IFRS 16 Leases:

Transition choices

February 2020

A lessee can choose to apply IFRS 16 through either a full retrospective approach or using a simplified approach.

The simplified approach seems to provide some benefits to the preparers of financial statements when applying module 2.

Retrospective approach

Under the retrospective approach, a company applies the new standard retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Comparatives also need to be restated.

Changes in accounting policies

An entity is permitted to change an accounting policy only if the change: is required by a standard or interpretation. [IAS 8.14]

Retrospective application means adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied. (In other words: restate prior financial information) [IAS 8.22]

Modified (Simplified) Approach

Under the simplified approach, a company applies IFRS 16 from the beginning of the current period. This requires the following:

- Calculating lease assets and lease liabilities as at the beginning of the current period using the unique rules included in IFRS 16.
- Do not restate prior-period financial information.
- Recognising an adjustment in equity at the beginning of the current period - depending on the unique rules included in IFRS 16.

Unique Rules

Adjustment to equity at beginning of current period (See Module 1)

This applies when:

- The lease was previously classified as operating lease and continues under IFRS 16.
- Management wants to reflect that IFRS 16 had always been applied.

No adjustment to equity at beginning of current period (See Module 2)

This applies when:

- Right-of-use (ROU) asset is based on the present value of remaining lease payments.

The Retrospective and Simplified approaches are best illustrated by way of example:

Leases Terms	Extract
Lease term	5 years
Interest rate	10%
Lease term past	2 years
PV of lease payments	R380
Depreciation	R76
Lease payments @ 5 years	R100

Year	Cash	Interest	Capital	Balance
0	-	-	-	380
1	100	38	62	318
2	100	32	68	250
3	100	25	75	175
4	100	17	83	92
5	100	8	92	0

Compare the accounting under IAS 17 and IFRS 16

Year	Cash IAS 17	Interest IFRS 16	Dep IFRS 16	Total IFRS 16	Difference
	1	2	3	4 = (2)+(3)	5 = (4)-(1)
1	100	38	76	114	14
2	100	32	76	108	8
3	100	25	76	101	1
4	100	17	76	92	-8
5	100	8	76	84	-15
		120	380	500	0

Full retrospective approach

Restatement of opening balances of the earliest period presented (that is: BEFORE 1 January 2018)

Account	Dr	Cr
ROU (right of use) asset	304 (380 − 76)	
Retained earnings in equity	14	
Lease liability		318

Restatement of the comparative period (year 2018)

Account	Dr	Cr
Lease liability	68	
Interest	32	
Depreciation	76	
ROU asset		76
Operating lease expenses		100

Simplified Approach

IFRS 16 had always been applied (Model 1)

Account	Dr	Cr
ROU asset	228 (380 - 76 -76)	
Retained earnings in equity	22	
Lease liability		250
Depreciation	76	
Accumulated depreciation		76

Based on lease liability (Model 2)

Account	Dr	Cr
ROU asset	250	
Lease liability		250
Retained earnings (in equity)	0	0
ROU asset measured by Lease Liability		
Depreciation (3 years remain)	83	
Accumulated depreciation		83