

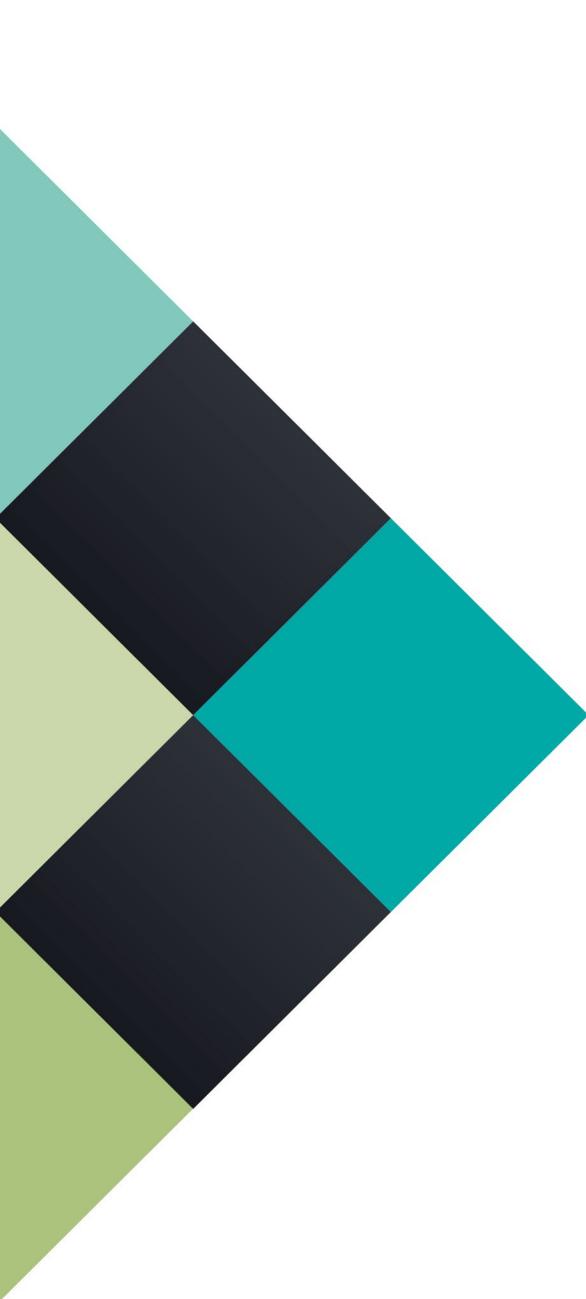
# Financial Reporting Update: For-profit entities

4 June 2020

AUDIT NEW ZEALAND  
Mana Arotake Aotearoa

# Agenda

- NZ IFRS 16 *Leases*
- NZ IFRIC 23 *Uncertainty over Income Tax Treatments*



# NZ IFRS 16 *Leases*

# Overview

- Applies for reporting periods starting on or after 1 January 2019 (i.e. 31 December 2019, 31 March 2020 and 30 June 2020 financial statements)
- Lessees to recognise most leases on the balance sheet
  - Lease liability and associated “right to use” asset
  - Both initially measured at PV of lease payments over the lease term
  - Depreciate right of use asset
  - Interest expense on lease liability using discount rate determined at I
- Lessor accounting largely unchanged from NZ IAS 17 *Leases*

**Lease Agreement**  
A lease agreement is a contract between a lessor and a lessee to pay the lessor for the use of an asset for a fixed period of time. The agreement identifies the leased asset and the terms under which the asset is to be used.

# NZ IFRS 16 – Consequences

- Assets Increase
- Liabilities Increase
- Gearing Increase
- Operating expenses Decrease
- EBIT Increase
- EBITDA Increase
- Total expense over lease term Unchanged
- Total expense early years on of lease Increase
- Total expense later years of lease Decrease
- Operating cash Outflows Decrease
- Financing cash Outflows Increase

# Lease recognition exemptions for lessees

- Option to apply simplified accounting for short-term leases
  - Short-term if lease term is 12 months or less
  - Election made by class of underlying assets (similar nature and use)
- Option to apply simplified accounting for underlying assets of low value
  - Based on value of asset when new
  - Lease-by-lease election
- Lease payments are expensed on a straight-line basis over lease term or other systemic basis if more representative of lessee's benefits



# Lease term

- Non-cancellable period of the lease, plus:
  - periods covered by an **option to extend** the lease if the lessee is **reasonably certain to exercise** that option; and
  - periods covered by an **option to terminate** the lease if the lessee is **reasonably certain not to exercise** that option
- Consider all relevant facts and circumstances that create an economic incentive
  - Significance and life of leasehold improvements
  - Costs relating to termination (e.g. termination payments, relocation costs, reinstatement costs)
  - Specialised nature of asset
- Will be an area of judgement, especially long-term property leases



# Lease payments in measuring lease liability

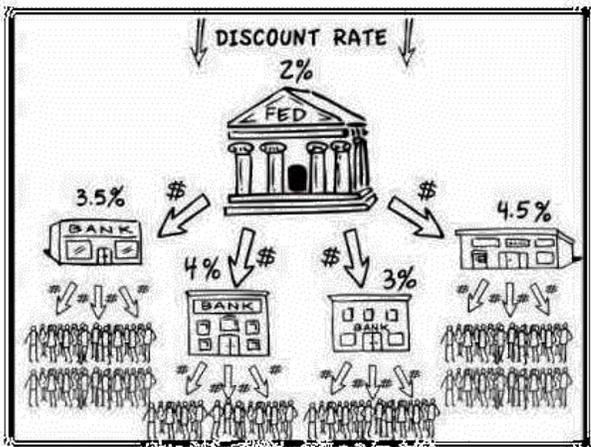
- Variable lease payments based on turnover or usage – not part of lease liability
- If lease payments are initially fixed and then periodically reset based on changes in CPI or market rents, liability initially measured based on rate at lease commencement
  - Do not forecast changes in CPI or market rents
  - Lease liability is remeasured in the future when those changes take effect with adjustment to right of use asset
  - This adds complexity to the accounting that finance teams will need to carefully track and monitor



# Discount rate

- Interest rate implicit in lease, if can be readily determined ; otherwise
- Lessees incremental borrowing rate

*The rate of interest that a lessee would have to pay to borrow over a **similar term**, and with **similar security**, the funds necessary to obtain an asset of a **similar value** to the ROU asset in a **similar economic environment**.*



# Discount rate – how?

- Level of precision in determining discount rates will depend on the materiality of the undiscounted lease cash flows in the context of the financial statements
- Is WACC a valid approach?
- Is a property yield a valid approach?
- Approaches to consider:
  - Existing borrowing rate
  - Build based on a reference rate plus credit spread/other factors
  - External expertise

# COVID-19 related lease concessions

- Amendment to IFRS 16 that provides lessees with a practical expedient that relieves assessing whether a COVID-19-related rent concession is a lease modification
- Require lessees that apply the practical expedient to account for COVID-19-related rent concessions as if they were not lease modifications
- Only applies when:
  - The change in lease payments results in a revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change
  - Any reduction in lease payments affects only payments originally due on or before 30 June 2021; and
  - There is no substantive change to other terms and conditions of the lease.
- Amendment to NZ IFRS 16 going through NZ ASB approval process

# Transition options - lessees

For lessees the options are:

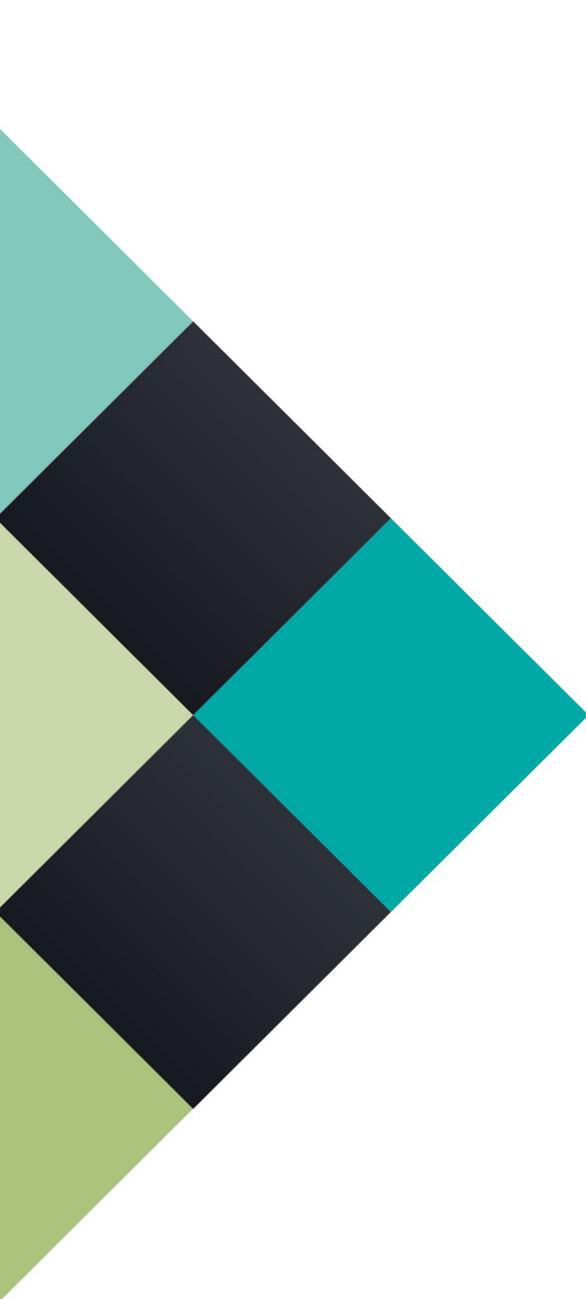
- Full retrospective application:
  - Restate comparatives as if IFRS 16 always applied (apply NZ IAS 8)
  - Could be complex as no concessions
- Modified retrospective application (cumulative catch-up approach at the date of initial application i.e. start of current period):
  - Leave comparatives as previously reported
  - Any difference between asset and liability recognised in opening retained earnings at start of current year

# Consolidation - key considerations

- For-profit group consolidation:
  - Need to consider if all entities are using the same transitional options/practical expedients/accounting policy choices.
  - If not, who is responsible for making any required adjustments?
- Mixed group consolidation:
  - Operating vs. finance lease distinction still required, consider materiality
  - Will need to reverse transitional changes
  - Could be extensive number of line items affected

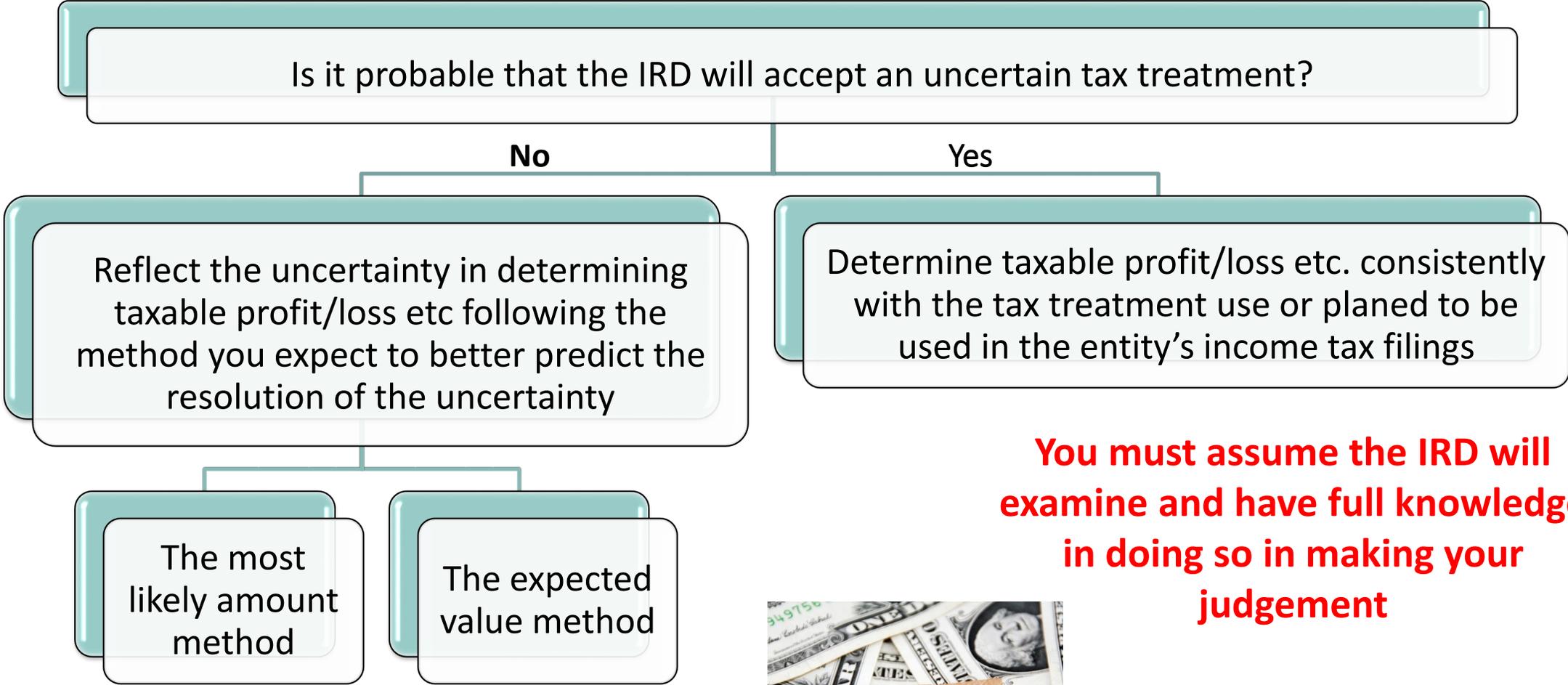
# What we have not covered today

- Lease definition
- Sub-leases
- Other lease modification matters
- Non-lease components e.g. services provided by lessor
- Disclosures



# NZ IFRIC 23 *Uncertainty over Income Tax Treatments*

# Overview



**You must assume the IRD will examine and have full knowledge in doing so in making your judgement**





AUDIT NEW ZEALAND  
Mana Arotake Aotearoa