IFRS 16 LEASE ACCOUNTING HANDBOOK

A 2019 Guide for Lessees

Implementing Processes, Controls, & Systems to Achieve & Maintain Compliance with the New Lease Accounting Standard

leaseaccelerator®

Contents

INTRODUCTION TO THE NEW LEASE ACCOUNTING STANDARDS

In 2019, the new IASB lease accounting standard, IFRS 16, began to go into effect for companies worldwide. However, there are still some companies that have yet to adopt the new standard, as well as those who may be struggling with how to handle leasing processes post-adoption in order to maintain compliance with IFRS 16.

This handbook will provide an overview of the technical accounting of IFRS 16 as well as how companies can successfully achieve and maintain compliance with the new standard.

Why the New Standard Was Introduced

The change to lease accounting rules comes with many other accounting standard updates, all created with the purpose of closing loopholes in accounting guidance that could potentially allow companies to mislead financial statement users as to the true nature of the company's financial state.

IFRS 16 closes the lease accounting off-balance sheet loophole which allowed corporations to report their operating leases in the footnotes of financial statements. Under the new standard, companies are required to recognize most leases and report them as right-of-use (ROU) assets and lease liabilities. As a result of the shift, lease portfolios will face increased auditor scrutiny, pushing companies to focus on ensuring accuracy and completeness of what they report as well as leading to greater comparability of financial statements.

The Major Changes for Lessees

The most notable change is the elimination of the operating lease classification. Under IFRS 16, all leases, excluding those that meet the practical expedient for low-value and short-term leases, if elected, will be treated as finance leases. The lease assets and liabilities will be recognized on the statement of financial position, which may result in a significant increase in the amount of assets and liabilities many companies report.

Finance leases are also reported differently on the profit and loss (P&L) statement than operating leases under the previous standard. Operating leases were reported as a straight-lined rent expense. However, under IFRS 16, all leases are reported as a separate (usually straight-lined) depreciation expense of the asset and front-loaded interest expense on the liability. Therefore, as a result of the new standard, all leases will expense on the liability, potentially impacting financial metrics, like EBITDA, that are dependent on the P&L statement.

The IASB also considers leases to be debt, so debt to equity ratios may see a dramatic increase, which could impact debt covenants not covered by frozen GAAP contractual provisions as well as credit ratings, if the lease liability recognition resulting from the adoption of IFRS 16 is significantly different from analysts' expectations.

Lastly, when measuring the lease liability, variable rents, such as those based on an index or rate, will be included. IFRS 16 requires that the lease liability be reassessed and remeasured anytime the index or rate adjusts.

Exhibit 1: Executive Summary of the New Lease Accounting Standard

Timeline:

- The final standard was issued in 2016.
- Companies that did not early adopt the standard began transitioning to the new standard January 1, 2019 and will continue to do so throughout 2019 depending on their fiscal year start date.

New Lessee Accounting Standard Summary

- All leases will be recognized (except where the entity has elected to use the short-term and low-value exemptions) at the present value (PV) on the statement of financial position.
- All leases will have a P&L pattern that is front-loaded (where rent expense is replaced by a usually straight-lined depreciation of the asset and front-loaded interest on the liability).
- Variable rents based on a rate (e.g. LIBOR) or an index (e.g. CPI) are recognized based on spot rates. The value of the lease liability, with a corresponding adjustment to the lease asset, must be remeasured when the rate or index adjusts.
- Short-term (less than or equal to 12 months) and low-value leases (less than or equal to US $5,000 even if material in the aggregate) can continue to be accounted for off-balance sheet if so elected.

SECTION I

THE NEW LEASE ACCOUNTING STANDARD: KEY PROVISIONS AND CHANGES IN DIRECTION

Key Changes for the New Standard

For lessees, adoption of the new rules will result in a significant change from IAS 17 reporting where operating leases were off-balance sheet.

Leases Capitalized: The operating lease classification will no longer exist under IFRS 16. The new rules will require a lessee to capitalize all leases that do not meet the short-term and low-value practical expedient lease exemptions.

Estimates of Lease Term and Lease Payments: For purchase, extension, and termination options, a lessee should reassess whether the exercise of an option is "reasonably certain" (and thus must be recognized) only upon the occurrence of a significant event or a significant change in circumstances that is within the lessee's control.

Transition: IFRS 16 provides two transition methods.

1. The Full Retrospective Approach: This approach would require companies to restate comparative figures for the year prior to adoption by recognizing a cumulative effect adjustment to the equity at the beginning of the prior year. A company's financial statements would be presented as though the company had always been on the new standard.

2. The Modified Retrospective Approach: Under this approach, the cumulative effect of applying IFRS 16 is recognized as an adjustment on the effective date and comparative figures are not restated. The ROU asset may be recognized as equal to the lease liability or may be stated at a value reflecting amortization since commencement of the lease with the offset to equity. Under either method for the ROU asset presentation at adoption, the lease liability is the same in both elections.

Present Value Calculation: The lessee will calculate the PV of the estimated lease payments using the implicit rate in the lease, if it is readily determinable, or the company's incremental borrowing rate ("the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment"). However, the IASB in the Basis for Conclusions stated that it is likely to be difficult for a lessee to determine the interest rate implicit in the lease and as a result it is expected that the company's incremental borrowing rate will be used in most cases.

The implicit rate is defined as follows in the new IASB standard:

"The rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor."

The PV is considered to be both (1) the value of the right to use the leased asset , and (2) the "principal" balance of the obligation to pay rent. This amount will be recorded as both an asset and a liability.

The Profit & Loss Statement: All leases where the lessee has not elected the short-term or low-value exemptions will be accounted for as finance leases. The asset will be amortized as a depreciation or amortization expense in the P&L over the estimated lease term on a usually straight-line basis (SL). Interest expense on the lease liability will be front-loaded. The sum of the interest and amortization creates a front-loaded lease expense pattern.

Exhibit 2: New Lease Accounting: A Real-World Example

Below is an example of lessee accounting under the new IFRS 16 standard and contrast to the previous IAS 17 standard.

A company leases several general use PCs for three years. The PC's have a useful life of 5 years. There is no purchase option.

The rent is $1,700 a month for 36 months ($61,200 in total). Under IAS 17, this is considered an operating lease, as the PV of the payments is less than substantially all of the fair value of the assets and the lease period is for less than the majority of the asset's useful life. Under the new IASB standard, the lease must be treated as a finance lease. That is, it is recognized as an asset and liability on the balance sheet with interest expense and amortization expense reported on the P&L statement.

At a 5.5% incremental borrowing rate, the present value of the rental payments is $56,557. This is the amount that is recognized on the balance sheet. The lessee's initial balance sheet entries are:

- Debit Right-of-Use Lease Asset = $56,557
- Credit Lease Obligation = $56,557

On the P&L, the first year's interest expense is $2,572 and the amortization expense is $18,852. Together, these two items total $21,425 for the first year's lease expense.

Under the previous lease standard, the rent expense would total $20,400 on a straight-line basis. Thus, capitalizing the lease has increased the company's lease expense by $1,025 in the first year.

The cross-over point occurs in the second year of the lease, when the total lease expense under the new standard would be less than the expense under IAS 17.

Table 1. Illustrated Example of the IFRS 16 Lease accounting

ASSUMPTIONS	
Rent in advance	$1,700
Term in months	36
Incremental borrowing rate	5.50%
Fair Value of leased assets	$65,000
CALCULATIONS	
PV of payments - Inception	$56,557
Total lease payments	$61,200

Table 2. Annual Journal Entry Summary

ENTRY TO RECOGNIZE THE LEASE AT INCEPTION		
ROU asset	$56,557	
Lease liability		$56,557
ENTRY TO RECORD FIRST YEARS LIABILITY ACTIVITY		
Imputed Interest Expense	$2,572	
Liability	$17,828	
Cash		$20,400
ENTRY TO RECORD FIRST YEAR'S ASSET ACTIVITY		
Amortization expense	$18,852	
Accumulated Amortization		$18,852

Table 3. Income Statement Impact of Front-Ended Lease Expense

COMPARATIVE REPORTED OPERATING LEASE EXPENSE					
Year	IFRS Depreciation	IFRS Interest Expense	IFRS Total	IAS 17	Variance
1	$18,852.36	$2,572.18	$21,424.54	$20,400	$1,024.54
2	$18,852.36	$1,566.55	$20,418.91	$20,400	$18.91
3	$18,852.36	$504.2	$19,356.56	$20,400	$(1,043.44)
Total	$56,557.07	$4642.93	$61,200	$61,200	$0

Evolution of Key Issues Regarding Lease Payments

Lease Term: The IASB decided that the lease term will be defined at commencement as the non-cancellable term plus extension or termination options, where the lessee is "reasonably certain" to exercise the option. Under the new standard, for purchase, extension, and termination options, a lessee should reassess whether the exercise of an option has now reached the level of "reasonably certain" (and thus must be recognized) only upon the occurrence of a significant event or a significant change in circumstances that is within the lessee's control. The IASB has stated that the term "reasonably certain" is a high hurdle.

Variable Lease Payments: Only certain variable lease payments will be included in the lessee's lease capitalization, including:

- Variable lease payments that depend on an index or a rate, using the spot rate at lease inception for floating leases.
- In-substance fixed payments that are "disguised" minimum lease payments based on usage of the underlying asset or on lessee performance — in other words, payments that are unavoidable, in which case the expected payments must be included in the lease payments to be recognized.

Impact of the New Standard

Companies will see significant changes because the majority of leases will now be reported as finance leases. Potential impacts include higher debt amounts, permanent lost capital, new permanent deferred tax assets, and temporary reduced earnings after taxes in the first early years following adoption of the standard.

Ratings agencies have typically included estimates of operating lease obligations in their analyses, so unless there is a large discrepancy between their estimate and what the company reports, there is not expected to be a large impact to credit ratings.

However, because the IASB considers lease liabilities to be "debt," the new standard may result in debt covenant breaches that will require negotiation and adjustment.

Financial metrics like return on assets, liabilities to net worth, leverage ratio, EBITDA, etc. will/may change, so a lessee should make pro forma calculations to determine if debt covenants, other contracts, or internal performance and incentive plans using those metrics are affected.

Tax Impact — Minimal: The changes to lease accounting for IASB companies may increase the administrative burden with regards to tracking deferred income taxes. This results from differences between the book value (based on IFRS 16) and tax calculations (based on unchanging tax laws).

Operational Impact — Substantial Increase in Administrative Burden: The new lease accounting standard will increase a lessee's administrative burden due to the required increase in process controls; data collection, analysis, and maintenance; monitoring; internal reporting systems; and, most importantly, audit scrutiny. Here are some of the key factors contributing to the added burden:

- Data to calculate payments comes from several sources in the organization, including Accounting, Procurement, Accounts Payable, and the asset users.
- Calculation of lease payments is complex.
- Non-lease components in gross or bundled billed payments must be separated (unless the practical expedient not to separate is selected by asset class).
- Calculation of some payments involves judgments and estimates.
- Financial disclosure requirements are expanded.

For most companies, the scale of the administrative requirements will mean additional systems and tactical support.

To Meet the Timetable for Implementation, Lessees Must Prepare Now

For those lessees that have not already adopted, it is critical to not underestimate the timetable for implementation. This is especially true if a company's lease portfolio includes many lease schedules with multiple assets, non-homogeneous assets, lessors, countries, or languages.

It is likely to take more than twelve months for some companies to fully overhaul the lease accounting processes, systems, and controls that will be required to comply with the new standard. Companies must: (1) understand the new rules to determine compliance requirements, (2) start and complete a transition process, and (3) develop an ongoing process for complying with the new standard beginning on the effective date.

The lease accounting rules are complex, so lessees must read them in detail to understand how to comply.

Setting Objectives and Defining Compliance and ROI Success

To address the lease accounting changes, companies will have to change how they manage their leasing activities. Accounting for operating leases was relatively simple, since those leases were treated as operating expenses. Accounting for IFRS 16 leases, however, requires a much more rigorous approach, given the increase in risk and complexity. Such risks include the impact of estimation errors as well as the increased auditor scrutiny.

As with any change management project, you should start by defining the objective, scope, and strategy of the project or process. See an example of an objective that you might establish for your company's transition to the new standard. It is deliberately stated in past tense as if it has already been accomplished. The objective is not exclusively focused on compliance. Instead, it is designed to yield financial returns from the investment in compliance by improving the financial performance of your leasing process and portfolio.

Objective Example: By the implementation deadline for the lease accounting changes, we will have developed, deployed, documented, and iteratively refined a leasing process that is compliant with the new lease accounting standard. This process will be well-controlled, auditable, automated, and scalable. We will be able to demonstrate that we made good economic decisions throughout the lease lifecycle.

See the metrics you can employ to measure how well you achieved the objective.

Metrics Example: We know we have been successful in meeting this objective because:

- We can generate reports with the push of a button, quickly and easily, for:
  - The lease accounting changes that reflect the final new lease accounting standard.
  - Preparation of our financial reporting disclosures, with full auditability.
  - Internal management of all lease terms that require timely decision making.
- All stakeholders who use the data, trust the data.
- All stakeholders in the leasing process receive timely, accurate, and complete reporting and notifications, especially notifications about the end of term.
- The financial performance of our lease portfolio, processes, and people is measurable and continuously improving. For example, we know quantitatively how much money we are saving by leasing rather than buying. We know how much money we could be saving if specific underperforming people and groups managed their leased assets at the end of term more effectively and returned assets on time. We can provide those under-performers with the automated notifications and scorecards that they need to improve their performance quickly and easily.
- The lease sourcing process is rigorous and includes a standardized lease agreement with fair terms and conditions in addition to requiring a flexible lease structure that will allow for the lessee to maintain greater control of the lease program.

SECTION II

ACHIEVING AND MAINTAINING COMPLIANCE: HOW TO CONTINUOUSLY MEET THE NEW REQUIREMENTS AND DRIVE SAVINGS

Introduction

The remainder of this handbook will provide you with comprehensive guidance on implementing the new lease accounting standard and best practices for maintaining compliance in the long-term.

Complying with the new standard will require the collaboration of many individuals and departments within your company. At the same time, the processes we recommend here will achieve major efficiencies in the handling of lease related information across your entire company and improve the financial performance of your leasing process and portfolio. The result: significant, recurring, annual cost savings for the company as a whole and a measurable, positive ROI for your compliance project. Thus, while these process changes are motivated by the need to comply with the new standard, it is also an investment in managing the company's leasing activities more effectively.

We recommend an 8-step process (page 14) that will most effectively get your entire company into compliance with the new standard.

Before you start the 8-step process, it is critical to thoroughly evaluate your company's leasing policies because of: (1) the complexities of the new standard, (2) the additional administrative burdens that will be entailed, and (3) the changes that will be required.

Lease versus Buy: Review of your leasing policies includes reviewing your lease versus buy (LvB) analyses. The LvB analysis is not only crucial to achieving economic efficiencies, but also can serve as a control to ensure completeness of your lease portfolio.

In an asset purchase, depreciation is recognized over the asset's useful economic life. Under IFRS 16, all leases are depreciated over the lease term, which usually is less than the useful life of the underlying asset. Thus, under the new lease accounting rules, because of additional assets on the balance sheet and the acceleration of lease costs, the return on assets/return on equity calculations will look worse for a now capitalized operating lease. However, it is important to recognize that the difference is purely one of timing, which is why LvB analysis is so critical. It compares the option based on present value analysis, removing the timing difference as a factor.

Why Leasing Will Remain Attractive Despite the Accounting Changes: However, your review of leasing policies should also take into account the quantitative and qualitative reasons why leasing will remain attractive. Under the new rules, the accounting benefits for leasing (off-balance sheet financing) will only partially recede.

The PV of a lease that covers less than the asset's full economic life will still be less than the cost of buying the same asset. For example, if you lease an asset for 80% of its economic life, and the terms are fair, you will only be paying for 80% of the asset rather than 100%. Therefore, from a budget perspective and on an actual cash flow basis, the amount of the capitalized lease payments will still be less than the purchase amount.

There are also many additional reasons why companies lease, and most will still remain favorable per the chart below.

Ultimately, companies should conduct a lease versus buy analysis for every major asset procurement decision to analyze the pros and cons of the two scenarios to ensure that they enter into the most economical arrangement.

.

REASON FOR LEASING	DETAILS	STATUS AFTER NEW RULES
Raise Capital	Additional capital source, 100% financing, fixed rate, level payments, longer terms	Still a major benefit versus a bank loan, especially for SME & non-investment grade lessees with limited sources of capital
Low cost capital	Low payments/rate due to tax benefits, residual & lessor low cost of funds	Still a benefit versus a bank loan
Tax benefits	Lessee can't use tax benefits & lease vs. buy shows lease option has lowest after-tax PV cost	Still a benefit
Manage assets; Residual risk transfer	Lessee has flexibility to return asset	Still a benefit — if lessee can manage end of term
Service	Outsource servicing of the leased assets	Still a benefit
Convenience	Quick & easy financing process often available at point-of-sale	Still a benefit
Regulatory	Capital issues	Regulators should still treat ROU assets as "capital free" as they are an accounting contrivance and do not represent an asset in a bankruptcy liquidation
Accounting	Off-balance sheet	Partial benefit if the PV is less than the cost of the asset, which should be true for many leases

Source: https://www.elfaonline.org/docs/default-source/industry-topics/accounting/leaseacctingleasebuydecisionqb07132016.pd

Transitioning to the New Standard: A Comprehensive 8-Step Process

For many companies, leasing will continue to be an important technique for acquiring the use of assets. At the same time, given the nature and complexity of the requirements under the new standard, establishing new processes will require substantial time and effort.

To help those companies that have not yet transitioned achieve compliance in an efficient and timely fashion, we have devised an 8-Step Transition Process that will guide you from creating an internal transition team to acquiring lease accounting software that will facilitate your ongoing compliance efforts with the new lease accounting standard.

Step 1: Create a Lease Accounting Project Team

Companies should create a Lease Accounting Project Team that will oversee the transition process, establish timelines, and be fully responsible for timely and effective completion of the project. The team should include representative stakeholders that lease equipment, administer leases, or use information concerning leases from all sites around the globe. These would include Finance/Treasury, Procurement, Lease Administration, IT, Accounting, and other business units.

Step 2: Deploy Software Designed for Your Processes and Portfolios – Enterprise Lease Accounting for Real Estate and Equipment Leases

If your company is still using spreadsheets, a fixed asset subledger, or an asset management system (a system without the required lease and accounting capabilities) to manage your portfolio of leased assets, it is critically important to acquire software specifically for your unique lease accounting requirements. Full lease lifecycle automation is required to capture the data and documents and to maintain the completeness and accuracy required to generate auditable financial reporting, both on the initial deadline and beyond. Furthermore, you must verify that your software provider meets the new lease accounting standard's requirements; can support your firm's transition process; as well as support the new processes, policies, and controls you establish for ongoing compliance.

Because leasing is fundamentally an interdepartmental, decentralized process in most large geographically distributed companies, selecting a software system that is web-based or cloud-based is essential to including all of your stakeholders, wherever they may be, in order to achieve your objective. The software-as-a-service model is now widely accepted and available as a delivery model.

If you are an international company, the software should be multicurrency and have the capability to interact with multiple ERP environments. It should also have multi-lessor capabilities because most large companies lease from a mix of commercial banks, vendor captives, and independent leasing companies. This eliminates the possibility of using any software system offered by a single lessor (often offered to clients in an effort to monopolize their leasing business).

Your software provider should also have the ability to integrate with not only your internal ERP, procurement, and asset management systems, but also your lessors' systems to achieve straight-through processing (STP).

You also need to be able to load any kind of asset into the system—essentially, whatever you lease: real estate, furniture, airplanes, forklifts, water coolers, copiers, rail cars, pea pickers (seriously), etc.

To determine whether a particular lease administration and accounting software package is appropriate, start by giving the prospective software provider a sample data set so that you can test your data in their system. Then, ascertain whether or not the system can generate capital lease debits and credits for each asset, each transaction, and the portfolio as a whole. If it can't perform these basic and essential functions, it won't support your firm's transition to the new lease accounting requirements, and certainly won't support long-term compliance. The ability of your lease administration and accounting software to easily integrate into your ERP is also important. Your software vendor should have the ability to export journal entries at both the asset and summary levels with any account configuration.

Once you have decided on appropriate lessee software, you should configure and integrate the system for maximum efficiency. You should: (a) include your organizational structure, GL coding, and other business coding; (b) set up users, groups, and their authorizations; (c) integrate the system with your single sign-on, purchasing, accounts payable, and general ledger systems where appropriate; and (d) train your stakeholders.

Step 3: Establish a Lease Information Database

To be absolutely sure that you have all the information you need to comply with the new standard, you should establish a new lease information database. Of course, you already have accumulated a substantial amount of data about your current leases. But setting up a completely new database will ensure that all members of the company's team and all departments that need the information for compliance will have it at their fingertips. This procedure will also ensure that your current database is completely accurate, especially if you scrape the data from the original documents or reconcile your existing data to your original documents.

Here are the steps we recommend:

- Create a master list of data elements by obtaining all relevant reports and data from all stakeholders within your company.
- Compile a complete set of all internal lease-related documents.
- Capture the required schedule-level and asset-level data for every lease by abstracting and cleansing the data from the documents.
- Reconcile and integrate data from other sources, including lessors, vendors, and internal asset management systems.
- Require asset users to attest to the accuracy and completeness of the data.
- Populate your lease administration system with key financial variables such as the borrowing rate for the company, the spot rate for floating rate leases, and the CPI for leases with CPI-based variable rents.
- Load your lease information database into the lease administration system.

Step 4: Build a Reports Library and Automate the Distribution of Reports to Stakeholders

Create a set of reports that allows you to report on and analyze all leases and underlying assets, expenses, and obligations in your lease portfolio. The lease accounting software system that you choose should have a library of canned reports immediately available when you load your database. In addition, you should be able to easily build your own reports from scratch. The reporting should be automatically updated when you load the data and documents for a new lease.

In addition, your lease administration system should enable you to send the reports automatically to any other specified stakeholder on a routine basis.

Step 5: Analyze and Triage the End of Term – Generate Immediate Savings and Better Data

- Generate reports for all asset classes based on their end-of-term status: return, purchase, or renew.
- Generate an over-payment ("evergreen") report to determine the status of leases that are past their original lease end date, including all contractual extensions (intentional) and automatic evergreens (unintentional).
- Follow up with asset users for every lease schedule past due and resolve the issues:
  - Update information in the lease administration system at the asset level.
  - Recalculate expected payments if it is a partial buyout or partial return, where only some but not all of the leased asses are purchased or returned, and reconcile against invoices.
  - Perform analysis with users to determine the best economic option, make the decision, and act on it.
  - Calculate savings created from these actions.
- Configure end-of-term internal and contractual notifications.

- Develop procedures to manage the end of term effectively:
  - Pay attention to the date required to notify lessors about end-of-term decisions and use it as a marker to determine when to notify asset users.
  - Include asset-level data and economic analysis of end-of-term options to accelerate the decision about lease extension.
  - Require a decision and, if necessary, a commitment, for the return of the equipment by the deadline.
  - Send follow-up automated notifications on the date committed for the return of the equipment and require the asset user to report the date the equipment was returned, so that you can determine if you owe anything to the lessor.
- Create an asset user scorecard, which measures the performance of each asset user, and distribute it to the asset users and their supervisors.

Step 6: Maintain Database Accuracy and Completeness

In order to maintain the accuracy and completeness of your lease information database, you must capture all new leases as they become available. Because of the decentralized nature of many companies, this is often difficult to accomplish. One strategy that has proven to be effective is to mandate that users around the world use a common, simple, and automated country-specific lease versus buy tool that is integrated with your lease administration system. This will allow you to see all of the LvB activity, such that if the outcome of the LvB analysis is a recommendation to lease, you can track the transaction as it moves through your automated process. LvB is the earliest opportunity to establish a control that enables distributed, local decision making while facilitating centralized visibility. Here are the steps we recommend to maintain the accuracy and completeness of your database:

- Gain visibility into your leasing pipeline by mandating a global lease versus buy process and tracking lease originations.
- Identify internal sources for a variety of variables, including intentions to exercise options to renew leases or options to purchase.
- Manage transactions for efficiency and the benefit of internal users; capture new leases as they are signed.
- Send periodic notifications to asset users to test the accuracy of the data and capture changes during the lease term.
- Ensure consistency of contractual terms and conditions for new leases to improve the downstream administration and accounting process.

Step 7: Roll Out the Leasing Process Globally

Having completed all of the previous steps, you will be ready to implement the transition to the new lease accounting standard. Here are the steps in the global rollout:

- Develop a launch strategy that works for your company and culture (e.g., by business unit, country, etc.).
- Take into account the degree of centralization / decentralization within the company and with respect to the conduct of leasing activity.
- Seek to enable decentralized work and decision-making with centralized controls and reporting.
- Test launch the transition roll-out with early adopters and streamline the process by incorporating the lessons learned (e.g., 6-Sigma approach for repeatability and scalability).
- Train users (or train the trainers, as appropriate for your company's culture) on the new processes, procedures, and tools.
- Communicate with all concerned to achieve universal adoption of the processes.
- Listen to feedback and suggestions from users to improve the processes incrementally, especially concerning ease of use.

Step 8: Ongoing Activity — Generate Accounting Information Required by IASB Monthly and Annually

After completing this intensive preparation and roll-out process, you will be ready to transition to the new standard at your effective date and continuously improve the performance of your leasing program.

Companies will need to develop and implement operating procedures to generate the accounting information required for financial reporting under IFRS rules as required.

Using the automated reporting function of your lease accounting and administration system, you will be able to access and analyze complete, accurate, and up-to-date lease information. You will then be able to calculate: (1) contractual rents and bargain extension rents, (2) the variable rents for the term, (3) any expected payment under residual guarantees, (4) the PV of the total estimated payments over the term, and (5) the principal and interest of the lease obligation.

Keeping Internal Groups Up-To-Date

Meet Routinely: On each accounting reporting date as defined by your controller's team, review all leasing assumptions with the appropriate internal group. For example, review:

- Variable rent assumptions with the controller's team
- Extension assumptions with Operations
- Changes in floating rate or CPI based variable rents
- Changes in residual guarantees

Auditors may look at historical extensions to corroborate assumptions being made on existing leases. Companies should assume that historical extensions and evergreen (over-payment) activity will need to be readily available for audit scrutiny. This will require systems that are more sophisticated and transparent than traditional ERP systems.

Provide Controller with Reports for Financial Statements: Prepare disclosure information annually for the controller's department to be included in the annual report's leasing footnote. The following are the quantitative disclosure requirements for lessees:

1. Additions to right-of-use assets.
2. By class of underlying asset, the year-end carrying amount of the right-of-use assets.
3. Lease liabilities.
4. Maturity analysis for lease liabilities.
5. Depreciation expense of right-of-use assets.
6. Interest expense on lease liability.
7. Expense relating to short-term leases when they are exempted from being capitalized.
8. Expense relating to low-values leases when they are exempted from being capitalized.
9. Expense relating to variable lease payments NOT included in lease liabilities.
10. Income from subleases.
11. Gains/losses from sale-leaseback transactions.
12. Total cash outflow for leases.
13. Amount of short-term lease commitments when current short-term expenses are not representative of the next year.

Provide Journal Entry Information: Provide information for necessary journal entries directly from the lease administration system, which has a lessee accounting subledger that can generate debits and credits at a detailed asset level and/or general ledger summary level.

Conduct a Periodic Review of Estimates: Every time the company reports earnings, you should rerun the entire process as outlined above, contacting internal sources to get new estimates of key information. Then, input changes into the system and assess any requirements for adjusting journal entries.

Send Reports for Tax Leases to the Tax Team: Each year, provide to the tax department actual rents paid under "true" (tax) leases and accounting lease expenses for those leases. This information is to be included in the company's tax return and used to prepare deferred tax entries, as the accounting expense may be different from the tax deductions for those leases. You should specifically provide the actual rent paid (for the tax return) and the deferred tax accounting entry.

If You Haven't Already, Start Now

Getting ready for the implementation of the new lease accounting standard is going to take a great deal of resources, dedication, smart planning, and cooperation across all groups in the organizations that are involved with leasing activity.

Based on companies that have already completed the implementation project, the time frame from start of the transition to total readiness could be in the 9-18 month range, or perhaps longer, depending on the complexity of the portfolio. It will likely take 3-6 months to secure the budget and resources to move forward in the transition program. It will likely take an additional 6-12 months to establish the systems and set up the processes and procedures to prepare the company's financial and accounting systems. The more lease transactions in a company's portfolio, the longer the transition is likely to take.

Maintaining Compliance

Compliance with the lease accounting standards doesn't end once you adopt. IFRS 16 is an ongoing compliance project. To save time and effort post-adoption, incorporate establishing sustainable processes, policies, and controls to manage your lease portfolio into your project. If you are already post-adoption, look to best practices, like requesting asset updates from the asset users to maintain accuracy and utilizing a lease versus buy analysis to capture new leases and maintain completeness. Many companies made the mistake of focusing only on achieving compliance by the deadline and did not plan for how they would maintain compliance beyond the deadline, so they fell behind again. It will save your company from a major headache if you plan for post-adoption ahead of time and secure lease accounting software that you know is capable of supporting you on day 2 of the new standards and beyond.

In Sum

The transition process to the new lease accounting standard will include the development of a new leasing strategy; the creation of new processes and controls; and the selection, management, and implementation of new software. Throughout the process, it will be important to incorporate lessons learned from companies that have already adopted the standards in order to continuously improve the implementation and ongoing, sustainable processes for lease accounting.

LeaseAccelerator Inc.
447 Beaconsfield Blvd., Unit 3
Beaconsfield, QC, Canada H9W 4B9
647-258-1762
www.leaseaccelerator.ca