



Bringing clarity to an IFRS World
IFRS 16: Leases and other
financial reporting matters

May 11, 2016



Agenda

IFRS 16, Leases

- Overview
- Definition of a lease
- Lessee/Lessor accounting
- Transition

Other financial reporting matters

- New for 2016
- Other reporting developments
- IASB workplan
- Securities update



Important caveats

- This webcast does not provide official Deloitte interpretive accounting guidance
- Consult your Deloitte advisor for additional support

Please note – No certificates will be provided for attending this update, we encourage stakeholders to check with their provincial institutes regarding potential CPD credits.



IFRS 16

Overview

Setting the stage

The drivers of change...

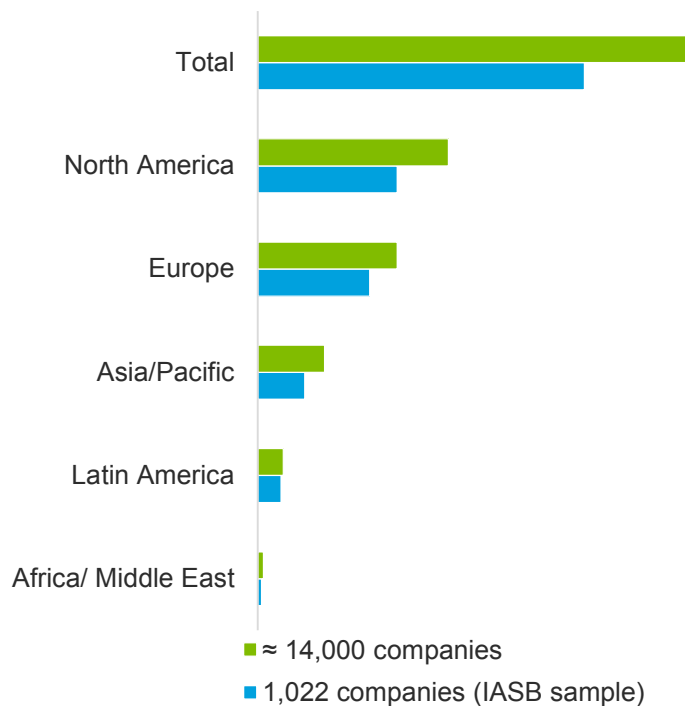
- Current model (IAS 17) requires lessees to classify leases as operating versus finance lease
- Operating leases do not result in the recognition of a leased asset or lease liability
- Operating leases perceived as creating “off balance sheet” financing (not transparent)
- Analysts and other financial statement users often “adjust” for operating leases in order to better understand an entity’s leverage
- Economically similar transactions were being accounted for differently

Setting the stage (cont'd)

Current off-balance sheet leases

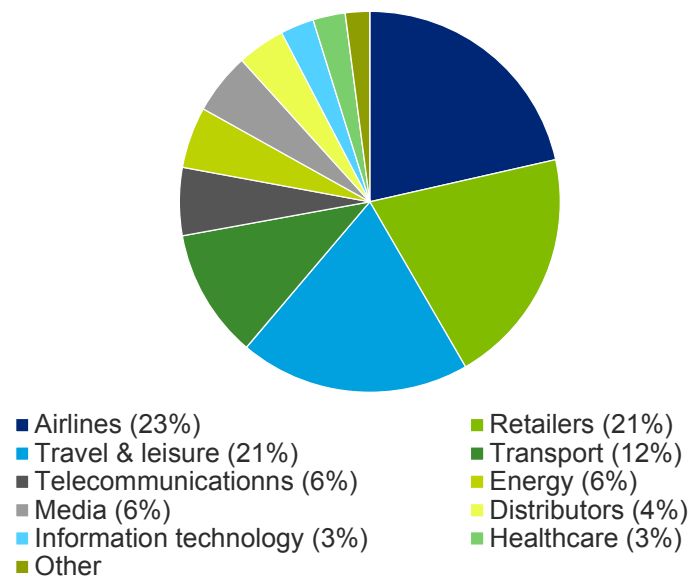
Off-balance sheet leases by region

in U.S.\$ trillions (discounted)



Excerpt from the IASB's IFRS 16 Effects Analysis

Impact by industry for lessees



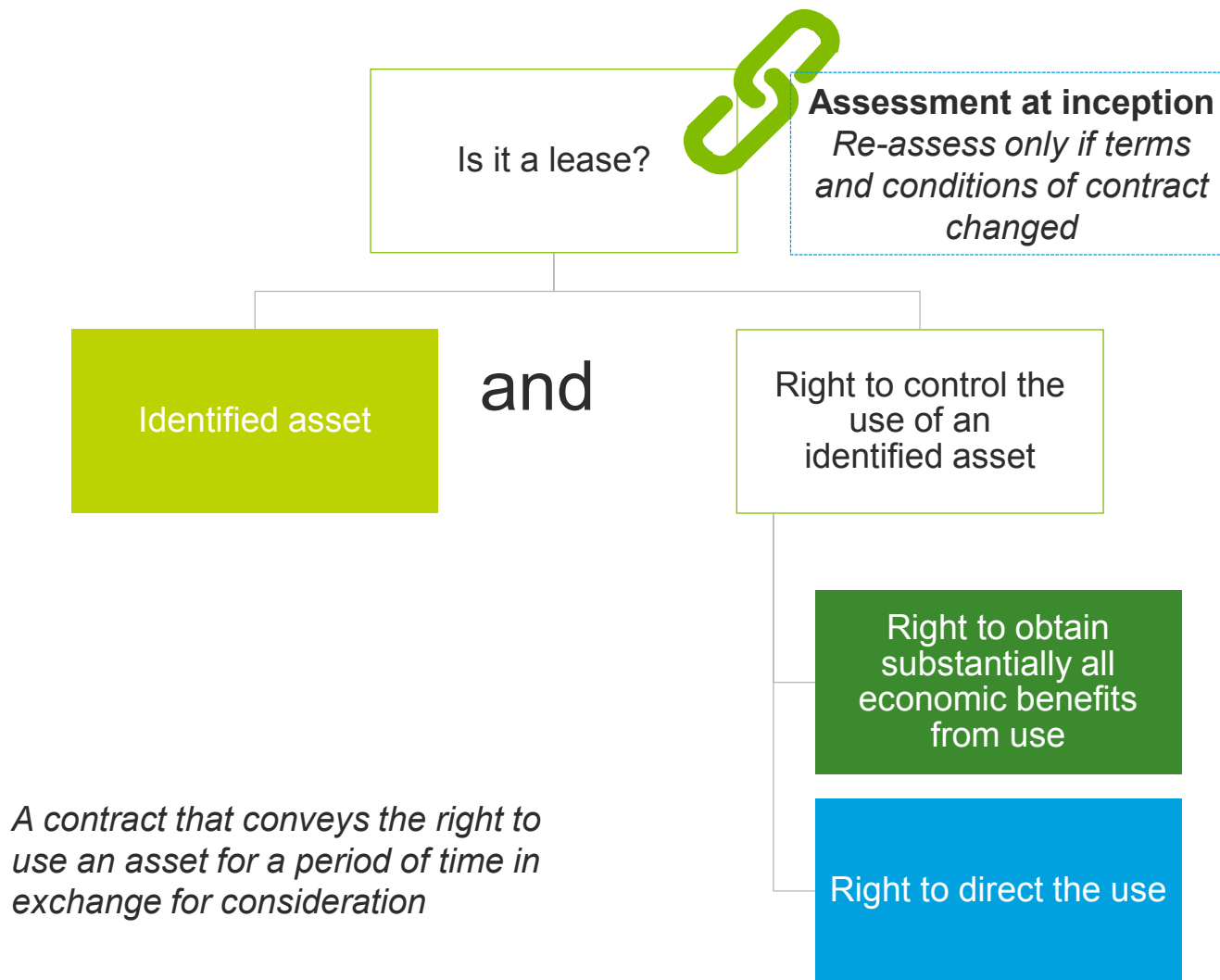
Based on the data from the IASB's Effect Analysis

IFRS 16

Identifying a lease

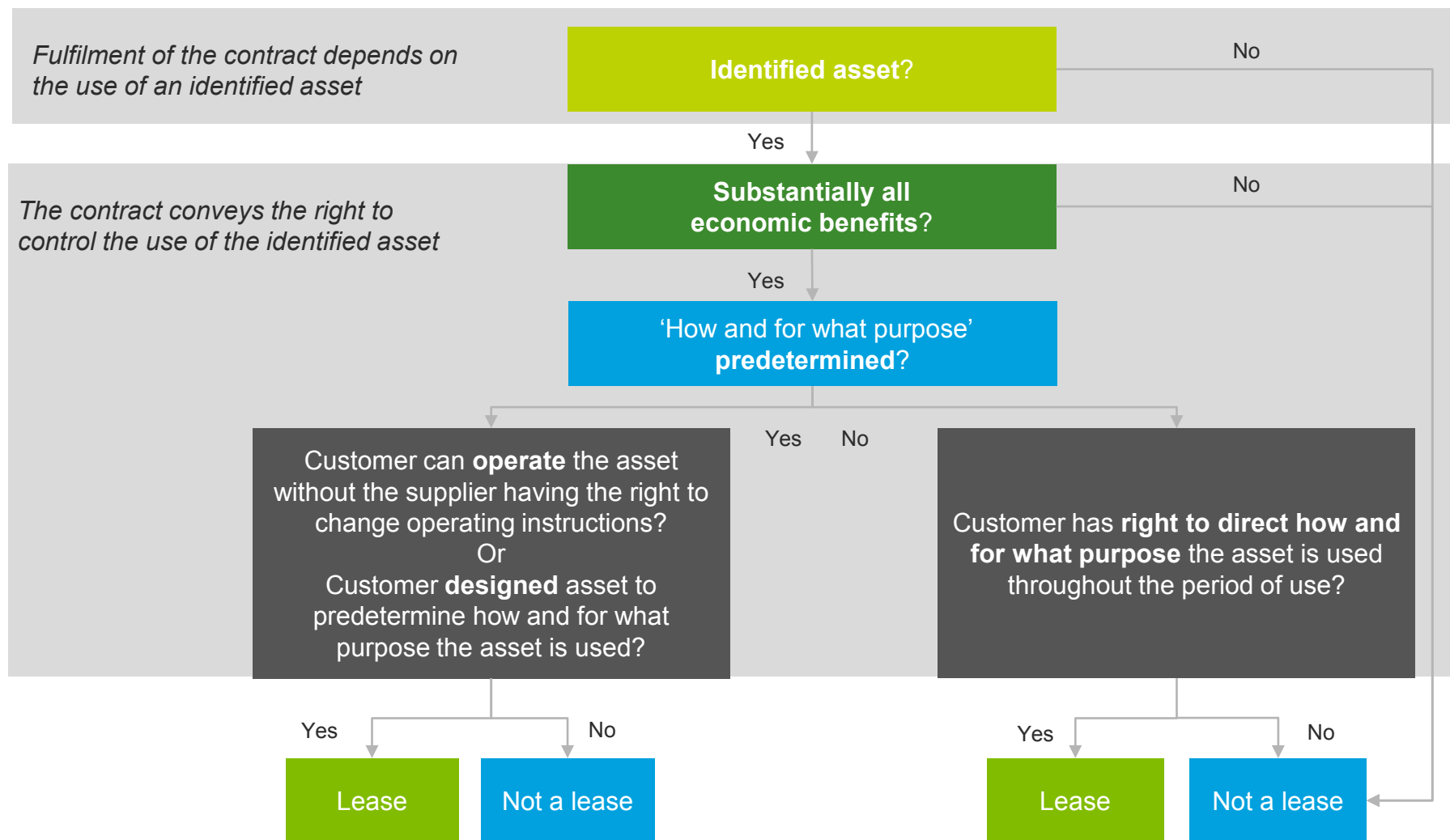
Identifying a lease

The requirements



Identifying a lease (cont'd)

A decision tree



Identifying a lease (cont'd)

Example [IFRS 16 IE6(B)]

Facts:

- Customer enters into a contract with Supplier for the use of a specified ship for a five-year period.
- The ship is explicitly specified in the contract and Supplier does not have substitution rights.
- Customer decides what cargo will be transported, and whether, when and to which ports the ship will sail, throughout the five-year period of use, subject to restrictions specified in the contract.
- Restrictions prevent Customer from sailing the ship into waters at a high risk of piracy or carrying hazardous materials as cargo.
- Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship.
- Customer is prohibited from hiring another operator for the ship of the contract or operating the ship itself during the term of the contract.”

Definition of a lease

Determine whether a contract is, or contains a lease?

1	Concept	Consideration under IE 6(B)	Other examples
	Use of an identified asset	<ul style="list-style-type: none">• Ship explicitly specified in the contract• No right to substitute	<ul style="list-style-type: none">• Capacity portions if physically distinct asset but not a portion that is not physically distinct, except in certain circumstance
2	Concept	Consideration under IE 6(B)	Other examples
	Right to obtain economic benefits from use of identified asset	<ul style="list-style-type: none">• Customer has exclusive use of the ship for the five-year period of use	<ul style="list-style-type: none">• A lease which includes a limit for mileage use
3	Concept	Consideration under IE 6(B)	Other examples
	Right to direct the use of the identified asset	<ul style="list-style-type: none">• Customer decides whether, where and when the ship sails, as well as the cargo it will transport, such decisions are subject to change over the period of use	<ul style="list-style-type: none">• Rights to change: type of output produced by the asset; and when or where the output is produced

IFRS 16

Lessee accounting

In a nutshell

Lessee accounting model

Old standard	
Balance Sheet	FY 20xx \$

Income statement	FY 2015 \$
Lease payments	xxx
EBITDA	xxx
Profit before tax	xxx

New standard	
Balance Sheet	FY 20xx \$
Lease assets	xxx
Lease liabilities	xxx

Income statement	FY 2015 \$
Low-value/short-term leases	xxx
EBITDA	xxx
Depreciation and amortisation	xxx
Finance cost	xxx
Profit before tax	xxx

In a nutshell (cont'd)

Lessee accounting model

Balance sheet



Assets and liabilities



Impact on gearing

- Recognise lease assets and liabilities on balance sheet
- Initially measured at the present value of unavoidable lease payments

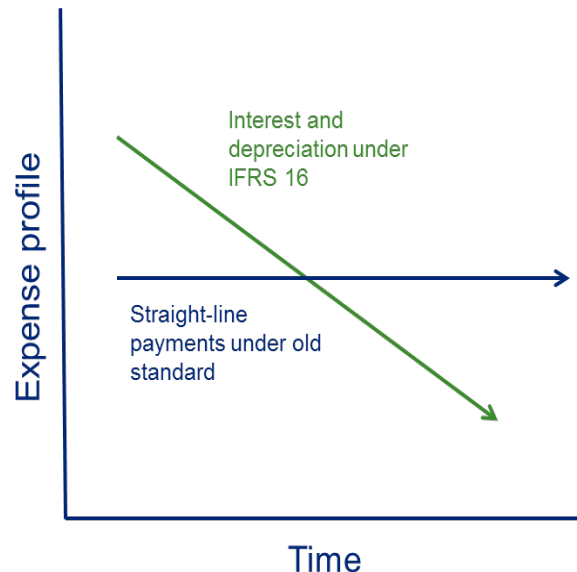
Income Statement



EBITDA



Profit profile (lower in earlier years of lease)



Cash flow statement



Operating cash inflows



Financing cash outflows

- Repayment of principal: **finance activities**
- Repayment of interest: **finance or operating activities** (depends on accounting policy for interest)
- Some variable payments, payments from short-term leases and from assets of low value: **operating activities**

Lessee accounting

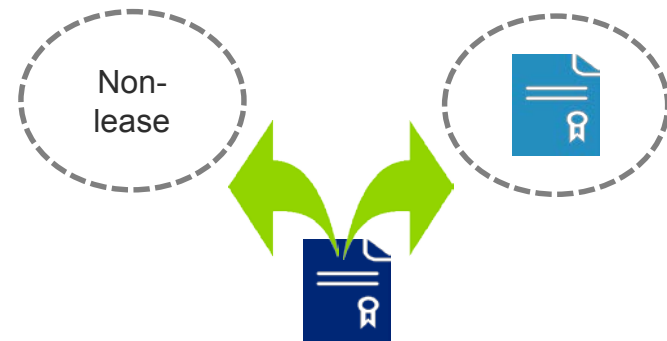
Some practical expedients

Combine two or more contracts with a portfolio



Account for as a single contract

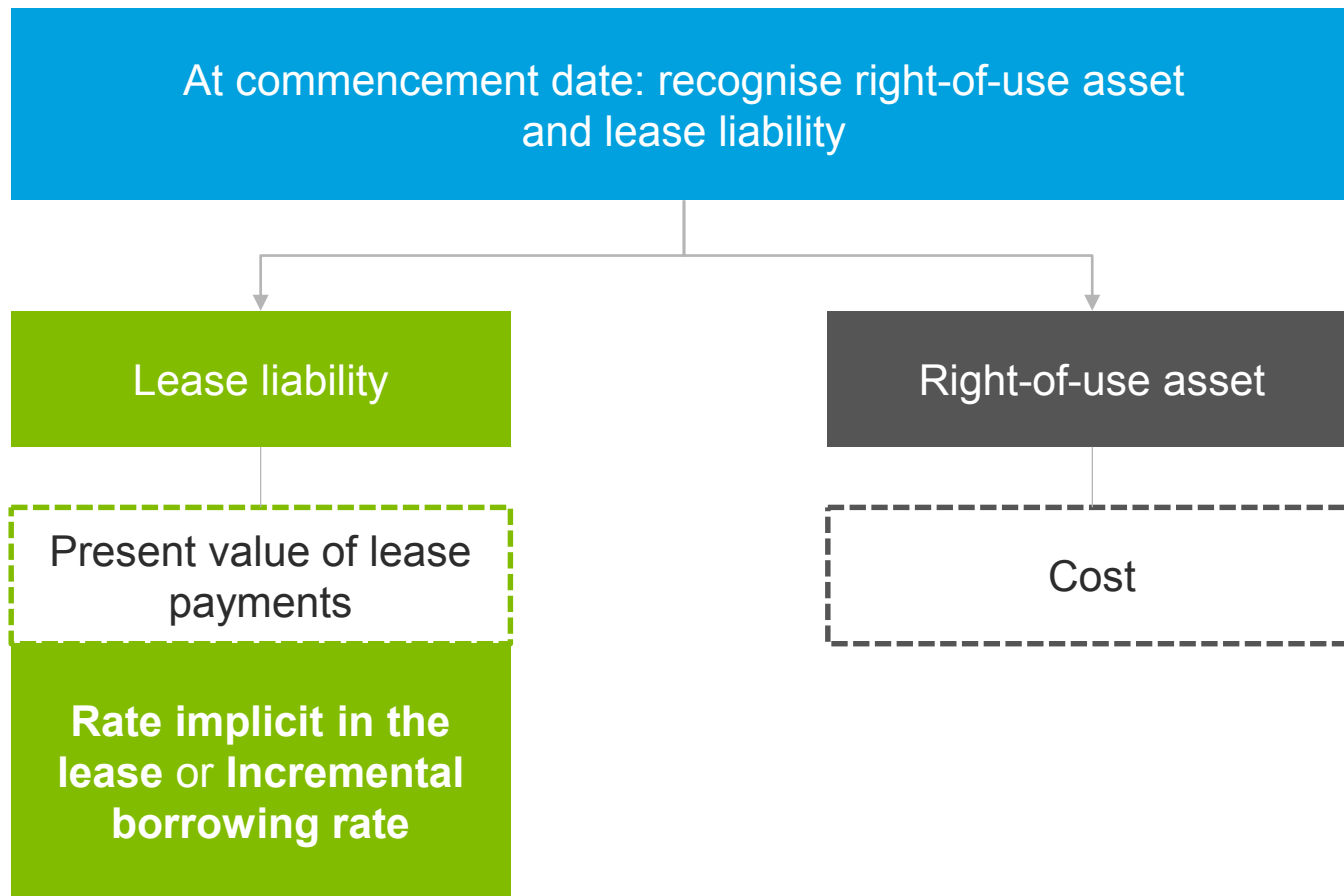
Identify separate lease components



Account for separately from non-lease components of a contract
or
Elect not to separate
(by class)

Lessee accounting (cont'd)

Measurement



Lessee accounting (cont'd)

Lease payments

Fixed payments

- Include in-substance fixed payments, net of any lease incentives
- In-substance payments can be variable but must be **unavoidable**

Index or rate linked variable payments

- Any variable lease payments **not** related to an index or a rate will be recognized in profit or loss as incurred (e.g., variable lease payments related to future performance)

Residual value guarantee amount

- Amounts expected to be payable under residual value guarantees
- Triggers potential disclosures

Purchase option exercise price

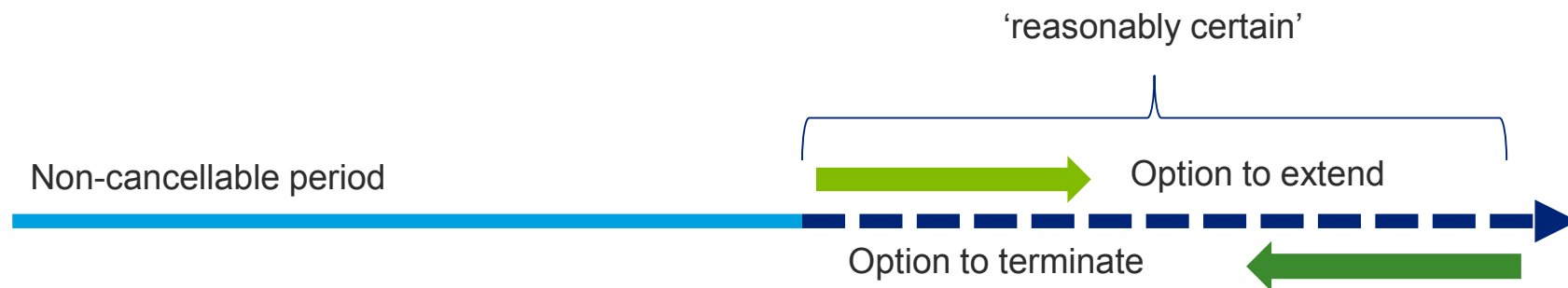
- Only include if lessee **reasonably certain** to exercise the option

Lease termination penalty payments

- Only include if lessee is **reasonably certain** to exercise an option to terminate the lease

Lessee accounting (cont'd)

Lease term



Consider all facts and circumstances that create an **economic incentive**, including expected changes:

- Contractual terms for optional periods
- Significant leasehold improvements
- Costs of termination and return
- Importance to operations (Specialised, location, alternatives)
- Conditionality associated with option

Reassess significant event or change in circumstances that lessee controls and affects whether exercise 'reasonably certain'.

Revise: change in non-cancellable period.

Lessee accounting (cont'd)

Exemptions

Accounting policy choice:
Apply IFRS 16 or straight-line the expense
(if applying the exemption: Apply IAS 37 to assess onerous contracts)



Short-term leases
(12 months or less)

A lease that contains a purchase option is
not a short-term lease

Election by class of underlying asset



Low-value
leases

Assessment on an absolute basis

Election on a lease-by-lease basis

IFRS 16

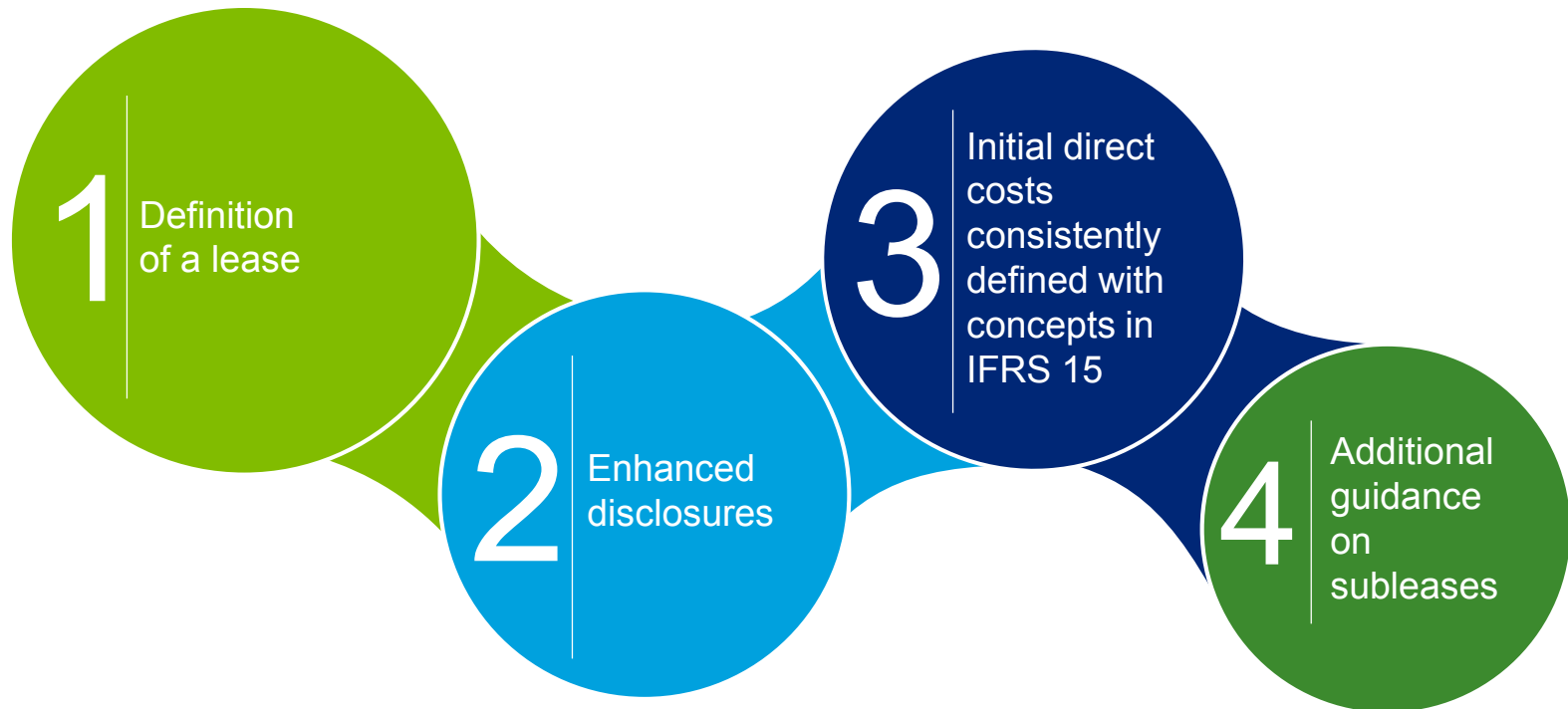
Lessor accounting

Lessor accounting

IFRS 16 vs IAS 17

Lessor accounting largely unchanged

Main changes are...



IFRS 16

Transition

Transition

Practical considerations

Effective for periods commencing on or after **January 1, 2019**

Earlier application permitted if IFRS 15 has also been applied

Not required to reassess whether a contract is, or contains, a lease at the date of initial application

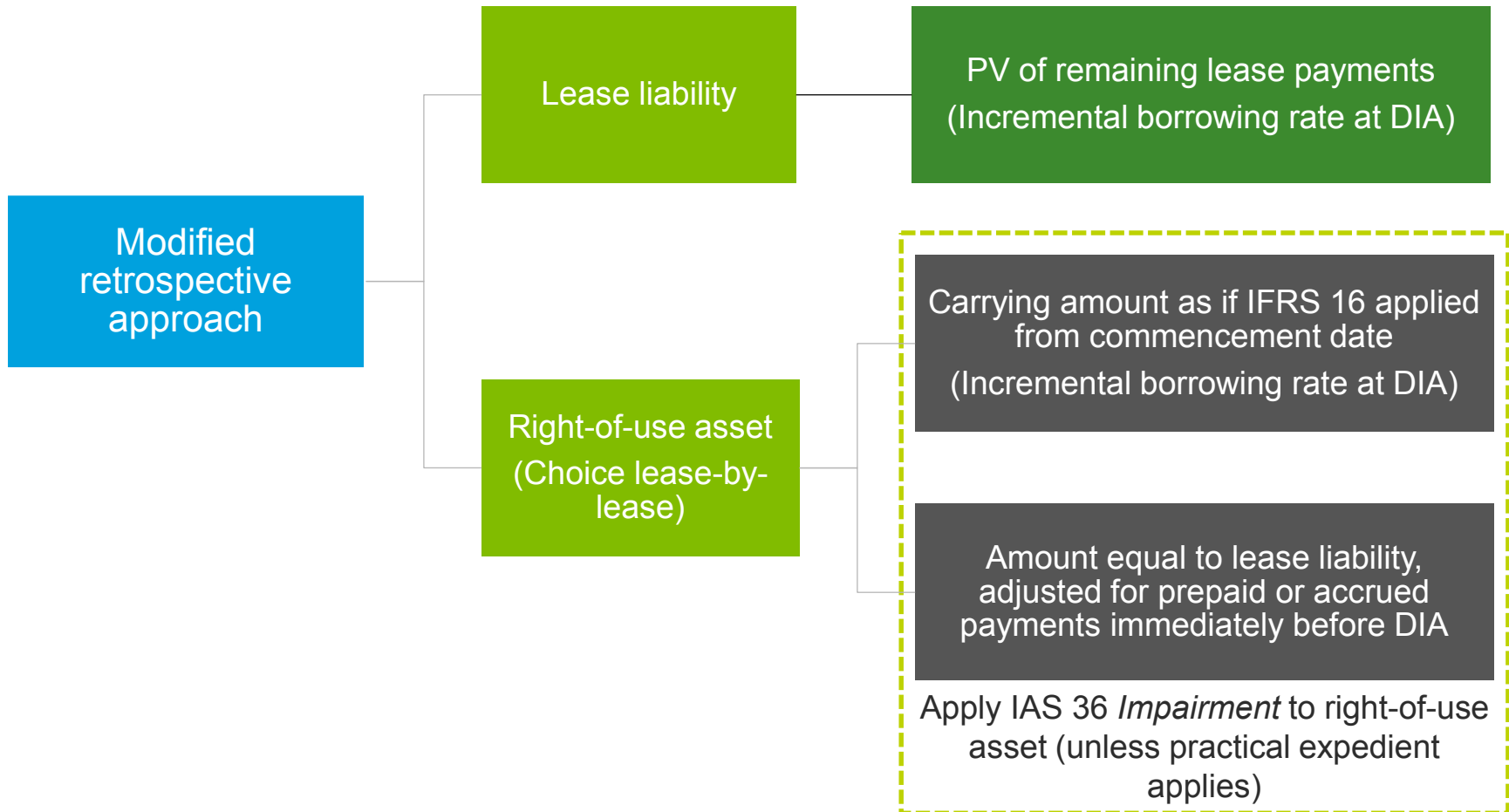
Challenge for systems to capture all data?

Either apply IFRS 16:

- i. With full retrospective effect, or
- ii. Modified retrospective approach (Comparative information unadjusted but opening retained earnings adjusted)

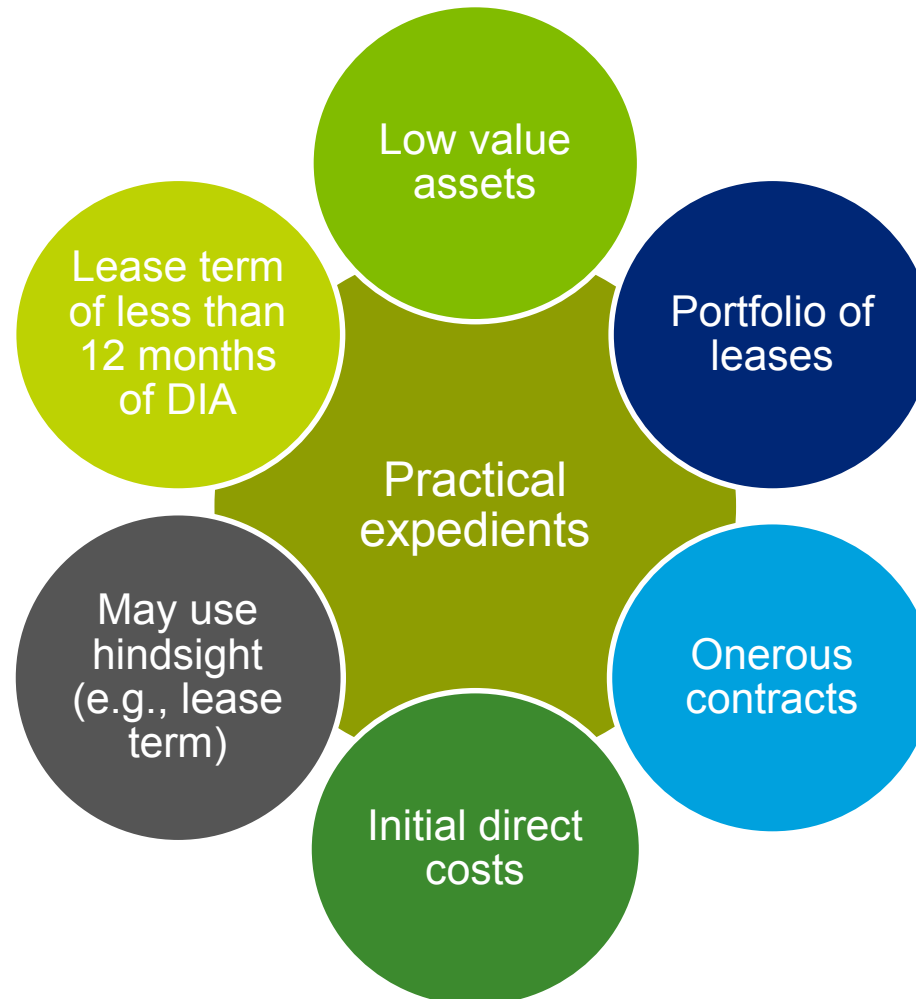
Transition (cont'd)

Lessees: Modified retrospective approach



Transition (cont'd)

Lessees: Modified retrospective approach – Practical expedient



Transition (cont'd)

Broad considerations for lessees

Financial reporting

- Bringing a large financial liability onto the balance sheet
- Financial statement volatility for some
- Higher costs in earlier years
- of leases
- Impact on management information needs
- Implication of the accounting process for large groups

Board level considerations

- Gearing and covenant compliance
- Management KPIs
- Transparency and communication
- Increased focus on corporate real estate costs and strategy
- Tax risk
- Impact on capital requirements

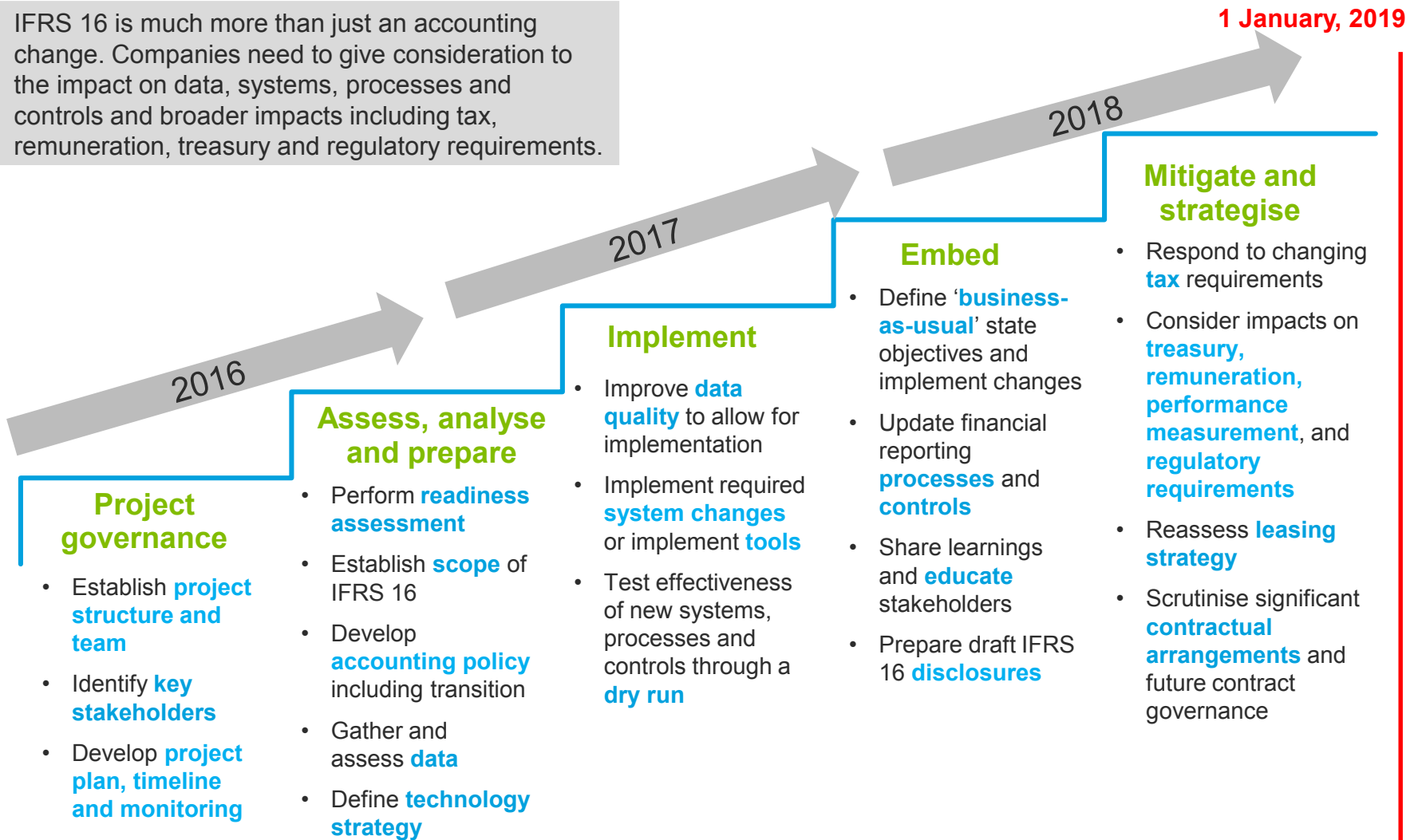
Practicalities

- Significant workload to calculate liabilities
- Availability of information, data integrity and collection (initial and reassessment)
- Resourcing and reporting lines
- Preparing the market/shareholders

Next steps

Steps to success

IFRS 16 is much more than just an accounting change. Companies need to give consideration to the impact on data, systems, processes and controls and broader impacts including tax, remuneration, treasury and regulatory requirements.



Other financial reporting matters

Overview

New for 2016

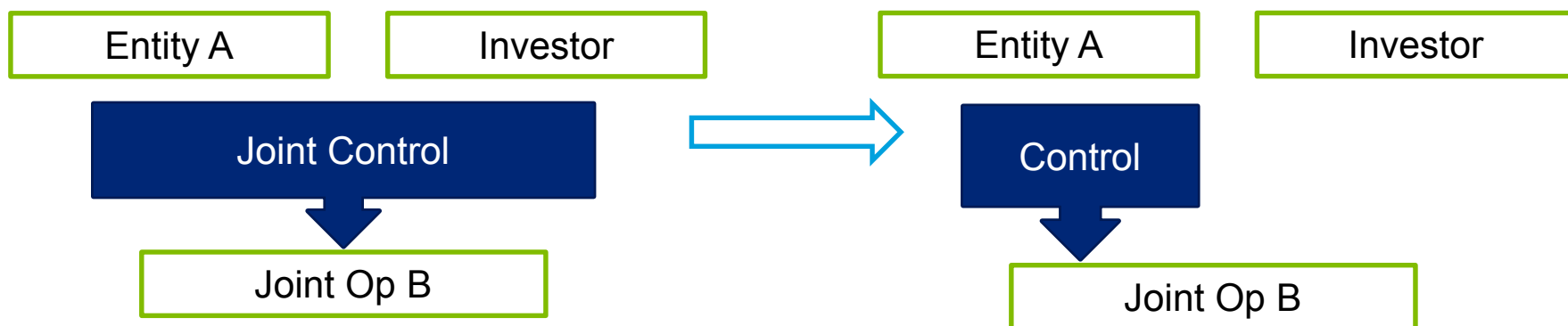
IAS 1.82A – Presentation of items in Other Comprehensive Income (“OCI”)

- Requires separate presentation of OCI attributable to equity accounted associates and JVs

	2016	2015
Profit for the year	27,142	30,584
Other comprehensive income, net of income tax		
Items that will not be reclassified subsequently to profit or loss		
Gain on revaluation of property	1,150	0
Share of gain (loss) on property revaluation of associates	500	100
Remeasurement of defined benefit obligation	64	34
	1,714	134
Items that may be reclassified subsequently to profit or loss		
Exchange differences on translating foreign operations	(39)	85
Net fair value gain on available for sale financial assets	105	77
	66	162
Other comprehensive income for the year, net of income tax	1,780	296
Total Comprehensive Income for the year	28,922	30,880

New for 2016 (cont'd)

IFRS 11 - Accounting for acquisitions in joint operations



- Joint Op = Business under IFRS 3
- Deemed business combination achieved in stages
 - Remeasure previously held share of business at acquisition date fair value
 - Recognize gain or loss, as appropriate
 - Recognize identifiable assets and liabilities under IFRS 3, subject to IFRS 11 measurement principles

New for 2016 (cont'd)

IAS 16 and 38 - Clarification of acceptable methods of depreciation and amortization

- **PP&E** - Use of a revenue-based depreciation method is **prohibited**
- **Intangible assets** - A **rebuttable presumption** exists that a revenue-based amortization method is inappropriate, but can be overcome only in limited circumstances:
 - a) when the intangible asset is expressed as a **measure of revenue** or
 - b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are **highly correlated**
- Criteria a) is met when the predominant limiting factor is the achievement of a revenue threshold
 - For example, a contract may allow the extraction of gold from a mine until total cumulative revenue from the sale of gold reaches \$2 billion, not based on time or on the amount of gold extracted
- The amendments do not define “**highly correlated**” so judgment is required

Other reporting developments

IFRIC decision re: IAS 16 Property, Plant & Equipment and IAS 38 Intangible Assets – Variable payments for asset purchases

- Whether variable payments that depend on the purchaser's future activity should be recognized as a liability until that activity is performed and what the initial measurement of this liability should be

Final Agenda Decision

- Two schools of thought:
 - All variable payments meet the definition of a liability and should be initially recognized and measured at fair value; vs.
 - Variable payments that depend on purchaser's future activity meet definition of liability when activity occurs
- IFRIC considered additional concepts proposed in definition of liability in the Conceptual Framework Exposure Draft (published in May 2015) and noted IASB members had mixed views
- Issue is too broad and therefore not to add to agenda

Other reporting developments (cont'd)

IFRIC decision re: IAS 32 Financial Instruments: Presentation—Offsetting and cash pooling

IFRIC considered the following example:

- Cash pooling arrangement where subsidiaries each have separate bank accounts
- At the reporting date, there is a legally enforceable right to set off balances in these accounts
- Interest is calculated on the net balance of all the accounts
- The company regularly initiates transfers of balances into a single netting account, but transfers are not required and are not done at the reporting date
- Further, as at the reporting date, balances are expected to change due to individual account activities before the next transfer date.

Question: Can the intent to settle net be demonstrated to support offsetting of the accounts at the reporting date under IAS 32?

Final Agenda Decision

- IFRIC decided not to add this to their agenda
- The rejection notice indicates that in this fact pattern the intention to settle net was not demonstrated and therefore offsetting would not be appropriate

Other reporting developments (cont'd.)

What the SEC is saying about the new revenue standard

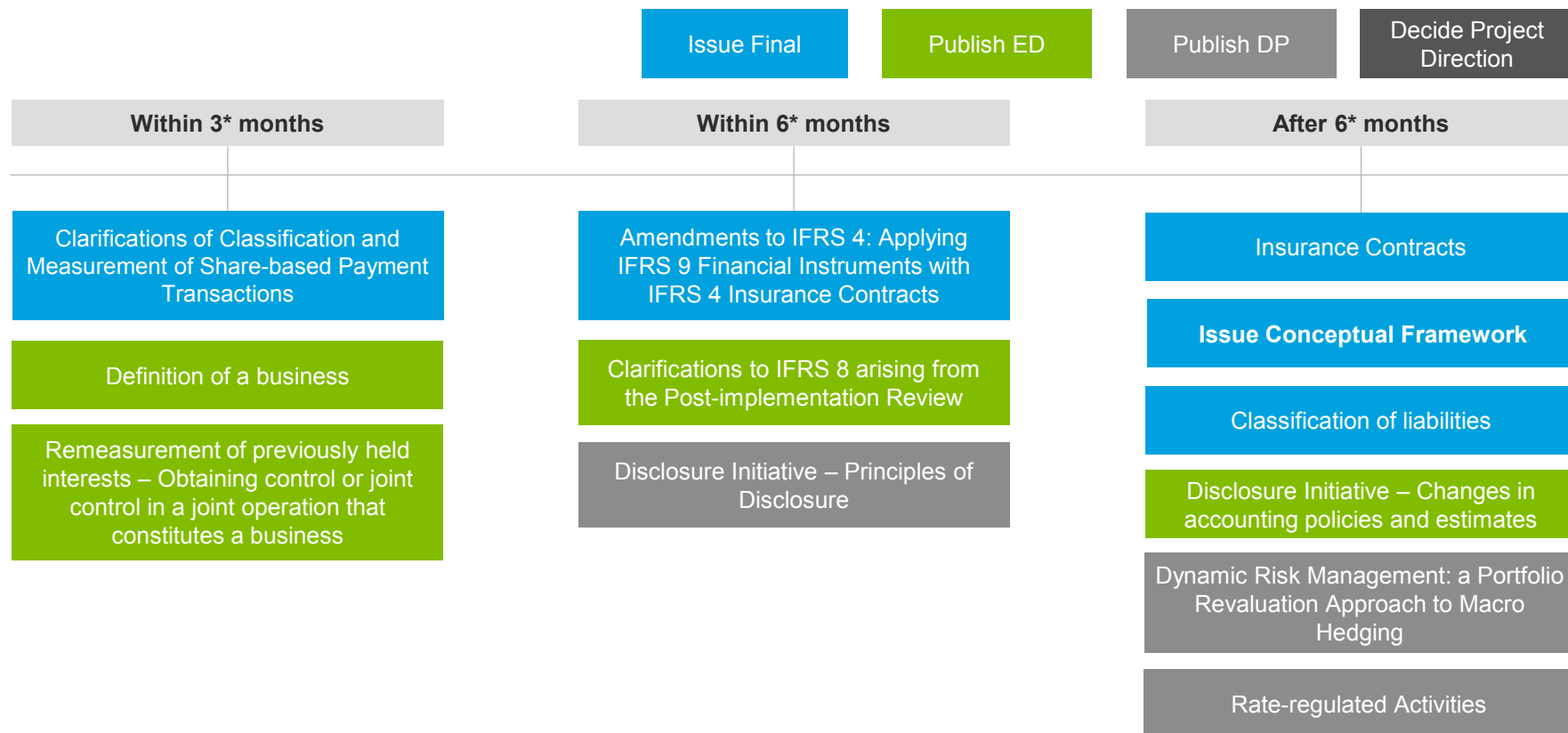
The Chief Accountant from the SEC's OCA gave a speech in March 2016 re: the new revenue recognition standards.

Some key takeaways:

- Registrants are expected to monitor the TRG discussion and meeting minutes to support their selection and implementation of 'reasonable' accounting policies.
 - The SEC expects domestic and foreign private issuer registrants to have converged (consistent) reporting outcomes for identical transactions
- Implementation may not only require adjustment to accounting policies, but potentially changes to the design of related controls.
- The SEC is expecting more detailed disclosure on the effect of the new standard
- Auditors have an obligation under PCAOB standards to communicate with the audit committee about any concerns regarding management's anticipated application of accounting pronouncements

Coming soon...

IASB work plan



Expected timing based on April 22, 2016 IASB work plan.
<http://www.ifrs.org/current-projects/iasb-projects/Pages/iasb-work-plan.aspx>

Securities considerations

What is new?

- NI 52-306 Non-GAAP Measures (effective Jan 1, 2016)
- Deloitte U.S.' Heads Up: “Top 10 Questions to Ask When Using a Non-GAAP Measure” (issued April 7, 2016; Volume 23, Issue 10)
- Continuous disclosure reviews underway

Resources...

Resources

Deloitte's centre for financial reporting at: <http://www.iasplus.com/en-ca>

- [Quarterly Technical Update Webcasts](#)
- [Financial Reporting Insights newsletter](#)



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