



The Institute of Chartered Accountants of Pakistan

Workshop on IFRS 16
Training Deck

November 2017

Aspire with assurance

Audit 

Introduction

IFRS 16 Highlights

Long-standing project
concluded – Final standard
now issued

Joint project with FASB –
Converged in some respects
but **not all**

**Significant changes to
lessee accounting** are
introduced, with the
distinction between operating
and finance leases removed
and **assets and liabilities**
**recognized in respect of all
leases**

**Lessor accounting did not
include significant
changes**

Entities will need to consider
the impact of the changes
introduced on IT systems and
internal controls

Effective for periods
commencing on or after
January 1, 2019

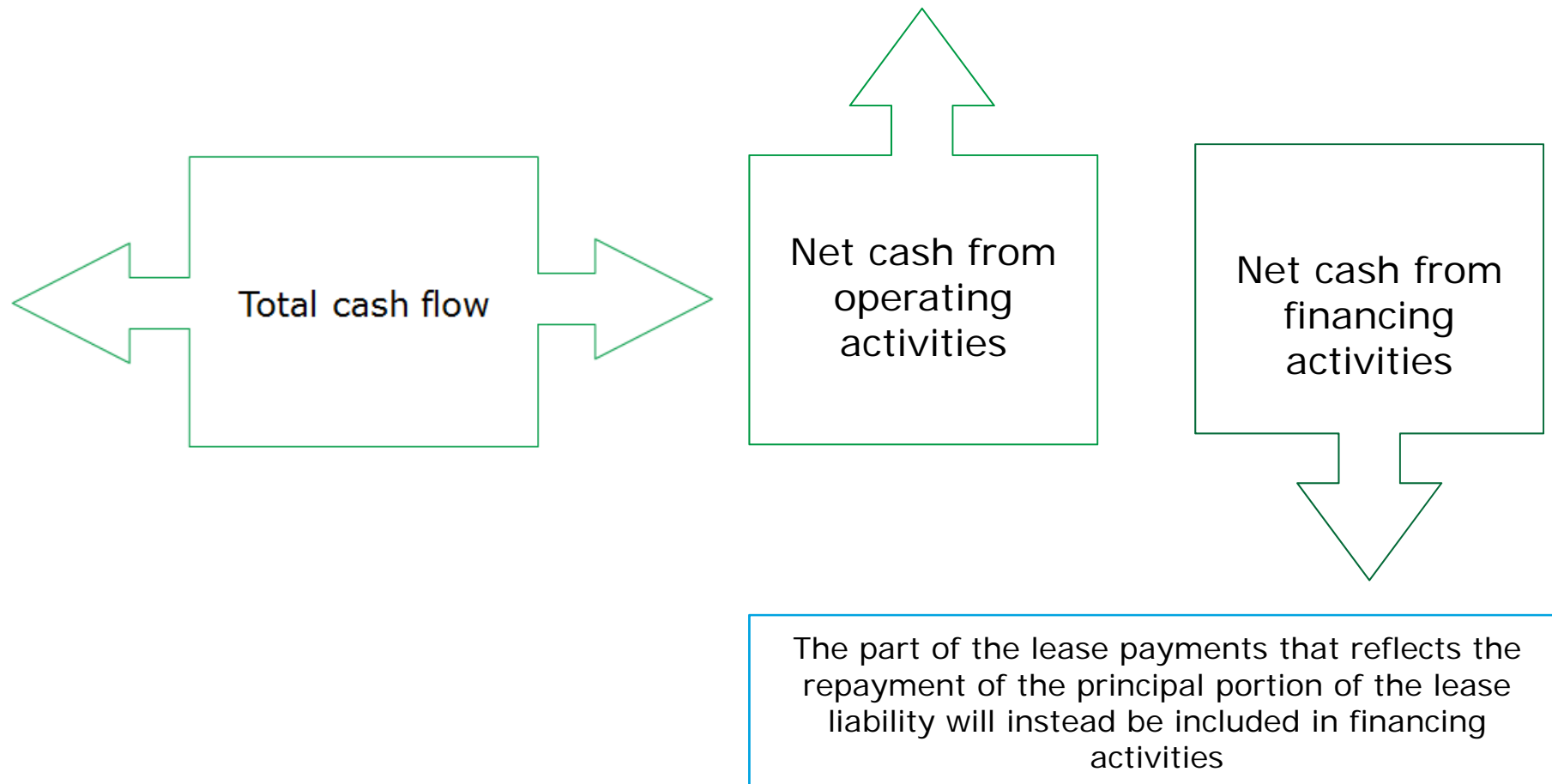
A comparison of statement of financial position and income statement – The “Before” and “After”

Statement of financial position			
	IAS 17 / Topic 840		IFRS 16 / FASB model ⁶
	Finance leases	Operating leases	All leases
Assets	✈️ 🏠	---	✈️ ✈️ 🚗 🚚 🏠 🏠 🏠
Liabilities	\$\$	---	\$\$\$\$\$\$\$\$
Off balance sheet rights / obligations	---	🚗 🚚 ✈️ 🏠 🏠 \$\$\$\$\$	---

Charts were excerpted from the IASB's IFRS 16 Effects Analysis

Income statement			
	IAS 17 / Topic 840 / FASB model		IFRS 16
	Finance leases	Operating leases	All leases
Revenue	x	x	x
Operating costs (excluding depreciation and amortisation)	---	Single expense	---
EBITDA			↑↑
Depreciation and amortisation	Depreciation	---	Depreciation
Operating profit			↑
Finance costs	Interest	---	Interest
Profit before tax			↔

A comparison of statement of cash flows – The “Before” and “After”



Classifying lease contracts



Scope

IFRS 16 is applicable to all leases, including leases of right-of-use assets in a sublease, except for:



Leases to explore for or use **natural resources**,



Leases of **biological assets**,



Service concession arrangements within the scope of IFRIC 12 *Service Concession Arrangements*,



Licences of intellectual property granted by a lessor within the scope of IFRS 15 *Revenue from Contracts with Customers*, and



Rights held by a lessee under licensing agreements within the scope of IAS 38 *Intangible Assets* for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

Identifying a lease contract

Identifying a Lease

Inception of the contract

earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms of conditions of the lease.

Evaluate accounting implications of contract

- only reassessed in case of **modification** to terms and conditions of contract.

Identifying a lease

Here is where a material error could occur



Not a lease

Lease

Identifying a lease contract



What is a lease?

A contract, or part of a contract, that conveys **the right to control** the use of **an identified asset** for a period of time in exchange for consideration.

While the definition has changed somewhat from IAS 17, it is not expected to effect vast majority of contracts applying lease accounting i.e., leases accounted for under IAS 17 are generally expected to be leases under IFRS 16

Right to control the use of an identified asset

Assess whether, **throughout the period of use**, customer has **both**:

- (a) the right to obtain **substantially all** of the economic benefits from use of the identified asset, **and**
- (b) the right to **direct** the use of the identified asset.

Right to control

Does the customer have the right to obtain substantially all of the economic benefits from use of the identified asset?

Consider **all facts and circumstances** at the inception of the contract.

Are benefits obtained directly or indirectly?

Either by using, holding or sub-leasing the asset.



JUDGEMENT

What is the defined scope of the contract?

Consider the impact of protective rights and the benefits from use of asset within the defined scope of contract.

What about payments to the supplier?

Still considered to be part of the benefits obtained by the customer.

Concept	Definition	Examples
Right to obtain substantially all the economic benefits from use of identified asset	<ul style="list-style-type: none">The economic benefits from use of an asset include its primary output and by-products, and other economic benefits from using the asset that would be realized from a commercial transaction with a third party.	<ul style="list-style-type: none">A lease which includes a limit for mileage use. That limit is the scope of the contract and the customer will assess the economic benefits within this limit.

Does the customer have the right to direct the use of the identified asset throughout the period of use?

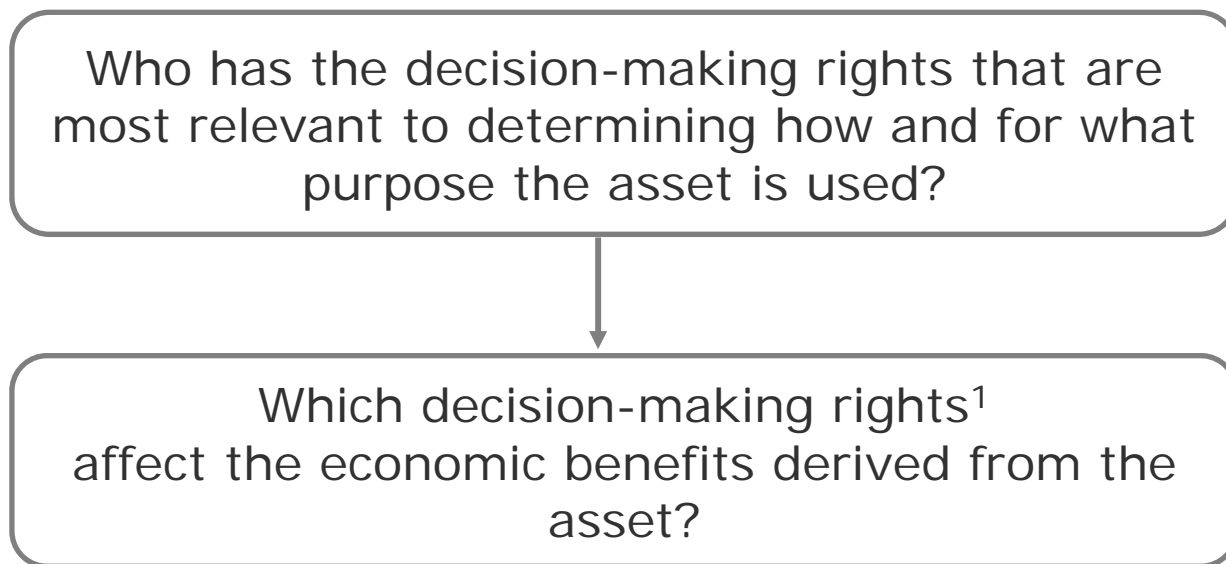


A customer has the right to direct use of an asset throughout the period of use only if **either**:

- It can direct **how and for what purpose** the asset is used, **or**
- The relevant decisions about **how and for what purpose** the asset is used are **predetermined** and:
 - i. The customer has the right to operate the asset, without the supplier having the right to change those operating instructions throughout the period of use, **or**
 - ii. The customer designed the asset in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

Does the customer have the right to direct the use of the identified asset throughout the period of use?

How and for what purpose is the asset used?



JUDGEMENT

What type?

When & where?

How much?

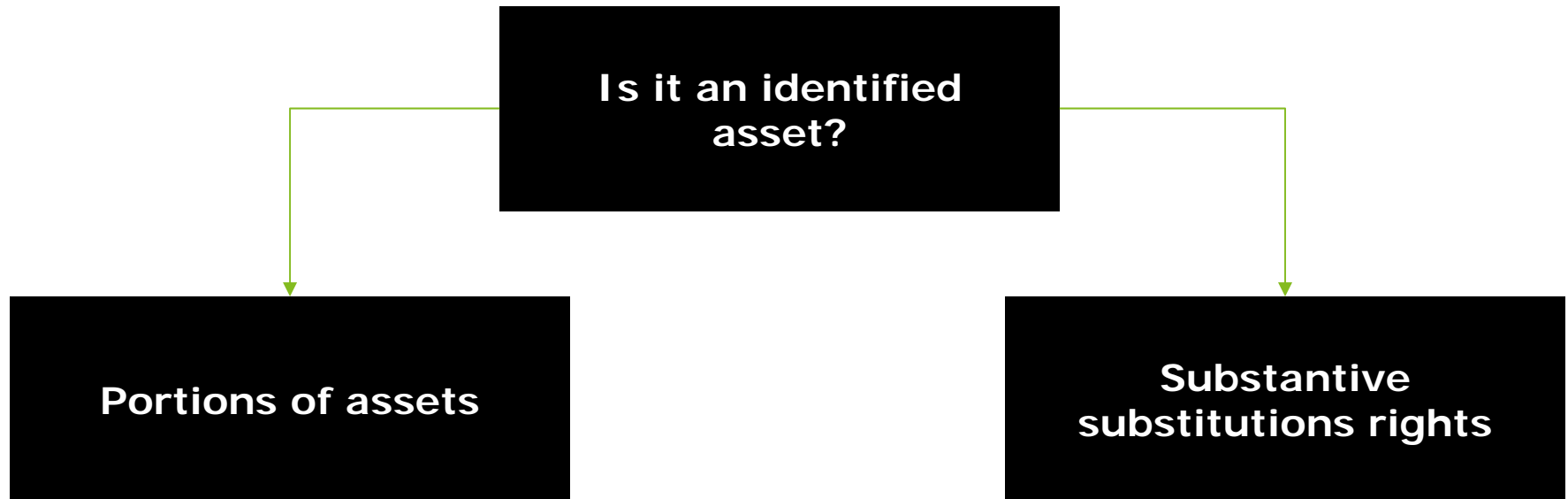
- Rights to change the type of output produced by the asset
- Rights to change when the output is produced
- Rights to change where the output is produced

¹ Rights to operate and maintain the asset are not decision-making rights

Identified Asset

Identified asset

What to consider...



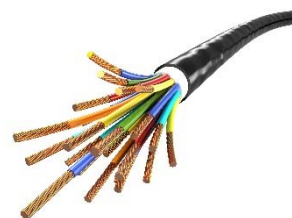
Is there an identified asset?

Physically distinct single asset or capacity portion of an asset

Firstly determine whether the contract specifies a single asset or a capacity portion of an asset.



Single asset



Capacity portion of an asset

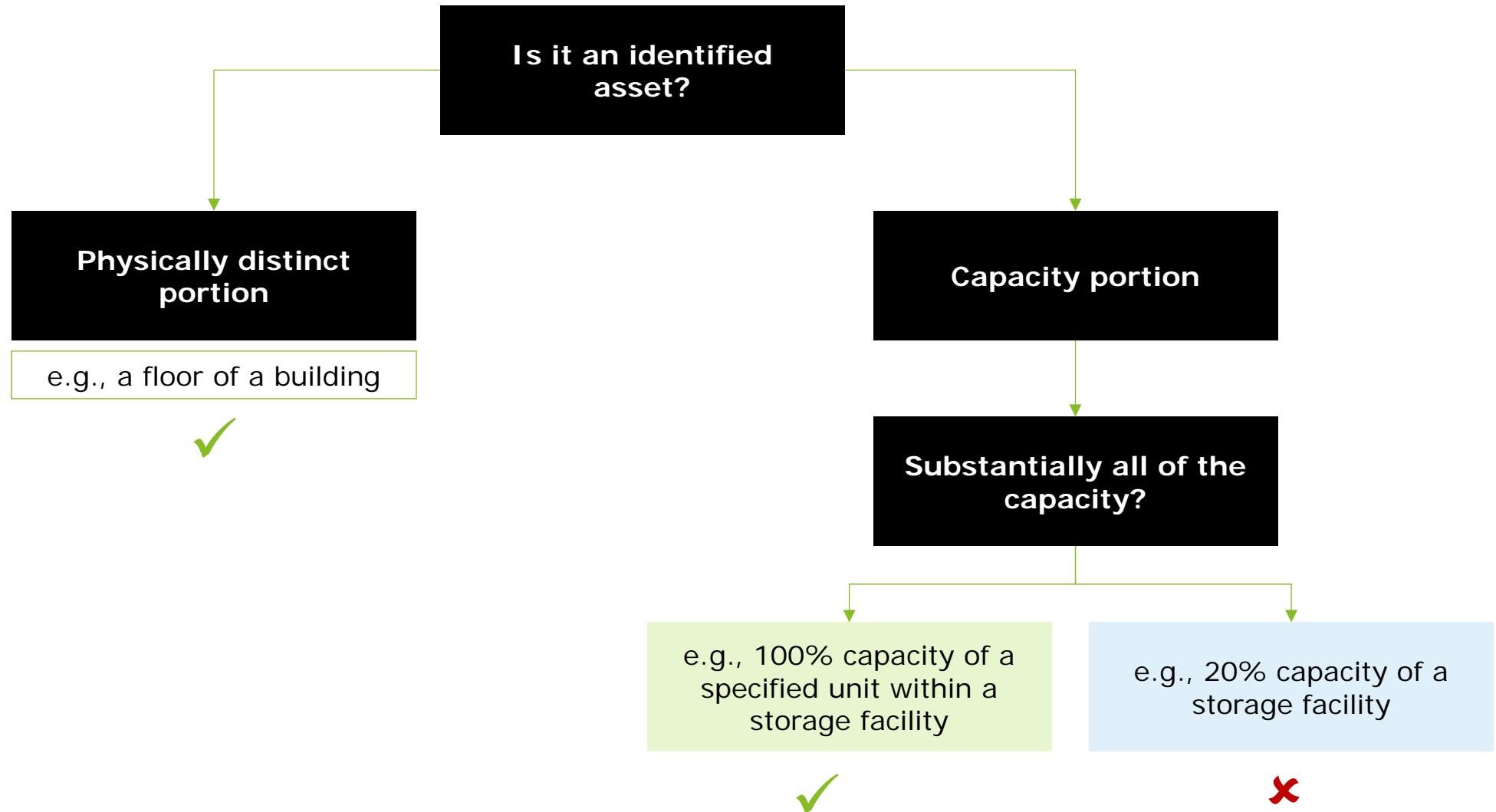
- It is physically distinct; or
- It represents substantially all of the capacity of the asset and the customer has the right to obtain substantially all of the economic benefits.



JUDGEMENT

Identified asset *(Contd..)*

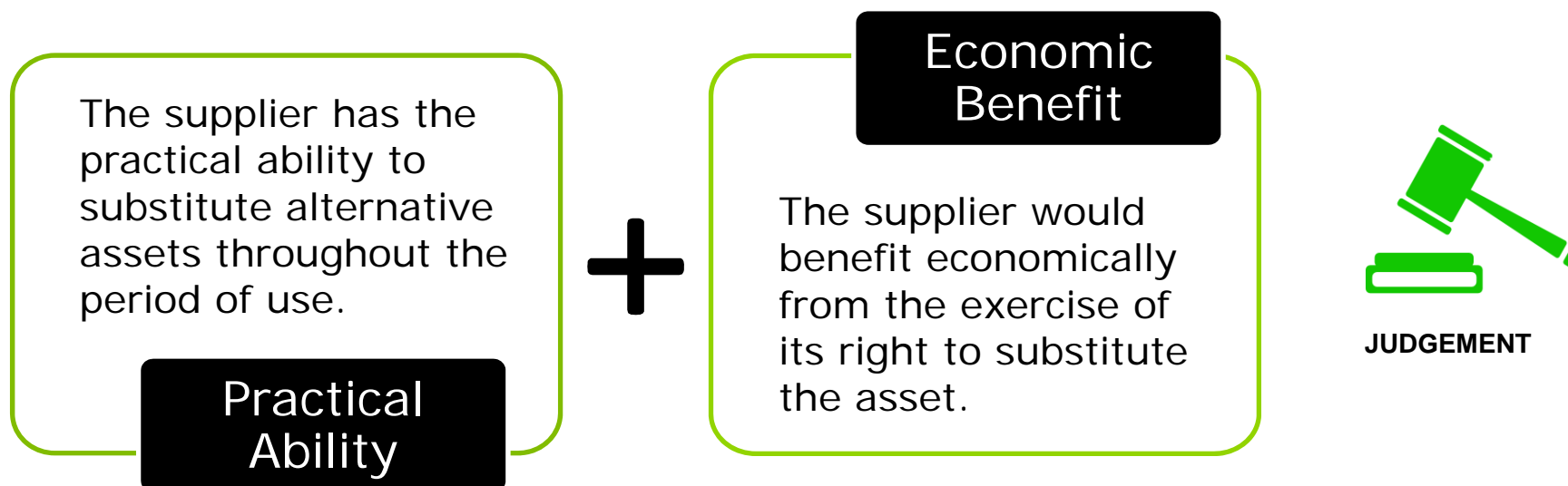
Portions of assets



Is there an identified asset? *(Contd..)*

Substantive right to substitute an asset

A supplier's right to substitute an asset is substantive only if **both** of the following conditions exist:

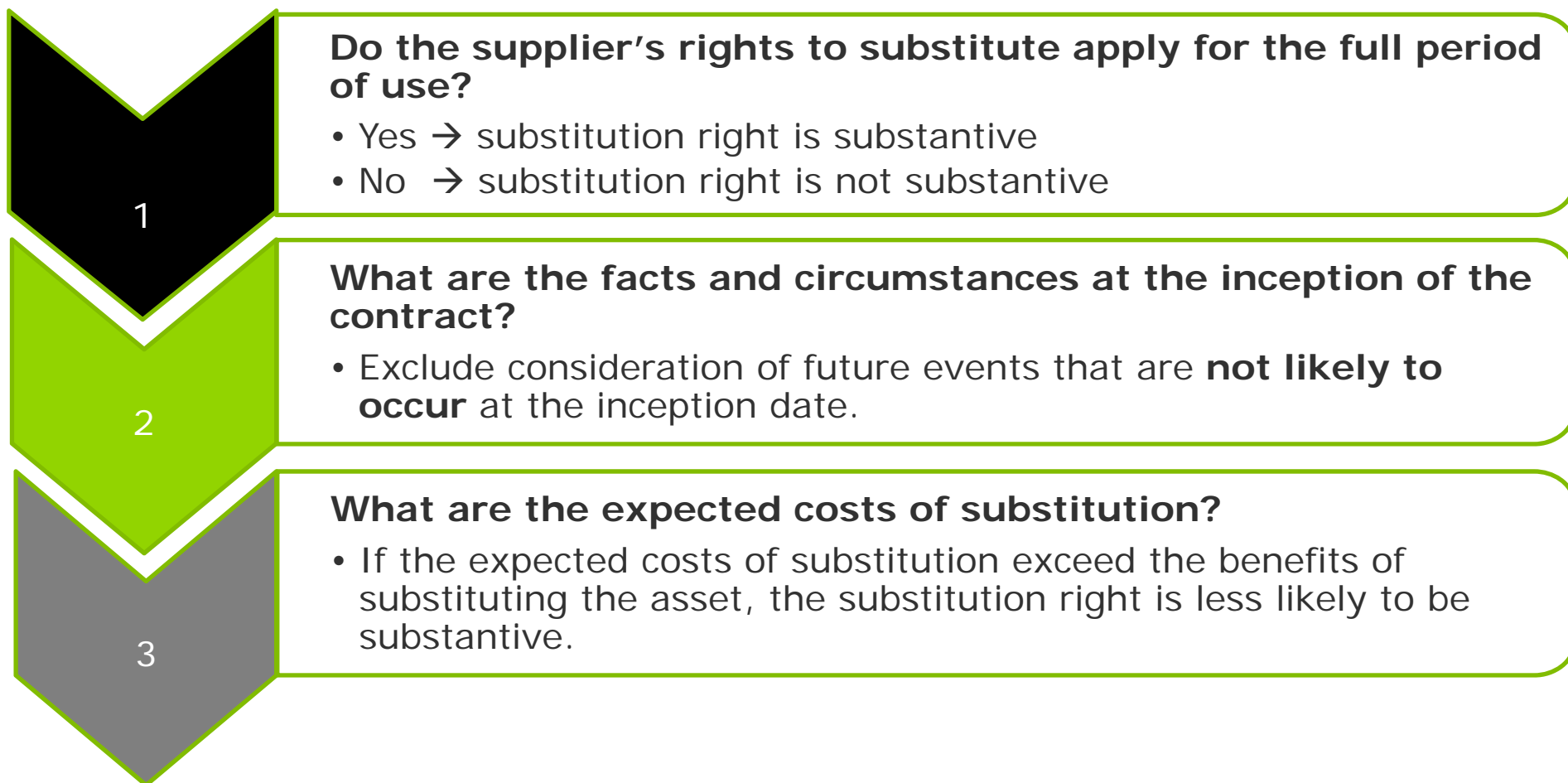


Is there an identified asset? *(cont'd)*

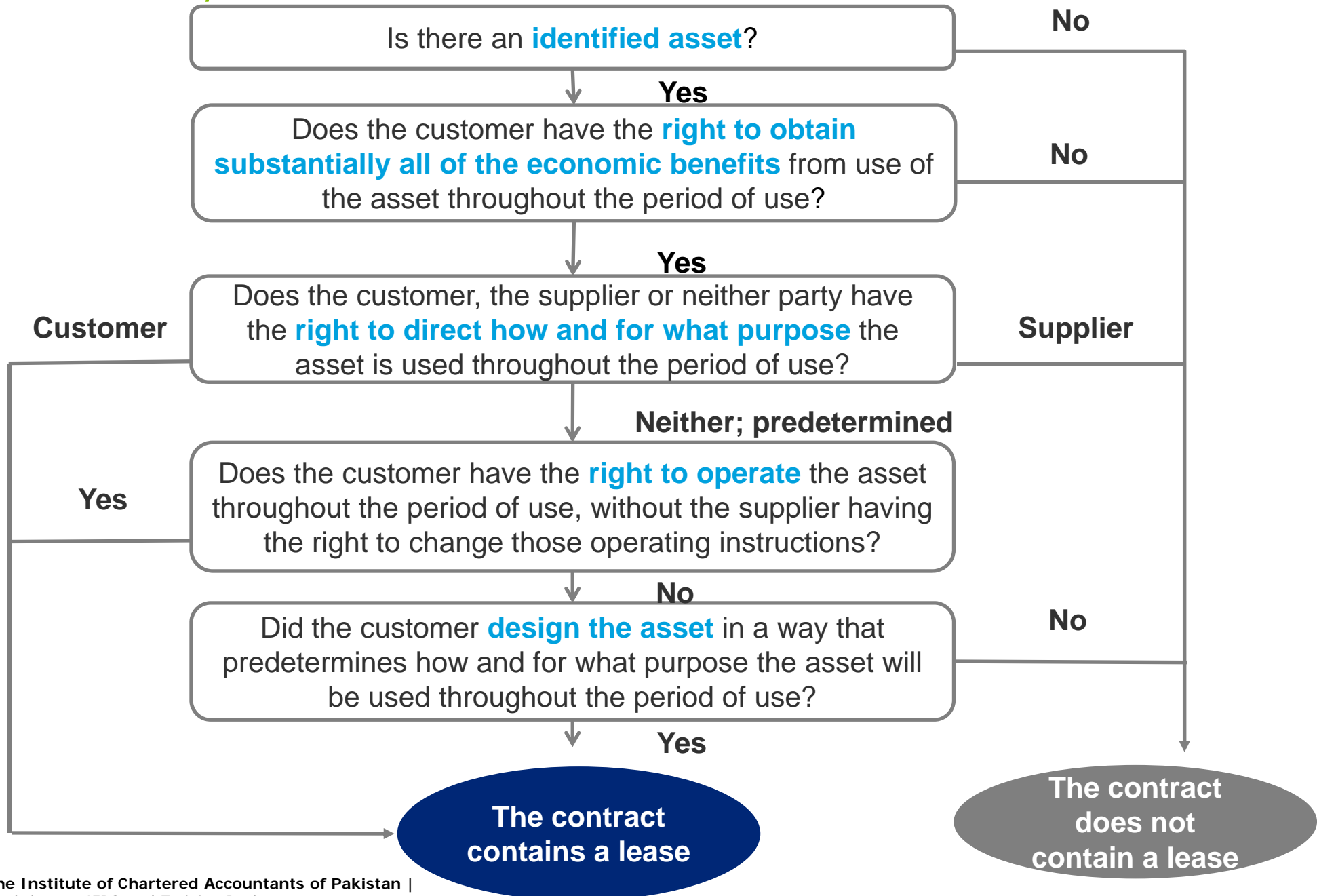


Substantive right to substitute an asset

Key client considerations

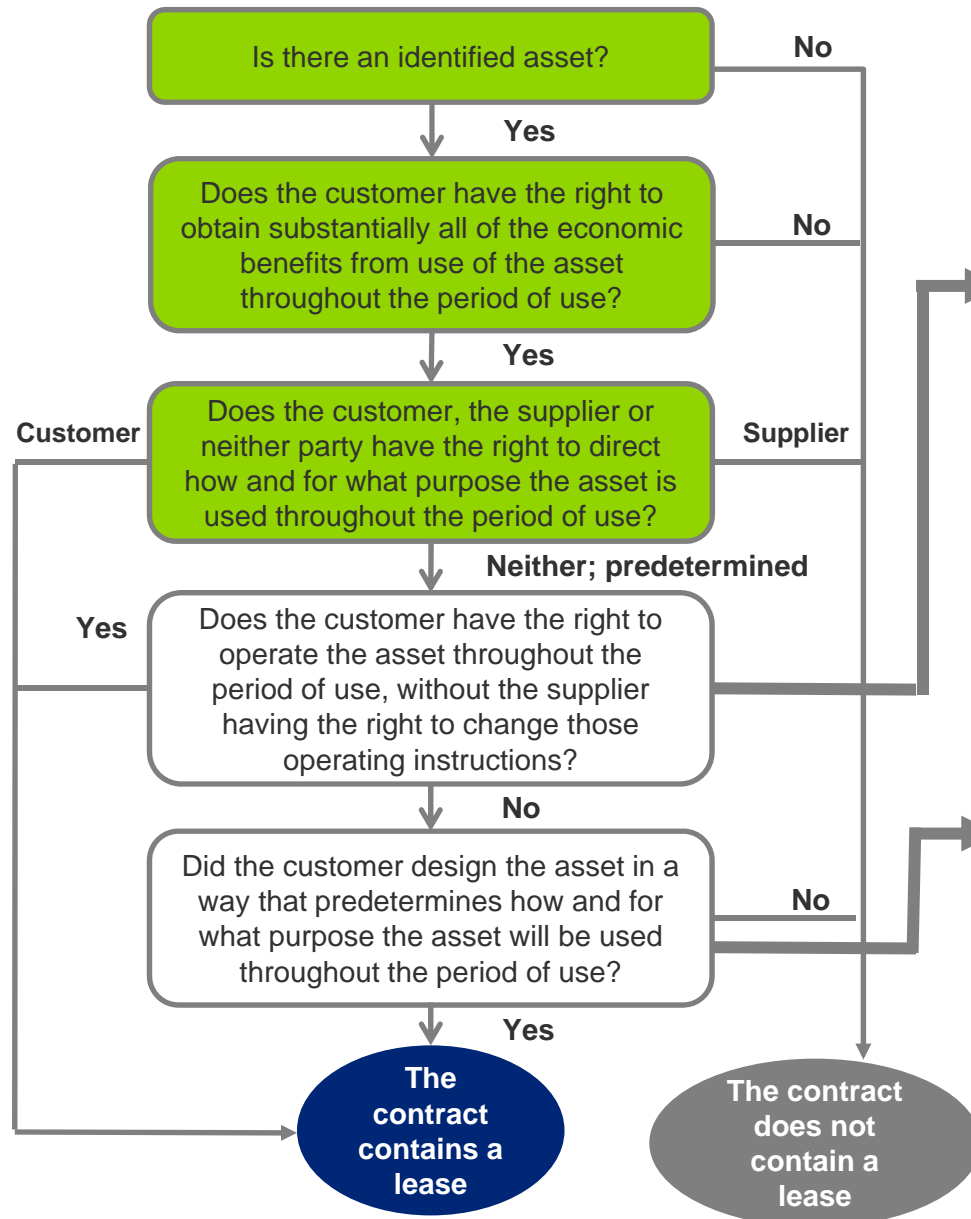


Assessing whether a contract is, or contains, a lease



What if the decision-making rights are predetermined?

Additional two considerations



Example:

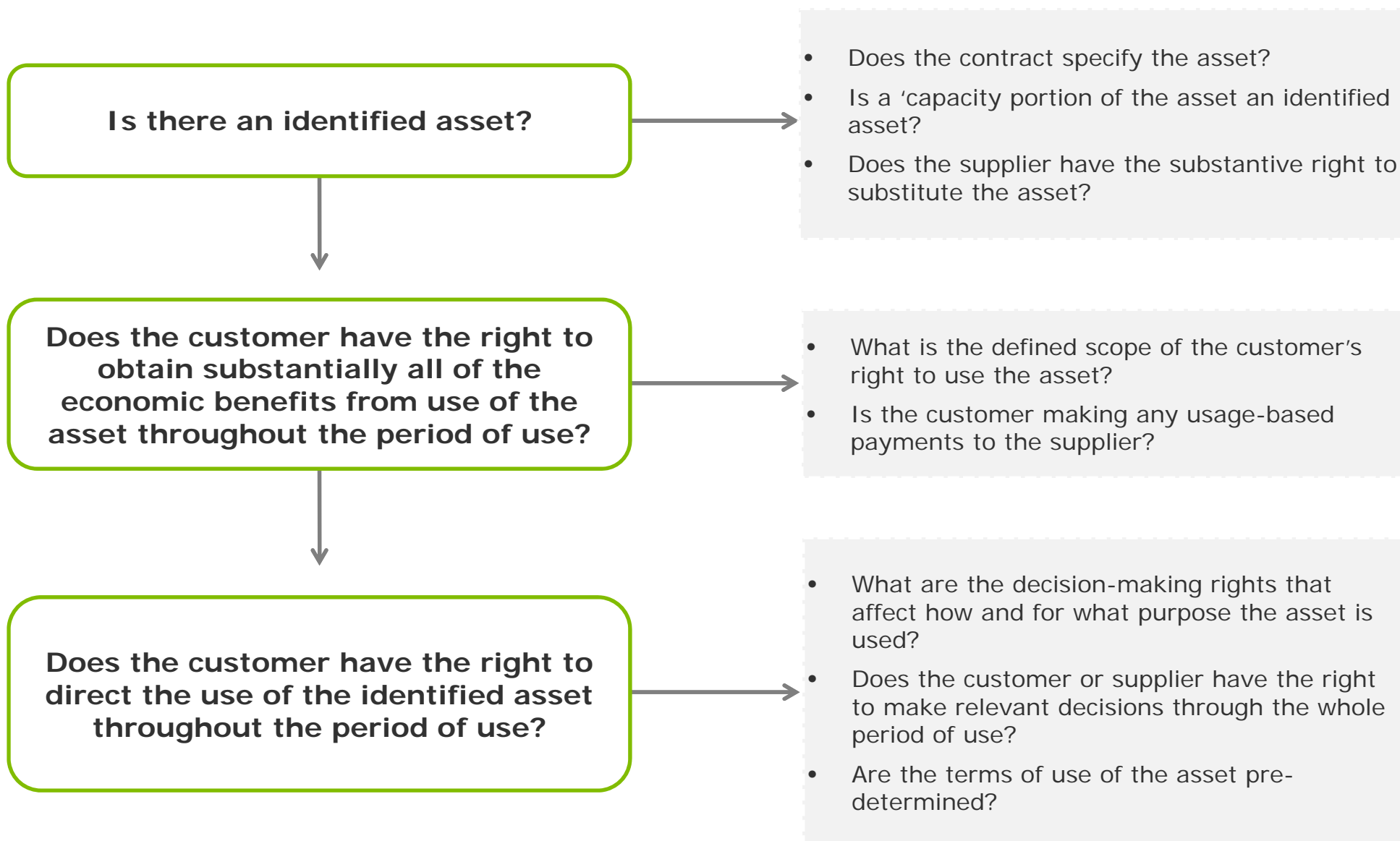
- A customer signs a contract for delivery services, where the supplier has only one truck.
- The destinations and the cargo are specified in the contract.
- The customer can choose how to complete the journey (the driver, route, speed, when to take rest breaks, etc.)
- The customer have the right to operate the asset.

Example:

- A utility entity leases from a power entity for the electricity generated by a specified solar farm in a 20 year period.
- The solar farm was **designed** by the utility entity, but is **owned** by the power entity.
- The utility entity designs the solar farm that predetermines how and for what purpose the asset will be used.

Recap - Identifying a lease contract

Key considerations



1.2 Contracts with multiple components

Contracts with multiple components

Lease and non-lease components



- Identify the non-lease components and account for these separately from the lease components.
- A practical expedient is available.

Contracts
may have
multiple
components

Multiple lease components

if

- The lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee, **and**
- The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.



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Accounting for a contract with multiple components

Lessors and Lessees





Account for the lease and non-lease components separately

Lessee

Allocate the consideration based on the relative stand-alone price of the lease components and non-lease components

Lessor

Allocate the consideration by applying IFRS 15, paras 73-90

Contract components	Maintenance (Non-lease comp.)		Lease		Total
					\$
Selling prices:	\$5K	\$15K	\$30K	\$50K	\$100K
Total contract consideration					\$90K
Allocation of lease component consideration					
			\$27K (\$30K * 90/100)	\$45K (\$50K * 90/100)	\$72K
Allocation of non-lease component consideration					\$18K

Accounting for a contract with multiple components

Stand-alone selling price ("SASP")

The SASP for a component is:



The price the lessor, or a similar supplier, would sell the promised good or service separately to a customer.

Commercially sensitive, may not be readily available



If the observable stand-alone price is not readily available, the lessee should make an **estimate**, maximizing the use of **observable information**.

Estimation methods include for example:

- Adjusted market assessment approach,
- Expected costs plus margin approach, and
- The residual approach.

Observable information might be:

- Market-conditions,
- Information of customer / class of customer, and
- Other entity-specific conditions.

Accounting for contracts with multiple components

Practical expedient

The accounting for non-lease components is different under IAS 17 and IFRS 16.



IAS 17

- Similar treatment for operating leases and service components.
- Clients may not have focused on identifying service components (i.e. non-lease components).

IFRS 16

- Separately account for lease and non-lease components (i.e. services)
- Clients should identify non-lease components unless applying the practical expedient.

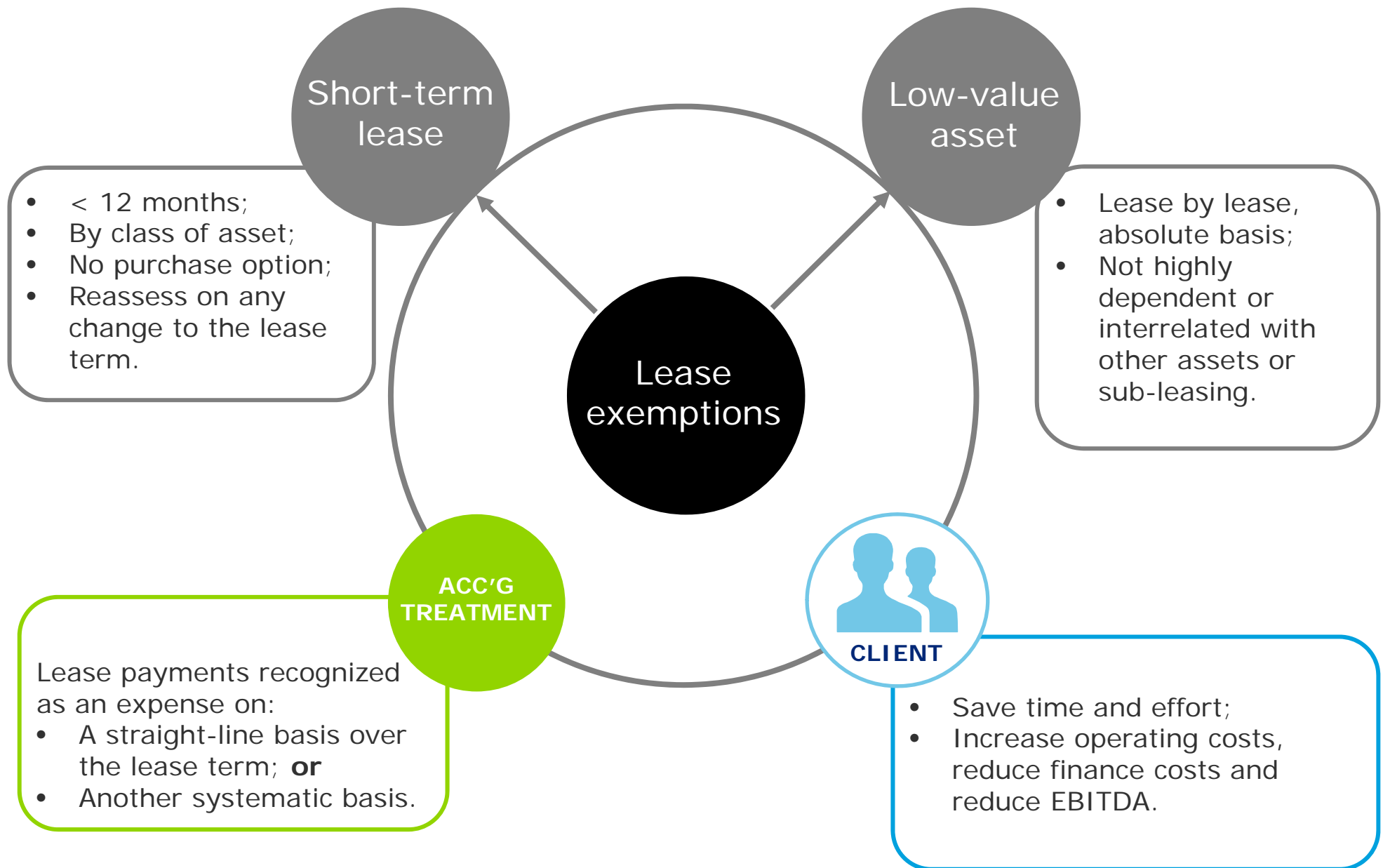
Practical expedient:

- ❖ Policy election for lessees not to separate non-lease components from lease components (*by class of underlying asset*).
- ❖ Account for lease and non-lease components as a single lease component.

Note: Not applicable for embedded derivatives that meet the criteria in paragraph 4.3.3 of IFRS 9 *Financial Instruments*.

Recognition exemptions

Recognition exemptions



Practical expedient: Portfolio approach

An entity may apply IFRS 16 to a portfolio of leases with similar characteristics if the entity **reasonably expects** that the effects on the financial statements of applying this standard to the portfolio would not differ materially from applying this standard to the individual leases within that portfolio.



There are no rules determining how to allocate leases to a portfolio – this requires the use of **judgment**.



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