IFRS 16 and research opportunities

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Agenda

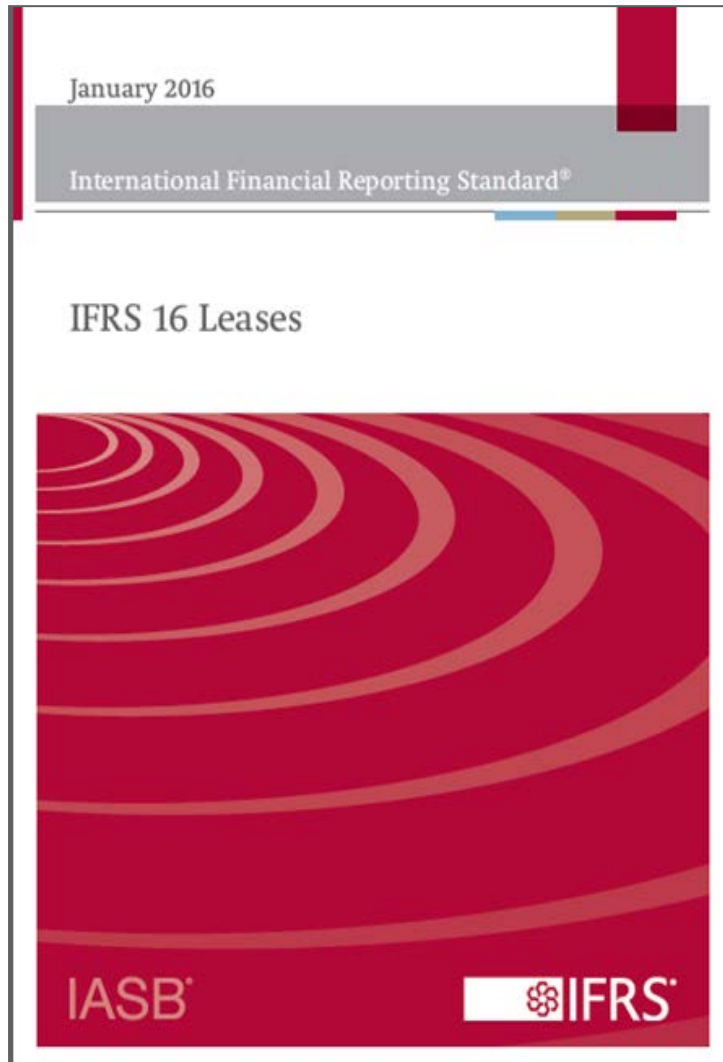Introduction and objectives

IFRS 16 *Leases:* Overview of the basics

Research Opportunities

Questions

IFRS 16 *Leases*: Overview of the basics

IFRS 16 at a glance

(Cover of IFRS 16 Leases publication)

- Issued in January 2016
- Effective for annual reporting periods beginning on or after 1 January 2019
- Replaced IAS 17

Key points:

- Brings almost all leases onto the balance sheet for lessees
- Significant change for lessees; little change for lessors

Why IFRS 16? The need for change

Leases are an important and flexible source of financing – listed companies using IFRS Standards or US GAAP estimated to have US$3.3trillion lease commitments

Over 85% of lease commitments did not appear on balance sheet before IFRS 16 was implemented[1]

This created **challenges** for **users of financial statements**

[1] Data from the Board's IFRS 16 Effects Analysis: https://cdn.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf

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The need for change: a lack of information

- Six retail chains that ultimately went into liquidation

Retailer	Off balance sheet leases		On balance sheet debt[1]	Discounted leases as multiple of debt[3]
	(undiscounted)[1]	(discounted)[2]		
Borders (US)	$2,796M	$2,152M	$379M	5.68
Circuit City (US)	$4,537M	$3,293M	$50M	65.86
Clinton Cards (UK)	£652M	£525M	£58M	9.05
HMV (UK)	**£1,016M**	**£809M**	**£115M**	**7.03**
Praktiker (DEU)	€2,268M	€1,776M	€481M	3.69
Woolworths (UK)	£2,432M	£1,602M	£147M	10.90

[1] Based on averaged published financial statement data available for 5 years before company entered Chapter 11 (US), liquidation (UK) or bankruptcy (DEU). This data was included in the Board's IFRS 16 Effect Analysis https://cdn.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf

[2] Estimated using (i) a discount rate of 5% and (ii) estimated average lease terms based on the information disclosed in the financial statements.

[3] Off balance sheet leases (discounted) as a multiple of on balance sheet debt

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The Board's objectives

"The new Standard will provide much-needed transparency on companies' lease assets and liabilities.... It will also improve comparability between companies that lease and those that borrow to buy"

(Hans Hoogervorst; 13 January 2016)

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What has changed for lessees?

- Former operating leases capitalised

- All[1] leases accounted for similarly to today's finance leases

  - ROU asset and lease liability recognised

  - Depreciation of all ROU assets

  - Interest expense for all lease liabilities

What has changed for lessees?

Balance sheet

	IAS 17		IFRS 16
	Finance leases	**Operating leases**	**All leases**
Assets	✈🏛	---	✈✈🚗🚌 🏛🏛🏛
Liabilities	$$	---	$$ $$$$$
Off balance sheet rights / obligations	---	🚗🚌 ✈🏛🏛 $$$$$	---

Income statement

	IAS 17		IFRS 16
	Finance leases	**Operating leases**	**All leases**
Revenue	x	x	x
Operating costs *(excl. depreciation and amortisation)*	---	Single expense	---
EBITDA			⇧⇧
Depreciation and amortisation	Depreciation	---	Depreciation
Operating profit			⇧
Finance costs	Interest	---	Interest
Profit before tax			⇔

Definition of a lease

Based on which party **controls** the use of an **identified asset**

| Customer has control | → | **Lease** |
| Supplier has control | → | **Service** |
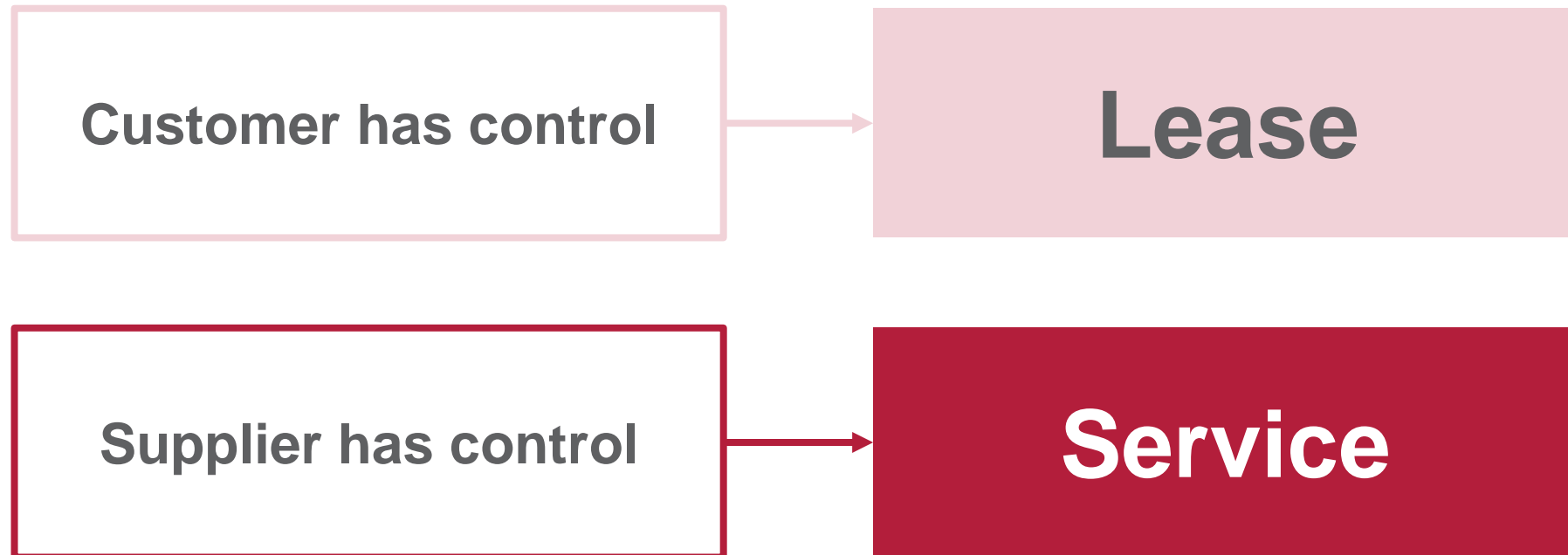
Optional recognition exemptions

Short-term leases

Leases of low-value assets

- If exemption is taken, account for these leases similarly to operating leases in IAS 17
- ie recognise **expense in P&L**

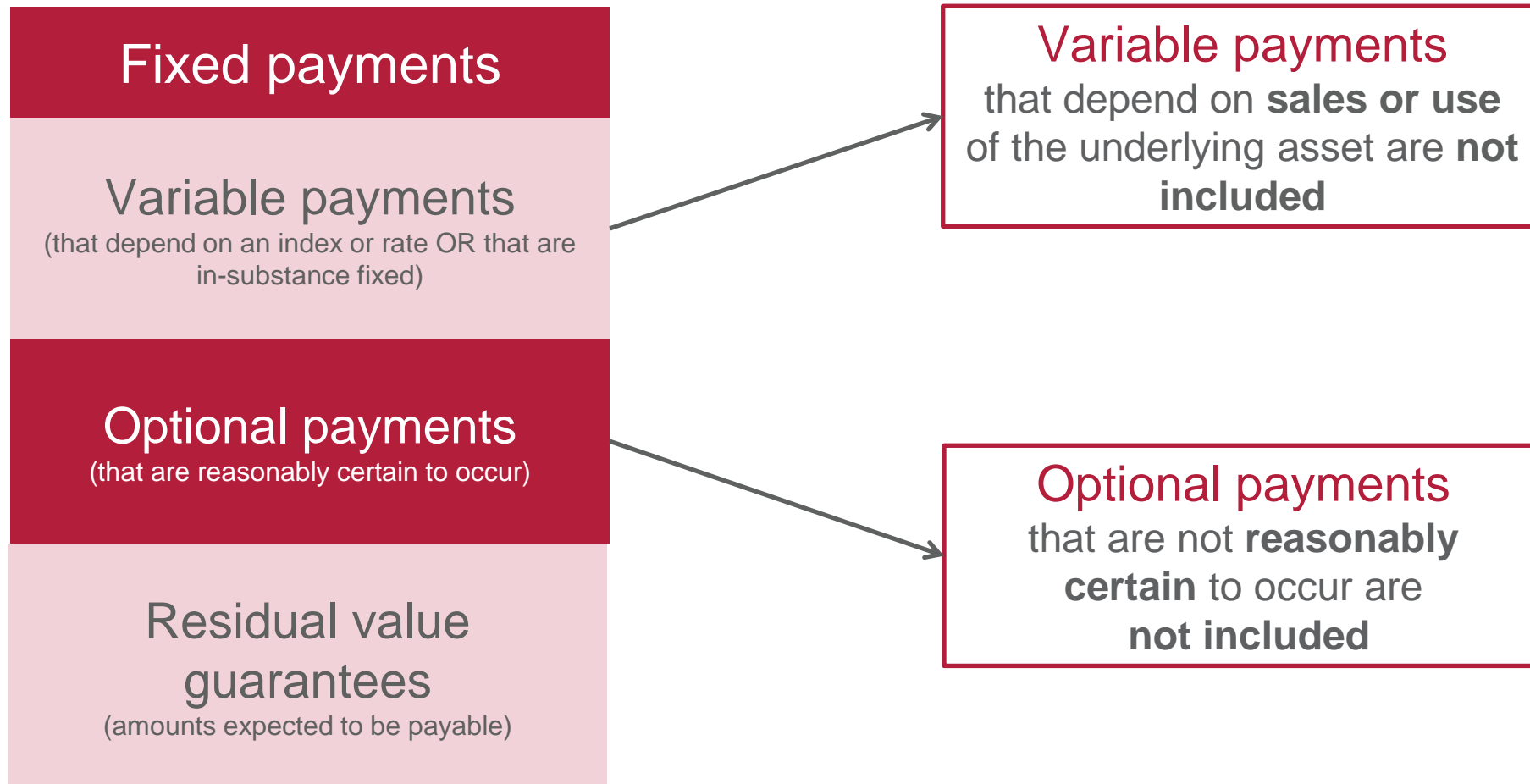# Balance sheet measurement: Lease liability

Lease liability	=	Lease payments during the lease term

$$\times$$

Discount rate

- If readily determinable: rate implicit in the lease
- Otherwise: lessee's incremental borrowing rate

Balance sheet measurement: Lease liability

Lease payments:

Fixed payments

Variable payments
(that depend on an index or rate OR that are in-substance fixed)

Optional payments
(that are reasonably certain to occur)

Residual value guarantees
(amounts expected to be payable)

Variable payments that depend on **sales or use** of the underlying asset are **not included**

Optional payments that are not **reasonably certain** to occur are **not included**

Lessor accounting

- Substantially retained the lessor accounting model in IAS 17

- Feedback on 2013 ED
    - Lessor accounting in IAS 17 is not broken
    - Concerns about cost and complexity

Subleases

Enhanced disclosures

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IFRS 16 *Leases*: Research Opportunities

Is IFRS 16 achieving its objectives?

(1) Providing transparency on companies' lease assets and liabilities

- What is the financial impact of the capitalisation of leases in the financial statements? For example:
  - What proportion of companies are now recognising lease assets and liabilities on the balance sheet that were not recognised applying IAS 17?
  - What is the approximate total value of lease assets and liabilities recognised as a result of IFRS 16 implementation?
- Did implementation of IFRS 16 lead companies to identify any additional leases or longer lease terms that were not previously included in IAS 17 operating lease commitments?

Is IFRS 16 achieving its objectives?

- Are companies providing disclosures about complex lease portfolios and lease exposures that are not reflected on the balance sheet? For example, about:
  - Variable lease payments
  - Residual value guarantees
  - Extension options and break clauses
  - Sale and leaseback transactions
- How do these disclosures compare to the information provided applying IAS 17? Are investors able to better understand complex lease portfolios and lease exposures as a result of IFRS 16 implementation?
- What have been the effects of increased transparency for companies? For example:
  - Have companies identified obsolete lease contracts (for example, payments being made for an asset that is no longer held?)
  - Have companies changed their accounting or lease management practices as a result of implementing IFRS 16?

Is IFRS 16 achieving its objectives?

(2) Improving comparability

- How has IFRS 16 implementation affected investors' ability to compare:
  - Companies that lease assets with companies that buy similar assets
  - Companies in different industries
- Has IFRS 16 implementation affected companies' decisions about whether to buy or lease assets?
- Have the options offered in IFRS 16 affected comparability in any material way? For example:
  - Optional recognition exemptions (short term leases and leases of low value assets)
  - Accounting for lease and associated service components as a single lease component
  - Transition options (fully retrospective vs modified retrospective approach)

Relevant materials

- *IFRS 16*

- Overview: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-16-leases/

- List of supporting materials: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-16/
    - Effects Analysis*: https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf*
    - Project Summary and Feedback Statement: https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-project-summary.pdf
    - Articles: https://www.ifrs.org/-/media/feature/resources-for/investors/investor-perspectives/investor-perspective-jan-2016.pdf

- https://www.ifrs.org/news-and-events/2016/03/hans-hoogervorst-article-shining-the-light-on-leases

- https://www.ifrs.org/-/media/project/leases/ifrs/educational-materials/ifrs16-leases-article-jan2017.pdf

- https://www.ifrs.org/news-and-events/2016/01/gary-kabureck-article-little-to-fear-in-new-world-of-lease-accounting/

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IASB Research opportunities

See News on our Academic page https://www.ifrs.org/academics/

- Webinars:
  - IFRS 9 *Financial Instruments*

    Thursday 21 January, 09:00-10:00 and Thursday 21 January, 15:00-16:00
  - IFRS 16 *Leases*

    Friday 22 January, 09:30-10:30 and Friday 22 January, 15:00-16:00
  - IFRS 15 *Revenue from Contracts with Customers*

    Monday 8 February, 09:00-10:00 and Monday 8 February, 15:00-16:00
- Journal special issues
- Upcoming conferences, including IASB Research Forum 2021

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Questions?

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