Nexia SAB&T Training and Technical

Tips on how to successfully manage the transition to the new Lease Accounting Standard

January 2019

IFRS 16 *Leases* comes into force for years commencing on or after 1 January 2019, which means that the transition date (the opening date of the comparative period) for December year ends has just passed.
Bearing this in mind, if you have not yet started work on your IFRS 16 impact assessment, now is the time to start.

To become – and remain – compliant, companies need to address five key challenges in the life cycle of a lease as far as lessees are concerned:

> **Note**: The requirements for **lessors** remain basically unchanged since IFRS 16 substantially carries forward the requirements of IAS 17 based on the distinction between operating leases and finance leases.

1. Engage with your auditors and advisors
   a. IFRS 16 requires a significant amount of judgement and estimations.
   b. Engaging with your auditors and IFRS advisors ensures you begin with the end in mind, and will make good choices that will withstand the test of time, and help you sleep better at night.

2. Determine if the contract contains a lease?
   a. Is there an identified asset?
   b. Does the person renting the asset obtain substantially all of the economic benefits?
   c. Does the person renting the asset have the right to direct the asset's use?
   d. Does the person renting the asset have the right to operate the asset?

3. Determining the lease term
   a. Non-cancellable period of the lease PLUS
   b. Period covered by an option to extend (if option is likely to be exercised) PLUS
   c. Period covered by an option to terminate (if option not exercised) contract (non-lease component).

4. How to determine the appropriate discount rate.
   a. If there is an interest rate implicit in the lease then you should use this to discount the minimum lease payments.
   b. However, if this cannot be readily determined, you should use your company's incremental borrowing rate (which is the rate of interest that you would have to pay to borrow a similar amount of money to fund a similar asset for a similar length of time with similar securities.)

5. Presentation and disclosure requirements.
   a. As IFRS 16 requires much of the information that was previously disclosed in the notes to financial statements to appear on the balance sheet, investors may expect that lease liabilities on the balance sheet under IFRS 16 will reflect the discounted amount of lease commitments disclosed in the notes section under the previous Standard.
   b. Making sure that the disclosures are as complete as possible in the period between now and the application of the new Standard, will help avoid unnecessary complications.

Remember to make use of the practical expedients during the transition:

- ❖ Application of a single discount rate to a portfolio of leases with reasonably similar characteristics.
- ❖ Use of the exemption to apply lease accounting to leases for which the lease term ends within 12 months of the date of initial application.
- ❖ Use of the exemption to apply lease accounting to leases of low-value items.
- ❖ Exclusion of the initial direct costs from the measurement of the right-of-use asset at the date of initial application.
- ❖ Using the "grandfather" approach on the previous assessment of contracts – this means the definition of a lease in terms of IFRS 16 is only applied for contracts entered into after the date of initial application.

The 'date of initial application' is the beginning of the annual reporting period in which a company first applies the standard. If a company prepares financial statements for annual periods ending on 31 December, presents one year of comparative financial information and adopts IFRS 16 in 2019, then its date of initial application is 1 January 2019.