IFRS 16 Transition options for lessees

IFRS 16 is complex and requires significant judgement

IFRS 16 *Leases* comes into effect for accounting periods beginning on or after 1 January 2019. The IASB issued the new standard as part of its drive to reduce off balance sheet accounting, essentially bringing operating leases on to lessee's balance sheets. This means, for lessees, there will be a gross up of the balance sheet which is highly likely to impact financial ratios. IFRS 16 is extremely complex. To implement it successfully, you'll need to make a number of assumptions and use substantial judgment. Given the amount of preparation required, and decisions to be taken, IFRS 16 implementation will take considerable effort and many months' work.

Why is your choice of transition methods so important?

One of the most significant decisions you'll make during your implementation of the standard is which transition method to use. Your choice will impact the level of effort required to implement the standard as well as ongoing financial measures. Some of the impacts are:

Implementation	Financial reporting
Cost	Carrying amount of assets and liabilities
Resources	Profit trends
Timeline	Comparability of financial information

What are your main transition options?

Full retrospective	Modified retrospective	Simplified

Note	Method	Description	What you'll need	Practical expedients	Pros	Cons
If choosing the full retrospective approach, it must be applied to all leases in your portfolio.	Full retrospective	Apply IFRS 16 retrospectively to leases. This means restating prior financial information.	Extensive historical information about your lease agreements including rent payments, reviews and renewals, discount rates and any information used to determine whether or not the organisation was likely to exercise a renewal, termination or purchase option, amounts expected to be paid under residual value guarantees and amortisation and impairment of the right-of-use asset.	None. With the exception of the option to grandfather the definition of a lease, there are no further expedients or relief.	Better ongoing NPAT profile that the modified approaches. You will be able to more accurately present comparable financial trend information.	You'll have to restate prior period information resulting in increased transition costs and a longer implementation. Need the complete history of the lease. Need the discount rate at the commencement of a lease. If you elect this approach it applies to the while portfolio.
If applying the modified approach, for leases previously classified as operating you are able to choose, on a lease-by-lease basis, how to measure the ROU asset, either using the modified retrospective or simplified approach.	Modified retrospective	Apply IFRS 16 from the beginning of the current period by calculating the lease assets and liabilities as at the beginning of the period. Measure the ROU asset retrospectively using discount rate at the transition date.	Extensive historical information about your lease agreements including rent payments, reviews and renewals. The lessee's incremental borrowing rate at the beginning of the application and the remaining lease period payments.	Yes – practical expedients can be applied on a lease-by-lease basis including use of hindsight, initial direct costs, discount rates, impairment and onerous leases and leases with a short term remaining.	You do not have to restate prior-period information. Doscount rate is at transition. Lower depreciation expense than simplified approach. You can choose on a lease-by-lease basis.	Not possible to present comparable trend information in current and subsequent years. Requirement to make disclosures explaining differences between previous reported leasing commitments and opening lease liabilities under IFRS 16. Higher expense profile than full retrospective.
	Simplified modified	Your ROU asset equals your lease liability plus or minus prepaid and accrued payments.	Previous carrying value of lease liability and lease asset and information at the date of initial calculation.		Simpler and less costly to apply than Modified Retro as it only requires information from the initial application and calculations are simpler. Discount rate is at transition. Can choose on a lease-by-lease basis.	Not possible to compare profit or loss trend data (due to distor-tion) until the last lease in place on initial application expires. Highest ongoing expense profile.

6 steps to help you select the right transition method

1. Audit your leases
2. Work out how many would need to be restated
3. Work out the proportion of those you hold all of the relevant information for
4. Model the impact of the options on initial application and post transition
5. Identify stakeholders and assess their requirements
6. Document your calculations and assessment

Which factors will influence your decision?

- The availability of lease agreements and related historical data
- Time and resources to support your implementation project
- The importance of comparable financial data to your organisation and key stakeholders
- Ability to determine historical discount rates

How can Nomos One help?

Nomos One is an end-to-end lease management and lease accounting solution that will transform the way you manage your leasing portfolio while giving you complete confidence in your IFRS 16 compliance. We've worked with chartered accountants who live and breathe IFRS 16 to design a world class IFRS 16 compliant module that has been tested against over 100 scenarios provided by global accounting firms.

Our purpose built module:

- Walks you through the transition requirements
- Let's you compare financial impacts under all three transition approaches
- Let's you select the simplified or modified retrospective approach on a lease-by-lease basis
- Has everything you need for the initial and subsequent measurement of the lease liability and the right-of-use asset
- Produces journals and a range of other financial reports.

To check out Nomos One features or to schedule a personalised demo visit: www.nomosone.com