The intricacies of implementing the new leases standard

The new leases standard, IFRS 16 *Leases*, was issued by the International Accounting Standards Board in January and is effective for annual periods beginning on or after 1 January 2019. IFRS 16 supersedes IAS 17 *Leases* on its effective date.

One of the key changes from IAS 17 to IFRS 16 is the requirement for lessees to report all lease obligations, subject to materiality, on the balance sheet. Under IAS 17, lessees accounted for lease obligations as operating leases (off balance sheet) or finance leases (on balance sheet).

The October 2015 IFRS Conference, which the Institute and the IFRS Foundation co-hosted in Hong Kong, discussed at length the implementation of the new lessee accounting requirements under IFRS 16. Contributors to the discussion were senior technical partners from the Big Four accounting firms, a senior finance personnel of a large conglomerate based in Hong Kong, an IASB member and IASB technical director in-charge of the leases project.

This article outlines the practical experience and advice in implementing the new lessee accounting requirements shared by these experts at the conference.

Experience and advice on implementing the new lessee requirements

Focus on your own facts and circumstances

IFRS 16 provides useful examples of how the standard should apply in practice. Do not get caught up in the details of the examples by trying to retrofit the examples onto your own operations. Begin the implementation exercise with an awareness of your own operations to determine what items could be a lease.

Prepare for new data collection and changes to reporting systems

- Start collecting the additional data required for comparative periods and disclosure requirements now.
  - IFRS 16 requires entities to apply the standard retrospectively (i.e. apply the standard as if it has been applied in prior periods). Entities will need to obtain data relating to leases of prior periods. Two approaches are provided by the standard to restate the comparative amounts in prior periods: the full retrospective restatement (i.e. restating each prior reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) and the modified retrospective restatement (i.e. recognizing the cumulative impact of the standard in the financial year of adopting the standard).
  - Do not underestimate the information necessary for disclosure requirements. Oftentimes disclosure requirements dictate the volume and format of data or information collection.
- Assess the need to revise your internal reporting systems. A high level assessment done by a conglomerate revealed that it has 6,000 plus leases just for its retail business group

alone. Leases are currently manually recorded using spreadsheets. In preparation for IFRS 16, the conglomerate engaged with a service provider three years ago to design a lease management module to facilitate the reporting of its lease obligations. The module can be tinkered with to accommodate future updates on the standard or reporting obligations (if any), and is capable of interfacing with the group's payment systems.

Plan for effective communication
Communication with various stakeholders is key when implementing new standards.

- Assess the impact of the new standard on the financial performance and position of your entity to manage investor expectations upfront.
- Discuss and agree with your debt providers about what metrics, other than just balance sheet indicators, can be used to assess the entity's gearing when negotiating debt covenants.
- Consider how to facilitate the sharing of IFRS 16 requirements and the sharing of live implementation issues between the finance or accounting department and the individual operating business units. For example, for entities with diverse operations or businesses, one or more implementation task-force committees comprising the finance team and/or implementation consultants could be formed to support each business unit.
- Actively engage with senior management when planning for implementation to avoid any last-minute changes to key reporting matters. For example, although it may be easier to adopt IFRS 16 using the "modified retrospective method" from an operational perspective, senior management may prefer to adopt the standard using the "full retrospective method" to provide users of the financial statements with year-on-year comparison (i.e. five years of historical financials). Changing from the modified retrospective method to the full retrospective method will significantly impact the systems requirements.

Review existing KPIs
Spend some time to understand how the lessee requirements will impact the performance reporting of each business unit within an entity, and revise the key performance indicators if necessary.

Last words from the IASB

HKFRS 16 exempts entities from applying the standard for "low-value underlying assets" or "short-term leases" to provide some relief for entities. The exemption is optional and should only be used in the most practical way possible.

In January, the IASB also published an effects analysis which accompanies IFRS 16 and details the expected impact of implementing the standard. The effects analysis is available on the IASB website.

This article is contributed by the Institute's Standard Setting Department