

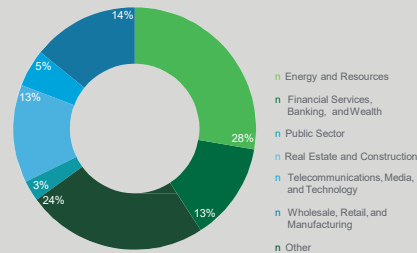
AASB 16, Leases ('AASB 16') introduces a new lease accounting model for lessees that requires all leases to be brought to account on the balance sheet. This is expected to have a significant impact on those organisations with large or material lease portfolios due to the extensive data collection, process and system changes that may be required on implementation.

Who did we survey?

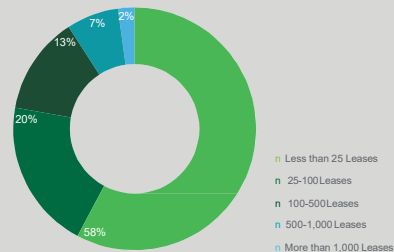
Deloitte surveyed over 150 finance professionals across the country at our June 2017 client financial reporting update breakfast to assess how far along the AASB 16 journey their organisations are.

An overview of the participants in the survey is as follows:

Surveyed respondents by industry



Surveyed respondents by size of lease portfolio



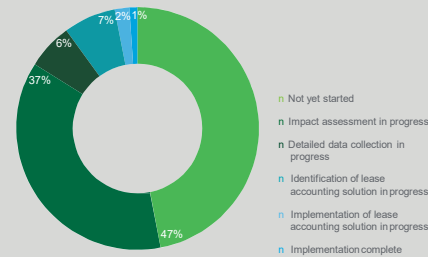
Current stage of implementation

84% of finance professionals surveyed have not yet started an AASB 16 implementation project or are currently performing their impact assessment of the new standard.

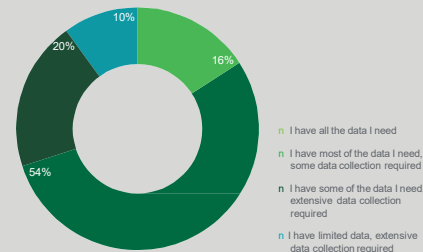
Further, only 16% believe that they have all of the data required to transition to the new leasing standard and 36% acknowledge that data collection is where they expect most of their effort will be required during implementation.

Transition and implementation is expected to be challenging, with the extent of impact differing from entity to entity. Output from a comprehensive assessment of all of the requirements of AASB 16, including understanding the effort required to collate the necessary data, may result in unexpected outcomes. Early assessment and planning will be critical to ensure that implementation risks and opportunities are appropriately managed.

Current stage of implementation



Data readiness



Solution identification

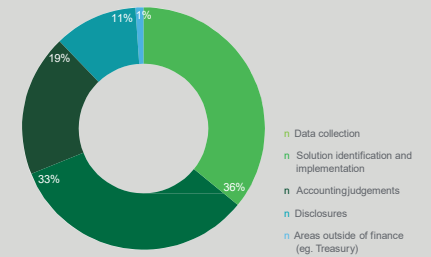
In addition to data collection (36%), finance professionals surveyed believe that much of their implementation effort will be spent on solution identification and implementation (33%), with accounting judgements (19%) following as the third biggest consideration.

Further, 77% of those surveyed believe that Microsoft Excel would be a suitable solution for the implementation and maintenance of their leases, despite the increased data and analysis required by AASB 16.

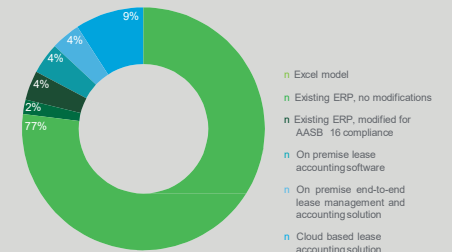
This is a surprising outcome considering that 34% of the respondents that prefer Microsoft Excel have between 25 and 1,000 leases, with 2 of the respondents maintaining more than 1,000 leases.

The data and analysis required to maintain AASB 16 compliant information for reporting and disclosures should not be underestimated by organisations with large lease portfolios.

Where will most implementation effort be spent?



Lease accounting solutions



Key challenges

Some key challenges that entities may face in assessing the impact of AASB 16 include:

- Determining whether contracts meet the definition of a lease. AASB 16 applies a control model to the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer
- Significant resource and systems implications, particularly for entities with a significant number of lease contracts, for example to track leases individually or at a portfolio level and to perform calculations
- Increased requirement for management judgement particularly in respect of the definition of a lease and in the assessment of the lease term
- The impact of AASB 16 on key metrics, debt covenants and management compensation. These need to be modelled and considered at an early stage
- Opportunities to revisit leasing strategy and consider smarter contracting options
- Extensive data requirements, beyond what many entities currently have available
- Establishing an accurate and cleansed lease register to form a correct baseline of financial information. This will support lease accounting under both existing lease reporting requirements and improve the effectiveness and accuracy of the transition to new lease reporting requirements
- Availability of resources to undertake what could be a complex transition exercise.

Key judgements

Some key AASB 16 judgements, exemptions and policy choices requiring consideration include:

Judgement

- Identifying a lease will sometimes require a significant amount of judgement based on the elements of the definition of a lease
- Determining whether it is reasonably certain that an extension or termination option will be exercised
- Identifying the appropriate rate to discount the lease payments may involve significant judgement.

Exemption

- Exemptions may be taken for short-term leases (by class of asset) or low-value asset leases (lease-by-lease basis).

Policy choice

- Requirements of AASB 16 can be applied to a portfolio of similar leases provided that such aggregation is not expected to have a material effect
- Lessee may elect not to separate non-lease components from lease components by class of asset
- Lessee may, but is not required to, apply AASB 16 to leases of intangible assets
- There are a number of transition options available that require consideration, including grandfathering lease identification and selecting a full retrospective or cumulative catch-up approach on transition.

Transition and effective date:

AASB 16 is effective for annual reporting periods beginning on or after 1 January 2019, with earlier adoption permitted only when AASB 15 *Revenue from Contracts with Customers* has also been adopted.

The knock-on effect

AASB 16 is not merely a financial reporting issue. Entities need to consider:



Commercial

- Impact on long term contract negotiation, gearing and banking covenants, forecasts, cash flow.



Managing stakeholders

- Educating financiers, regulators, board audit committees and other stakeholders about expected impacts.



Indicators and key metrics

- The recognition of a right-of-use asset and a lease liability for lessees will lead to the recognition of depreciation and interest expense, instead of straight-lined operating lease expenses under the current accounting standards. This change in presentation will result in an increase in total assets, financial obligations and net debt. This may impact remuneration schemes, including bonuses and share-based payments amongst other matters.



Data and systems

- Impact on IT systems, high volumes of lease data capture and reporting, business models, accounting policies, creating robust internal controls in order to maintain integrity of lease information
- May create the need for technology solutions that provide accurate lease data and calculations. As such, some organisations will need a comprehensive technology road map with considerations for modifying existing systems or implementing new solutions
- Entities need to first confirm the accuracy of existing lease databases/data sources. Commencing transition calculations without confirming the accuracy of the underlying lease information could significantly impact on the reported lease assets and liabilities.

Deloitte's Lease Accounting Solution offers a comprehensive approach to implement AASB 16:

Assess the impact

- Use of a simulation tool to provide a *high level illustration* of the possible adjustments required if the operating lease commitments, as currently disclosed in an organisations financial report, were recognised on the balance sheet as a liability with a corresponding asset
- The simulation includes illustration of possible *impacts on various financial ratios*, particularly the Net Debt to Equity ratio.

Transition readiness

Use of a *Lease Transition Tool* and your current lease portfolio to:

- Model an *in-depth impact assessment* on your key financial metrics if you were to adopt AASB 16 today using detailed lease contract data supported by key assumptions
- *Compare* the impact of the three different *transition methods*.

Lease data readiness

- Use of proven, *artificial intelligence* software to *automate the process* of reading and extracting critical data from your lease documents and contracts.

Long term solution

- Assistance with your assessment and identification of an appropriate long term lease accounting software solution, including *determining the required functionalities and compliance* with AASB 16 requirements

Contact us:



Megan Strydom
Partner, Assurance & Advisory
Tel: +61 89365 8012
megstrydom@deloitte.com.au



Soter Tiong
Partner, Assurance & Advisory
Tel: +61 39671 8195
stiong@deloitte.com.au



Alison White
Partner, Assurance & Advisory
Tel: +61 2 93225304
aliswhite@deloitte.com.au

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