Arazzo Solutions, LLC

Learning Series: Lease Accounting Changes for Non-accountants

What are the key requirements of IASB IFRS 16?

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Key Requirements for IFRS 16

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In the previous volume of this learning series, we explored the basics of FASB ASC 842, and you'll find some similarities with IASB IFRS 16.

This Learning Series is intended to simplify the vast amount of information relating to the latest FASB/IASB lease accounting guidelines. Our goal is to boil down these standards to make them easily understood by CRE professionals who are not accountants by trade. We want to help you understand the concepts and the lingo (with a bit of humor) without having to be a CPA, while also enabling you to hold your own with the newly extended group of stakeholders and executives. We hope you enjoy this series and we look forward to your feedback.

Remember for global companies, it's important to understand the guidelines required by both accounting boards (FASB and IASB). Whereas the FASB provides two lease classifications (Operating and Finance), the IASB determined that only one classification is needed: Finance. (Volume 6 of this series will look at the differences between FASB ASC 842 and IASB IFRS 16 in more detail.)

The IASB assumed that having one classification would simplify the accounting necessary in moving leases to the balance sheet. They are likely right. The IASB also excluded leases on low-value assets (e.g., laptops, mobile phones, office furniture). They set a minimum threshold value of $5,000 USD. Leases less than that amount remain off the balance sheet. This has an added benefit in that you don't have to spend time (i.e., money) to prove the immateriality of certain leases. This should be especially helpful to smaller companies. As with ASC 842, leases less than twelve

Buzz Words to Know

Low-value asset: Assets valued at $5,000 or less are excluded from the balance sheet and are expensed

Short-term Leases: Leases of 12 months or less are excluded from the balance sheet and are expensed

Residual Value Guarantee: An additional payment made by a lessee when a lease terminates

Lease Liability: The obligation to make lease payments over the lease term

Right of Use (ROU) Asset: The right to use the asset during the lease term

Gross Lease: Tenant pays one lump sum for rent, which also includes real estate taxes, insurance, and operating expenses; OPEX is considered "services" months are also excluded from the balance sheet.

The IASB left intact the definition found in the prior guideline (IAS 17) of what constitutes a lease (the right to control the underlying asset for a period of time). However, IFRS 16 changes how you approach residual value guarantees. (see Buzz Words) Under IAS 17 you were required to include the maximum amount guaranteed, but IFRS 16 says you only have to include the amounts "expected to be payable". This falls into that "reasonably certain" gray area we've discussed previously.

Like ASC 842, under IFRS 16 there are two parts to moving the lease to the balance sheet: the lease liability (the obligation to pay rent) and the Right of Use (ROU) asset. (See Volume 4 for more details.) The lease liability is the present value (PV) of the lease payments for the term of the lease (i.e., rent charges) plus other things like renewal and termination options and variable lease payments based on an index or rate. Under IFRS 16, one thing to remember on variable payments is that a remeasurement is required whenever the index or rate changes. Since this typically occurs annually, it's imperative that a close eye is kept on these leases.

The IASB has given companies flexibility to determine if, for gross leases, they want to deduct the amount pertaining to services (OPEX) from the rent amount. This can present a conundrum for companies. It requires a lot of time for your CRE team to break out the amounts for services, however breaking them out reduces the load on the balance sheet. Your CFO and auditors should provide guidance on this.

The IASB also provides for *IFRS for SME's* (Small and Medium Enterprises). These are privately held companies that report general purpose accounting statements for external users. These organizations are allowed to report under the previous IAS 17 guidelines, at least for the foreseeable future. (Note that IFRS for SME's is not allowed in EU countries.)

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Papers in this Learning Series (Past, Present, & Future)

Volume 1: Why did FASB and IASB change the guidelines?

Volume 2: Why is moving leases to the Balance Sheet such a big deal?

Volume 3: How do the accounting changes impact my CRE team?

Volume 4: What are the key requirements of FASB ASC 842?

Volume 5: What are the key requirements of IASB IFRS 16? (CURRENT ISSUE)

Volume 6: What are the differences between ASC 842 and IFRS 16?

Volume 7: What comes first – the chicken or the egg?

Volume 8: What do I need to consider when evaluating software systems?

Volume 9: What potential impacts will there be to leasing space?

Arazzo Solutions, LLC *is a boutique professional services firm focused on the Commercial and Corporate Real Estate (CRE) industry. Having more than a combined 45 years of CRE experience, our team has a unique combination of expertise in lease administration, lease accounting, project management, and IWMS (Integrated Workplace Management System) support.*

We are here to augment your internal CRE teams, assist you with ASC 842 and IFRS 16 compliance, including required data points, data management and governance, evaluation of systems, and best practices, and act as your advocate to manage IWMS vendors. Whether you have seasonal demands or need assistance year-round, we can help you meet your responsibilities and deadlines without the need to hire additional employees.

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