13th Annual AOSSG meeting Sri Lanka

Lessons from IFRS 16 *Leases* transition relief *and* practical expedients

Joint MASB-AASB project

Disclaimer:

These slides have been prepared by MASB and AASB staff for presentation at the 13th Annual AOSSG meeting in November 2021

Any views are individual MASB and/or AASB staff views and not necessarily those of the FRF, MASB, FRC or AASB

What is being researched and why?

IFRS 16 includes a choice between two transition approaches, optional transition relief and practical expedients a lessee can choose to apply:

- On transition from IAS 17 to IFRS 16
- On an ongoing basis under IFRS 16

Stage 1: A review of the transition-year financial reports of the 80 largest listed companies (LLCs Malaysia: 30; Australia: 50)

Stage 2: Interviews with Malaysian and Australian financial statement preparers (not limited to the 80 LLCs), auditors and users to ascertain:

- Which practical expedients are applied
- Reasons for applying / not applying them
- Ideas for other possible practical expedients

Lessons learned about applying IFRS 16 transition relief and practical expedients might provide useful information on making practical expedients available in future IFRS

Who have we interviewed?

MASB staff have (to date) interviewed:

- Preparers from Bursa-listed entities (11)
- Malaysian-based large firm auditors (7)
- Users of Bursa-listed entity financial statements (3)

AASB staff (to date) have interviewed:

- Preparers from ASX-listed entities (9)
- Australian-based large firm auditors (1)
- Users of ASX-listed entity financial statements (1)

Interviews were conducted throughout 2021 and covered the year of adoption and at least one subsequent year of IFRS 16 application

Transition relief and practical expedients

- No need to reassess whether a contract is, or contains, a lease [¶C3]
- Full or partial retrospective application [¶C5]
- If partial:
  - Measure lease liabilities at PV of remaining lease payments discounted at IBR and choose to measure RoU assets as:
    a. carrying amount from commencement discount at IBR; or
    b. equal to lease liability adjusted for accruals [¶C8]
  - Single discount rate for similar leases [¶C10]
  - Rely on earlier assessment of whether onerous [¶C10]
  - Leases in last year treated as operating [¶C10]
  - Exclude initial direct costs (NA to option b) [¶C10]
  - Use hindsight (NA to option b) [¶C10]

Ongoing practical expedients

- Available to all:
  - Short-term leases can be treated as operating [¶ 5&6]
  - Low-value leases can be treated as operating [¶ 5&6]
  - No separation of non-lease components [¶ 15]
  - Accounting for portfolios of leases [¶ B1]

Transition: what we’ve found so far

- Most lessees applied partial retrospective approach for cost-benefit reasons (% was higher for Australia vs Malaysia)
- Some of those applying full retrospective approach used transition as an opportunity to ‘improve’ their records of leasing transactions (% was higher for Malaysia vs Australia)
- Partial retrospective para.8 expedients – most chose RoU assets = lease liability (Many applied the same option to all leases, but more applied the options differentially to different leases)
- Partial retrospective para.10 expedients were widely appreciated by preparers and selectively applied for cost-benefit reasons

Transition: what we've found so far

- Partial retrospective para.10 expedients applied by LLCs

Single discount rate	Earlier onerous assessment	Leases in last year treated as operating	Exclude initial direct costs	Use hindsight
Two-thirds	Just over half	Almost all	Just over half	Two-thirds

- Preparers and auditors devoted considerable resources to analysing practical expedient choices
- Users generally unconcerned about partial retrospective transition numbers

Ongoing: what we've found so far

- Universal application of short-term lease expedient on the basis there's no substantive impact on P/L
- Almost universal application of low-value lease expedient on the basis there's no substantive impact on P/L
- Mixed use of non-separation of non-lease components– usually based on the balance sheet impact – large % service components usually treated separately
- Accounting for portfolios of leases not widely used – generally regarded as difficult to justify – but use may grow over time
- Users did not seem perturbed by use of various expedients and consider disclosure of their use as adequate to overcome most concerns

Other observations

- Both transitional and ongoing practical expedients are widely appreciated – saves large % of preparation and audit costs (relative to having no exceptions)
- Some advocate 'core' versus 'non-core' RoU asset distinction, with non-core = operating lease accounting
- Management reporting in many 'asset heavy' entities treat all leases as operating or still use IAS 17 accounting
- Some users concerned about cash flows being classified as 'financing' when they are considered 'operating' – cash flow and income statement classifications do not tally
- Some users want non-cancellable versus cancellable lease debt distinguished – they analyse 'committed debt' versus 'lines of credit'