



# IFRS Today

KPMG's podcast series on IFRS and financial reporting

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## EPISODE TRANSCRIPT

### The new leases standards: Overcoming the challenges of complying

#### Speakers

- Dean Bell
- Markus Kreher
- Brian O'Donovan
- James Bowe (Host)



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#### James

Hello – and welcome to 2019's first episode of *IFRS Today*.

Whether we're talking IFRS or US GAAP, the new lease accounting standards are now effective for calendar year-end companies...

Our latest survey reveals that companies are facing considerable challenges in implementing the requirements of these new standards.

Today, I've invited three KPMG colleagues to explore what companies can do to overcome these challenges. First, **Dean Bell** and **Markus Kreher** – who are helping companies with their implementation projects globally – and **Brian O'Donovan**, who specialises in the accounting requirements.

Dean – to start, what would you say are the stand-out takeaways of this survey?



**Brian O'Donovan**  
KPMG International Standards Group

#### Dean

Thanks, James. When we analysed the data to get a clear snapshot of companies just prior to the effective date, I'd say we observed three major themes.

- The glaring one to me is that many companies simply just **aren't ready**.
- Second, the **challenge of system selection, integration and implementation** is proving to be very tough and difficult.
- And last, **getting the transition right is crucial**.

Companies will get there and get their figures out, but we're a long way from sustainable compliance.

## James

Okay, thanks, Dean. Now, I'm interested in your first point that a lot of companies just aren't ready. What do you think of this, Markus?

## Markus

There are some positive results. Most of the companies have set up a programme management team. However, 83 percent of the respondents hadn't completed the data gathering and the validation step, which means a significant number of companies haven't actually got their implementation projects up and running yet.

## Dean

Look, it's pretty much a tedious process, I think we can all acknowledge, but it's really important to make sure we have the information to perform the calculations that are necessary to get the right financial reporting under this new standard. So again – very necessary – but I am surprised to see where we are at this point.

## Brian

That's right, Dean – it's tedious, but it's *not optional*. Now, we'd all heard rumours about what was happening in the market place, but this survey gives us hard data. And what that hard data tells us is that in the run up to the effective date, a lot of people had a lot of work still to do.

And looking at those numbers, only 3 percent of respondents said they'd actually completed implementation.

## James

I see, so with so many companies playing catch-up, I guess that explains why the majority of respondents said their expected costs have gone up year-on-year?

## Dean

Absolutely. Time is running out and companies are having to hire more external resources than they'd actually planned.

I'd encourage those companies that are behind with implementation to assess whether they have the skill sets they need in-house to address the actual real-time challenges...

And if they don't, consider bringing in some external resources to provide both experience and knowledge of best practices, as well.

## Markus

Yes – and from what I'm seeing in the market place, companies have to spend more time on new software than they'd intended.

Bottom line: the process of bringing operating leases onto the balance sheet is complex, and many businesses are just getting to grips with the scale of the task.

After all, leases are numerous and often geographically dispersed – more than 40 percent of the companies have more than 500 leases, and more than 40 percent of the respondents also have leases in more than 10 locations!

## James

Okay, so that's certainly a lot of leases. What are the other main obstacles that companies are facing?

## Brian

Well, James, there are lots of judgements and estimates to make, as well.

If I think about the question I'm getting the most, it's all about discount rates. Specifically, how should a lessee determine its incremental borrowing rate? Our survey shows that barely half of companies believe they can do that themselves internally. Everyone else is having to go outside the organisation, look for advice, information – or just don't have a way forward yet.

And these discount rates are so important. The lease liability, the big headline number that's coming on-balance sheet – is very, very sensitive to discount rate. It's a key judgement. So whatever a company is doing, it needs to be robust and supportable and to stand up to external scrutiny and to external audit.

## Dean

In the Americas, identifying embedded leases seems to be the most common challenge. There have really been concerns around the actual population of lease portfolio and making sure it's accurate.

And with embedded leases, companies are really digging into service arrangements to identify if a lease is present. It is quite possible there's no change from the current accounting, but management must really go out and prove it's gone through this exercise to appropriately support compliance.

## Markus

And, let me add that, in Europe, companies find it difficult to integrate the lease accounting system into their existing ERP system.

With that in mind, any implementation efforts need to be sustainable for the long-term and not just a one-off compliance exercise. It makes commercial and strategic sense to make sure that you are ready for the future.

## James

Excellent, so that's probably a good segue into the systems challenges. Nearly half of companies said they'd already selected their lease accounting software. Yet, only a quarter had actually completed their accounting assessment.

## Markus

James, that's right – and the figures here imply that some organisations might have jumped too quickly into choosing their software.

My advice is to perform proper due diligence – taking time to really understand the accounting, operational or process gaps – so that the system chosen is optimal for the future.

## Dean

Markus, I would agree with that, and one thing I want to make sure everyone is clear about is that implementing an IT system takes a lot of time.

So those companies that are behind today have to be realistic and start thinking about a 'Plan B' to make sure that any interim planning they are dealing with today is fit for purpose and gets them aligned for the future, as well.

## Markus

That's crucial, Dean, and on that point I was concerned that the survey indicated that many companies are planning to rely on spreadsheets and manual solutions on a go-forward basis.

## Dean

I agree – the manual approach is not ideal and I tell my clients this all the time...

You have to think about the fact there's going to be a lot of data coming through. And beyond that, you'll need to continually update your information, and do regular assessments going forward.

My view of it is, 'Go ahead and invest time in an automated system.' That to me is time well spent...

## Markus

Absolutely and, in summary, if you haven't implemented a software solution by the effective date, it's not too late.

My advice is, 'Create an interim plan and keep working towards a long-term solution in parallel.'

## James

Great. This brings us quite neatly onto Dean's last point around getting the transition right.

Brian, the survey tells us that nearly a third of respondents haven't decided their transition method yet. What do you make of this?

## Brian

Well, James, to be honest, I was surprised. Now the standards offer lots and lots of flexibility around transition and that's great. You can choose the best way forward for your individual business.

But those choices have to be made... They can be complex but they *have to be made*. People have to get off the fence and decide which way they're going.

I was expecting most people to have been there at the date we did the survey, particularly with the pressure to disclose the expected transition approach and the expected impacts in this year's financial statements.

## Markus

Yes, Brian – and I would add that all stakeholders need to be involved; for example, the C-level executive and the audit committee need to agree to the proposed transition method. They have to understand the impact on the financials and help to obtain budget for the remaining efforts.

And your auditors will need to audit the transition adjustments, the new accounting policies and the management assertions, and also test the new systems and the controls.

## James

Thanks, Markus. Now, over to all of you – in a few words, what would be your top tip for our listeners? First, Brian...

## Brian

Well, James, if a company isn't where it hoped to be at this point in time, you should get the project team and the financial reporting guys in a room together to have a tough, honest meeting about exactly what they can and should say in their 2018 annual reports about project status and the expected impact of adoption. And once that's out of the way they can then move on to think about communication more broadly.

## Markus

My top tip would be something I encourage my clients to do, which is to run certain work streams in parallel – accounting, systems, business impacts and people – to avoid a scramble at the end of the process...

## Dean

James, for me it's two words – *sustainable compliance*. Whatever you're doing today, whether it's a sticking plaster approach or a full implementation, you've got to be ready – not only for today but also for tomorrow as well.

## James

Thanks, all. So there's a lot to consider here...

You'll be able to find out more about the findings we've discussed today in our *Global lease accounting survey*. Take a look at the web article page for this podcast.

And if you like what you've heard, please subscribe to *IFRS Today* – on iTunes, Spotify or any other podcast app.

But for now, thank you all very much for taking the time to listen to this edition of *IFRS Today*. And look out for our next episode, to be released in the coming weeks...

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