

A photograph of a modern, brightly lit architectural interior. The scene features a long, wide staircase with a metal railing leading upwards. The architecture is characterized by clean lines, white walls, and curved walkways. Large windows and skylights allow natural light to flood the space, creating a bright and airy atmosphere. The overall design is contemporary and functional.

IFRS 16 RISK ASSESSMENT

October 2018

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INTRODUCTION



OUTLINE OF THIS WEBINAR

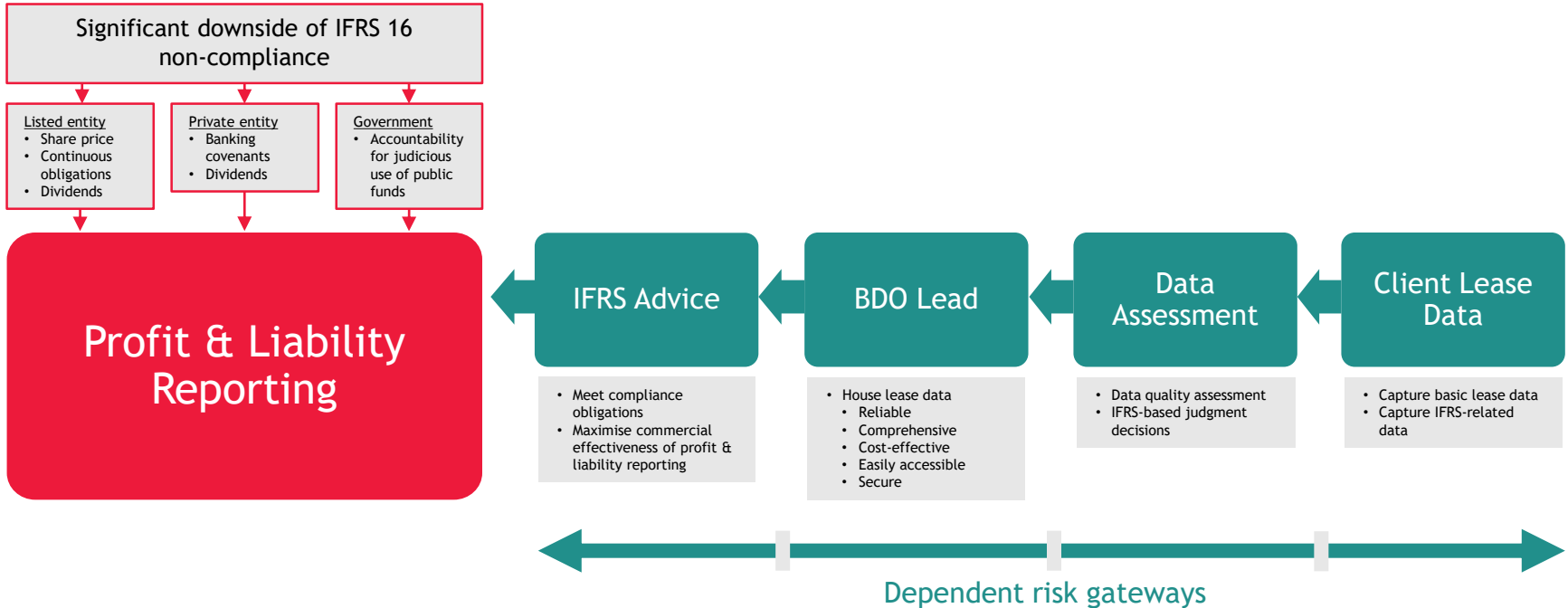
- ▶ What is the business problem?
- ▶ 1 January 2019 - The Clock is Ticking Down!
- ▶ Questions directors should ask
- ▶ Risk assessment questions for management
- ▶ Next steps
- ▶ Do you need assistance?



WHAT IS THE BUSINESS PROBLEM?

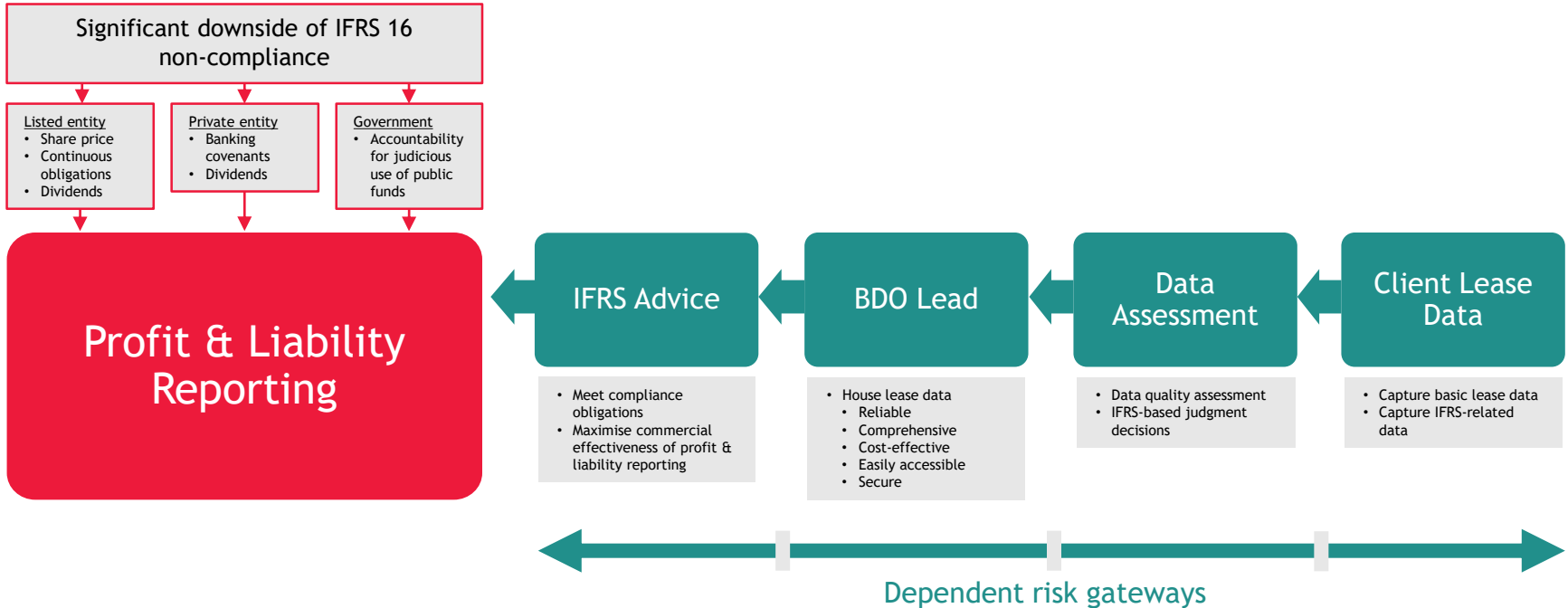
Private Sector Entities - Preserve Shareholder Value

IFRS 16 will create winners and losers for organisations with multiple leases, depending on how effectively they control the risk at each point in the lease management lifecycle.



Public Sector Entities & NFP Entities - Maintain Public Support

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AFR, 5 SEPTEMBER 2018

<https://www.afr.com/business/retail/myer-woolworths-hardest-hit-by-new-lease-accounting-standard-20180905-h14yqo>

Myer, Woolworths hardest hit by new lease accounting standard



AFR, 9 JULY 2017

<https://www.afr.com/business/retail/wesfarmers-woolworths-among-retailers-bracing-for-new-lease-accounting-rules-20170706-gx69ij>

Wesfarmers, Woolworths liabilities to double under lease accounting change

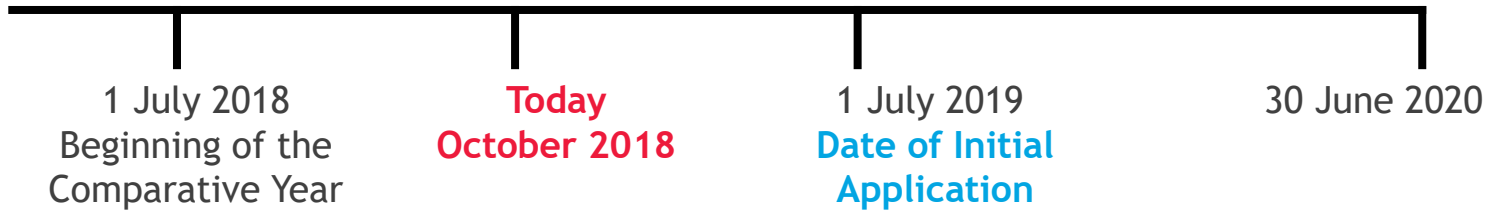
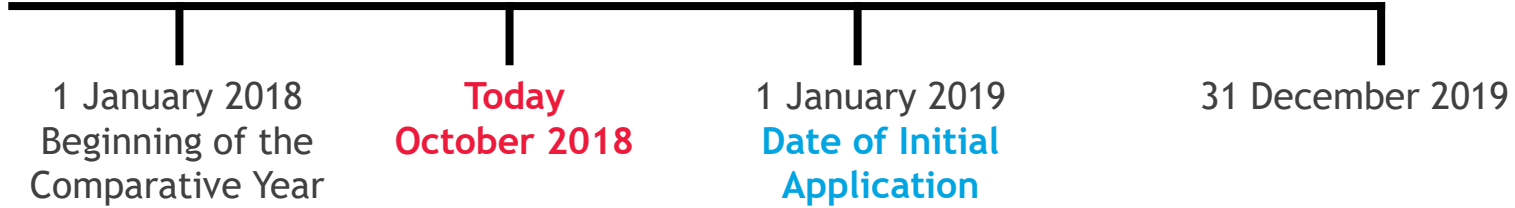


1 JANUARY 2019 - THE CLOCK IS TICKING DOWN!

EFFECTIVE DATE OF IFRS 16

Accounting Standard	Effective Date - Years Beginning on or after ...	31 December Year-ends	30 June Year-ends
AASB/IFRS 16 <i>Leases</i>	1 January 2019	31 December 2019	30 June 2020

WHY NOW?





QUESTIONS DIRECTORS SHOULD ASK

QUESTIONS DIRECTORS SHOULD ASK IN RELATION TO THE NEW ACCOUNTING STANDARDS

- ▶ <https://aicd.companydirectors.com.au/membership/the-boardroom-report/volume-16-issue-10/questions-directors-should-ask-for-the-new-aasb-standards>

OVERALL QUESTIONS DIRECTORS SHOULD ASK

- ▶ How could these new accounting standards impact shareholder value?
- ▶ How can we mitigate the potential negative impact of these accounting standards on shareholder value?
- ▶ Would the organisation be able to continue to declare dividends? Would these dividend declarations be aligned to our current dividend policy?
- ▶ How do these accounting standards impact the profit of the organisation in year of implementation and thereafter?
- ▶ How do these accounting standards impact the balance sheet position (assets, liabilities & equity) of the organisation in the year of implementation and thereafter?

OVERALL QUESTIONS DIRECTORS SHOULD ASK

- ▶ How have we updated and incorporated these new accounting standards into our budgets and forecasts?
- ▶ Would the organisation be able to continue to meet their current bank covenants?
- ▶ Should the organisation renegotiate their bank covenants to minimise the potential impact of the new accounting standards on their current bank covenants?
- ▶ What is the impact of the new accounting standards on current remuneration structures and incentives to key management personnel and other employees?
- ▶ Does the organisation need to adjust performance hurdles and KPIs of key management personnel and other employees, to reflect the impact of the new accounting standards?

OVERALL QUESTIONS DIRECTORS SHOULD ASK

- ▶ How are we going to communicate the immediate and future impact of the new accounting standards to our shareholders and other users of our financial statements?
- ▶ Has the organisation performed and documented an impact and/or risk assessment of the implementation of the new accounting standards?
- ▶ Does the organisation have documented position papers to support and justify the appropriate accounting treatment of existing transactions under the new accounting standards?
- ▶ Has the organisation updated their accounting policy manual to reflect the requirements of the new accounting standards?
- ▶ Has the organisation obtained independent accounting advice in relation to the implementation of the new accounting standards?

OVERALL QUESTIONS DIRECTORS SHOULD ASK

- ▶ Have the auditors of the organisation been involved in the discussions and impact assessment of the new accounting standards on the organisation?
- ▶ What research has been done on the potential impact of the new accounting standards on the organisation's industry?
- ▶ Has the organisation considered their technology needs and required changes to their existing systems and processes to deal with the new accounting standards?
- ▶ How can the directors access further information on the requirements and potential implications of the new accounting standards?

QUESTIONS DIRECTORS SHOULD ASK RE IFRS 16

- ▶ Has the organisation decided on an appropriate transitional approach?
- ▶ What process did the organisation follow to decide on the appropriate transitional approach in relation to AASB 16?
- ▶ What is the impact of each of the three possible transitional approaches on the organisations:
 - Retained earnings at the date of initial application
 - Lease liabilities and right-of-use assets at the date of initial application
 - Profit before tax (i.e. depreciation and interest expenses)

QUESTIONS DIRECTORS SHOULD ASK RE IFRS 16

- ▶ Does the organisation have a register of all leases?
- ▶ Does the organisation have a copy of all lease agreements?
- ▶ What process did the organisation follow to identify all leases, including embedded leases?
- ▶ How did the organisation decide whether it is reasonably certain to exercise lease extension options, termination options and purchase options included in lease agreements?
- ▶ Does the organisation have a technology solution to manage leases on an ongoing basis, i.e. after the date of initial application?

RISK ASSESSMENT QUESTIONS FOR MANAGEMENT

RISK ASSESSMENT QUESTIONS FOR MANAGEMENT

- ▶ Are there any service agreements whereby the services provided to the entity rely on the use of assets that are controlled by the entity?
- ▶ Does the entity have agreements where the entity have the right to control the assets?
- ▶ Does the entity have agreements where the entity have sole use of the assets (or right to substantially all of the assets)?
- ▶ Does the entity have agreements where the lessor does not have substantive rights to substitute the identified assets?
- ▶ Does the entity have agreements where the entity have the ability to direct the use of the identified assets?
- ▶ Are the assets within these agreements of low value?
- ▶ Are the assets leased for a short term (less than 12 month) period?

RISK ASSESSMENT QUESTIONS FOR MANAGEMENT

- ▶ Does the right to use the asset also provide the entity with other services?
- ▶ Are there any service agreements whereby the services provided to the entity rely on the use of assets that are controlled by the entity?
- ▶ Will the entity elect to apply the practical expedient on transition to grandfather the IAS 17 / IFRIC 4 lease classification for all its contracts?
- ▶ Does the lease contain one or more extension, purchase or termination options?
- ▶ Is the entity reasonably certain to exercise (one or more of) the extension, purchase or termination option(s)?
- ▶ Does the arrangement involve fixed lease payments?
- ▶ Do the lease payments include in-substance fixed lease payments?
- ▶ Are the lease payments dependent on an index or rate?

RISK ASSESSMENT QUESTIONS FOR MANAGEMENT

- ▶ Do the lease payments include variable lease payments?
- ▶ Do the payments under the lease involve contingent rental?
- ▶ Are amounts expected to be payable under residual value guarantees?
- ▶ Is the interest rate implicit in the lease known or readily determinable?
- ▶ Were any direct costs incurred when entering into the lease?
- ▶ At the end of the lease term, will costs be incurred to restore or remove the asset?
- ▶ Were any lease payments made at or before commencement of the lease?

RISK ASSESSMENT QUESTIONS FOR MANAGEMENT

- ▶ Were any lease incentives (including rent free periods) received?
- ▶ Has a significant event or change in circumstances occurred which would trigger a reassessment of the lease term?
- ▶ Has the entity changed its assessment of the likelihood of exercising extension, purchase or termination options (and hence has the lease term changed)?
- ▶ Does the lease contain a residual value guarantee?

RISK ASSESSMENT QUESTIONS FOR MANAGEMENT

- ▶ Have there been any lease modifications?
- ▶ Does the modification increase the scope of the lease (i.e. does it add the right to use one or more underlying assets)?
- ▶ Is the increase in the consideration payable commensurate with the standalone price for the increase in scope?
- ▶ Does the modification decrease the scope of the lease (i.e. is the modification (or part of the modification) a partial or full termination of the lease)?
- ▶ Is the interest rate implicit in the lease following the modification known or readily determinable?

RISK ASSESSMENT QUESTIONS FOR MANAGEMENT

- ▶ For contracts entered into prior to the date of initial application, has the entity determined whether to apply the practical expedient to use the IAS assessment made under IAS 17 / IFRIC 4 as to whether or not the contract is or contains a lease?
- ▶ Does the entity intend to apply the full retrospective approach on transition (instead of the modified retrospective approach)?
- ▶ Was the lease previously accounted for as a finance lease?
- ▶ Is the remaining term of the lease, as at the date of initial application, less than twelve months?
- ▶ Does the entity have a portfolio of similar leases (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment)?

RISK ASSESSMENT QUESTIONS

- ▶ Is the lease a lease of investment property (i.e. an investment property of the lessee)?
- ▶ On transition the entity has the choice to measure the RoU asset by (1) adjusting the lease liability for prepaid / accrued lease payments or (2) as if IFRS 16 had always been applied (but using the incremental borrowing rate at the date of initial application. Will the entity choose to measure the RoU asset using method (2) (adjusting the lease liability)?
- ▶ Will the entity NOT use hindsight in calculating the RoU asset on transition?
- ▶ Does the entity intend to exclude initial direct costs from measurement of the RoU asset on transition?
- ▶ Does the entity intend to rely on its previous onerous lease assessment in determining if RoU assets are impaired on transition?



RISK ASSESSMENT QUESTIONS

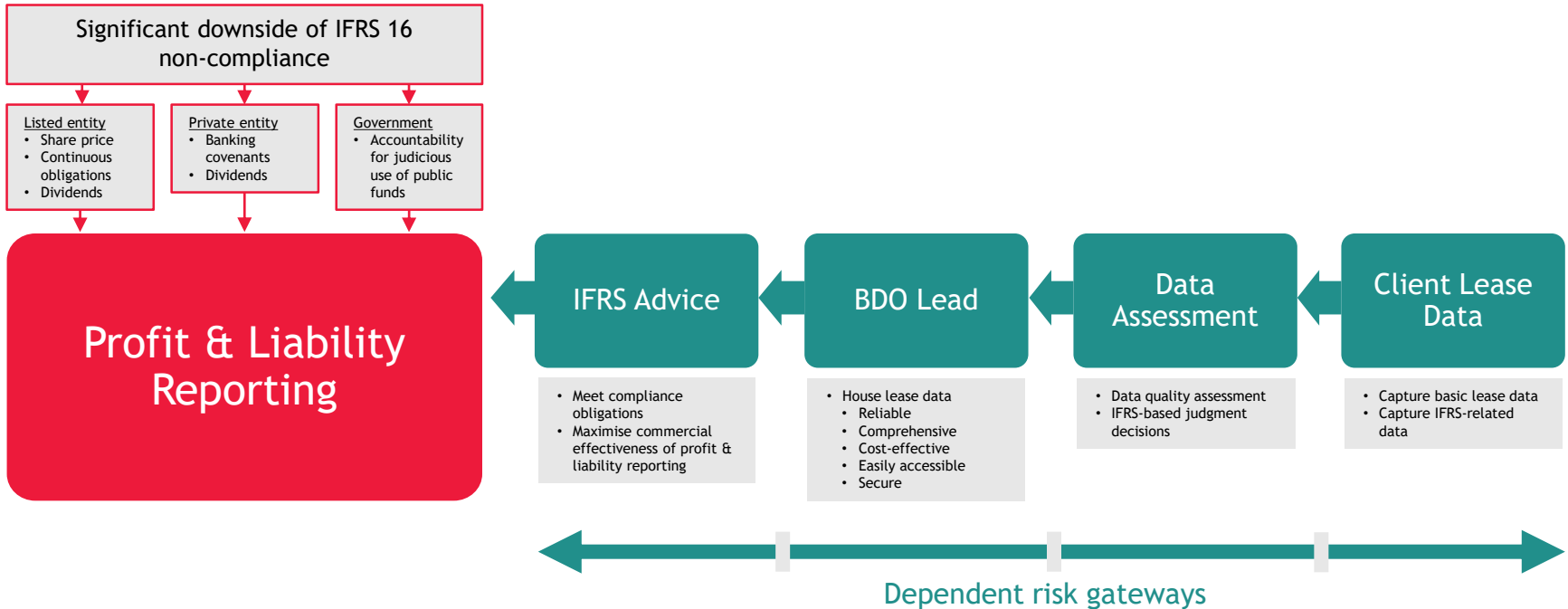
- ▶ Has the entity entered into any sale and leaseback transactions (as a lessee (seller)) since the date of initial application?
- ▶ Are both the sale and lease payments at market rates?
- ▶ Does the entity have any sale and lease back transactions existing at the date of initial application?



NEXT STEPS

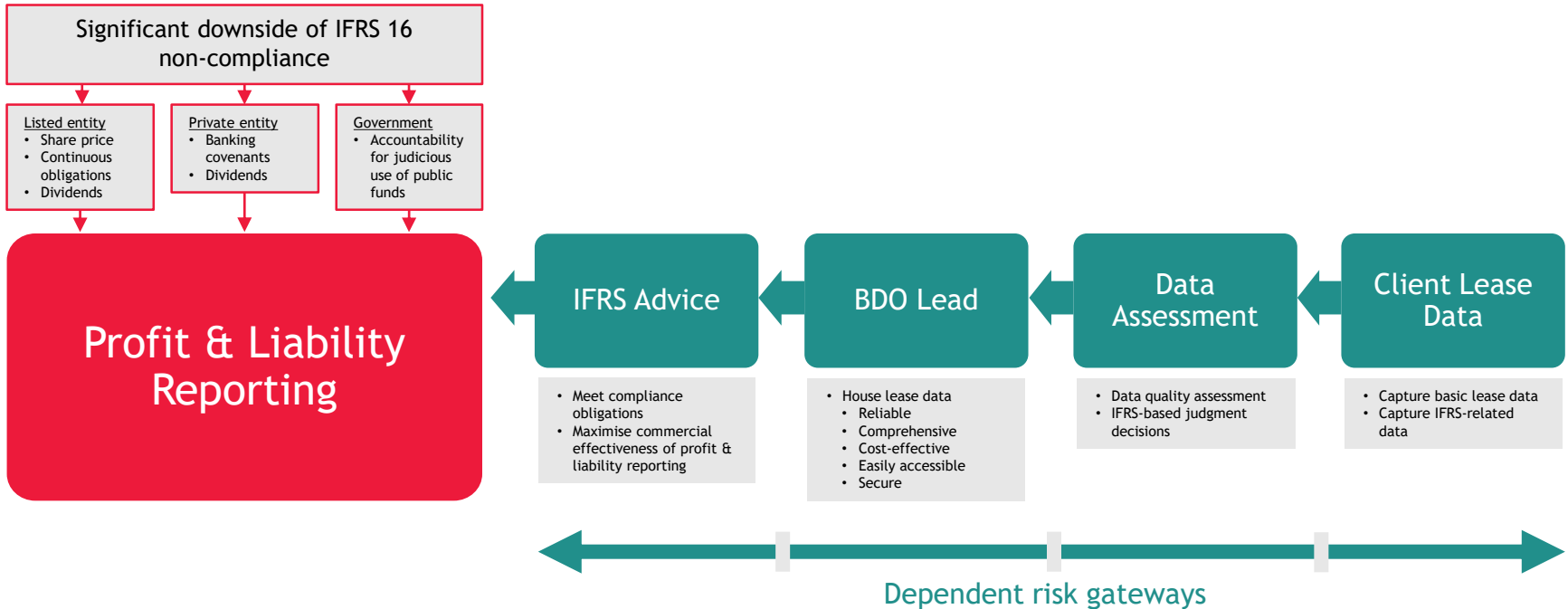
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BDO LEAD - OUR VERY OWN BDO AASB 16 TECHNOLOGY SOLUTION

<https://www.bdo.com.au/en-au/services/audit-assurance/ifrs-advisory-services/aasb-16/lease-management-ifrs-16-tool>



NEXT STEPS

- ▶ Do you have copies of all your operating & finance leases?
- ▶ Have you decided on a transitional approach?
- ▶ Do you have all the data necessary to implement IFRS 16?
- ▶ **Do you have a technology solution?**
- ▶ Can you maintain your leases on an ongoing basis?



NEXT STEPS

- ▶ Have you educated yourself and your team re the technical requirements of IFRS 16?
- ▶ Have you done a risk assessment re IFRS 16?
- ▶ Have you designed an appropriate response to the completed risk assessment re IFRS 16?
- ▶ Have you designed a **project plan** re the implementation of IFRS 16?
- ▶ Have you decided on an appropriate **transitional approach** re IFRS 16?
- ▶ Have you changed and improved your systems and processes to deal with the new IFRS 16?



DO YOU NEED ASSISTANCE?

MONTHLY FINANCIAL REPORTING WEBINARS

- ▶ <https://www.bdo.com.au/en-au/insights/audit-assurance/webinars/2018-financial-reporting-accounting-standards>
- ▶ Upcoming IFRS 16 Webinars
 - IFRS 16 - Problem Areas (12 December 2018)
- ▶ Previously recorded IFRS 16 Webinars
 - 22 February 2017 - Overview of IFRS 16
 - 20 September 2017
 - 18 October 2017
 - September 2018 (Transitional methods)



NEWSLETTERS & OTHER PUBLICATIONS

- ▶ <https://www.bdo.com.au/en-au/accounting-news/accounting-news-august-2018>
- ▶ <https://www.bdo.com.au/en-au/services/audit-assurance/ifrs-advisory-services/ifrs-technical-resources>

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QUESTIONS



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