

IFRS Foundation



The Leases Project

A look back at how major and controversial change was achieved—what can we learn?

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The need for change: a lack of transparency

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- 5 retail chains that ultimately went into liquidation

Retailer	Off balance sheet leases		On balance sheet debt ¹	Off balance sheet leases (discounted) to reported debt
	undiscounted ¹	discounted ²		
Circuit City (US)	\$4,537M	\$3,293M	\$50M	65.9 times
Borders (US)	\$2,796M	\$2,152M	\$379M	5.7 times
Woolworths (UK)	£2,432M	£1,602M	£147M	10.9 times
HMV (UK)	£1,016M	£809M	£115M	7 times
Clinton Cards (UK)	£652M	£525M	£58M	9 times

(1) Based on averaged published financial statements data available in the 5 years before the company entered Chapter 11 (US) or liquidation (UK).

(2) Estimated.

Time and controversy predicted

US SEC (2005) ¹: 'The fact that lease structuring based on the accounting guidance has become so prevalent will likely mean that **there will be strong resistance to significant changes to the leasing guidance**, both from preparers who have become accustomed to designing leases that achieve various reporting goals, and from other parties that assist those preparers... **[I]t is likely that a project on lease accounting would generate significant controversy**; many issuers see leasing as an attractive form of financing asset acquisition in part because leases can be structured so as to avoid recording debt... **a project on lease accounting is likely to take a significant amount of time as well as...resources. Nonetheless...the potential benefits in terms of increased transparency of financial reporting would be substantial enough to justify the time and effort required.**' (*emphasis added*)

(1) Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers

A thorough and measured approach

- Carefully considered the views of stakeholders
- Beyond minimum due process
 - Discussion Paper and 2 Exposure Drafts
 - More than 1,700 comment letters received and analysed
 - Meetings with the Board's advisory bodies
 - Formation of a Leases working group
 - Hundreds of outreach meetings—targeted focus
 - 15 public round tables
- Communication—via Project Updates

Project lifecycle—where was time spent?

Agenda decision	Discussion Paper (DP)	Exposure Draft (2010 ED)	Revised Exposure Draft (2013 ED)	IFRS 16
July 2006	March 2009	August 2010	May 2013	January 2016
33 months to DP	16 months to 2010ED*	33 months to 2013ED*	31 months to IFRS 16*	
Where time was spent	<ul style="list-style-type: none"> Single lessee model; no change to lessor Extensive time discussing lessee measurement 	<ul style="list-style-type: none"> Lessor accounting added (feedback on DP said to do this) 	<ul style="list-style-type: none"> Extensive changes to 2010 ED proposals in response to feedback (dual lessee model; lessor changed; measurement simplified) More feedback received than on DP 	<ul style="list-style-type: none"> Single lessee model; no change to lessor Further simplifications (responsive to feedback) 2-3 months extra on most significant topics 10 months on drafting and review (as expected) Project Updates / Effects Analysis
	<u>Leading to DP</u> <ul style="list-style-type: none"> Working group (WG) 02/07 and 10/08 	<u>Leading to 2010 ED</u> <ul style="list-style-type: none"> WG 03/09 Outreach during comment period 	<u>Leading to 2013 ED</u> <ul style="list-style-type: none"> Effects Analysis included in the Basis Extensive outreach on particular topics WG 01/11, 04/11 and 01/12 	<u>Leading to IFRS 16</u> <ul style="list-style-type: none"> Implemented Effects Analysis advice Extensive targeted outreach with users and preparers

* Includes 4 months of comment period

Process

- Delicate balance...
 - Major change cannot be rushed, and yet...
 - A time when decisions must be made and finalised
- Extensive consultation
 - Engage with stakeholders early in the process and throughout
 - Go beyond what might be considered 'enough'
 - Targeted outreach and consultation
- Thorough analysis of stakeholder views
- Joint projects add complexity

Communication

- Communicate in an accessible way—eg use examples
- Communicate need for change, and benefits of change, from the start
- Communicate work done, decisions reached and how we responded to feedback