



*cutting through complexity*

# IFRS 16 Leases Overview

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# Today's presenters



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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

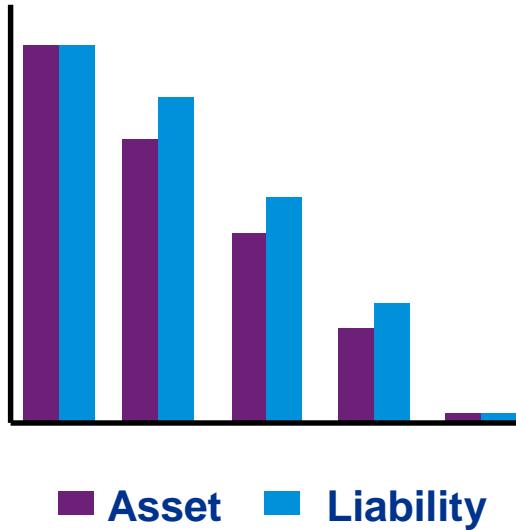
Depreciation

+ Interest

= Front-loaded total lease  
expense

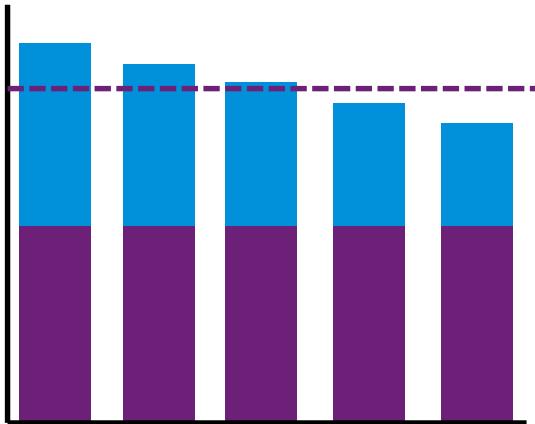
# Impact on balance sheet

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



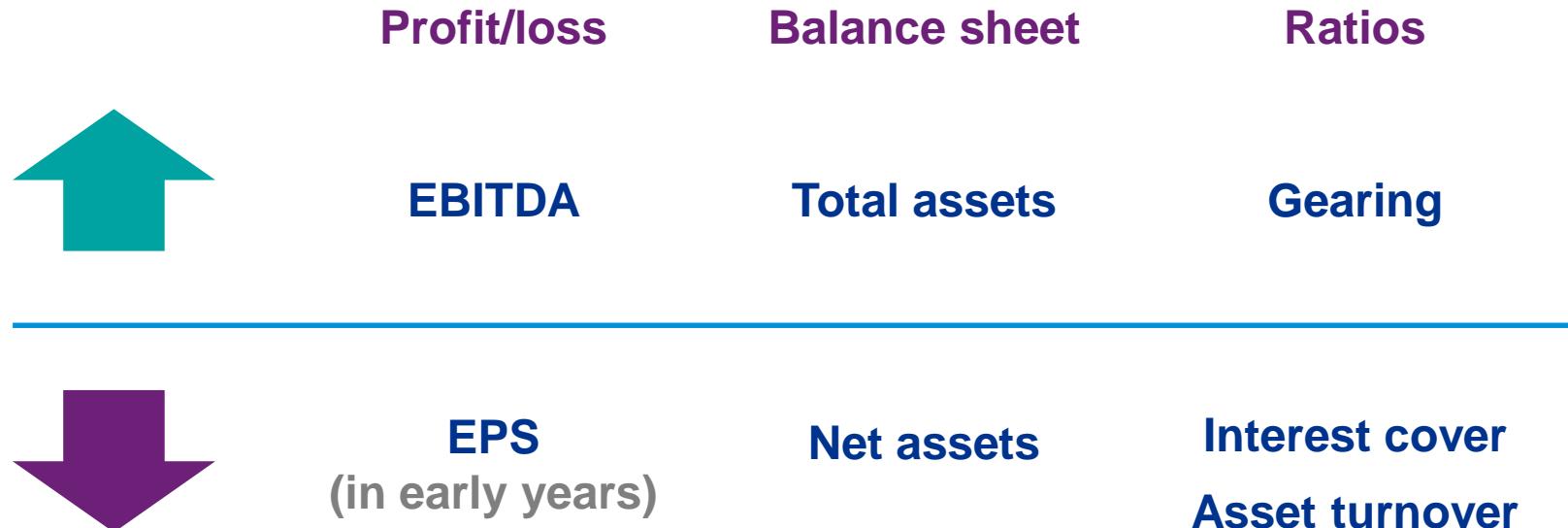
# Impact on profit/loss

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



■ Depreciation ■ Interest  
-- Cash rental payments

# Impact on financial ratios



# New definition

# Lease definition

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

**New standard**

Lease  
classification  
test

**Old standard**



ON

Lease  
Finance  
lease

OFF

Service  
Operating  
lease

# 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 subscribe 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**

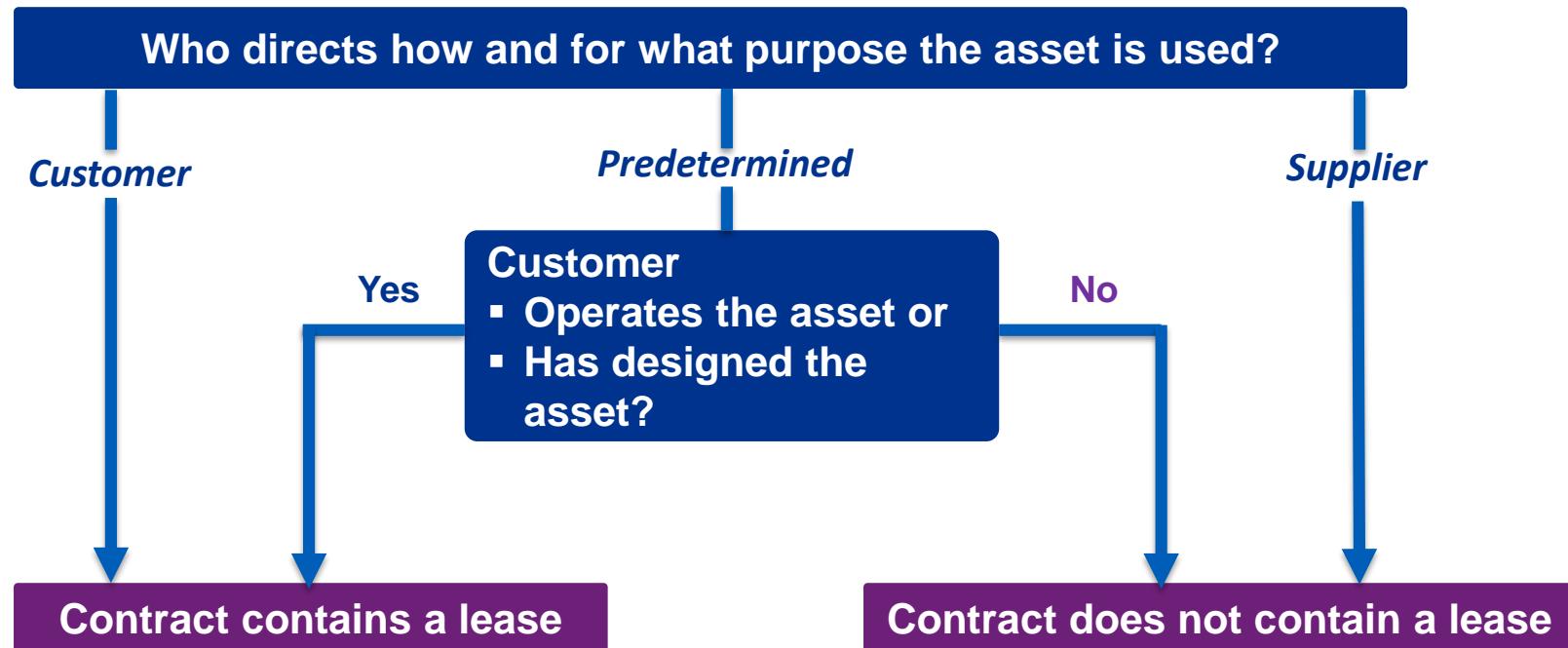
Construction tax credits



# 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**

$\leq$  12 months



**Leases of low value items**

$\leq$  USD 5,000 for example

# Measuring the lease liability

$$\text{Lease liability} = \text{Present value of lease rentals} + \text{Present value of expected payments at end of lease}$$

# Lease payments

Fixed payments



Variable lease payments



Residual value guarantees



Purchase option exercise price



Payments for terminating

includes in-substance fixed payments / incentives

only for index or rate / rate at commencement

at amount lessee expects to pay

if lessee reasonably certain to exercise

if lease term reflects termination by lessee

# Variable lease payments

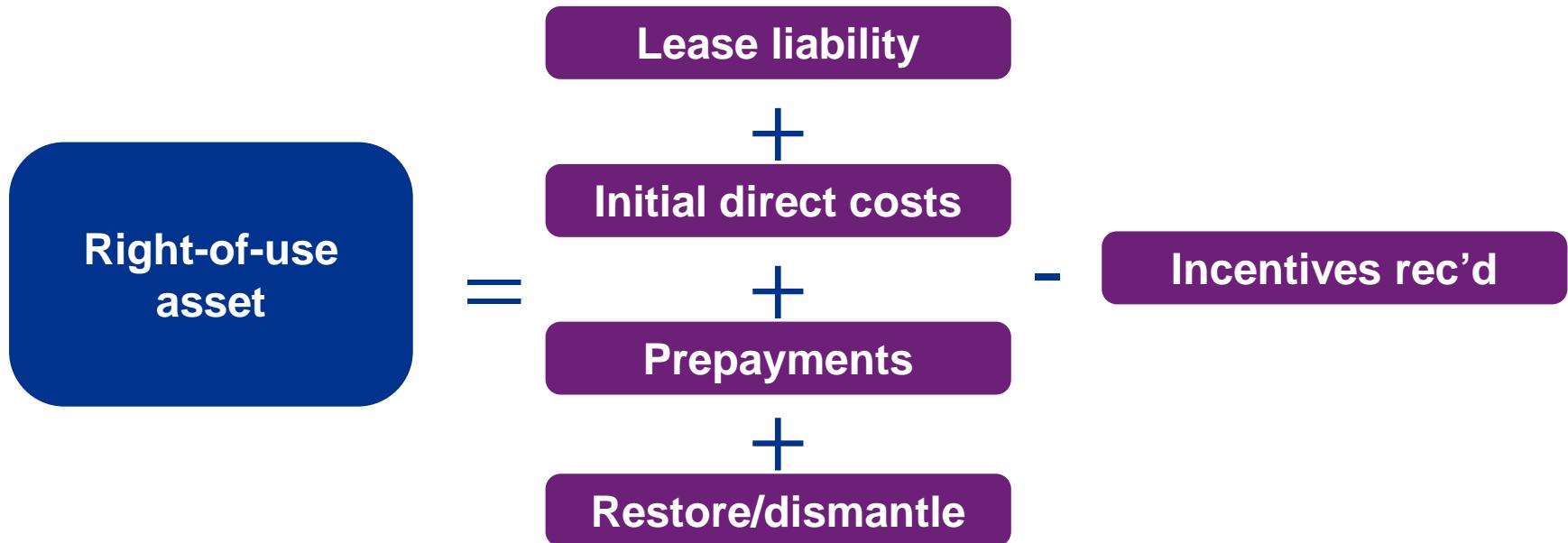
**Which variable lease payments are included in the lease liability?**



**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

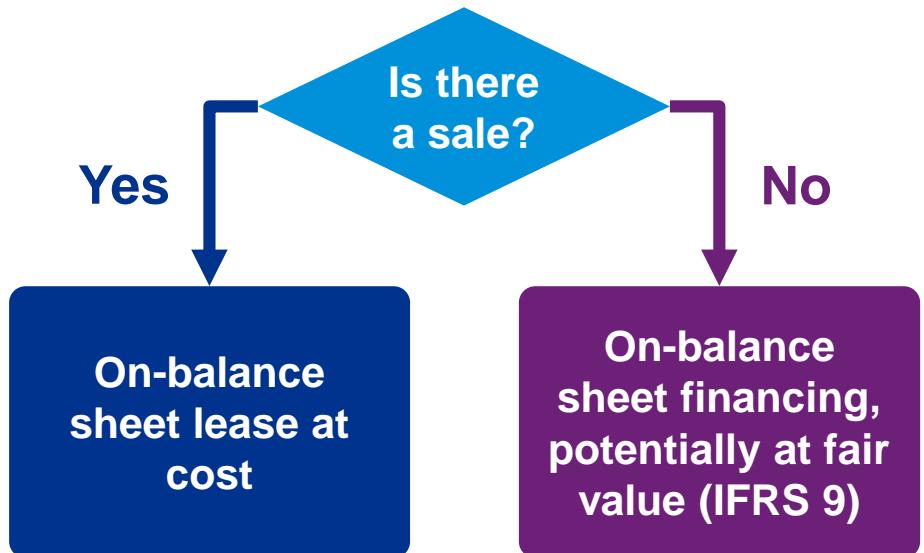
## **Wider changes have an impact**

- **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**

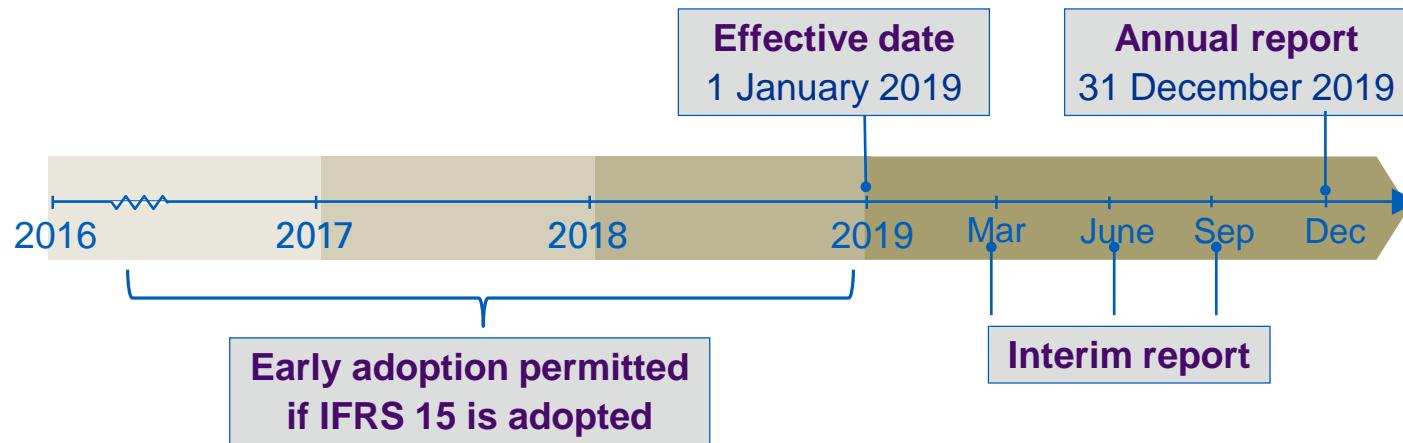
**Cost**



**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?

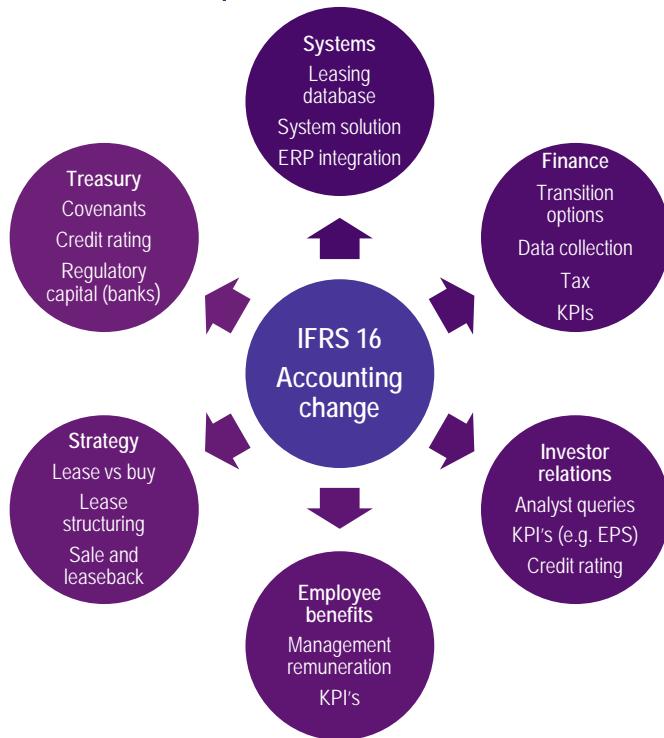
Systems and processes in place?

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

# 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.**



# Thank you



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