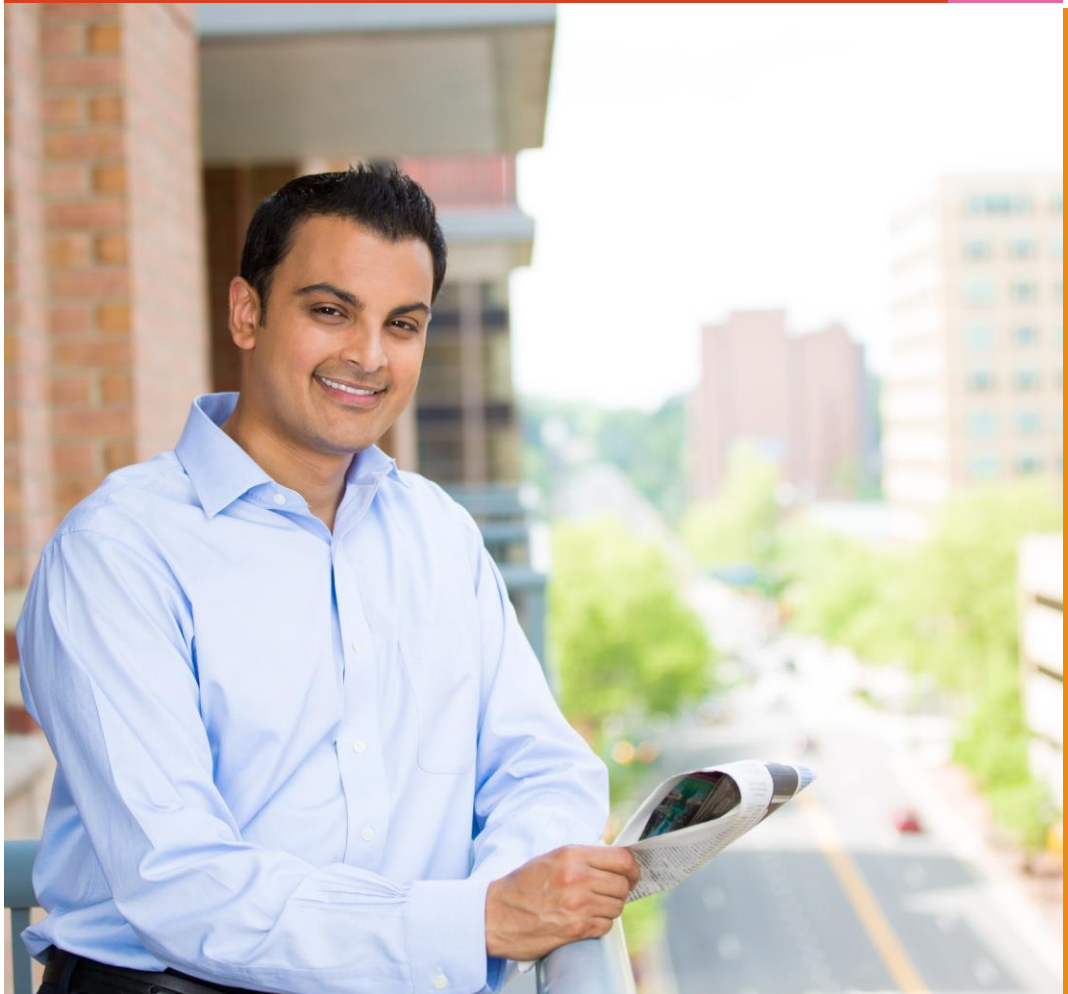


A new era of lease accounting

April 2018






A new era of lease accounting




The Financial Accounting Standards Board (FASB), International Accounting Standards Board (IASB) and the Accounting Standard Board (ASB) of the Institute of Chartered Accountants of India (ICAI) have embarked on ushering in a new era of lease accounting. New leasing standards are expected to bring about a paradigm shift in the accounting and recognition of leases by lessees.

The ASB has issued an exposure draft on Ind AS 116, *Leases*, with a proposed effective date of 1 April 2019, subject to notification by Ministry of Corporate Affairs. IFRS 16, *Leases*, is effective for annual periods beginning on or after 1 January 2019. ASC 842, *Leases*, is effective for fiscal years beginning after 15 December 2018.

Comparative summary

Although the objective of the IASB and FASB was to have a unified set of rules, there are still some differences in the standards issued. Significant areas of differences have been discussed below.

	IFRS 16	Ind AS 116	ASC 842
 <p>Investment property</p>	<p>If a lessee applies the fair value model for investment properties in accordance with IAS 40, <i>Investment properties</i>, it shall apply the fair value model for right-of-use assets that meet the definition of investment property.</p>	<p>The option to subsequently carry right-of-use assets at fair value is not available.</p>	<p>The option to subsequently carry right-of-use assets at fair value is not available.</p>
 <p>Presentation in balance sheet</p>	<p>Right-of-use assets may be presented either separately or within the same line item within which the corresponding owned assets would be presented.</p> <p>Similar option is available for presentation of lease liability.</p>	<p>Right-of-use assets and lease liabilities shall be presented on the balance sheet or disclosed in the notes separately from other assets and other liabilities.</p>	<p>Finance lease right-of-use assets and operating lease right-of-use assets shall be separated from each other and from other assets and be presented either in the statement of financial position or disclosed in the notes.</p> <p>Similarly, finance lease liabilities and operating lease liabilities shall be separated from each other and from other liabilities.</p>
 <p>Presentation in income statement</p>	<p>The income statement recognition for all the leases will consist of amortisation of the right-of-use asset and interest expense related to the lease liability.</p>	<p>Similar to IFRS 16.</p>	<p>There will be a different pattern of recognition for lease classified as operating leases in which the amortisation of the right-of-use asset and interest expense related to the lease liability will be recorded together as a lease expense to produce a straight-line recognition effect in the income statement.</p>

	<i>IFRS 16</i>	<i>Ind AS 116</i>	<i>ASC 842</i>
 <p>Presentation in statement of cash flows</p>	Repayment of interest may be classified as either an operating or financing activity.	Interest payments are to be presented as a financing activity.	Interest payments are classified as an operating activity.
 <p>Exemption</p>	Recognition and measurement exemption are available for low value leases.	Similar to IFRS 16.	No exemption for low value leases.
 <p>Variable lease payments</p>	Reassessment of a lease liability is required if change in lease payments occurs as a result of a change in an index or rate.	Similar to IFRS 16.	Change in the lease payments as a result of a change in index or rate is not a reassessment event.

Lessee accounting

- Lease liability is initially recognised and measured at an amount equal to the present value of minimum lease payments during the lease term that are not yet paid.
- Right-of-use asset is recognised and measured at cost, consisting of initial measurement of lease liability plus any lease payments made to the lessor at or before the commencement date less any lease incentives received, initial estimate of the restoration costs and any initial direct costs incurred by the lessee.
- The lease liability is measured in subsequent periods using the effective interest rate method. The right-of-use asset is depreciated in accordance with the requirements in Ind AS 16, *Property, plant and equipment*.
- Recognition and measurement exemption is available for low-value assets and short-term leases. Assets of low-value include IT equipment or office furniture. No monetary threshold has been defined for low-value assets. Short-term leases are defined as leases with a lease term of 12 months or less.
- If an entity chooses to apply any one of the exemptions, payments are recognised on a straight-line basis or another systematic basis that is more representative of the pattern of the lessee's benefit.

Key impact

Lessees were hitherto required to screen and distinguish each of the lease arrangements as either an operating (off balance sheet) or finance lease (on balance sheet). Ind AS 116 requires lessees to recognise a 'right-of-use asset' and a 'lease liability' for almost all of the leasing arrangements. Optional exemption is available in respect of short-term leases and low-value assets.

Ind AS 116 is expected to have a significant impact on the financial statements of a lessee and impact key ratios:



Statement of financial position

- Recognition of right-of-use asset and a corresponding lease liability result in an increase in the amount recognised for financial liabilities and assets for entities that had material operating leases.
- New accounting requirements for lessees will impact debt-equity ratios and may also cause entities to breach existing debt-covenants.



Statement of comprehensive income

- De-recognition of operating lease charges and recognition of depreciation and finance costs would positively impact EBIT and EBIDTA.
- Recognition of depreciation on right-of-use assets and unwinding of finance costs on lease liabilities result in higher costs being recognised during the beginning of the lease term.



Statement of cash flows

- Presentation of lease payments as 'cash flow from financing activities' has a favourable impact on 'cash flows from operations'.

Lessor accounting

Ind AS 116 does not contain substantial changes to lessor accounting compared to Ind AS 17. The lessor still has to classify leases as either finance or operating, depending on whether substantially all of the risk and rewards incidental to ownership of the underlying asset have been transferred.

Transition requirements

- Entities are not required to reassess existing lease contracts but can elect to apply the guidance regarding the definition of a lease only to contracts entered into (or changed) on or after the date of initial application ('grandfathering'). This applies to both contracts that were not previously identified as containing a lease applying Ind AS 17 and those that were previously identified as leases in Ind AS 17.
- Full retrospective application is optional.
- Lessee can elect to apply the simplified approach and not restate the comparative information. The cumulative effect of applying the standard is recognised as an adjustment to the opening balance of retained earnings at the date of initial application.

Disclosure requirements

Ind AS 116 requires enhanced quantitative and qualitative disclosures for both lessors and lessees.

Lease program management lifecycle

- Ensuring accounting policy alignment across the organisation
- Ensuring accounting inputs into data sourcing, calculations, and outputs
- Review business requirements and functional design specifications

Focus on

- Reassessment plan
- Management judgements
- Additional disclosures
- Transition considerations
- Tax implications



- Understand and document the Accounting policy touch points along the Acquire to Retire and Close to Report cycle continuum
- Determine changes to operating controls and policy/procedure manuals

Focus on

- Lease vs buy process decisions
- Contracting/buyer process controls
- Vendor process integration
- CAPEX budgeting and forecasting
- Loan covenants, credit ratings, and other agreement tracking

- Determine the organisational impacts, training strategy, and post-go live support model
- Employee mobilisation, training, and knowledge transfer
- Develop and execute against a communication strategy

Focus on

- Income and Indirect tax
- Treasury
- Real estate
- Internal audit
- Outsourced providers

- Understand the lease data landscape, gaps and maintenance
- Develop plans to gather 'unstructured' data if available only in contracts and not in tracking systems currently in use

Focus on

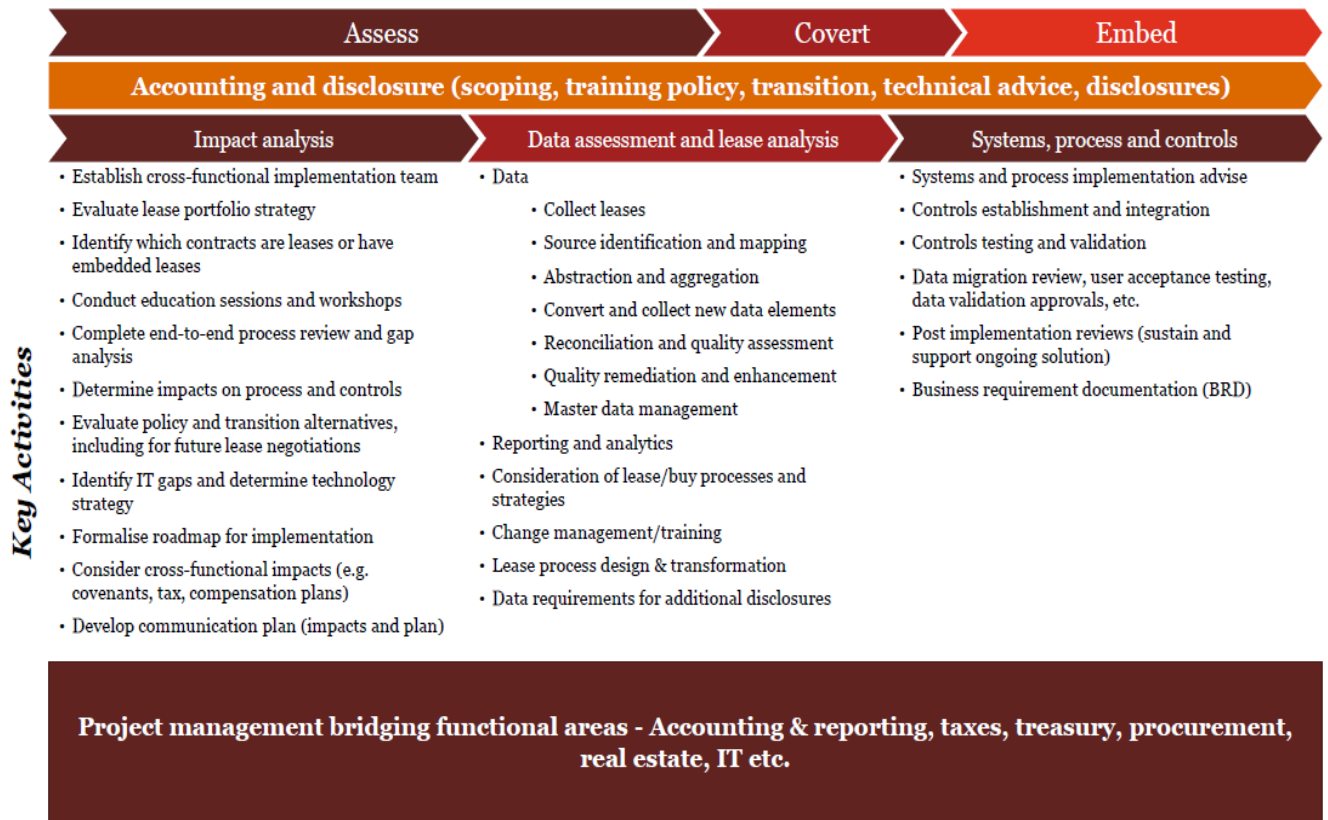
- Data baseline (what's our universe)
- Data plans related to gaps
- Data integration into A2R and R2R process points
- Ongoing data maintenance

- Facilitate the future state process/enable capabilities working with functional and Accounting teams
- Lead the overall implementation and provide inputs to IT

Focus on

- Reliance on spreadsheets
- Reporting and analytics
- Tracking systems integration to GL and sub-systems

End-to-end transition service



Explore our IFRS content on the new leasing standard



March 07, 2018

Retail and consumer ('R&C') industry supplement for IFRS 16 'Leases'

The retail and consumer industry is heavily impacted by IFRS 16 with a median increase in debt of almost 100%. This In depth supplement highlights the most significant challenges for the retail and consumer industry including renewal options, variable payments and key money.

<https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/retail-and-consumer-ifrs-16-leases.pdf>



February 14, 2018

IFRS 16, 'Leases' - Implications for the airlines industry - PwC In the Spotlight

All lease contracts will be landing on the balance sheet of the lessee under IFRS 16. This change is estimated to add trillions of dollars of lease obligations to the balance sheets of airlines world-wide. Most lease obligations are denominated in US-Dollars, with many airlines exposed to additional foreign currency volatility.

<https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/ifrs-16-implications-for-the-airlines-industry.pdf>



December 28, 2017

IFRS 16, 'Leases' for the shipping industry - PwC In depth supplement

The shipping industry is likely to be one of the most affected by the new standard, given that bareboat, time-charter contracts and other arrangements that are widely used in the industry will typically fall under the definition of a lease. This In Depth supplement explains how the arrangements common in the Shipping industry will be accounted for under IFRS 16.

<https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/shipping-industry-supplement-for-ifrs-16-leases.pdf>

In the Spotlight

An industry focus on the impact of IFRS 16 – Communications

IFRS 16, 'Leases'

April 04, 2016

An industry focus on the impact of IFRS 16 – Communications

Telecommunications

Publication

IFRS 16 will fundamentally change the accounting for lease transactions and is likely to have significant business implications for Telecoms.

<https://www.pwc.com/gx/en/communications/pdf/industry-focus-impact-ifrs-16.pdf>

In the Spotlight

An industry focus on the impact of IFRS 16 – Pharmaceutical & Life sciences

IFRS 16, 'Leases'

<https://inform.pwc.com/inform2/show?action=informContent&id=1635294902119791>

In the Spotlight

An industry focus on the impact of IFRS 16 – Chemicals

IFRS 16, 'Leases'

<https://inform.pwc.com/inform2/content?action=resource&id=0000018922460141.pdf>

October 06, 2016

The Leases Lab: Currency of lease contracts could create profit or loss volatility

IFRS 16

How can lessees deal with volatility created by lease contracts denominated in different currencies?

<https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/ifrs-news-2016-lease-contracts.pdf>

Explore our IFRS content on the new leasing standard



June 22, 2017

Episode 3: PwC IFRS Talks: IFRS 16, Leasing

IFRS 16

IFRS 16, Leasing - how will it impact you? What should you be doing now to get ready? Find out in just under 20 minutes.

<https://www.pwc.com/gx/en/services/audit-assurance/ifrs-reporting/podcasts/episode-3.html>



September 25, 2016

PwC Leasing Shortcuts

IFRS 16

Definition of a Lease according to IFRS 16

<https://youtu.be/Xv8QorwhGOU>

May 02, 2017

The Leases Lab: Do substitution rights automatically mean there is no lease?

IFRS 16

Substitution rights might allow customers to avoid lease accounting, but it's important such rights be substantive. We look at some examples and how companies should also consider the practical implications of obtaining such rights.

<https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/do-substitution-rights-automatically-mean-there-is-no-lease.pdf>



February 21, 2017

What you need to know: Expert and practical insights from IASB staff and PwC on the new standard and the impact on industries and companies.

IFRS 16

Our special guest speaker Patrina Buchanan, Associate Director at the IASB, discusses the highlights of the new guidance, including the new definition of a lease.

https://youtu.be/_91_jGaETCI



November 17, 2016

Find out how companies can prepare for the implementation of IFRS 16 Leases

IFRS 16

This video explores how companies are progressing in implementing the IFRS 16 Leases standard and answers questions on how to apply some of the requirements of the standard.

<https://youtu.be/hIQDVwmlAkk>

July 06, 2016

The Leases Lab: IFRS 16 also has a big effect on systems and processes

IFRS 16

The new standard requires greater oversight over lease accounting and contract management.

May 23, 2016

The Leases Lab: How will IFRS 16 affect lessee KPIs?

IFRS 16

Balance sheet ratios, income statement and cash flow statement KPIs might all be affected by the new standard.

<https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/ifrs-news-systems-and-processes.pdf>

<https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/ifrs-news-2016-key-performance-indicators.pdf>

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