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**Time to take action**  
IFRS 16 *Leases*

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**Financial Reporting**  
plus

# IFRS 16 *Leases* – Three steps to success

IFRS 16 *Leases* was issued by the IASB in January 2016. It will replace IAS 17 *Leases* for reporting periods beginning on or after 1 January 2019. **The time to take action is now.**

IFRS 16 will have broad implications:

- It could fundamentally alter the balance sheet and income statement of many companies.
- Extensive data requirements, beyond what many companies currently have available.
- Significant resource and systems implications, particularly for large property occupiers.
- Important choices and exemptions will need to be modelled and considered at an early stage.
- The impact is likely to affect a number of stakeholders, including finance departments, property teams, banking covenants, remuneration schemes and, where relevant, regulatory compliance.
- Opportunities to revisit leasing strategy and consider smarter contracting options.

IFRS 16 will have broad implications, the time to take action is now.

Our first high level review indicates that IFRS 16 will leave its marks on the financial statements of many Irish companies. There are three key phases to a successful implementation:



## Deloitte's unique proposition for property occupiers

Property leases are likely to be one of the most significant areas of impact. This applies also to the common lease/rental agreements in Ireland. Understanding the impact of IFRS 16 requires a joined-up approach looking at both financial and leasing strategy.

Our IFRS 16 implementation team brings together every Deloitte service line, including our Corporate Real Estate team. They will address every aspect of corporate real estate, including understanding the financial effects of IFRS 16 and shaping your property strategy in the new environment. Whilst our phased implementation plan includes consideration of lease strategy within 'Mitigate and strategise', it is important to be aware of the implications for real estate strategy from the beginning.

## Some of the many questions our corporate real estate teams can help businesses answer include:

- Should assets be bought rather than leased?
- Should services be procured in a way that does not meet the definition of a lease?
- How should the business manage its property portfolio and negotiate its property leases (including lease terms, incentives and structures)?
- Is your estates strategy up to date, and aligned to the needs of the business? Do you have metrics in place to demonstrate efficient use of accommodation?
- How will you educate those responsible for leasing strategy on the implications of lease structures for corporate performance reporting?
- What are the implications for international businesses?

## Our estates strategy review offering also enables us to provide you with:

- Critical insight into the company's estate strategy and benchmarking with industry practice.
- Identification of strategy gaps.
- Review of alignment of own vs. lease strategy with core business objectives.
- Assessment of efficiency and effectiveness of use of leased assets.

# The timeline for adoption: Steps to success



## Phase I – Assess and prepare



### Time to take action

The first critical steps for an IFRS 16 -leases implementation are to form a project team, gather information to assess the impact of the standard, analyse the data and prepare for the longer-term actions and decisions required.

Key activities within this phase:

- establish project governance;
- understand the standard;
- understand transitional options, scope and recognition exemptions;
- gather data;
- assess the overall impact on the business;
- assess the impact on business plans for the next three years;
- identify stakeholders;
- assess the impact on communications with investors and other stakeholders;
- make key decisions and judgements, including defining accounting policy; and
- plan the remainder of the project.

### Consider...



### Readiness assessment

Completing a **readiness assessment** can identify the scale of the challenge and the critical path for your company. At this stage, businesses should also consider the wider impact on **KPIs, remuneration schemes** and **lease strategy**, to determine areas they need to mitigate now rather than later. Refer to 'Mitigate and Strategise' for further details.

Provided by our multi-disciplinary team, Deloitte's comprehensive IFRS 16 Readiness Assessment will help you plan your implementation in more depth.

Visit [www.deloitte.com/ie/ifrs16-10-questions](http://www.deloitte.com/ie/ifrs16-10-questions) to find 10 questions you can ask yourself to help in preparing your plan for IFRS 16 implementation.



### Accounting policy

The new standard will require changes to **accounting policy**. The transitional provisions available are complex and include the cost/benefit implications of adopting the modified retrospective or the full retrospective approach. The applicability of the available recognition exemptions for short-term and low-value leases will also need to be addressed. IFRS 16 refreshes the definition of a lease, and it is possible that this may lead to different conclusions from IAS 17. Additionally, the determination of discount rates is likely to be a significant judgement point.

Deloitte's IFRS 16 team includes specialists who have been close to the development of the standard. They are exceptionally well placed to cut through complexity and advise you on the interpretation of the standard and the best decisions to be made. Our offerings range from general training sessions to detailed accounting policy advice and accounting manual development.



### Data assurance

Businesses with substantial lease portfolios are likely to find the adoption of IFRS 16 a data-heavy task. They will need to consider whether their **lease databases** are robust enough to facilitate analysis by the finance team.

Data requirements will be extensive, initial indications are that up to 80 data points may be required for each lease. The information will need to be accurate and frequently updated, to ensure the lease liability reflects the true obligations of the business. Businesses will want to consider challenges such as:

- missing documentation around lease, sublease, and deeds of variation;
- inaccurate or outdated information around current passing rent and rent reviews;
- multiple systems and sources of information;
- inconsistencies or disconnections between finance and property systems; and
- information in systems not kept up to date, whether by suppliers or in-house.

Deloitte's data analytics capabilities enable us to apply powerful analytics to large populations of data, to help you understand the data that you already hold, and what it means. Our data assurance team helps to assess the quality, integrity, completeness and robustness of the data already existing within the business.



### Technology strategy

Many businesses have large portfolios of leases for which spreadsheet analysis will be inefficient and poorly-controlled. Planning the technology strategy for your implementation will require a realistic evaluation of existing **system capabilities** and the desired end-state control environment. For some businesses, this will mean exploring complementary capabilities for existing ERP systems. For others, a bolt-on 'lease engine' approach will be more cost effective.

Deloitte can assist with a range of approaches to technology solutions, including contract analysis and modelling lease accounting entries. We can also assist in the context of M&A activity, including modelling the IFRS 16 income profile and balance sheet for targets.



## Phase II – Implement and embed



### Holistic approach to change

Implementing and embedding IFRS 16 will affect all businesses with leases, but for businesses which are currently lessees under operating leases it will be especially significant. 'Business as usual' planning will need to ensure that IFRS 16 implementation is more than a short-term fix. During 2017, businesses should complete the key elements of their implementation, leaving adequate time to test their effectiveness ahead of the required transition date.

Key activities within this phase:

- improve data quality;
- implement system changes and make changes to related processes and controls;
- perform a 'dry run', assess accounting impact and refine judgements;
- share learnings and educate stakeholders; and
- prepare IFRS 16 disclosures.

### Consider...



### Data manipulation

With lease data in hand and validated, and accounting policy established, businesses will need to consider how to **implement the calculations** necessary for IFRS 16 in a sufficiently robust manner. Development of an **in-house tool** may prove fit for purpose, although the complexity of the requirements means that any tool will require robust governance.

Deloitte's IFRS 16 team can advise on options related to the implementation of IFRS 16 calculations.



### Technology implementation

For businesses more significantly impacted by IFRS 16, change may be required to augment or supplement existing ERP systems in order to track the right data across the lease portfolio and facilitate the production of IFRS 16 financial information. Early design of the **technology solution** will enable implementation and dry run testing prior to going live with IFRS 16 implementation.

Our Systems Change and Implementation teams are experienced in supporting companies through ERP system changes whether implementing new accounting modules released by software providers, or with more bespoke projects.



### Controls and governance

On adoption, **financial reporting processes** will need to be updated to reflect the more complex requirements of the standard for both external and internal financial reporting. A successful implementation requires a robust **internal control framework** for comprehensive risk mitigation. Businesses need to design, implement and monitor effective controls that will ensure complete regulatory and legislative compliance but will be practical, pragmatic and align with the risk appetite of the organisation.

Deloitte's Financial Operations & Support team are expert at advising on the smartest ways to implement updated financial reporting processes as a result of changes to accounting standards and can provide operational resource and project management to support you. Our Governance & Controls team can advise on internal control enhancement and optimisation and designing new controls to ensure regulatory compliance is maintained.



## Phase III – Mitigate and strategise

1 January 2019



### Broad implications, strategic opportunities

IFRS 16 will have broader impacts that need to be effectively mitigated or managed, some of which may come as a surprise. It may also act as a catalyst for strategic decisions relating to a company's leasing and contracting arrangements. Some of these impacts will be critical, others less urgent. Early consideration is key, to enable sound decision making and avoid surprises on implementation.

Key activities within this phase:

- consider impacts on treasury, remuneration targets, covenants and regulatory matters (e.g. regulatory capital);
- reassess leasing strategy; and
- consider contracting approach.

### Consider...



### Managing the impacts

IFRS 16 will have several consequential impacts for most companies:

- The implications of IFRS 16 for EBITDA may have unintended consequences for **remuneration schemes, performance targets** and **earn-outs**. Businesses will need to ensure that their remuneration arrangements remain appropriate and address the accounting impact if mitigating actions are required to manage anticipated pay-out.
- **Debt covenants** may include a 'frozen GAAP' concept but consideration needs to be given to planned covenant arrangements on issuance of new debt. In the absence of a frozen GAAP basis, mitigating action may be required, depending on the covenant metrics concerned. The changes in lease accounting may also have an impact on a company's refinancing activity given that a liability will be included in the balance sheet for many leases for the first time.
- IFRS 16 may impact key trends which are used for managing the business. Companies need to consider the impact on **management information**, including **KPIs**, and on **budgeting** and **forecasting processes**.
- For financial service sector entities, understanding and responding to the impacts of IFRS 16 on **Regulatory Capital** will be key.

Deloitte's IFRS 16 team includes specialists who can help companies respond early to these wider impacts of IFRS 16.



### Lease and contract strategy

With IFRS 16 will come renewed focus on existing leases and scrutiny of future leasing strategy. Leasing can be expected to rise up the board room agenda as increased scrutiny is placed on the overall **Corporate Real Estate strategy**. Key trigger points will include renegotiating key lease terms such as duration and rent review structures on renewals, re-gears, own vs. lease decisions and understanding the revised cost-benefit analysis for capital release projects, including sale and leasebacks.

Deloitte's unique integrated Real Estate advisory team routinely advise companies on their corporate leasing strategy and can help bring focus and a fresh perspective to the table. They can also assist with identifying and responding to these aspects of leases as well as other contracts.

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