

IFRS 16 Leases Overview

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Why a new leasing standard?

Currently analysts adjust financial statements for off-balance sheet leases

Under IFRS 16, companies will bring these leases on balance sheet, using a common methodology



Agenda

1. Major impacts for lessees
2. New definition
3. New accounting
4. Multiple transition options
5. Next steps & how we can help
6. Key points to remember



Major impacts for lessees

Lessees face major changes

Leases on balance sheet

Balance sheet

Asset

= 'Right-of-use' of underlying asset

Liability

= Obligation to make lease payments

P&L

Lease expense

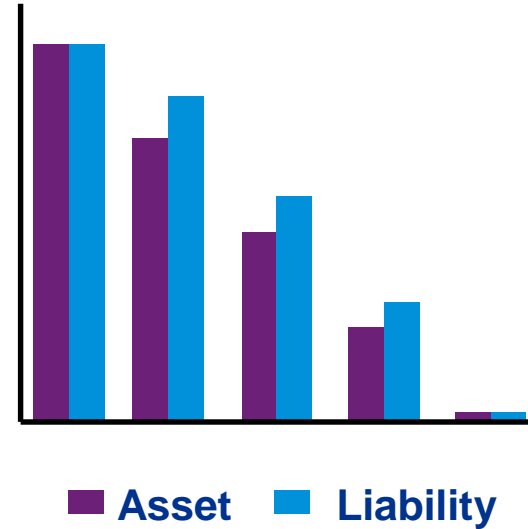
Depreciation

+ Interest

= Front-loaded total lease expense

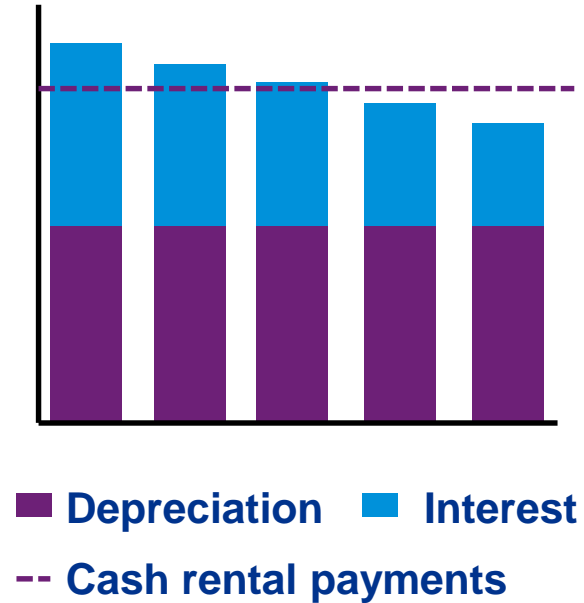
Impact on balance sheet

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

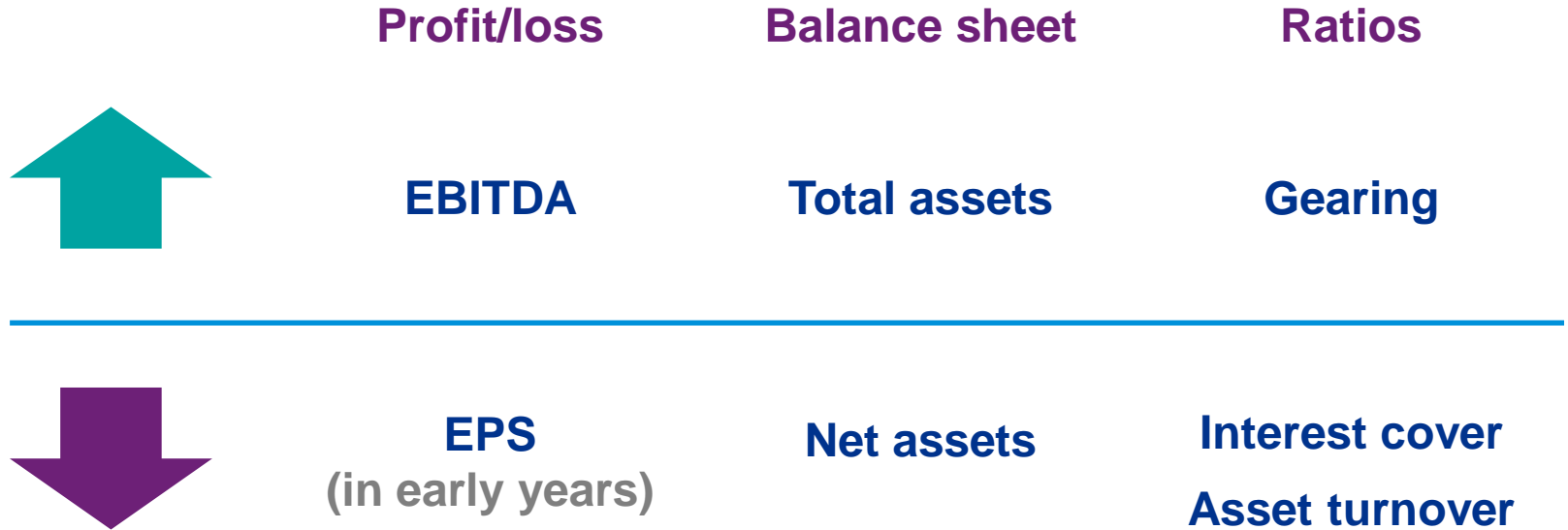


Impact on profit/loss

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



Impact on financial ratios



New definition

Lease definition

The new on/off-balance sheet test for lessees – a key judgement area



Lease definition

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, Appendix A)

Lease definition - Identified asset

The new definition increases focus on who controls the asset and may change which contracts are leases

Is there an identified asset?

No

- Identify asset can be specified *explicitly* or *implicitly*
- No identified asset if supplier has substantive right to substitute asset
 - Practical ability (right & availability)
 - Benefits economically from exercising right to substitute asset
- Identified asset is physically distinct

Contract does not contain a lease

Lease definition – Control



Solar farm example

Company C

20 yr purchase electricity



Renewable energy credits

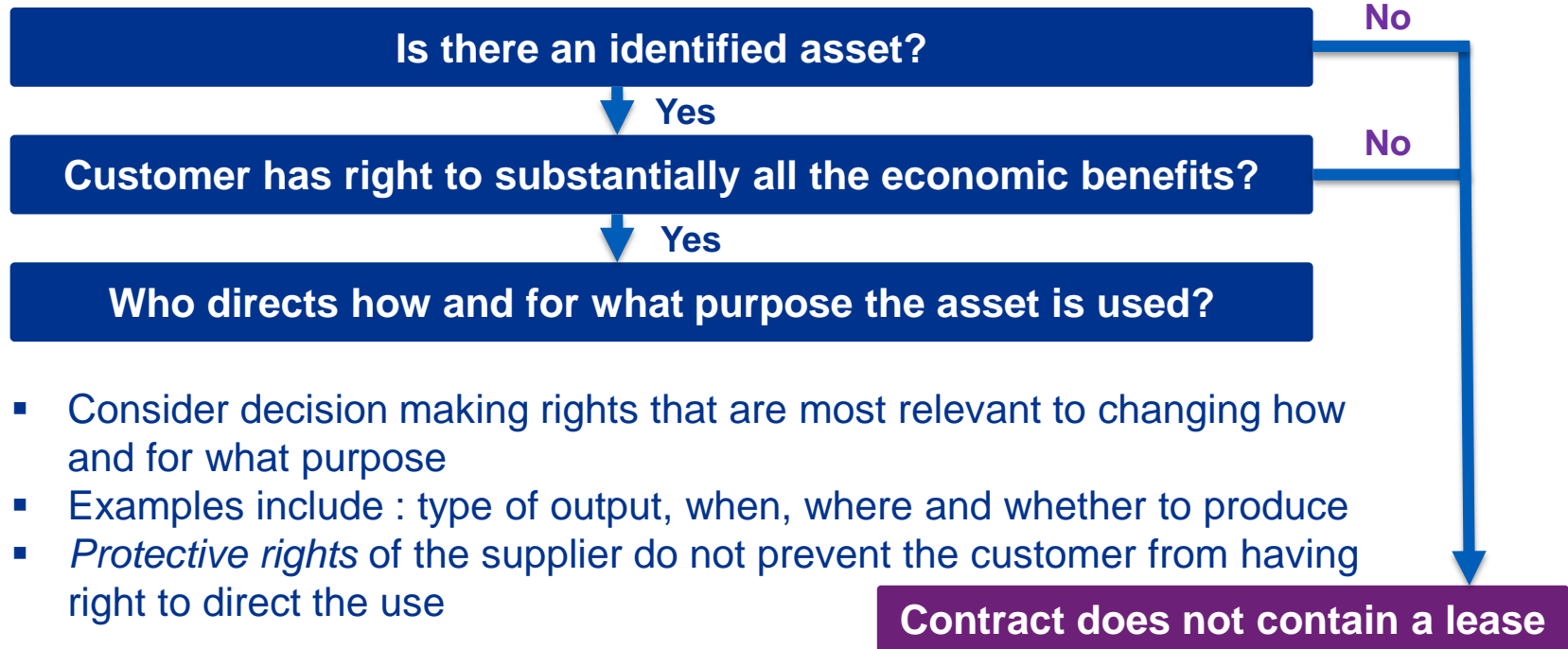


Company D

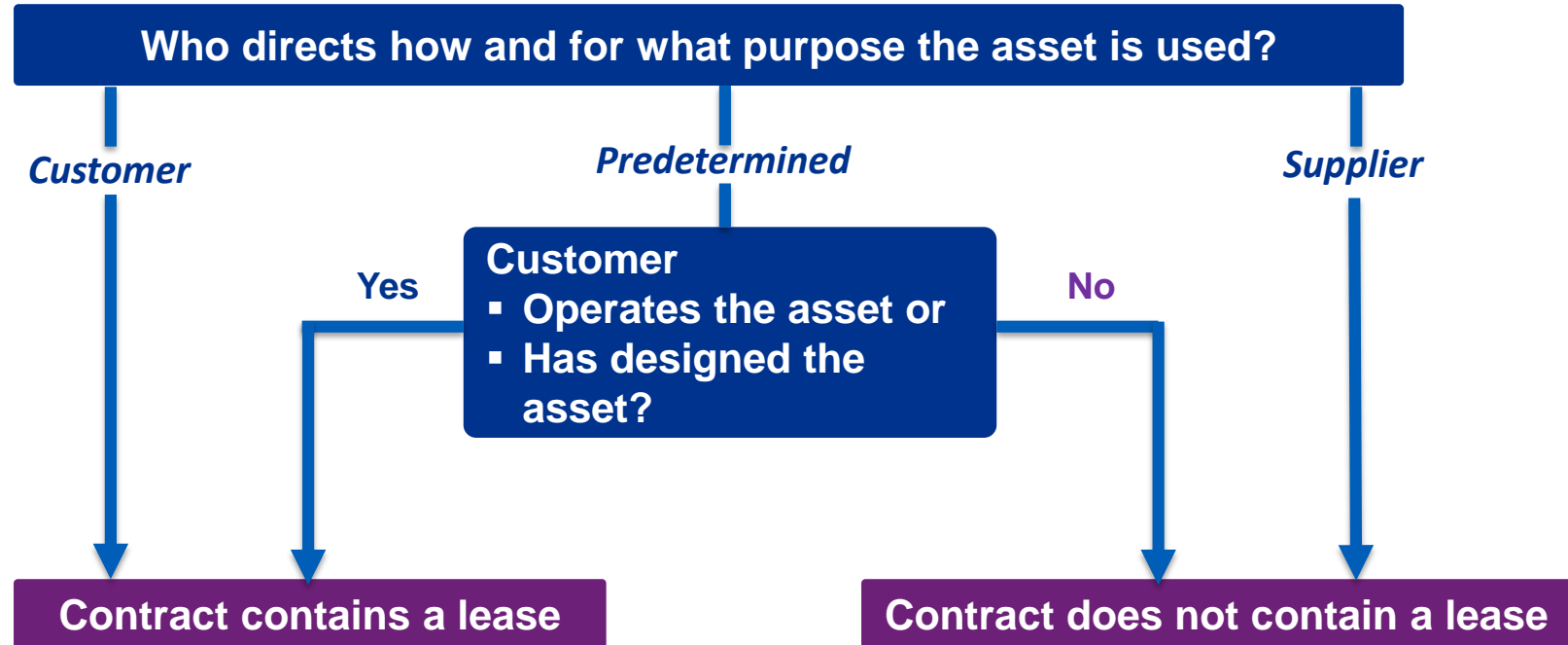
Construction tax credits



Lease definition - Control



Lease definition – Control



Power purchase example

- **Company C acquires all the output from cogeneration power plant owned by Company D**
- **What if:**
 - i. Company C directs how and for what purpose?
 - ii. Company D directs how and for what purpose?



New accounting

Lease recognition exemptions

Two major optional exemptions make the standard easier to apply



**Short term
leases**

≤ 12 months



**Leases of low
value items**

**≤ USD 5,000
for example**

Measuring the lease liability



Lease payments

Fixed payments

includes in-substance fixed payments / incentives

+

Variable lease payments

only for index or rate / rate at commencement

+

Residual value guarantees

at amount lessee expects to pay

+

Purchase option exercise price

if lessee reasonably certain to exercise

+

Payments for terminating

if lease term reflects termination by lessee

Variable lease payments

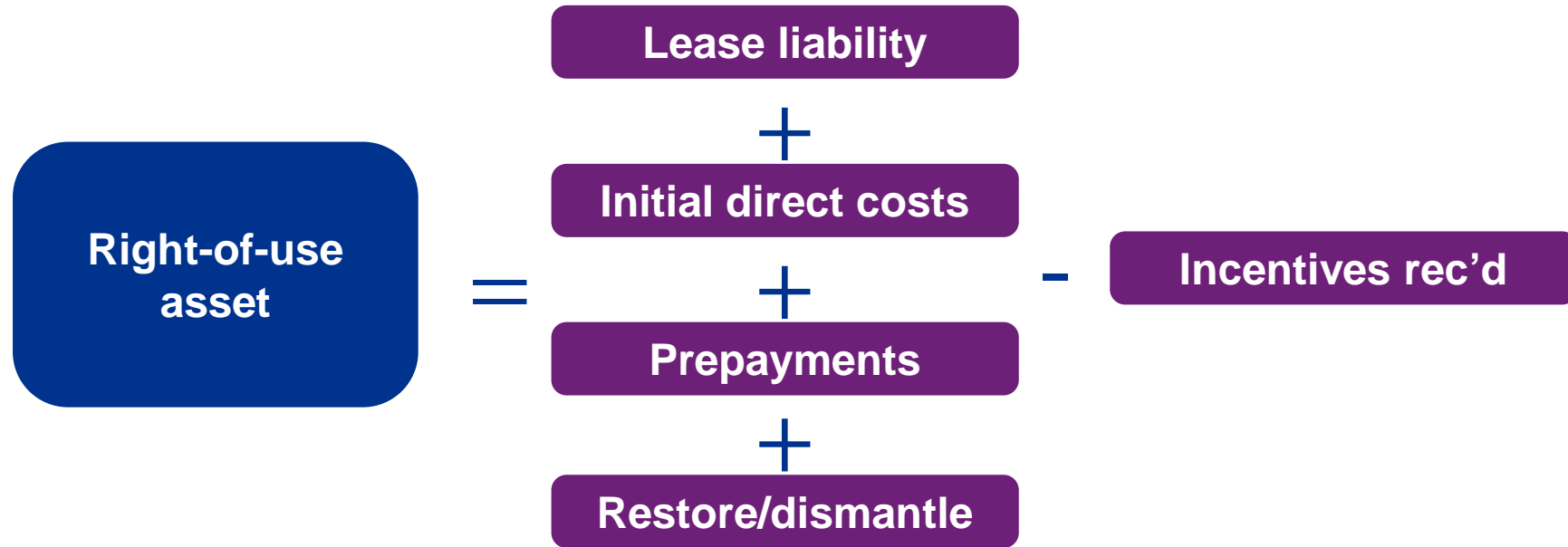
Which variable lease payments are included in the lease liability?



**Payments based on an
index or rate**

**Payments based on
turnover or usage**

Measuring the right-of-use asset



Lessor accounting

**Lessor accounting
remains similar to
current practice...**

**but lacks consistency
with new lessee
accounting model**

**Lease classification
test**



**Finance leases and
operating leases**



**Consistent
accounting model for
lessors and lessees**

Lessor accounting

Wider changes have an impact

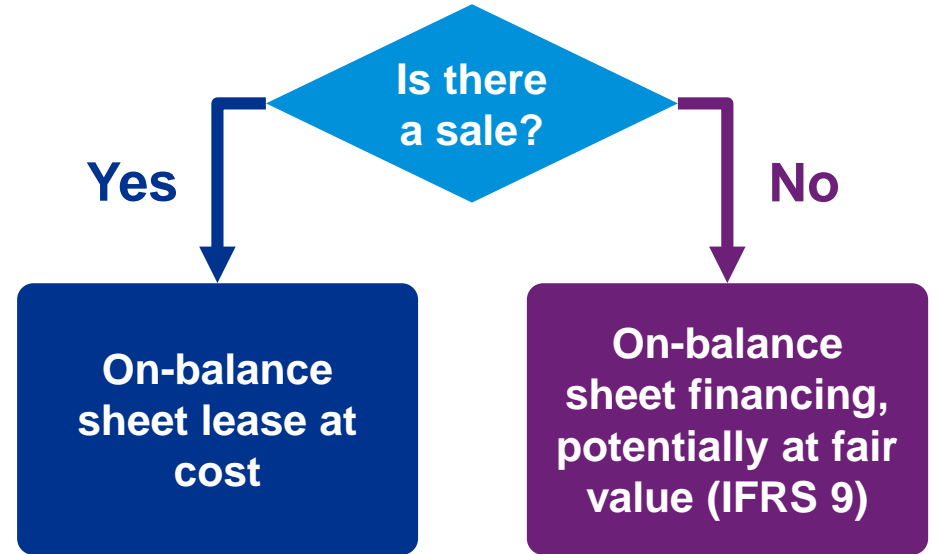
- **Definition of lease**
- **Lease payment guidance**
- **Sale and lease back guidance**
- **Sub-lease guidance**
- **Modification accounting**
- **Disclosure requirements**

Changes in contract terms and business practices



Sale-and-leaseback

IFRS 16 essentially kills sale-and-leaseback as an off-balance sheet financing structure



Multiple transition options

Applying the new lease definition

Apply the new definition to all contracts

OR

Grandfather existing contracts and apply the new definition only to new contracts

Cost



Comparability



Applying the new standard

A lessee can choose to apply the standard...

Retrospectively to all accounting periods

OR

As a 'big bang' at the date of initial application

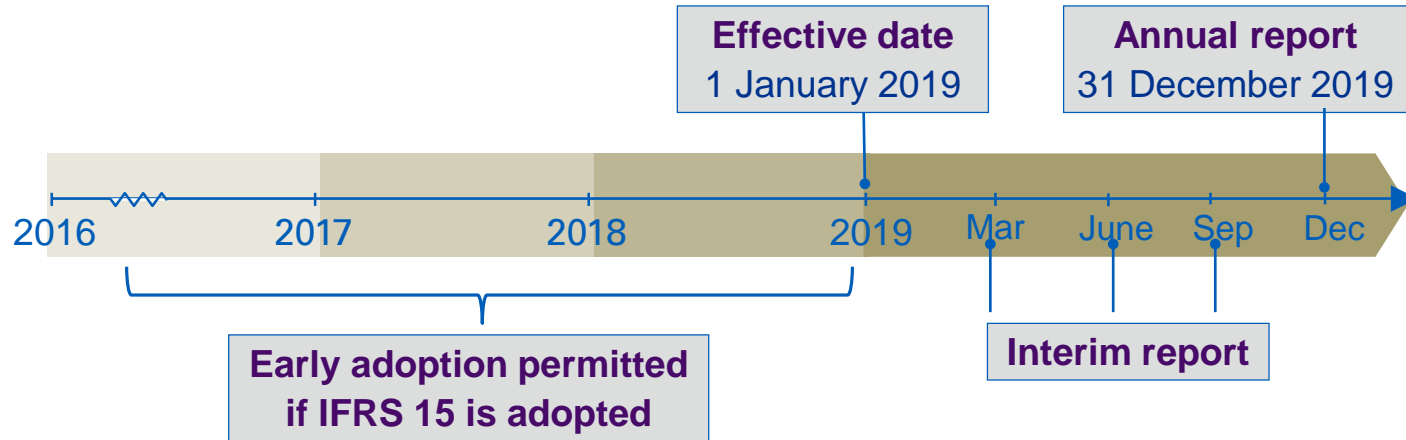
Cost



Comparability



Effective date



Next steps and how we
can help

Things to think about now

Some questions to assess the impact on your company's financial statements

Which contracts are leases?

Which transition options to choose?

Database of all leases?

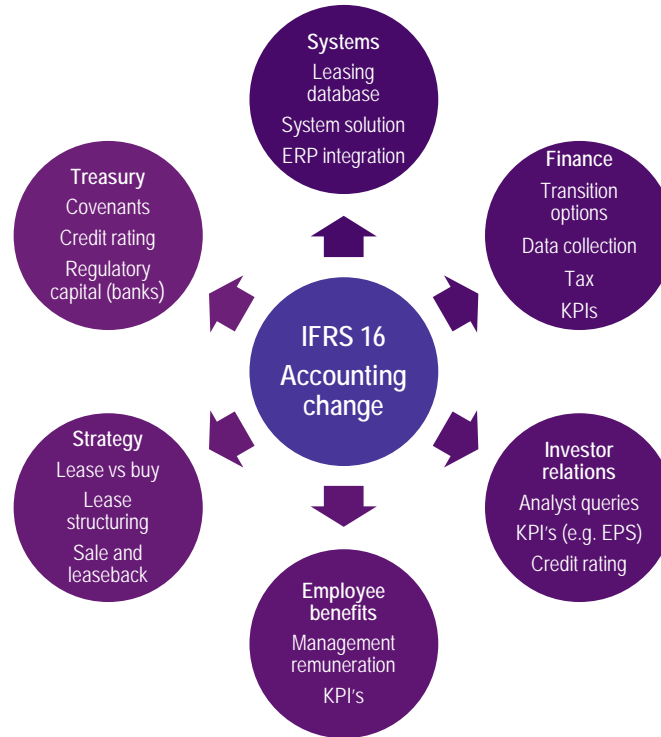
Systems and processes in place?

What about ratios and covenants?

Commercial opportunities

IMPACT ASSESSMENT

Broader business impacts



How can we help?

Assess	Design	Implement
<ul style="list-style-type: none"> i. Impact assessment: <ul style="list-style-type: none"> ✓ Impact on key business metrics and KPI's, such as debt covenants and EBITDA ✓ Estimated lease liability ✓ Impact on timing of expense ✓ Data requirements ✓ Identify commercial opportunities ii. Options analysis of key judgements: <ul style="list-style-type: none"> ✓ Transition options ✓ Whether arrangements are in scope ✓ Discount rates ✓ Lease term iii. Assessment of property database – is it sufficiently detailed, robust and fit for purpose. 	<ul style="list-style-type: none"> i. Support decision making around key accounting judgements ii. Technical advice on interpretation and application of standard iii. Support development of updated accounting policy iv. Support commercial negotiations with landlords to minimise any detrimental impact on key metrics. (e.g. shorter lease terms / more breaks / more variable rents) v. Support design of system solution – lease management system / database / ERP integration vi. Optionality to regear, sublet, dispose or merge properties and advice on acquisition strategy going forward 	<ul style="list-style-type: none"> i. Training of finance and commercial staff ii. Application of new accounting policy across group iii. Implement system solution iv. Implementation support - on go forward leases, remedies to existing leases, commercial input

Key points to remember

Key points to remember

- **New leases standard will impact most companies.**
- **Process of assessing impact should start now.**
- **Additional training and guidance on its way.**



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