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IFRS News Special Edition on Lease Accounting

# Major reforms to global lease accounting

## - IFRS 16 Leases

equivalent to MFRS 16 Leases issued by Malaysian Accounting Standards Board on 15 April 2016

IFRS News Special Edition
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The IASB has published IFRS 16 ‘Leases’ completing its long-running project on lease accounting.

This special edition of IFRS News explains the key features of the new Standard and provides practical insights into its application and impact.

We have covered lessor accounting, sale and leaseback accounting in the May 2016 issue. In this issue, the presentation and disclosure, effective date and transition are discussed.

# Presentation and disclosure

IFRS 16 requires a lessee and a lessor to provide information about leasing activities within their financial statements.

The Standard explains how this information should be presented and what disclosures are required. An overview of these requirements is summarised below.

## Presentation

For a lessee, a lease that is accounted for under the general model gives rise to:

- an asset and liability in the balance sheet. The asset and liability must be presented or disclosed separately from other, non-lease assets and liabilities (except for investment property right-of-use assets which are presented as investment property)
- interest expense on the liability (part of finance costs) and depreciation expense on the right-of-use asset.

In the statement of cash flows payments are classified:

- as **financing** for the amounts relating to the principal portion of the lease liability
- in the **same classification as interest paid** for amounts relating to the interest portion of the lease liability
- as **operating** for amounts relating to short-term and low-value asset leases that are accounted for off-balance sheet and for variable payments not included in the lease liability.

For a lessor, the requirements are largely the same as IAS 17's. In summary:

- for **finance leases** the net investment is presented as a receivable in the balance sheet
- assets subject to **operating leases** are presented according to the nature of the underlying asset.

## Disclosures

IFRS 16 requires different and more extensive disclosures about leasing activities than IAS 17.

The objective of the disclosures is to provide users of financial statements with a basis to assess the effect of leases on the entity's financial position, performance and cash flows. To achieve that objective, lessees and lessors disclose both qualitative and quantitative information.

**Lessee disclosures**

| Disclosure area | Summary of requirements |
| --- | --- |
| **Quantitative information about leases (generally in a tabular format)** | • depreciation charge for right-of-use assets by class of underlying asset<br>• interest expense on lease liabilities<br>• expense relating to low-value and short-term leases (other than leases of 1 month or less) if exemption(s) elected<br>• commitments for short-term leases if expense disclosed reflects a dissimilar lease portfolio to the period-end commitment<br>• expense relating to variable lease payments not included in lease liabilities<br>• income from subleasing<br>• total cash outflow for leases<br>• additions to right-of-use assets<br>• gains or losses from sale and leaseback transactions<br>• the carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset<br>• maturity analysis of lease liabilities<br>• additional information about right-of-use assets that are investment property or are revalued under IAS 16 |
| **Additional qualitative and quantitative information as necessary to meet the disclosure objective** | • nature of leasing activities<br>• future cash outflows to which the lessee is potentially exposed that are not reflected in the lease liabilities, including exposure arising from:<br>– variable lease payments<br>– extension and termination options<br>– residual value guarantees<br>– leases not yet commenced<br>• restrictions or covenants imposed by leases<br>• sale and leaseback transactions |

**Lessor disclosures**

| Disclosure area | Summary of requirements |
| --- | --- |
| **Finance leases** | • selling profit or loss<br>• finance income on the net investment in the lease<br>• income relating to variable lease payments not included in the measurement of the net investment in the lease<br>• qualitative and quantitative explanation of significant changes in net investment in the lease<br>• maturity analysis of lease receivable |
| **Operating leases** | • lease income, separately disclosing income for variable lease payments that do not depend on an index or rate<br>• as applicable for underlying asset, relevant disclosures in<br>– IAS 16 for leases of property, plant and equipment, disaggregated by class<br>– IAS 36 'Impairment', IAS 38, IAS 40 and IAS 41<br>• maturity analysis of lease payments |
| **Other** | • additional qualitative and quantitative information about leasing activities as necessary to meet disclosure objectives, including but not limited to:<br>– nature of leasing activities<br>– how the risk associated with any rights retained in the underlying asset is managed |

# Effective date and transition

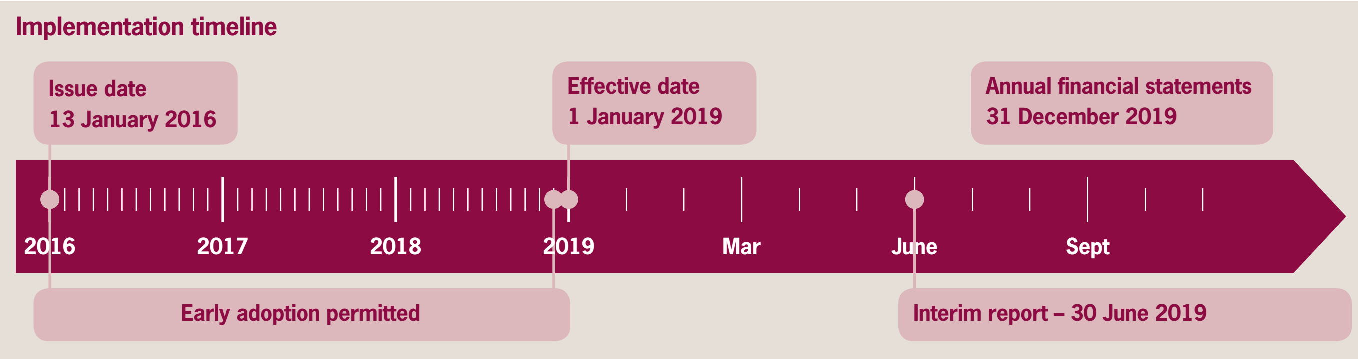
IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted for entities that apply IFRS 15 at or before the date of initial application of this Standard.

IFRS 16 includes two possible transition methods as follows:

- full retrospective application
- partial retrospective application

These are explained in more detail below.

The transition timeline (for an entity that produces interim financial statements half-yearly) is summarised in the diagramme:




IFRS 16 provides lessees with a choice between two transition methods:

- **full retrospective application** – with restatement of comparative information in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'
- **partial retrospective application** – without restating comparatives. Under this approach the cumulative effect of initially applying IFRS 16 is recognised as an adjustment to equity at the date of initial application (DOIA) (eg 1 January 2019 for a lessee that adopts IFRS 16 on the effective date and has a 31 December year-end).

If a lessee chooses partial retrospective application, a number of more specific transition requirements and optional reliefs also apply. These are summarised in the table below.

Lessors are not required to make any adjustments in respect of leases in place at the date of transition, except for intermediate lessors (ie lessors with sub-leases). Instead, the Standard is applied prospectively from the date of transition.

IFRS 16 also provides both lessees and lessors with optional transition relief from reassessing whether contracts in place at the DOIA are, or contain, a lease.

Finally, the Standard sets out transition requirements in relation to:

- sale and leaseback transactions before the DOIA
- leases assumed in previous business combinations.

**Transition provisions for lessees when using partial retrospective application**

| Area | Requirement or optional relief |
|---|---|
| **Leases previously classified as operating leases** | • lease liability at the DOIA is measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate at the DOIA<br>• choice to measure right-of-use asset at either:<br>– carrying amount as if IFRS 16 had been applied since commencement, but discounted at the incremental borrowing rate at the DOIA; or<br>– amount of lease liability, adjusted for prepaid or accrued rentals<br>• the right-of-use asset is measured at fair value at the DOIA for leases of investment property that were accounted for as operating leases under IAS 17 but to which the IAS 40 fair value model will apply in future<br>• optional reliefs are available in relation to:<br>– low-value asset leases and leases for which the lease term ends within 12 months of DOIA<br>– leases of investment property to which the IAS 40 fair value model has been applied<br>– use of a single discount rate for a portfolio of leases with reasonably similar characteristics<br>– relying on the IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' 'onerous' assessment instead of an impairment review on transition (in which case the right-of-use asset is reduced by the amount of any onerous lease provision)<br>– excluding initial direct costs from the right-of-use asset<br>– use of hindsight in determining the lease term if lease contains extension or termination options |
| **Leases previously classified as finance leases** | • right-of-use asset and lease liability are measured at the same amounts as under IAS 17 at the DOIA |
| **Disclosures** | • relief from disclosing the current period impact in accordance with IAS 8 if entity elects the partial retrospective application approach<br>• some additional disclosures required in year of transition |

# Practical insight – next steps

Although the new standard is not mandatorily effective until 2019, there are several actions that entities should take to prepare for implementing the requirements:

- evaluate both the recognition and disclosure requirements to determine how the information will be accumulated
- consider whether to adopt any of the practical expedients and policy choices that will impact the type of information that must be accumulated to prepare for transition
- compile information about existing leases to gauge the impact of the new leasing model
- design and prepare to implement new controls over the recording of right-of-use lease assets and liabilities, including transition, initial measurement, modifications, and impairment testing
- review loan covenants and other agreements that incorporate financial ratios and metrics, such as compensation arrangements, that could be affected by the new leasing model.

We hope you find the information in this Special Edition of IFRS News helpful in giving you an overview of IFRS 16. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.com.my**.

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