

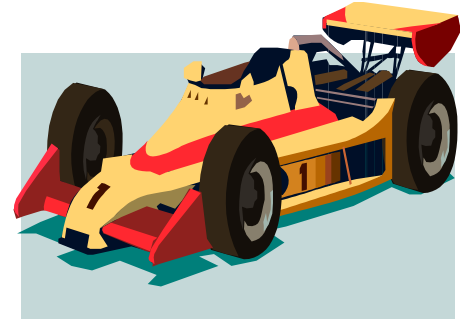
IAS 17 – Leases

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Partner, Deloitte & Touche

Lease definitions

Finance lease

- A lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.
- In substance the lessee obtains control of the asset, because the lessee has the ability to direct the use of the asset, and obtain substantially all the remaining benefits of the asset.



Operating lease

A lease other than a finance lease.

Accounting treatment—Lessee

Finance lease

- Recognize asset and liability at lower of fair value and present value of minimum lease payments.
- Depreciated as if an owned-asset.
- Lease payments apportioned between the finance charge and payments to reduce the outstanding liability.

Operating lease

- Lease payments are usually recognized in the statement of comprehensive income on a straight line basis over the lease term.
- Recognize incentives as an integral part of the net consideration (reducing total rental expenses).

Accounting treatment—Lessor

Finance lease

- Recognize a receivable equal to the net investment in the lease.
- Receipts of rental payments are allocated between finance income and repayments of principal

Finance lease: manufacturer dealer lessor

- Recognize selling profit or loss in accordance with the policy for outright sales.
- If the lessor quotes artificially low rates of interest, selling profit is restricted to market rate.

Operating lease

- Leased assets are depreciated and classified according to their nature, with no difference from the treatment of assets which are not leased.
- Lease income is usually recognized on straight line basis over the lease term.

Sale and leaseback transactions



- “a linked arrangement whereby the owner of an asset sells that asset and leases it back”
- – IAS 17:58.

Finance lease?



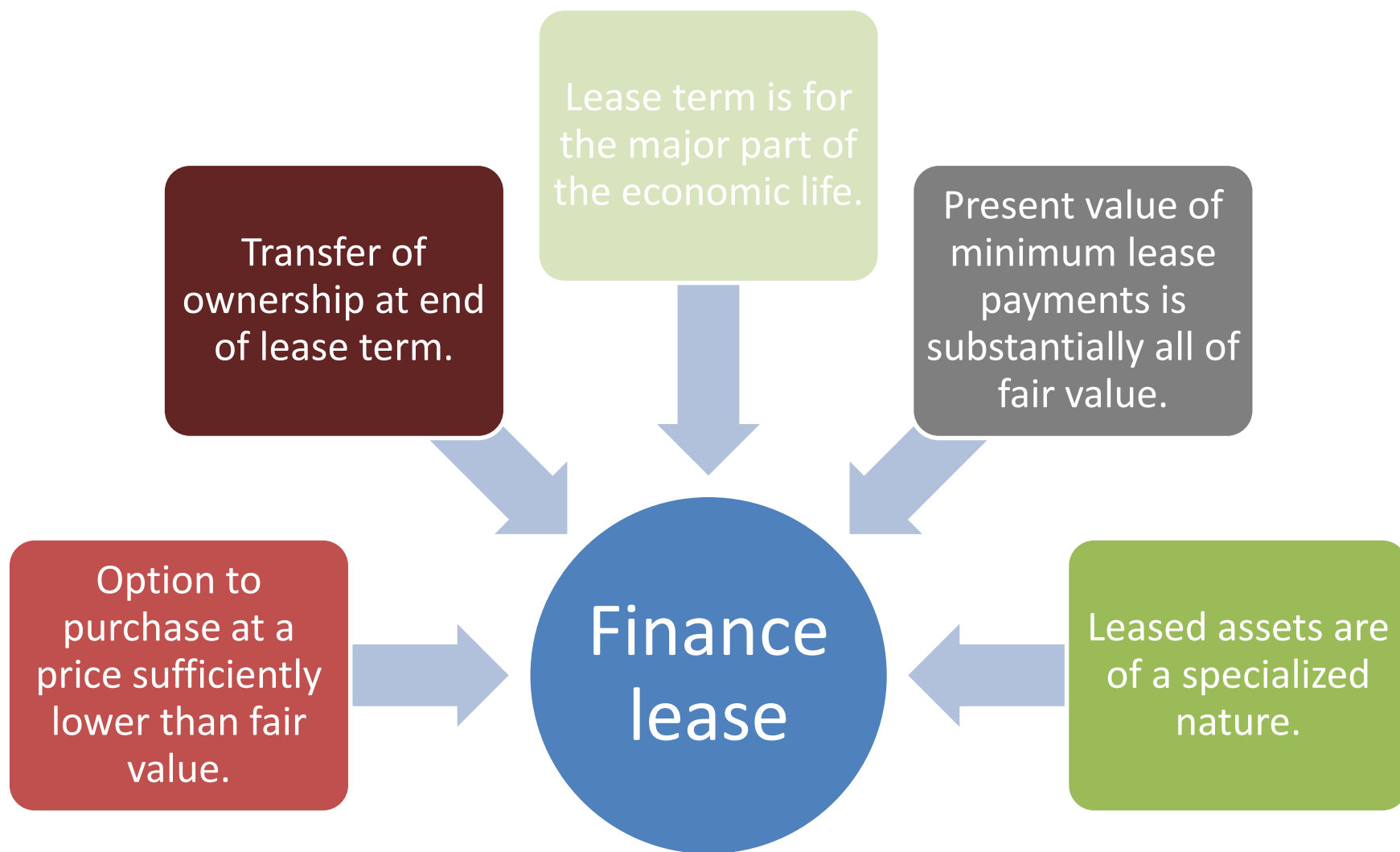
- No gain or loss recognized.
- Defer any excess of proceeds over carrying value and amortize this over the lease term.

Operating lease?



- Compare the contract sale price and fair value.
- Treatment depends on the relationship between FV, sale price and carrying value.

Examples of situations normally indicating finance lease— IAS 17.10



Examples of situations that could lead to a finance lease classification—IAS17.11

- If the lessee can cancel the lease, the lessor's losses from cancellation are borne by the lessee.
- Gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease).
- The lessee has the ability to continue the lease for a secondary period at a rent which is substantially lower than market rent.

Leases of land—an element in long-term leases

Land leases are generally classified as operating leases unless title transfers to the lessee by the end of the lease term.

“When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately.”
- IAS 17.15A

“In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.”
- IAS 17.15A

IFRS 16 - Leases

Introduction

What is the impact of IFRS 16?

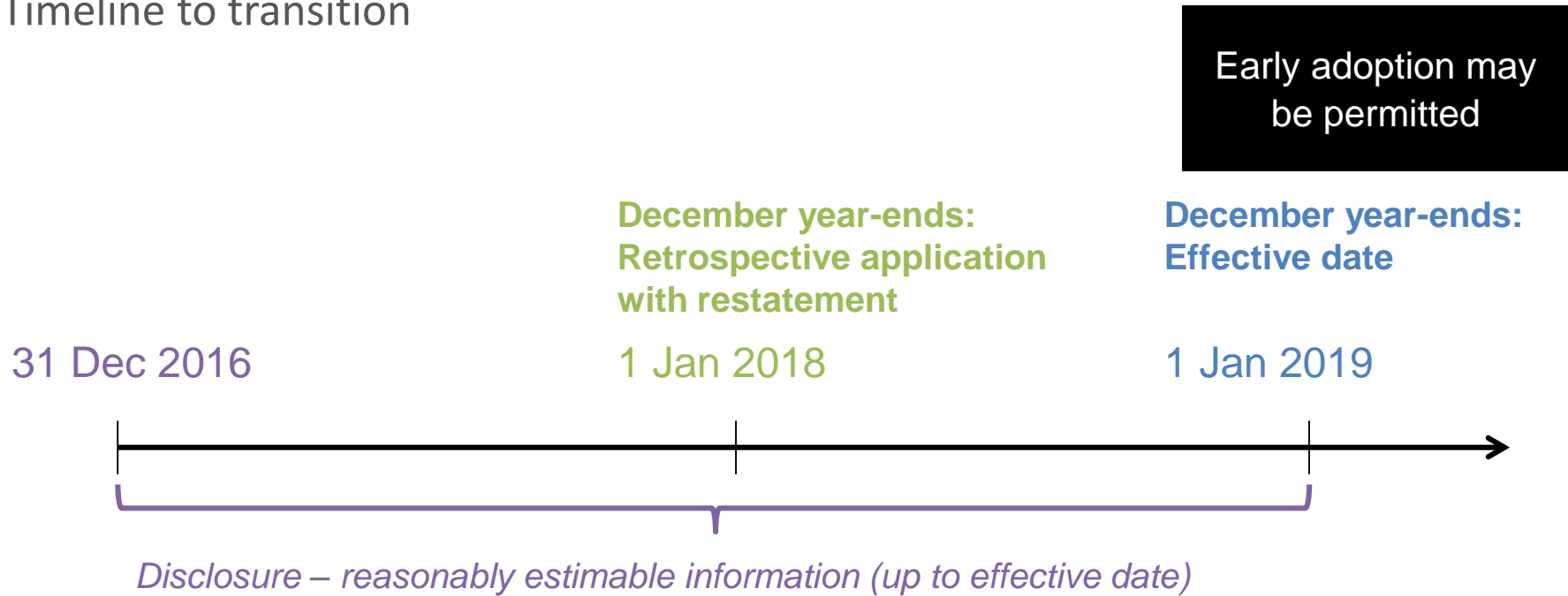
Two main changes are...



Lessor accounting largely unchanged

Introduction

Timeline to transition



PRACTICAL EXPEDIENT

Permits both lessees and lessors not to reassess whether a contract is, or contains a lease at the date of initial application.

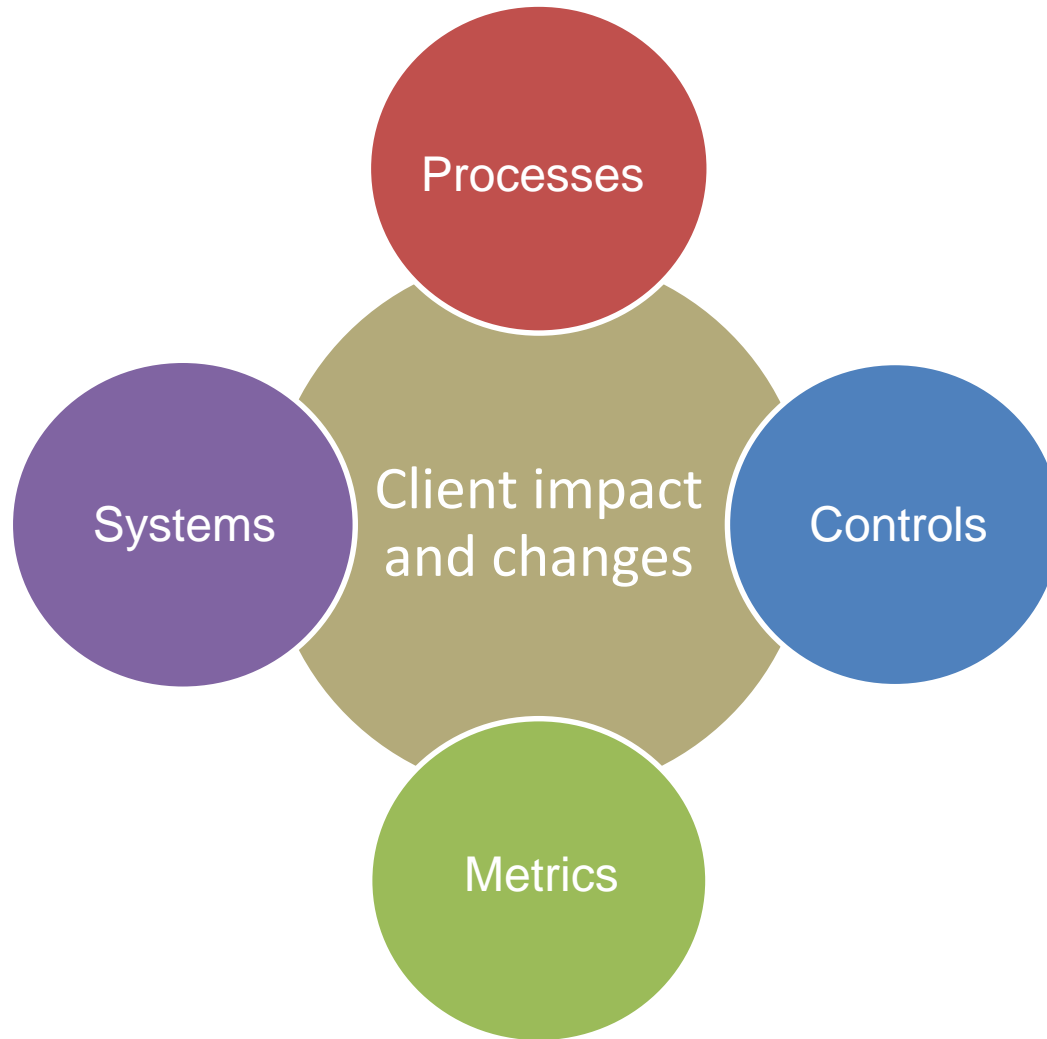
Entities can elect to apply **full retrospective approach** or a **‘modified’ retrospective approach** (with no restatement of comparatives)

Why now?

Introduction

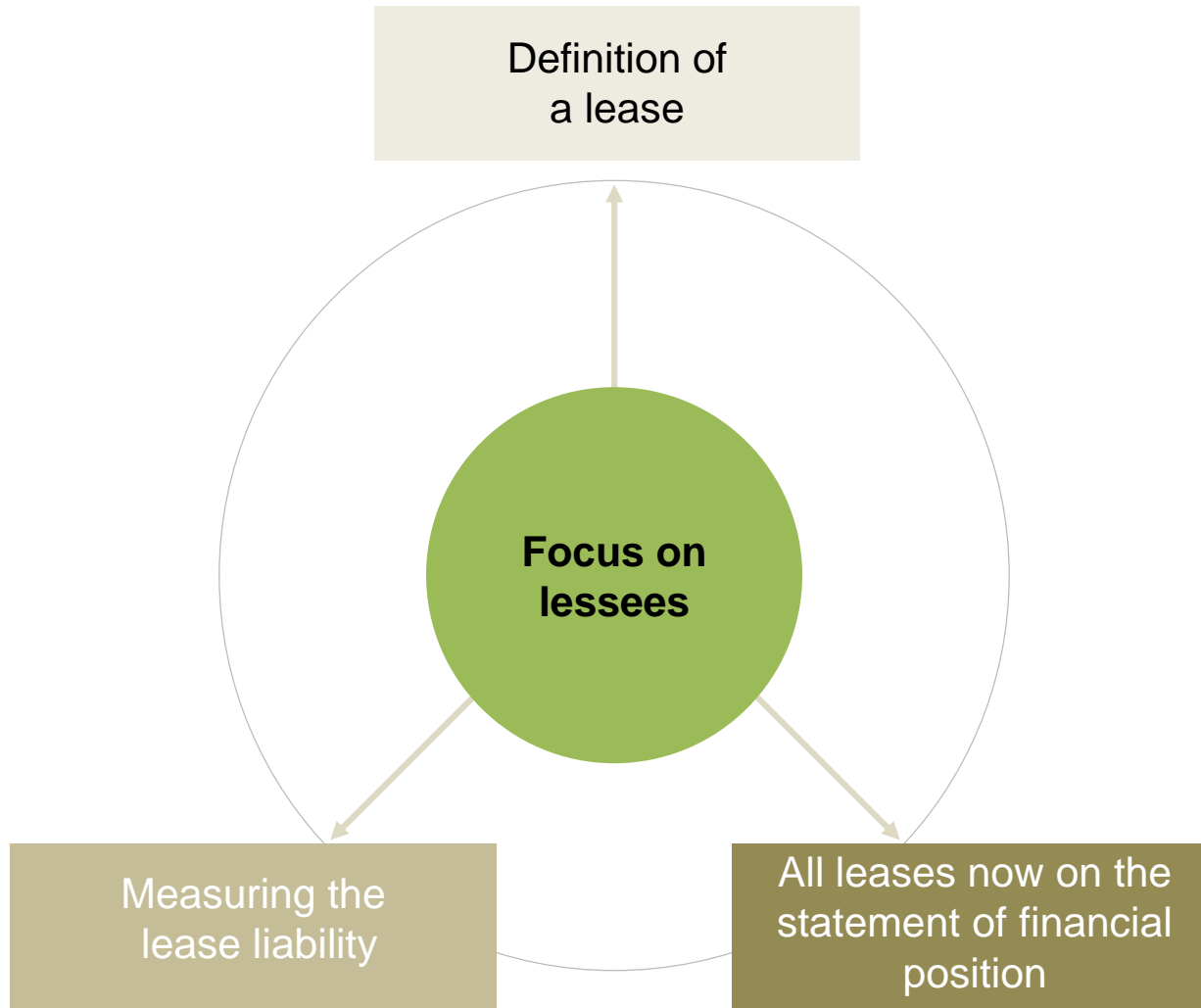


**KEY CLIENT
ADVICE**



IFRS 16 versus IAS 17

Key accounting focus areas



IFRS 16 versus IAS 17

Identification of a lease

IFRS 16 retains

Definition of a lease



A contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for consideration.

IFRS 16 changes

Application of the definition



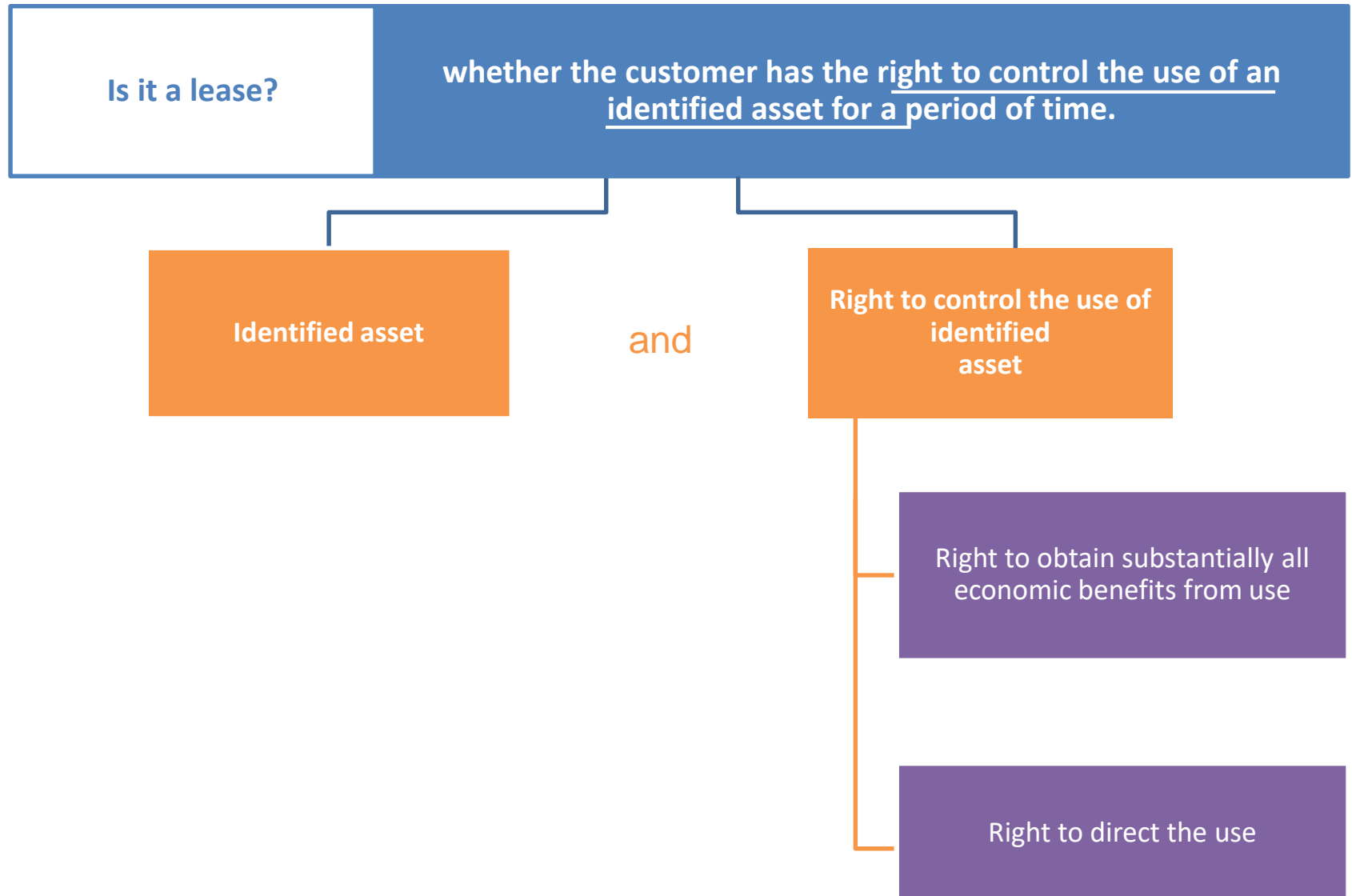
Concept of control is introduced



Identifying a lease may require significant judgment

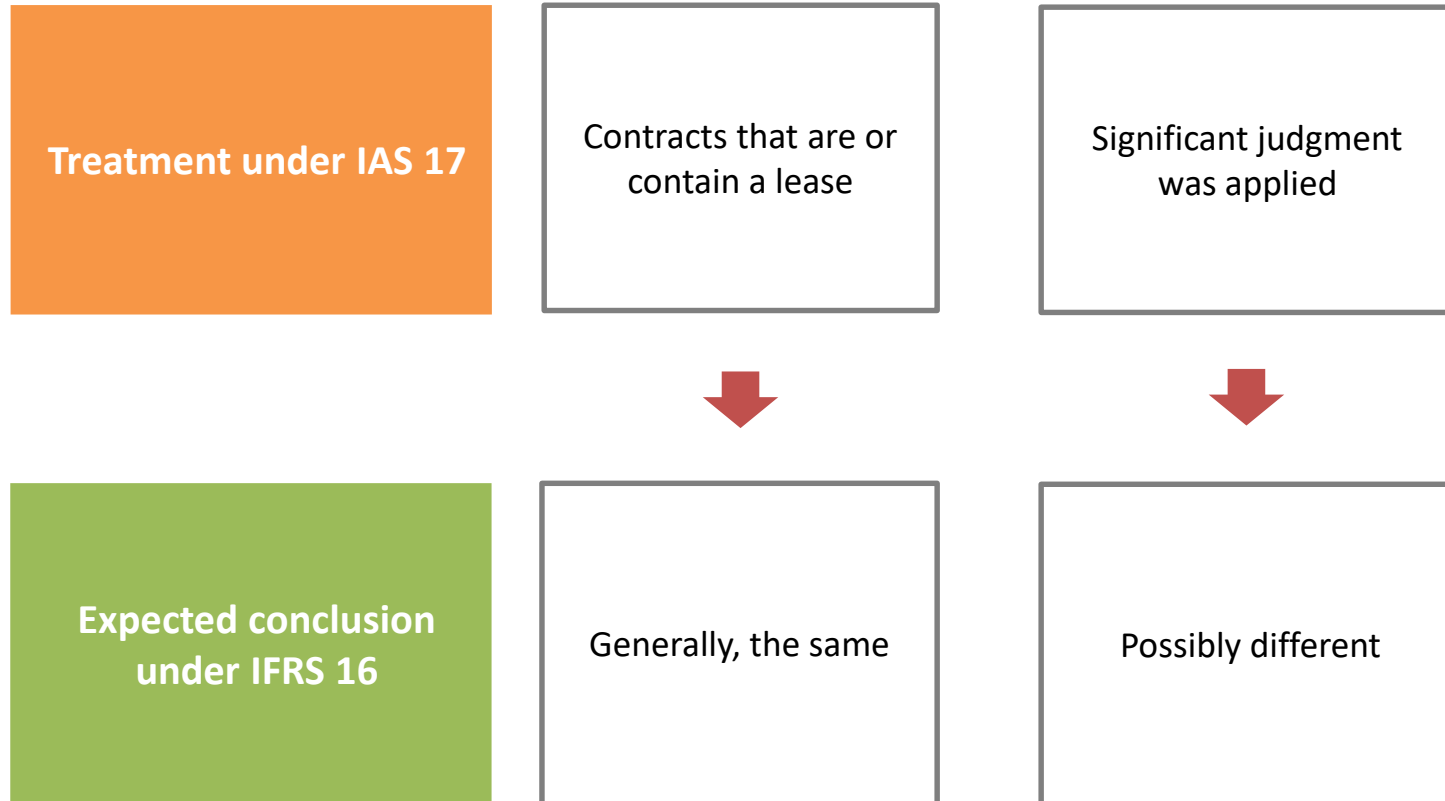
IFRS 16 versus IAS 17

Definition of a lease



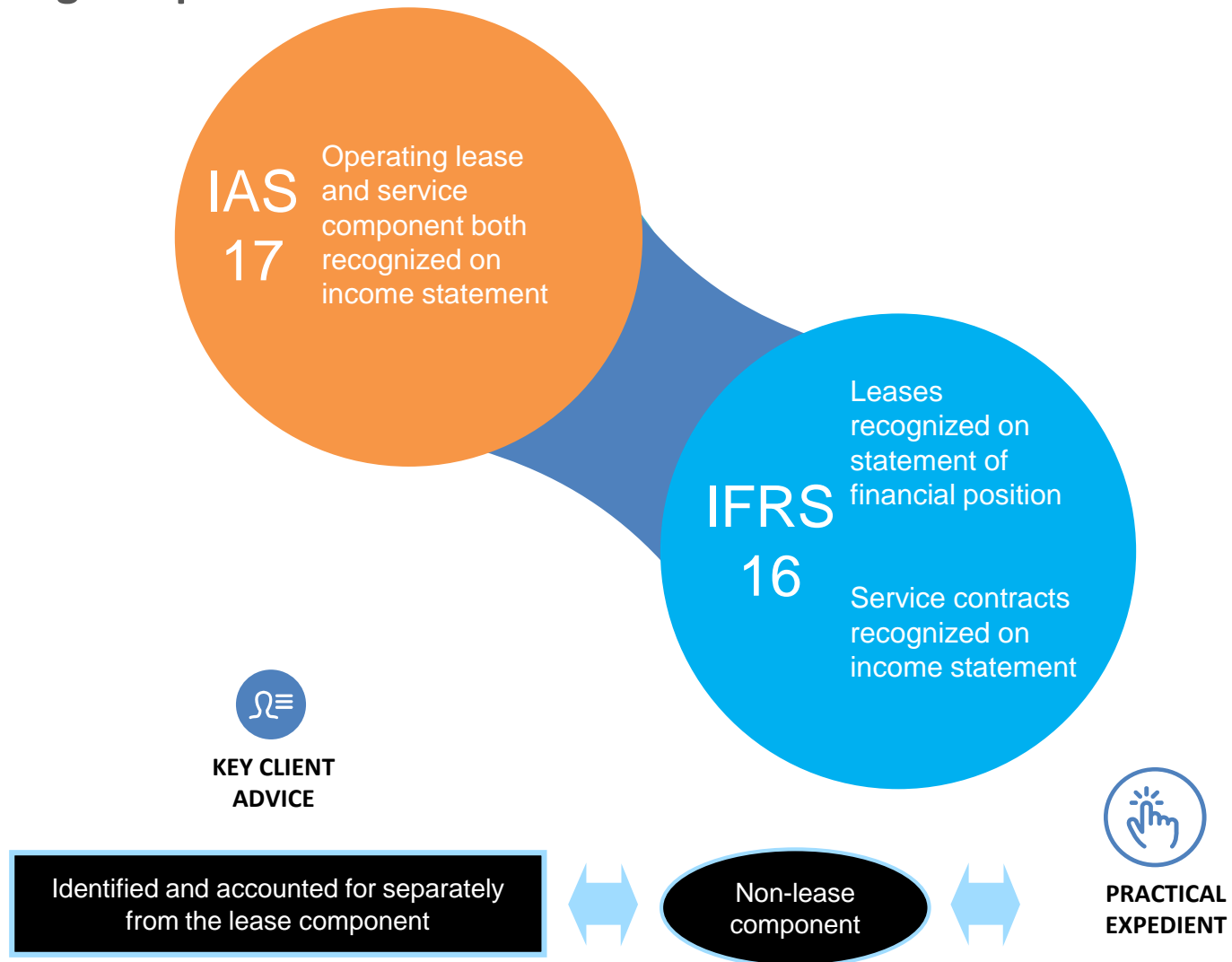
IFRS 16 versus IAS 17

Expected impact



IFRS 16 versus IAS 17

Separating components



IFRS 16 versus IAS 17

Single measurement model

IAS 17

Statement of Financial Position

Off-balance sheet

Income statement

Lease payments XXX

EBITDA XXX

Profit before tax XXX

IFRS 16

Statement of Financial Position

Lease assets XXX

Lease liabilities XXX

Income statement

EBITDA XXX

Depreciation XXX

Finance cost XXX

Profit before tax XXX

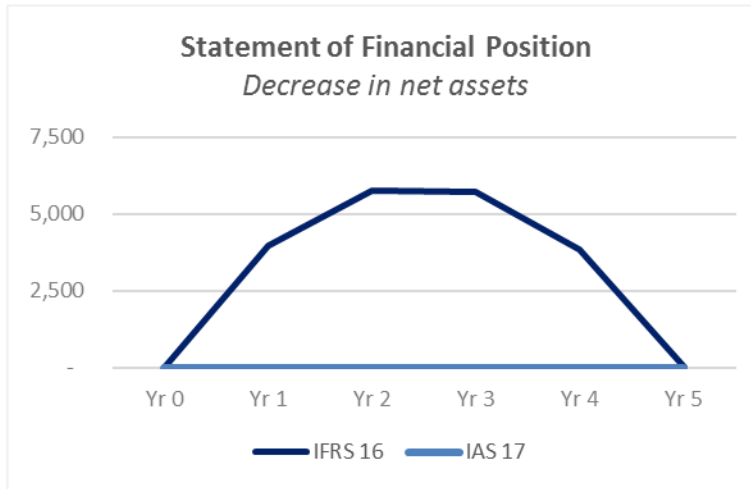
Right to use
underlying leased
asset

Obligation to
make lease
payments

Depreciation on
lease assets and
finance cost of
lease liability

IFRS 16 versus IAS 17

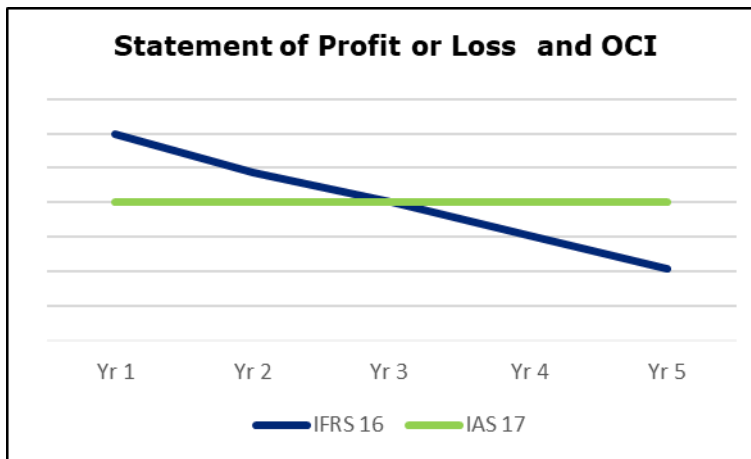
- Impact on net assets



↑ Total assets

↑ Total liabilities

- Significant impact on entities with material off-balance sheet leases.



↑ Finance costs

↓ Operating costs

↑ EBITDA

- Expenses are weighted towards at start of lease term and decrease as the lease matures (straight-line depreciation).
- EBITDA increases regardless of the entity's lease portfolio.

IFRS 16 versus IAS 17

- Areas of judgment

Present value of future lease payments



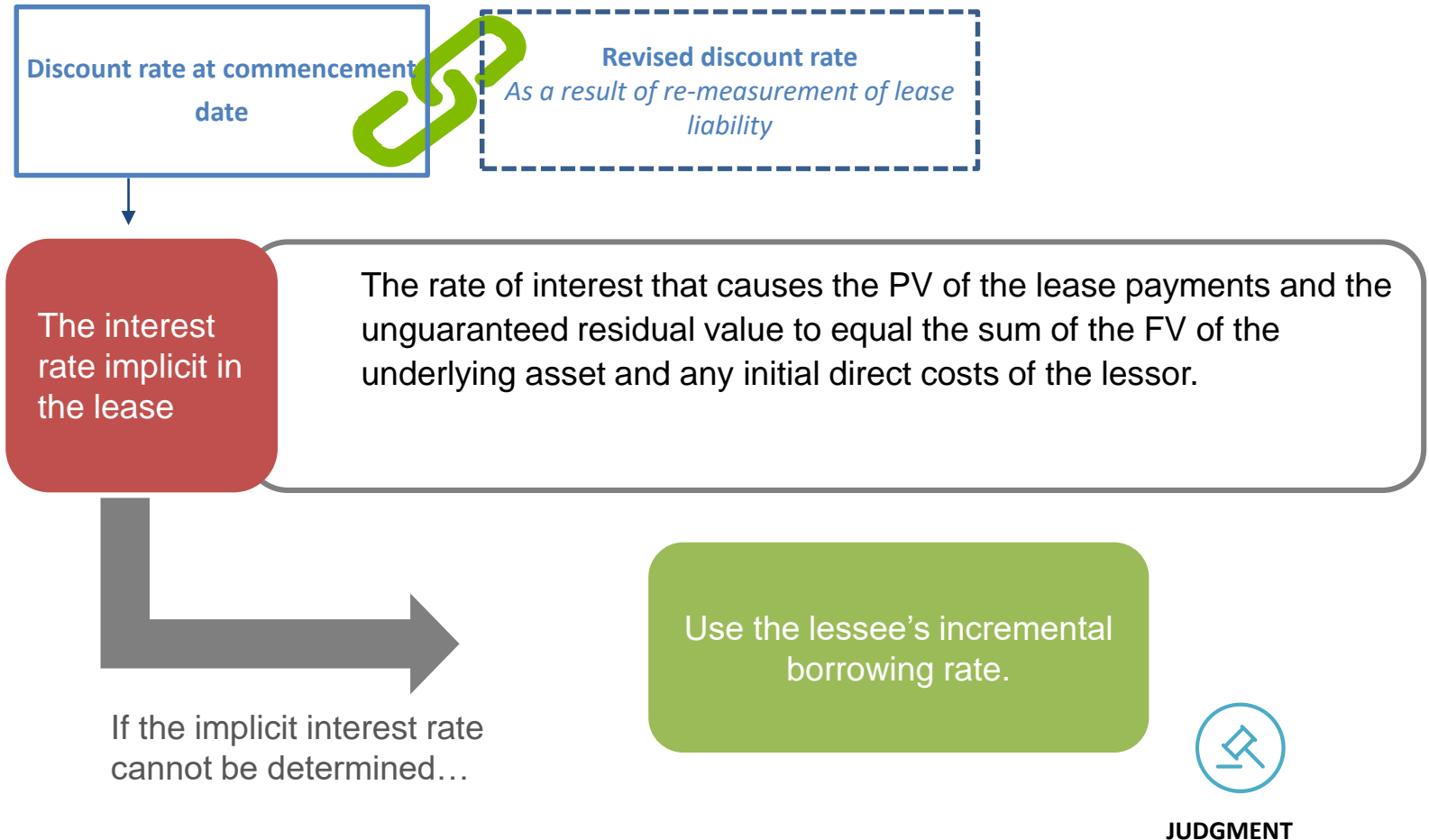
Most significant areas of judgment

	Discount rate	<ul style="list-style-type: none">• Rate implicit in the lease• Incremental borrowing rate
	Lease term	Non-cancellable term of the lease + periods covered by an option to extend and the option to terminate the leases

These concepts have not changed

IFRS 16 versus IAS 17

Determining the discount rate



IFRS 16 versus IAS 17

- Re-measuring the lease liability

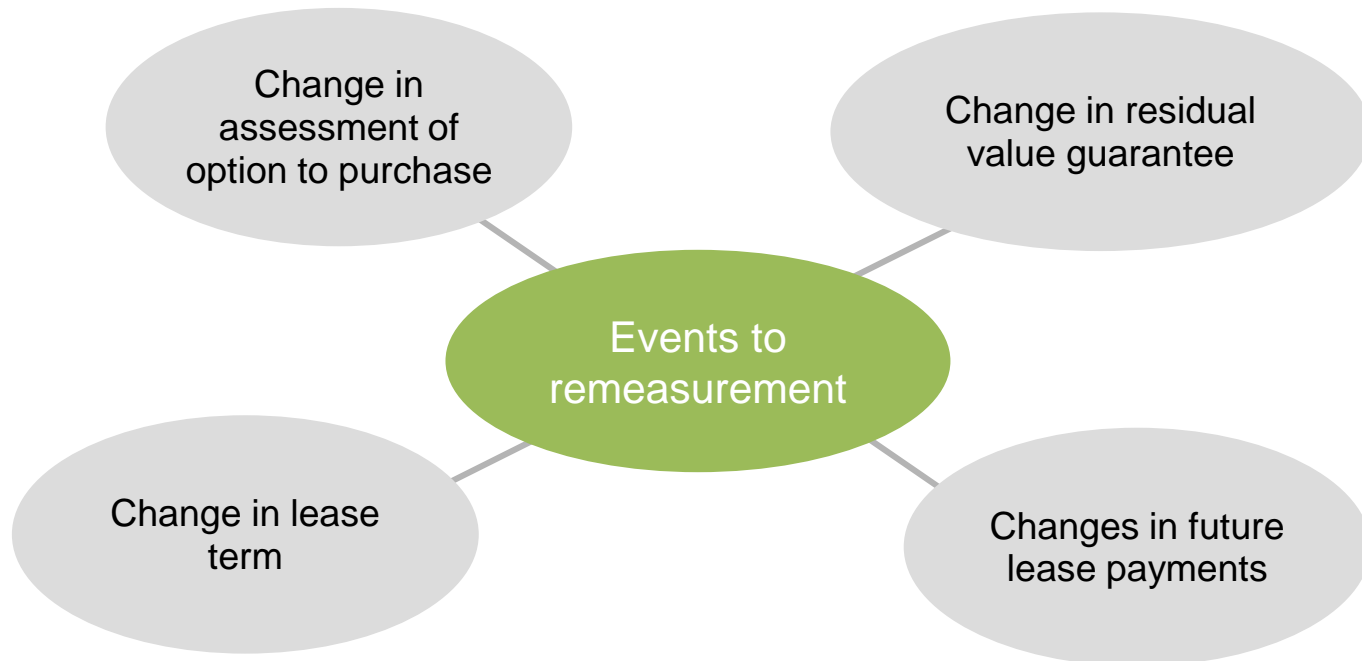


NO LONGER possible to compute a lease amortization schedule and simply roll that schedule forward



A lessee shall determine the revised discount rate and shall remeasure the lease liability by discounting the revised lease payments

JUDGMENT



Knowledge check



HC Market enters into a 5-year, non-cancellable property lease, with an option to extend for two years.

The lease payments are \$120,000 annually during the initial term and \$135,000 annually during the optional period, all payable at the beginning of each year.

At the commencement date, HC Market concludes that it is not reasonably certain to exercise the option to extend the lease. At the end of the fourth year, HC Markets decides to exercise the extension option.

At the lease commencement date, what is the contract's lease term?

Select one correct option and then select Submit.

- a) The lease term is 5 years, since at the lease commencement date, HC Market is not reasonably certain it will exercise the option to extend the lease.
- b) The lease term is 7 years, since at the lease commencement date, HC Market will consider the extended lease term.
- c) The lease term is 5 years, since the lease terms are more favourable in these years.
- d) The lease term is 7 years, since HC Market has historically extended to the full lease period in the past.



The assessment of the lease term must consider whether the lease contract includes an option to extend or terminate the lease.

IFRS 16 states that the lease term is determined at the lease commencement date based on the non-cancellable term of the lease, including:

- Periods covered by an option to extend the lease if the lessee is **reasonably certain** to exercise that option, and
- Periods covered by an option to terminate the lease if the lessee is **reasonably certain not** to exercise that option.

IFRS 16 versus IAS 17

Transition options

Lessees and lessors are permitted to grandfather assessments regarding whether a contract existing at the date of initial application contains a lease.

Cumulative catch-up approach

For leases previously identified as operating leases

Leases ending within 12 months of the date of initial application

Apply a single discount rate to a portfolio of leases

Use hindsight in determining the lease term

Adjust the right of use asset by the amount of provision for onerous leases

Exclude initial direct costs

Full retrospective approach

No reliefs available

IFRS 16 transition implications

IFRS 16 transition implications

Impacts on client's environment and audit risk assessment

An effective risk assessment requires a **deep understanding** of the entity, its environment and its internal control.



IFRS 16 transition implications

Determining ROMMs

1

Degree of complexity and judgment

2

Nature and composition of the Account Balances, Classes of Transactions and Disclosures

3

Economic, internal and historic factors

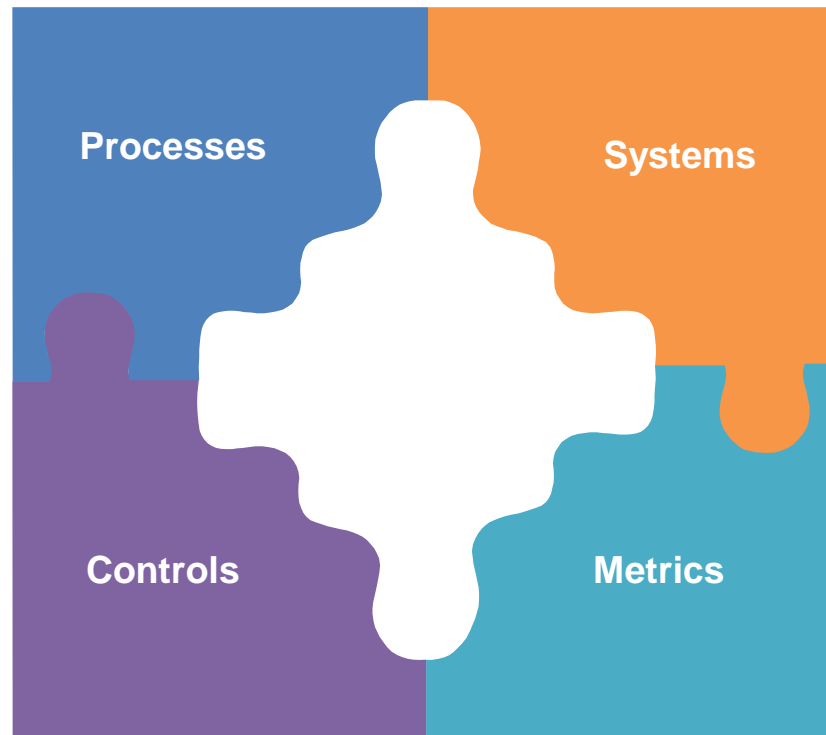
To assess ROMMs auditors need to understand our entities, their environment, internal controls and their lease transaction process

IFRS 16 transition implications

Understanding the client's selection and application of accounting policies

Process changes may be required to capture the data necessary to comply with accounting and disclosure requirements

Changes to systems and processes will result in entities' revisiting their existing internal controls to determine whether they are still adequate

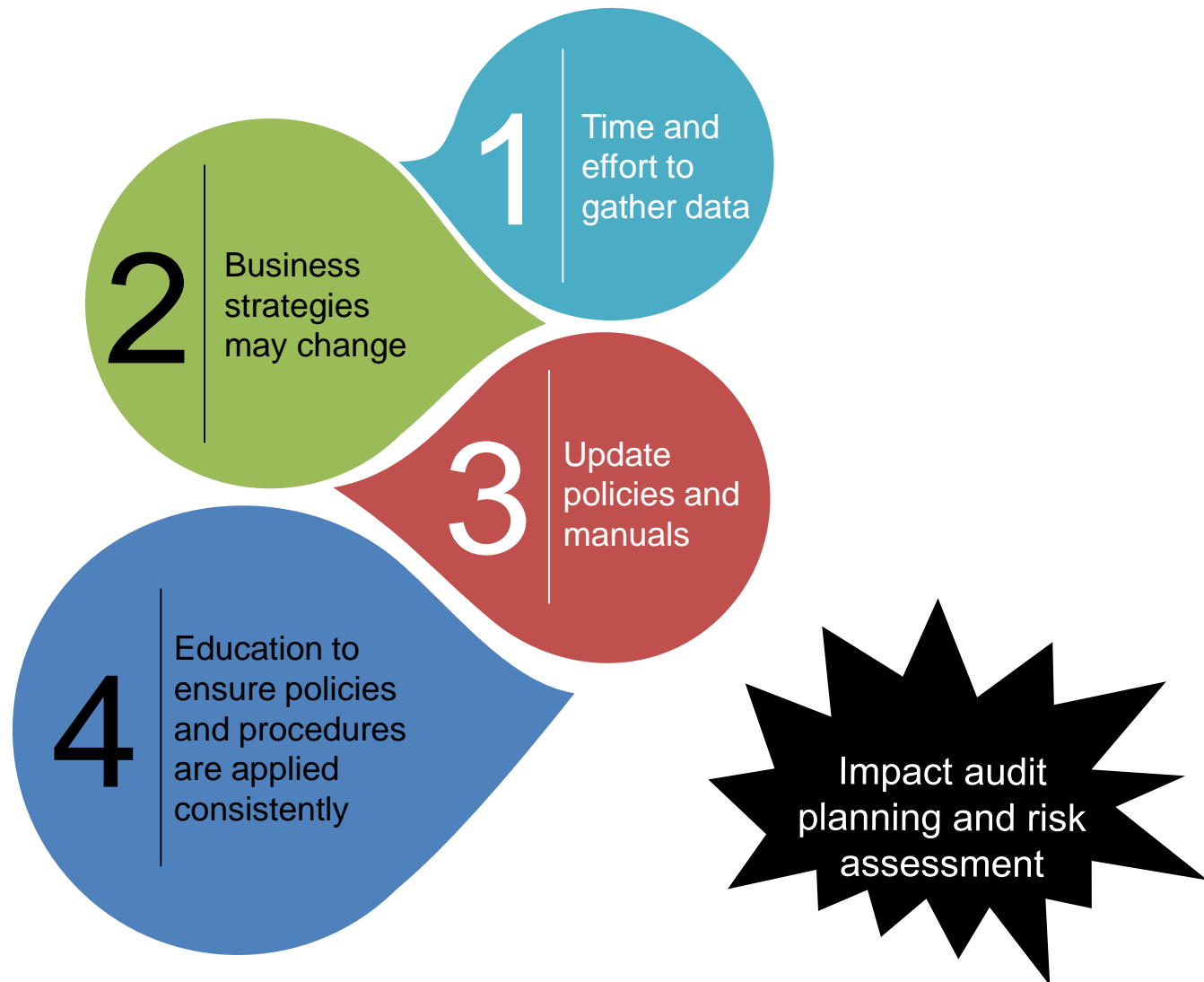


Lessees may need to consider implementing a contract management module for leases

This could impact debt covenants, tax balances and an entity's ability to pay dividends

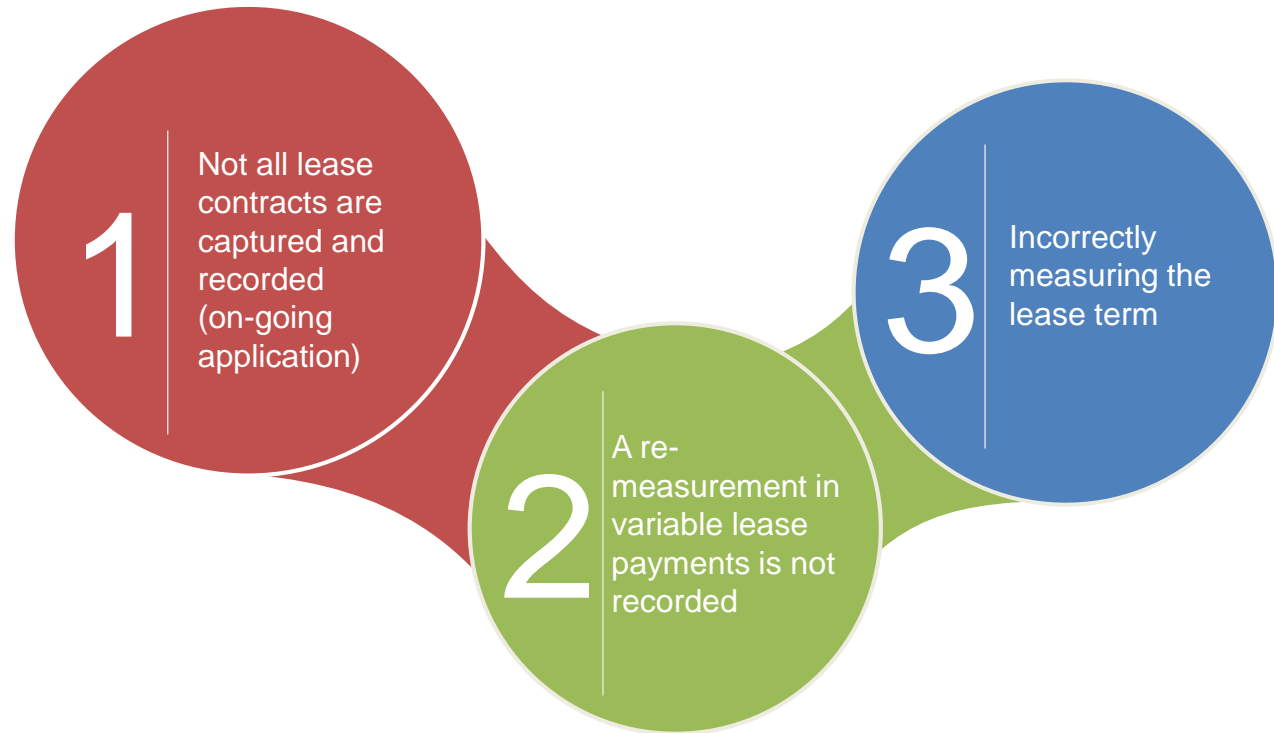
IFRS 16 transition implications

Impact on processes



IFRS 16 transition implications

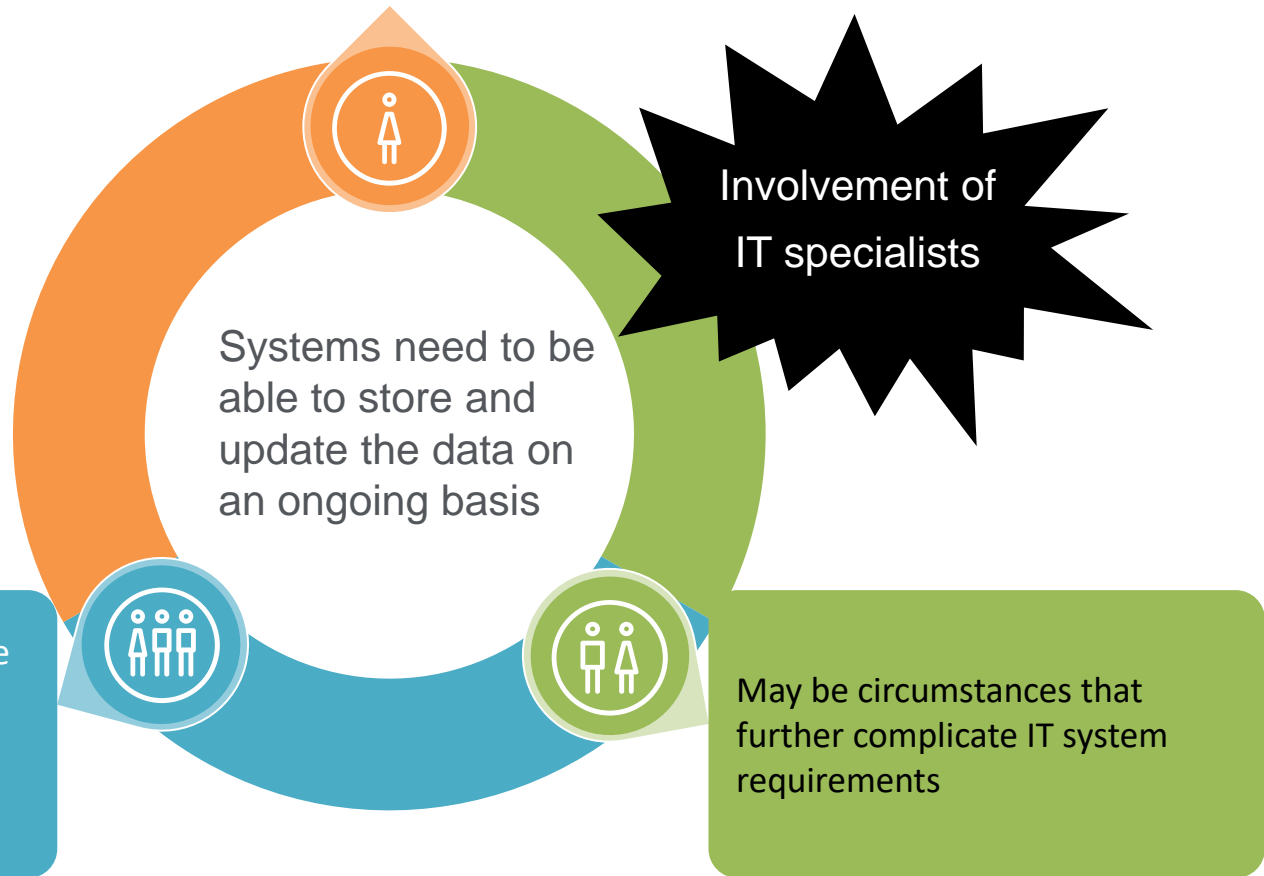
What could go wrong?



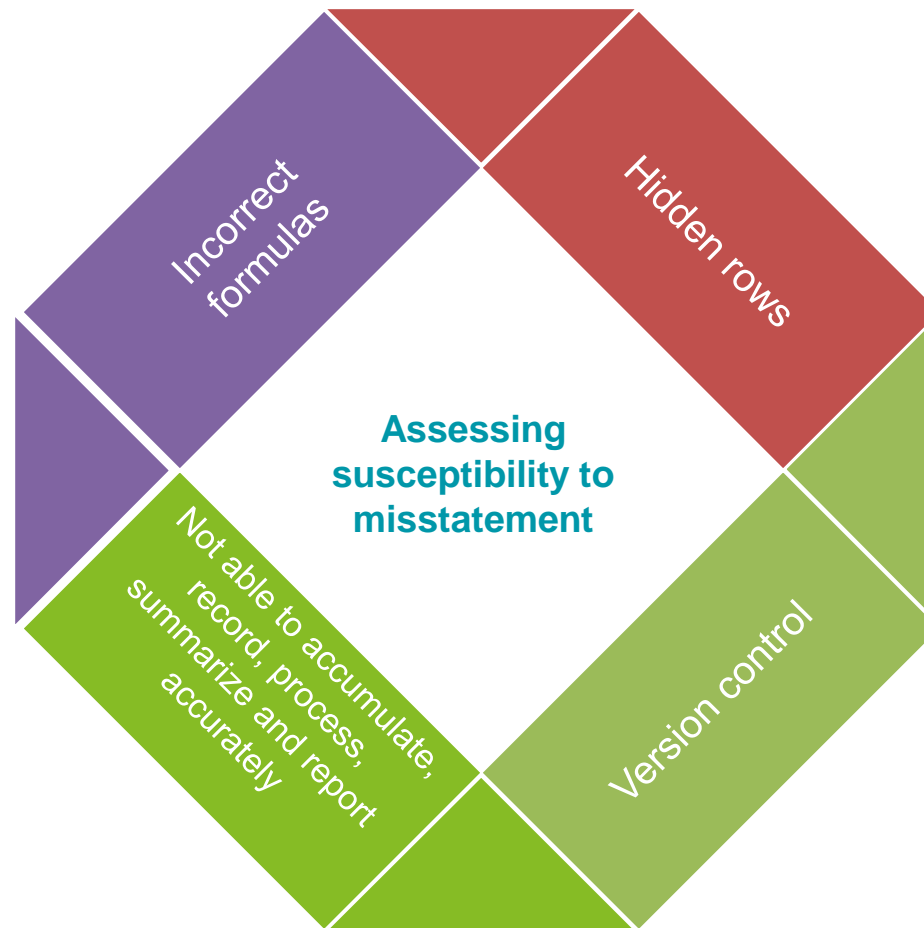
IFRS 16 transition implications

Impact on systems

IFRS 16 has more data requirements for calculation and disclosure purposes. entities need to assess adequacy of current systems.



What could go wrong?



IFRS 16 transition implications

Impact on controls



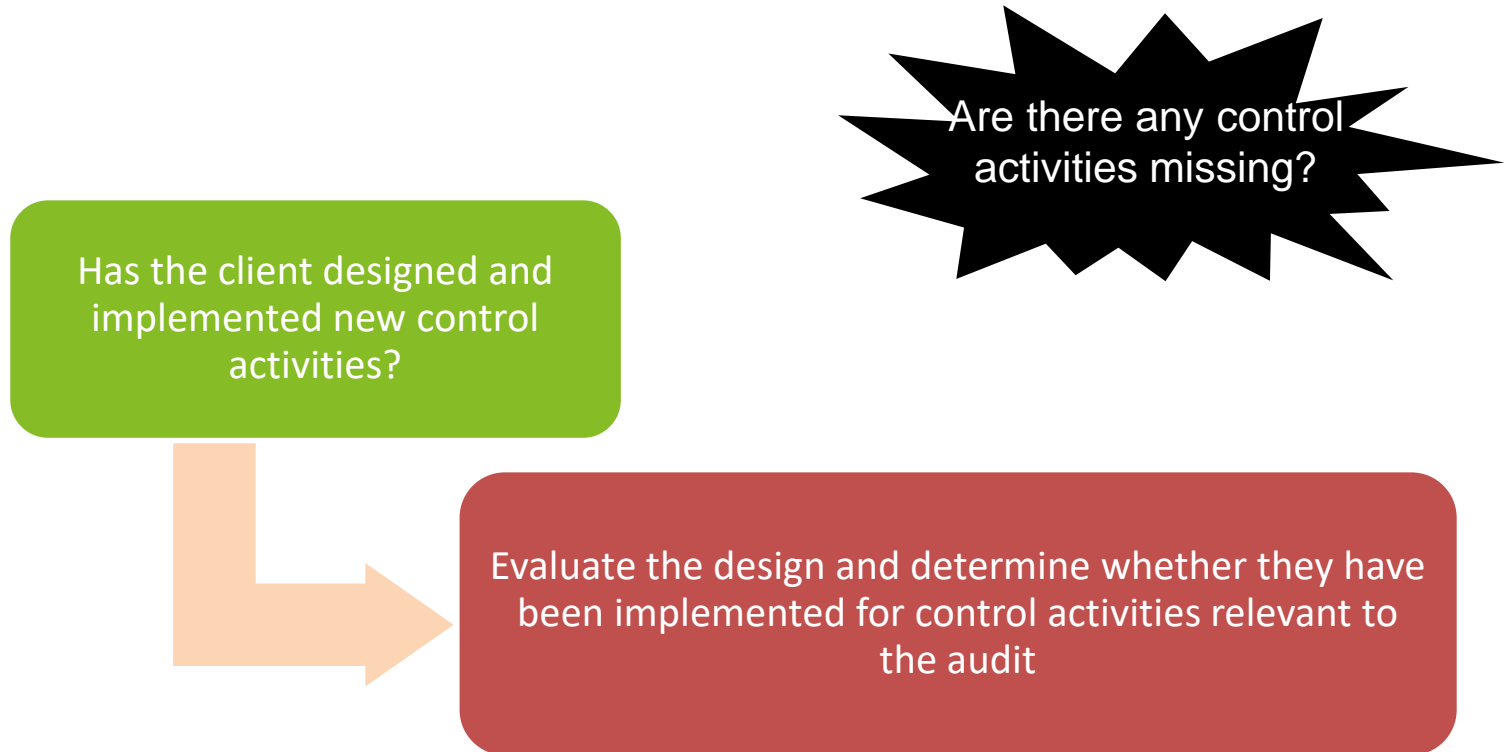
Auditors

We need to determine if entities have processes to identify risks as a result of adopting IFRS 16 and whether appropriate controls are in place.

IFRS 16 transition implications

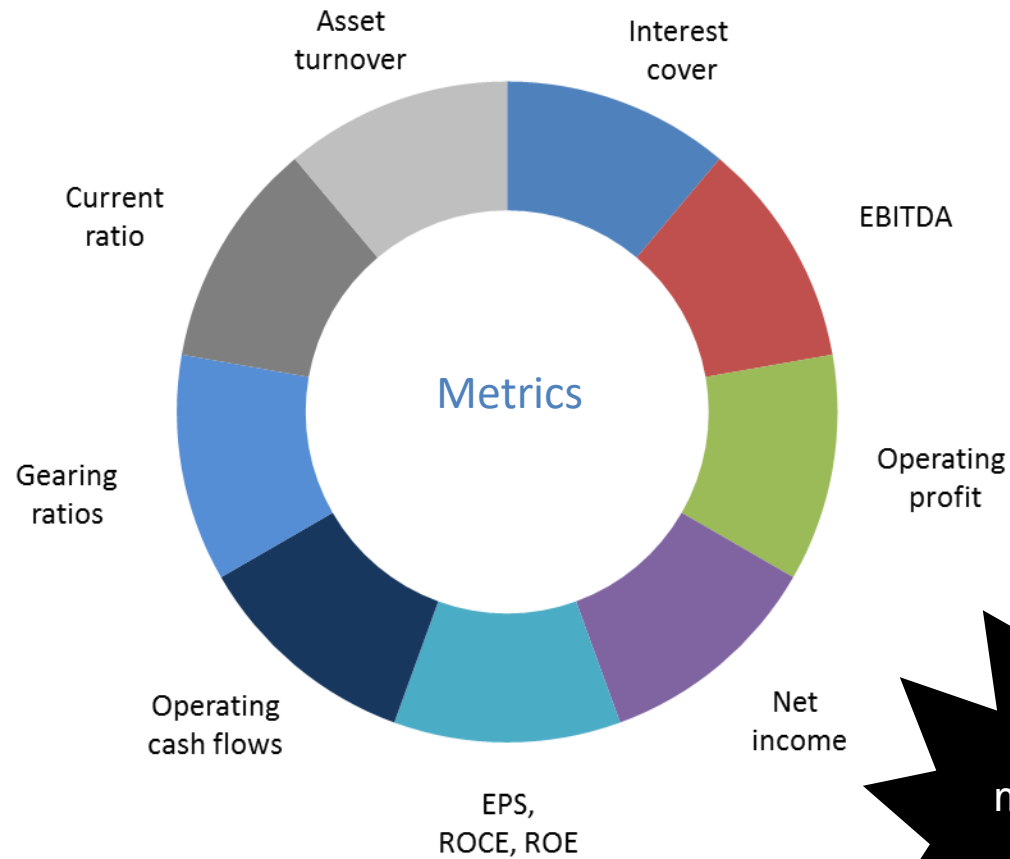


What could go wrong?



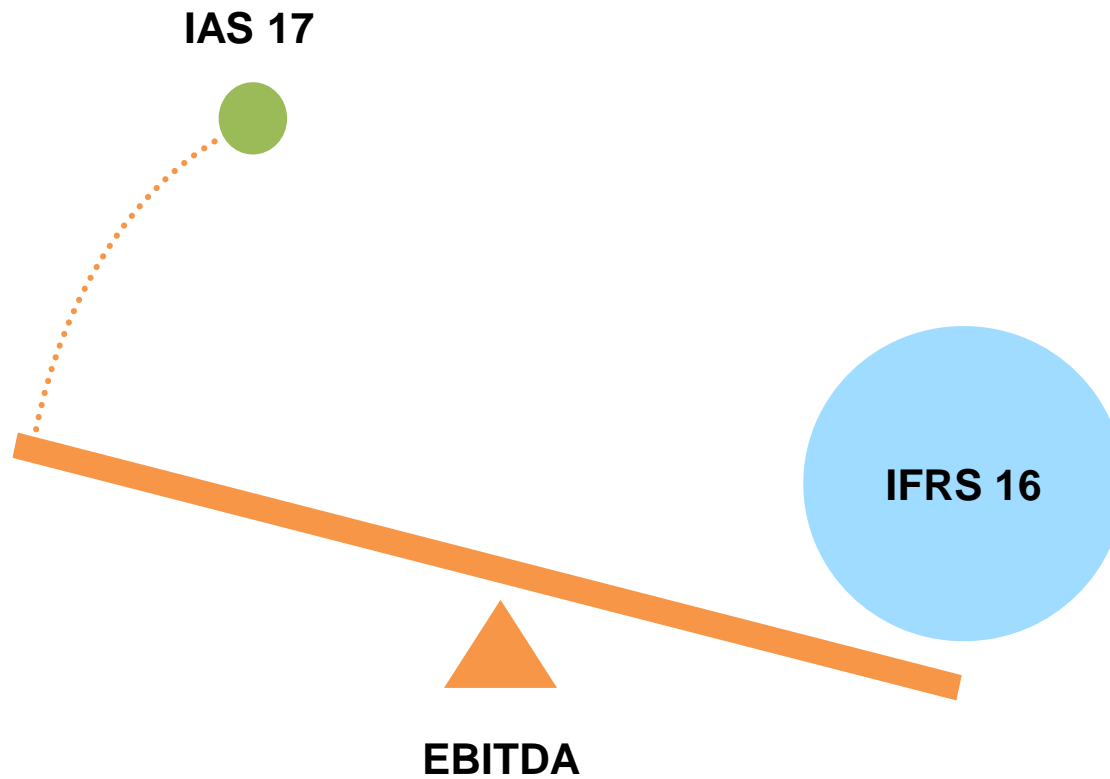
IFRS 16 transition implications

Impact on metrics



Consider
management
pressures

What could go wrong?



Knowledge check



Some of HC market's truck and fridge leases have lease terms of less than 12 months left on the date of transition.

Which of the following questions may prompt management to record their fridge off-balance sheet on application of IFRS 16?

Select the best response and then select Submit

- a) Have you considered whether your leasing strategy requires revising?
- b) Have you considered the use of IFRS 16's recognition exemption and practical expedients?
- c) Do you know which transition reliefs are available, and whether you will apply any of them?
- d) b) and c)

Knowledge check



Why is it important for our clients to build controls or processes around identifying which agreements contains leases?

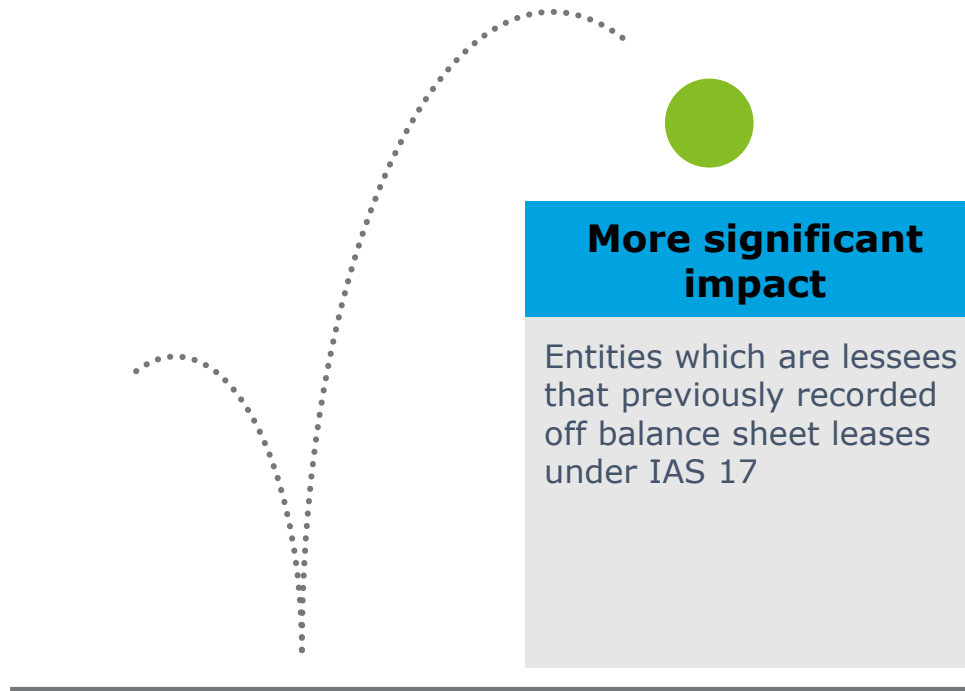
Select the best response and then select Submit

- a) The definition of a lease has changed.
- b) Guidance for determining a lease in IFRIC 4 and SIC 27 has been updated.
- c) IFRS 16 provides new guidance on how to apply the definition of a lease.
- d) As existing leases are grandfathered upon transition – this question is not relevant.

Wrap-Up

Wrap-Up

Main impact for IFRS 16 application



Entities will benefit from engaging with their auditors in the early stages of implementation.

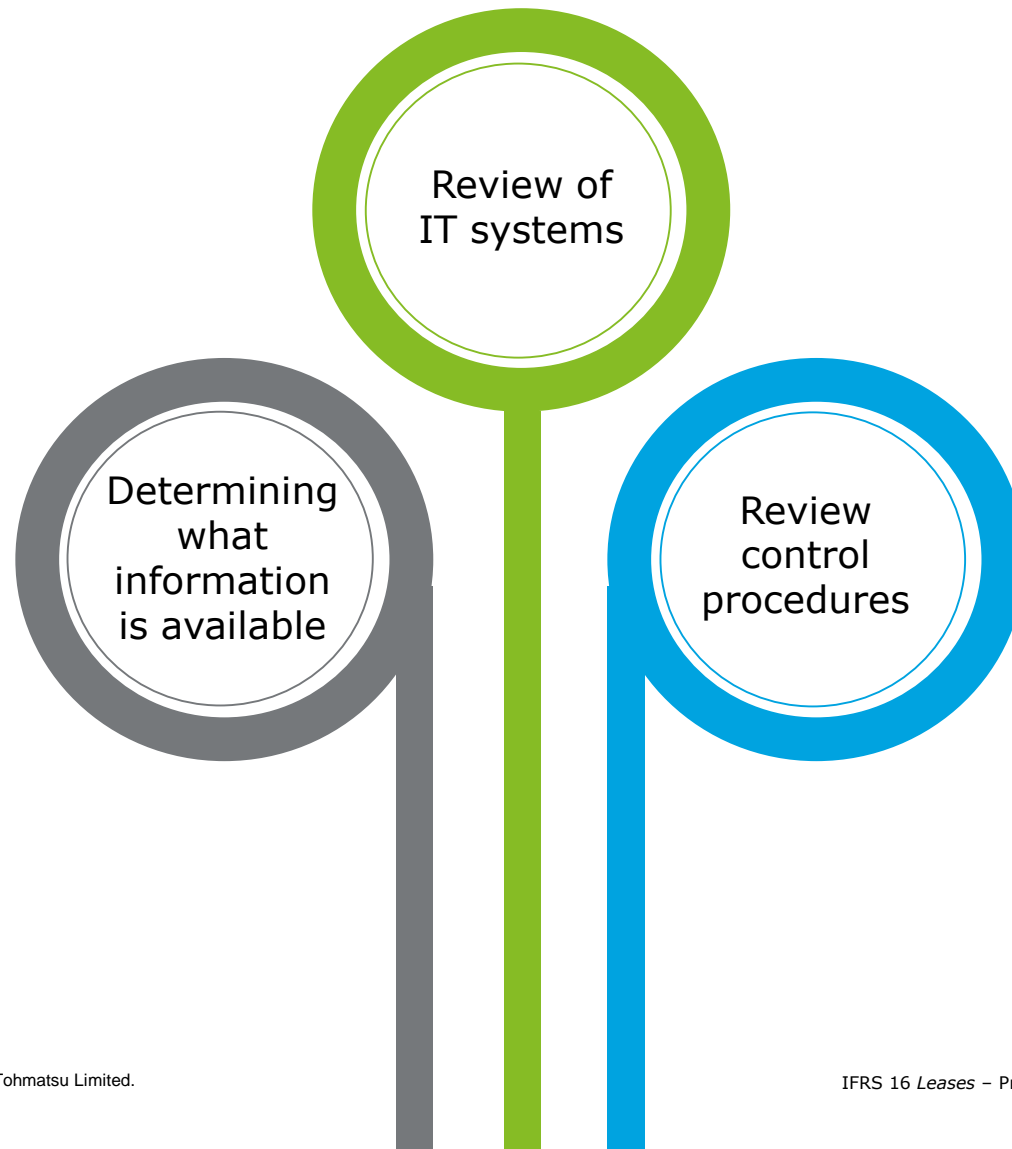
Wrap-Up

Client considerations: Accounting



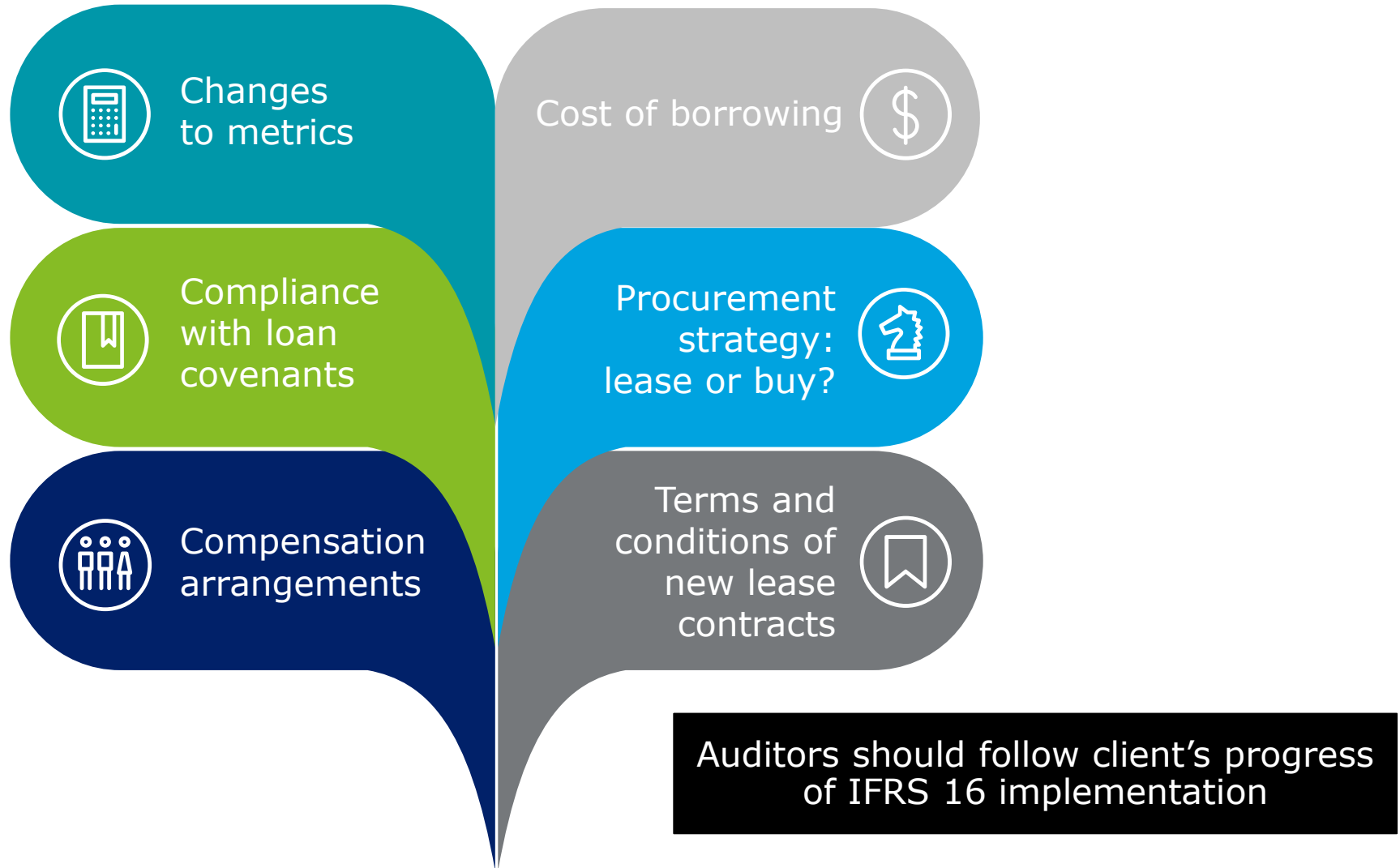
Wrap-Up

Client considerations: Broader implications



Wrap-Up

Client considerations: Broader implications (cont.)



Wrap-Up

Available resources

External resources

[IASPlus website](#)

- [Leases – A guide to IFRS 16](#)
- [Thinking allowed – the new lease accounting](#)

[Deloitte IFRS e-learning](#)

- IFRS 16 basic and advanced e-learning courses

Knowledge check



HC Market wants to learn about IFRS 16 and has asked for a list of resources you can provide. What resources can you provide to HC Market?

Select the best response and then select Submit

- a) A basic and advanced e-learning course available on deloitteifrslearning.com
- b) Industry specific publications regarding IFRS 16 available on iasplus.com
- c) Leases – A guide to IFRS 16 – a publication available on iasplus.com
- d) All of the above

Questions?



Ask
Answer
Who
Why
Where
What
When
How
Question
Answers
Apply
Understand
Query
Questions