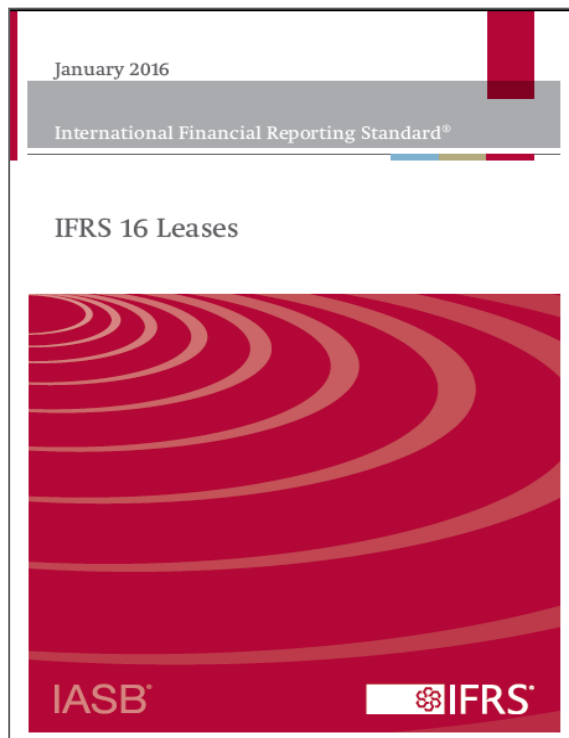
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# New Leases Standard

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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 (only with application of IFRS 15 Revenue from Contracts with Customers)

# The need for change

Leases are an **important and flexible source** of financing—  
listed companies using IFRS Standards or US GAAP  
estimated to have US\$3.3trillion lease commitments

Over 85% of lease commitments **do not appear** on balance  
sheet today

Therefore, it is difficult for investors and others **to**:

- **Get accurate picture** of entity's lease assets and liabilities
- **Compare** companies that **lease** assets with those that **buy**
- **Estimate** the amount of off balance sheet obligations: often overestimated

# The need for change

## *Currently a lack of information*

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- 6 retail chains that ultimately went into liquidation

Retailer	Off balance sheet leases		On balance sheet debt <sup>1</sup>	Discounted leases as multiple of debt <sup>3</sup>
	(undiscounted) <sup>1</sup>	(discounted) <sup>2</sup>		
Borders (US)	\$2,796M	\$2,152M	\$379M	5.68
Circuit City (US)	\$4,537M	\$3,293M	\$50M	65.86
Clinton Cards (UK)	£652M	£525M	£58M	9.05
<b>HMV (UK)</b>	<b>£1,016M</b>	<b>£809M</b>	<b>£115M</b>	<b>7.03</b>
Praktiker (DEU)	€2,268M	€1,776M	€481M	3.69
Woolworths (UK)	£2,432M	£1,602M	£147M	10.90

<sup>1</sup> Based on averaged published financial statement data available for 5 years before company entered Chapter 11 (US), liquidation (UK) or bankruptcy (DEU).

<sup>2</sup> Estimated using (i) a discount rate of 5% and (ii) estimated average lease terms based on the information disclosed in the financial statements.

<sup>3</sup> Off balance sheet leases (discounted) as a multiple of on balance sheet debt

# The Changes

# 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.** All<sup>1</sup> 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

<sup>1</sup> Exemptions for short-term leases and leases of low-value assets

# Definition of a lease

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- **Similar** to previous definition, changed **guidance on control**
- Control = **directing the use** and **obtaining the benefits** from use
- Based on control of the **use of an identified asset**

Who controls the use of the asset?		
Customer		Lease
or		
Supplier		Service

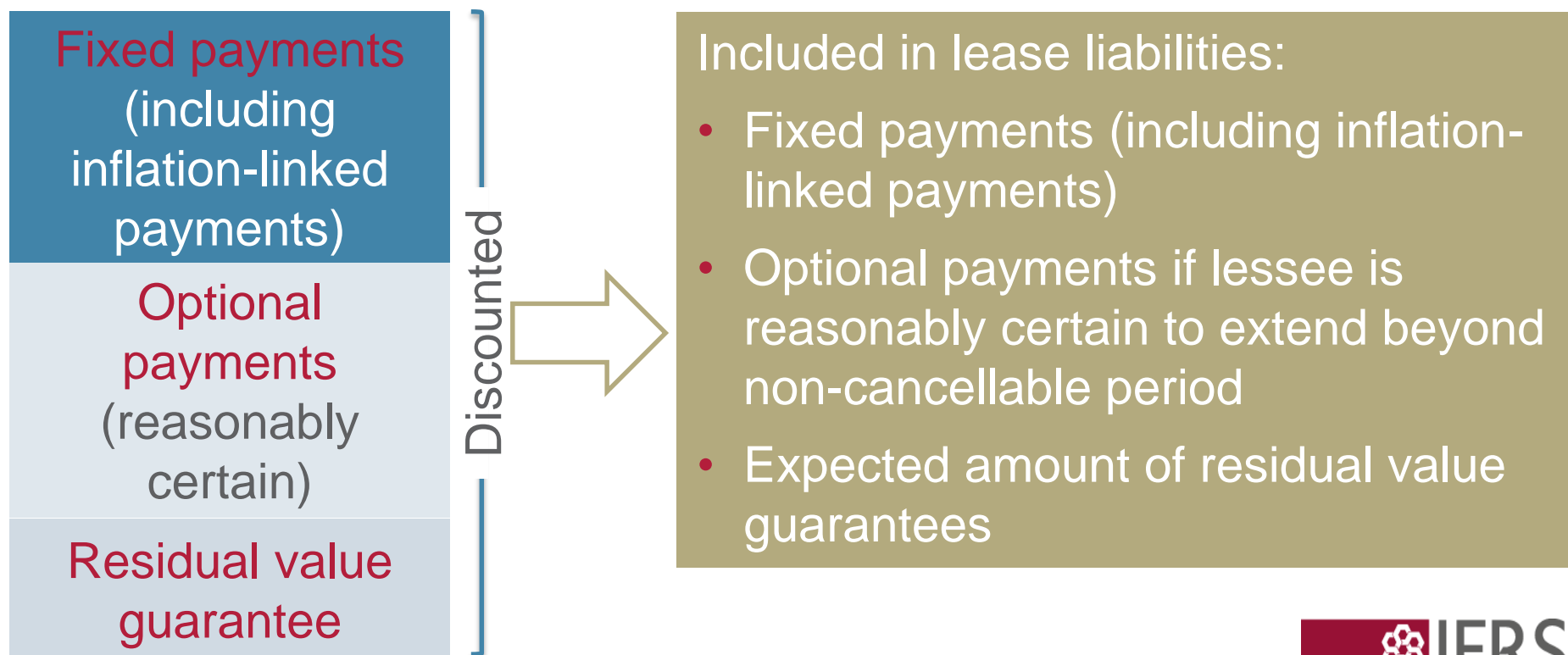
- **Separate services** provided with leases
  - Separate using available information (including estimates)
  - Option to not separate components

# Lessee Accounting

## *Balance sheet: what's included?*

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- **Increase in lease assets and financial liabilities**—all leases reported on balance sheet (other than short-term leases and leases of low-value assets)





# Lessee Accounting

## *Balance sheet: what's excluded?*

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Leases of low-value assets

Short-term leases

Not required to be included in lease liabilities

Variable lease payments linked to sales or use

Optional payments (not reasonably certain)

Excluded from lease liabilities

# Lessee Accounting

## *Initial measurement*

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Right of use  
asset  
(at cost)



Lease  
liability  
(present value  
of lease  
payments)

# Lessee Accounting

## *Right-of-use asset*

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Initially measure equal to lease liability, adjusted for:



**Prepayments**



**Lease incentives**



**Initial direct costs**



**Dismantling/restoration costs**

# Lessee Accounting

## *Subsequent measurement*

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- **Right of Use (ROU) Asset**
  - Balance sheet presentation separately as an **asset**
  - **Depreciated** over the life of the lease
  - Depreciation carried **in profit and loss**
  - Reassessed for **impairment**
- **Liability**
  - Balance sheet presentation separately as a **liability**
  - **Interest expense** (discount unwind) through profit and loss as interest
  - **Simplified reassessment**

## Balance sheet

- ROU assets together with PPE or as own line item
- Lease liabilities in accordance with IAS 1

## Income statement

- Depreciation of all leased assets
- Interest expense for all lease liabilities

## Cash flow statement

- Principal within financing activities
- Interest within either operating or financing activities (IAS 7 option)

- Subleases—Intermediate lessor
  - Account for head lease and sublease as two separate contracts
  - Classify a sublease with reference to the ROU asset arising from the head lease
  - Should not offset lease assets and liabilities, or income and expenses, unless meets existing IFRS guidance for offsetting
- Sale and leaseback transactions
  - Sale must meet the requirements in IFRS 15
  - Seller/lessee recognises only gain related to rights transferred
  - Adjustment made for off market terms

- In essence, **no change to lessor accounting** in IAS 17
- Feedback on 2013 ED
  - **Lessor** accounting in IAS 17 is **not broken**
  - Concerns about **cost and complexity**
- IFRS 16: **enhanced disclosures**
  - Information about the **residual value risk**
  - Operating leases: separate disclosures for leased assets and assets used by a lessor for other than leasing

## Quantitative disclosures

- Breakdown of **lease costs**
- Total lease **cash flows**
- **Maturity** analysis of undiscounted commitments
- Information about **ROU assets by major class** of leased asset

## Entity-specific information

- Additional information, if relevant
- **Extension and termination** options
- **Variable** lease payments
- **Residual** value guarantees
- Sale and leaseback



# Transition

## *Former operating leases*

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Fully retrospective approach

In accordance with IAS 8:

- Restate as if IFRS 16 always applied
- Provide line by line comparison disclosure

OR

Cumulative catch-up approach

Do not restate comparatives

- Adjust opening retained earnings
- Provide additional transition disclosure

Optional practical expedients:

- Do not transition if ending <12 months
- Simplified asset measurement
- Onerous lease provisions
- Portfolio application
- Use of hindsight

# Who will be affected?

# Key benefits

# Key benefits of IFRS 16

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- Greater transparency about financial leverage and capital employed
- More level playing field for all market participants
- Reduce the need to make adjustments and to provide 'non-GAAP' information
- Improve comparability between those who lease and those who borrow to buy

Facilitate better capital allocation by enabling better credit and investment decision-making by both investors and companies

- Leases website

<http://www.ifrs.org/Current-Projects/IASB-Projects/Leases>

- Effects analysis

<http://go.ifrs.org/Leases/effects-analysis>

- Project summary and feedback statement

<http://go.ifrs.org/Leases/project-summary>

- Register for email alerts

<http://eifrs.ifrs.org/eifrs/Register>

# Thank You

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