MOORE STEPHENS LLP
CHARTERED ACCOUNTANTS OF SINGAPORE

Moore Stephens
Financial Reporting Alert

www.moorestephens.com.sg

Adding Value to Your Business

New Lease Accounting Paradigm takes effect from 2019

On 13 January 2016, the International Accounting Standards Board (IASB) released the new, long-anticipated revised framework on lease accounting. The leases project has been the subject of substantial debate since the first discussion paper was released in 2009.

The new lease accounting standard, IFRS 16 Leases, will replace the existing framework in IAS 17, and will require lessees to capitalise all leases except for short-term (less than 12 months) or low-value leases (e.g. photocopy machine), thereby largely increasing the lease assets and financial liabilities recognised by lessees. In our view, the new lease accounting framework is expected to have its biggest impact on the airline, shipping, retail, and leisure industries. IFRS 16 will come into force on 1 January 2019, but can be early adopted to match the timing of application of IFRS 15 Revenue from Contracts with Customers.

In Singapore, the Accounting Standard Council (ASC) has not yet issued IFRS 16 under Singapore Financial Reporting Standards (FRS). However, we believe that ASC will incorporate IFRS 16 into Singapore FRS in due course.

In this article, we provide an overview of the key requirements of IFRS 16 and highlight key areas of focus when preparing for transition to the standard.

Does a contract contain a lease?

Given that IFRS 16 requires lessees to capitalise almost all leases, the question of what is a lease becomes critical as it becomes the segregating boundary between contracts that get capitalised and those that do not.

Under IFRS 16, a contract is a lease if it conveys to the customer the right to use an identified asset for a period of time in exchange for consideration. Prima facie, the definition appears straightforward, but significant judgment will be required in practice due to the wide range of variations in commercial lease terms. Issues arise, in particular, when assessing whether the customer has a "right to use" and whether there is an "identified asset". IFRS 16 provides detailed guidance on issues such as:

- Impact of supplier's rights to substitute the leased asset
- Impact of supplier's rights to repair/maintain/ update the leased asset
- Impact on assessment when the supplier can replace the leased asset with another identical/ similar item
- Impact of customer's restrictions with regards to use of the asset
- Impact of decisions that are "hard-coded" into the contract by either customer or supplier
- Impact of customer's involvement in asset design that predetermines the asset's use

Lessees will also need to exercise judgment to segregate out the lease element in a contract from other components of the contract. For example, a charter contract for a vessel may specify separate services such as provision of crew in the same contract. Under IAS 17, where the contract was regarded as an operating lease, this segregation has no significant impact on profit since both elements are expensed. Under IFRS 16, however, the segregation will have a significant impact on profit since only the lease element is capitalised and the others are expensed. Usually, the contract regards all the components as an entire bundle and may not specify separate component prices for each element. IFRS 16 requires the total contract consideration to be split between the lease and non-lease elements based on the relative stand-alone price of each element. Estimation issues may arise where there is no active market for the various elements on a stand-alone basis.

To facilitate transition, IFRS 16 does not require entities to reassess whether a contract contains a lease at the date of initial application, i.e. 1 January 2019. The assessment based on the revised framework is only required for contracts entered into (or changed) on or after the date of initial application.

Changes for lessor and lessee

IFRS 16 is not expected to substantially impact lessor accounting, since the requirements for lessor accounting are largely similar to IAS 17.

For lessees with significant operating leases under IAS 17, IFRS 16 will impact both the size of the balance sheet and the income statement expense recognition pattern. The following table summarises the expected impact for lessees' operating leases.

	IAS 17	**IFRS 16**
Balance sheet	Assets and liabilities are largely off-balance sheet.	1. Capitalise leased assets on the balance sheet initially measured at the present value of unavoidable future lease payments. 2. A corresponding lease liability is recognised.
Income statement	Recognise operating lease expense on a straight-line basis over the lease term.	1. Depreciate leased assets in accordance with accounting policy. 2. Recognise interest expense on lease liabilities measured at amortised cost using the effective interest rate method. This method results in higher interest expense recognised in earlier years.
Cash flow statement	Operating lease cash payments are usually recognised as part of operating cash flows.	1. Separate the total amount of cash paid into principal payments and interest payments in the cash flow statement. 2. Principal payments are presented as financing cash flows. 3. Interest payments are typically presented within either operating or financing activities.
Disclosures	IFRS 16 requires enhanced disclosures that reflect the complexity of the entity's leasing activities.	

Effects on balance sheet, income statements and cash flow statement for lessees

For companies with significant operating lease commitments, the new lessee accounting will result in recognition of lease commitments as leased assets and lease liabilities. The effect of changes in the lessee's balance sheet, income statement and cash flow statement is illustrated below:

Next steps

IFRS 16 is likely to have a significant impact on most lessees, and will require significantly more judgement and estimation than was previously the case. Affected entities are encouraged to commence implementation efforts early so that issues can be identified and highlighted for early resolution.

This summary does not cover all the changes required under the new standard, and advice should be sought on the detailed changes that will affect your business.

Balance sheet	Income statement	Cash flow statement
↑ Lease assets	↓ Operating expenses	↓ Operating cash outflows
↑ Financial liabilities	↑ Finance costs	↑ Financing cash outflows

Key Contact

Wong Koon Min - Partner and Head, Professional Standards
T +65 6329 2723
wongkoonmin@moorestephens.com.sg

MOORE STEPHENS LLP
CHARTERED ACCOUNTANTS OF SINGAPORE

10 Anson Road #29-15, International Plaza, Singapore 079903
T +65 6221 3771
F +65 6221 3815
E email@moorestephens.com.sg
www.moorestephens.com.sg