



AASB 16 *Leases*

**A fundamental overhaul of lessee
accounting effective 2019**



Understanding the impact to your company

A new leasing standard

AASB 16 *Leases* removes the concept of operating and finance leases for lessees which exists under AASB 117 *Leases*, replacing it with a single accounting model under which lessees must recognise all leases (including property and equipment) on the balance sheet as a new 'right of use asset' and 'lease liability'. Small value assets and short term leases are excluded. The rules for lessors have not significantly changed. The change to bring the majority of leases on balance sheet was driven by the IASB to improve transparency, comparability and disclosure of companies' leasing activities.

What is the impact of the new standard?

The changes in accounting are not limited to the balance sheet. For example, the lease expense profile will be front-loaded for most leases, even when rental payments are constant year-to-year. New information will also be required to support the determination of new judgments and estimates used in the calculation of the leased asset and liability on inception date and throughout the lease. These include lease term, discount rates, in-substance lease payments, rents linked to a rate or index, expected payments under residual value guarantees and inclusion of purchase options and termination payments.

Although the economic benefits and risks of leasing does not change, the new lease accounting model will change key financial metrics and KPIs and introduce volatility to the balance sheet and profit or loss due to continual re-measurement requirements. As such, careful communication of this impact to key stakeholders such as investors, banks and credit rating agencies will be critical.

Expected impact to KPIs / ratios

	Profit or loss	Balance sheet	Ratios
▲	EBITDA	Total asset Total liabilities	Gearing
▼	EPS (in early years)	Net assets (in early years)	Asset turnover

Companies will see an increase in their EBIT / EBITDA profitability and ratios given the lease expense will be reported below the line. An increase in leverage ratios will reflect additional debt on the balance sheet from the lease liability.

Transition to AASB 16

On transition to AASB 16 an entity will have a number of interdependent options and practical expedients available. The different transition options will result in a different impact on transition and subsequently to the balance sheet and profit or loss. We therefore recommend companies model the various transition option results to their balance sheet and profit or loss going forward to assist in the determination of the most optimal transition method.

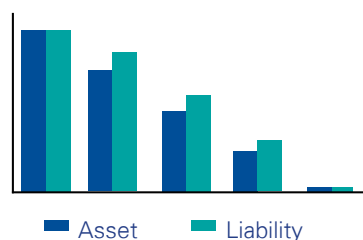
Business-wide impacts

As well as financial reporting changes, AASB 16 also has business-wide impacts, including, but not limited to, modifications and management of:

- New leasing systems to capture data and perform calculations;
- Debt covenants and credit rating, given new debt on balance sheet;
- Impairment tests and tax effect accounting, given increase in assets and liabilities; and
- Opex, capex approval processes and buy vs. lease strategies.

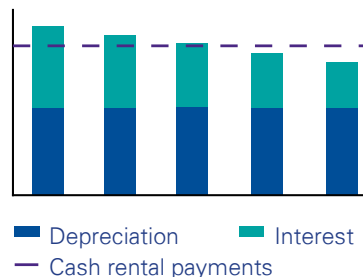
These impacts should be managed and carefully communicated to stakeholders at both the transition date and on an ongoing basis.

Impact on lessee balance sheet



Companies with operating leases will appear to be more **asset-rich**, but also more **heavily indebted**.

Impact on lessee profit or loss



Total lease expense will be **front-loaded** even when cash rentals are constant.

What are your next steps?

One of the biggest hurdles your organisation may face is obtaining an understanding of your lease portfolio characteristics and setting up new systems, processes and controls to manage your lease portfolio going forward. Organisations should not under-estimate the time required to collect lease data and assess the impact of the new standard. Below are suggested steps to ensure a successful transition to the new lease accounting standard.

1



Establish your project team

- Who is leading and supporting your implementation project?
- Which business areas should be involved?
- Are there any training requirements to raise awareness?

4



Select transition option

- Which transition method will you apply?
- Do you have all the data to be able to apply the full retrospective approach?
- Will you apply any optional exemptions?
- What will you say about AASB 16 in your 2018 annual report?

2



Understand your lease portfolio

- How many leases do you have?
- Where is your lease information stored?
- Do you have all the data required to calculate a right of use asset and a lease liability?
- Could there be any embedded leases in service contracts?
- What new leases will you sign by 2019?
- Where are accounting judgments and assumptions required?

5



Gap assessment of current systems, processes & controls

- Which processes and controls for affected business units will need to be modified or established?
- Can your existing systems cater for the new data and measurement requirements or will a new system be required?
- Which accounting policies will you need to update?

3



Investigate structural solutions to reduce impact

- Which terms can you negotiate to reduce your lease liability or eliminate volatility?
- Can alternative off balance sheet arrangements be structured?

6



Determine future state design

- How will you implement, test and embed new systems, processes and controls?
- What are your timing, cost and resource restraints?

7



Implementation







- Will your company be set up to meet the requirements of AASB 16 by 2019?
- Can you deliver on your implementation plan?

Implementation timeline



KPMG provides a range of services and solutions that can help your organisation successfully implement AASB 16, please see next page to understand how we can assist you.

How KPMG can help with your implementation project

 Run or support your implementation project	<ul style="list-style-type: none">– Provide our global tools and methodologies to support your project needs, including experienced project managers with proven methodologies and tools to assist you with gap analysis, transition option modelling, impact assessment for key financial metrics, analysis of changes required to processes and systems and project management support.
 Accounting advice	<ul style="list-style-type: none">– Support the finance team with analysis of complex contracts and provide assistance with key judgments and assumptions.– Develop solutions to minimise the impact of the new standard.
 Transition impact assessment	<ul style="list-style-type: none">– KPMG Impact Analysis Tool can help you determine the most appropriate transition option by quantifying the impacts to the balance sheet profit, or loss and key metrics under the different transition options to assist you with communicating the change to key stakeholders.
 Transformation & IT system change solutions	<ul style="list-style-type: none">– Perform systems assessment, strategy, design, configuration and implementation services.
 KPMG Lease Portfolio Manager	<ul style="list-style-type: none">– Cloud based software solution that will help you store and manage your lease portfolio and assist you meet the requirements of AASB 16 on a go forward basis. This solution will prepare your AASB 16 journal entries, and information for your financial reports including note disclosure.
 Leasing strategy & valuation services	<ul style="list-style-type: none">– Support the company to determine the optimal procurement strategy and lease terms.– Provide valuation services of KPMG's SGA and Real Estate Advisory Services teams.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates.

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