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IFRS 16 Leases
Implementation considerations in a Belgian context
Focus on car and real estate leases

After a very long and controversial standard-setting process on lease accounting, 2019 is the first year IFRS 16 – *Leases* becomes mandatorily effective for entities reporting under IFRS. With this new standard, the International Accounting Standards Board ensure that significant rights and obligations resulting from lease contracts are properly reported in the financial statements of the lessee, which also allows a meaningful comparison between companies that have different practices with respect to the funding of their fixed assets.

The purpose of this article is to share some common interpretation and implementation challenges observed on the Belgian market in the (initial) application of IFRS 16.

After a short overview of the IFRS 16 requirements together with the main transition alternatives, we will further elaborate on the most significant judgements in the application of the new standard in order to finally focus on two lease agreements that are most commonly and significantly impacting Belgian entities: company cars and real estate leases.

The article is not meant to cover all potential aspects of IFRS 16[1] and focuses on the situation of the lessee.

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1 The purpose of this article is thus not to provide a detailed and exhaustive description of the IFRS 16 requirements. In that respect, we refer to A Guide to IFRS 16, Deloitte: https://www2.deloitte.com/be/en/pages/audit/articles/ifrs16-guide-EN.html.

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IFRS 16 in a nutshell

Under the old lease standard (IAS 17), a distinction needed to be made between operating leases (off-balance sheet of the lessee) and finance leases (on balance sheet of the lessee) based on an assessment of whether substantially all of the risks and rewards incidental to the ownership of the underlying asset were transferred from the lessor to the lessee.

"IFRS 16 will significantly change the structure of the balance sheet, income statement and statement of cash flows"

Under IFRS 16, most leases will have to be recorded on the **balance sheet** as a lease liability (representing the present value of future lease payments) and a right-of-use asset. The IFRS 16 treatment is thus similar to the finance lease accounting under IAS 17. The balance sheet total will increase and more importantly, the gearing ratio (debt/equity) and related indicators will deteriorate as liability is increasing while equity remains essentially stable. This could potentially lead to breach of debt covenants in existing financing agreements.

Not only will the balance sheet presentation changes, but also the **income statement** classification. While operating leases were recorded as a straight line operating expense under IAS 17, the IFRS 16 related expenses will be presented as depreciation (on the right-of-use asset) and interest expense (on the lease liability). This will significantly change the structure of the income statement for some entities and lead to an improvement in key performance indicators such as the EBITDA.

Similarly, the operating **cash flow** will improve as lease liabilities are part of the financing activities under IAS 7 – *Statement of Cash Flows,* so the capital reimbursements are to be presented as financing cash out, rather than operating cash flow for operating leases under IAS 17. The interests paid are presented as operating or financing cash out flow depending on the existing accounting policy under IAS 7.33.

There are two **optional recognition exemptions** where IFRS 16 does not have to be applied (IFRS 16.5):

- Short term leases (equal to or less than 12 months). This option is to be applied by asset class.
- Low value leases (assets with a value of less than USD 5.000)[2]. This option can be applied on individual asset basis.

Though we observe in practice that most entities are planning to use both exemptions to simplify the IFRS 16 implementation, some entities may have an incentive not to use these exemptions (e.g. to improve EBITDA).

Lease payments (i.e. payments made by the lessee to the lessor relating to the right to use the underlying asset) to be included in the measurement of the lease liability mainly encompass fixed payments and variable lease payments that depend on an index or a rate (see further guidance below).

As a result, other variable lease payments and non-lease components, such as services charged by the lessor to the lessee under the lease contract, are not included in the measurement of the lease liability. However, IFRS 16.15 allows including (fixed) non-lease components in the measurement of the lease liability. This option is available by class of underlying asset and can be interesting to avoid splitting up invoices between lease and non-lease components and/or to further improve factors like the EBITDA. However, we see in practice that most entities are making the effort to split up the contract to avoid further increase in the lease liabilities.

2 This threshold is explicitly mentioned in the Basis of Conclusions to IFRS 16 (BC100). It is unique under IFRS that there is a monetary threshold implicitly included in a standard. This was actually part of the convergence effort with the equivalent US GAAP requirement. Note that this is not a materiality threshold as such. The low value exemption can be applied for each asset individually if the value of one asset is below the threshold. E.g. if a service company leases 1.000 laptops of 1.500 EUR each, it can still apply the exemption even though the total lease liability could be material. In addition, the general materiality judgements remain applicable and shall be shared with the auditors using appropriate guidance e.g. IFRS Practice Statement 2 issued in September 2017: Making Materiality Judgements.

As there is no change in lease accounting principles under **Belgian GAAP**, Belgian companies will treat operating leases differently for statutory and tax purposes (off-balance sheet) compared to consolidated financial statements under IFRS (on balance sheet). In accordance with IAS 12 – *Income Taxes,* deferred taxes shall in principle be recognised on the related temporary differences arising from this IFRS adjustment[3]. In a typical lease contract, a (net) deferred tax asset is to be recognised, as the lease liability is higher than the right-of-use asset.

An evolution of Belgian GAAP towards the principles of IFRS 16 is to our knowledge not at the agenda of the Belgian standard-setter, knowing that such a change would require an amendment of the accounting Royal Decree dated 30 January 2001. In that respect, it shall be noted that a lease is classified as a finance lease under Belgian GAAP only if the sum of the lease payments (excluding interests) represents the *entire* value of the leased asset. In other words, many leases that are financing transactions in substance are kept off-balance sheet of the lessee under Belgian GAAP, which is a concern in terms of true and fair view. As a first step in the modernisation of lease accounting under Belgian GAAP, it seems thus appropriate to further elaborate the lease classification criteria in order to treat such financing transactions as finance leases on-balance sheet. Advice 2015/4 of the Accounting Standards Commission (CNC/CBN) is an attempt in that direction but without amending the principle of the accounting Royal Decree, the latitude is too limited.

3 It shall however be noted that the so-called "initial recognition exemption" in IAS 12 (see IAS 12.15(b) and IAS 12.24) applies to the extent temporary differences are considered separately for the lease liability and the right-of-use asset. However, the IFRS interpretation Committee decided in June 2018 to propose amendments to IAS 12 in order to remove the possibility to apply the initial recognition exemption for leases. This proposition was further discussed in the IASB meeting of 24 October 2018, in which the IASB supported the proposal of the Interpretation Committee. Hence, it is expected that recognition of deferred taxes on leases will be required even if temporary differences are considered separately. An Exposure Draft with proposed amendments to IAS 12 is expected to be released in Q2 2019.

Overview of transition options

Appendix C of IFRS 16 outlines the different transition options when implementing IFRS 16. As for IFRS 9 and IFRS 15, the choice is available between a full retrospective method and a so-called "modified retrospective method". Under the full retrospective method, the comparative figures (of 2018) have to be adjusted as if IFRS 16 had always been applicable. We observe that there is very little appetite for this transition method as it requires going back to the commencement of all lease contracts in order to reconstitute the carrying amount of lease assets and liabilities as if the standard had always been applied.

It is therefore expected that nearly all Belgian entities will apply the modified retrospective approach. Under this method, for leases previously classified as operating leases under IAS 17:

- Comparative information (2018) is not adjusted;
- At the date of initial application (i.e. typically 1 January 2019), the lease liability is measured at the present value of the remaining lease payments (IFRS 16.C8(a))
- At the same date, the right-of-use asset can be measured on a lease-by-lease basis at either (IFRS 16.C8(b)):
  - its carrying amount as if IFRS 16 had been applied since the commencement date of the lease (so-called "Modified A"); or
  - an amount equal to the lease liability as measured above, adjusted by the amount of any prepaid or accrued lease payments (so-called "Modified B").

The net impact of IFRS 16 (if any) is recorded in the opening equity at the date of initial application (1 January 2019). The Modified A approach requires more effort and typically result in a net negative impact on equity (as asset < liability) but future depreciation will also be lower. This option is sometimes considered by entities who are focused on their future net profit.

It is however expected that most entities will apply the Modified B method, as this is the easiest to apply. The higher future depreciation under this method is not really a concern for entities with EBITDA as key performance indicator. If this transition method is selected, the impact on the opening equity 2019 is expected to be low, if not nil.

"The selection of the transition option does not only impact the transition efforts, but also the future P/L"

Significant judgements in the application of IFRS 16

The application of IFRS 16 requires several judgements to be made by management with some of them having the potential to materially impact the financial statements. These significant judgements are commented below with a focus on real estate and car leases.

A. Lease definition

A lease is defined as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration (IFRS 16, appendix A). The decision tree developed in IFRS 16.B31 summarizes the different steps to be analysed when assessing whether a contract is or contains a lease.

In some cases, assessing whether a contract is a lease or a service-type agreement can be very judgmental knowing that the direct consequence is that the related commitments are or not recognised on the balance sheet.

For the two typical leases analysed further in this article, it is however generally straightforward to conclude whether a contract is or contains a lease. Some attention points however need to be highlighted:

- Most lease contracts include **protective clauses** that restrict the use of the underlying asset (e.g. car cannot be used outside Europe, building can only be used as office building, and retail shop can only be opened during the opening hours of the shopping mall). This type of clauses are generally considered protective for the lessor and do not prevent meeting the lease definition.
- If the asset is not **identified** or if there is a **substantive substitution right** allowing the lessor to replace the asset during the lease term, the standard clarifies that there is no lease. This will for example be the case in the following 2 scenarios:
  - Lessee leases a limited number of **parking spots** that are not identified in the contract (e.g. 10 spots in a parking of 100). The cars can be parked anywhere in the parking. In this example, it will not be a lease. If however substantially all of the capacity of the parking (typically around 90%) would be leased, then it would still qualify as a lease (IFRS 16.B20).
  - A **retailer** leases a surface in a shopping centre and only requires limited leasehold improvements to sell its goods. The contract states that the lessor can replace the surface by a store with similar characteristics in the same shopping centre. If the conditions in IFRS 16.B14 (practical ability and economic benefit for the lessor) are fulfilled, the substitution right would be substantive and consequently there is no identified asset and so no lease. On the contrary, when the lessee has to agree to change location, the substitution right is deemed not to be substantive.
- In our Belgian ports, long-term rights of use on land are common practice, sometimes contractually referred to as "**concession rights**". Although IFRS 16.3(c) scopes out service concession arrangements that are within the scope of IFRIC 12, the related long-term rights are typically not meeting the notion of a concession as elaborated in IFRIC 12[4] and generally qualify as a lease in the scope of IFRS 16.

B. Lease term

The lease term consists of the non-cancellable period of a lease, together with periods covered by an option to:

- extend the lease if the lessee is reasonably certain to exercise that option; and
- terminate the lease if the lessee is reasonably certain not to exercise that option (IFRS 16.18).

Significant judgement is required in assessing whether these options will be exercised or not knowing that 'reasonably certain' is generally interpreted as a high threshold of probability. IFRS 16.B37-40 includes factors to consider in order to evaluate whether there is an economic incentive (not) to exercise the options, e.g. if significant leasehold improvements were done, it will increase the likelihood that the extension option will be exercised.
For real estate contracts, assessing the lease term is the judgment that has the most significant impact on the outcome of the IFRS 16 implementation to this type of contract. See below for further considerations on typical Belgian real estate leases.

4 IFRIC 12 is rarely applied in Belgium and relates to public-private partnerships whereby the grantor (land owner) controls or regulates what services the operator (lessee) must provide with the infrastructure, to whom it must provide them, and at what price; and the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement (IFRIC 12.5). This is usually not the case for the long-term land leases referred to as "concession agreements".

C. Measurement of the lease liability – Components of lease contracts

For a contract that is or contains a lease IFRS 16.12 requires accounting for each lease component within the contract as a lease separately from non-lease components of the contract.
As mentioned above, the lessee can however decide on a class-by-class basis to account for (fixed) non-lease components similarly as lease components in the measurement of the lease liability under the practical expedient of IFRS 16.15.

Considering other guidance in IFRS 16.B32-33, this leads to 4 possible categories of components within a lease contract:

1. Lease components that firstly include **lease payments** defined as payments under the lease contract made from the lessee to the lessor for the right to use the underlying asset during the lease term comprising the following:

- **fixed payments** (including in-substance fixed payments), less any **lease incentives**;
- **variable lease payments** that depend on an index or a rate[5];
- the exercise price of a **purchase option** if the lessee is reasonably certain to exercise that option; and
- payments of **penalties for terminating** the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

For the lessee, lease payments also include amounts expected to be payable by the lessee under **residual value guarantees** (IFRS 16, appendix A).

As mentioned above, only variable lease payments that depend on an index or a rate are included in the lease liability. Other variable lease payments, for example lease payments that depend on the turnover generated in a shop in the retail sector, are not part of the lease liability. As a result, such variable lease payments are expensed as incurred as part of the operating activities, which negatively affects the EBITDA of the lessee.

2. Non-lease components are not defined as such in the standard, but represent payments for services or goods transferred from the lessor to the lessee in addition to the right to use the underlying asset, e.g. maintenance, cleaning and security services. These are not included in the lease liability unless the lessee elects to combine non-lease components with a lease component and to account for them as a single lease component (IFRS 16.15). The latter is however only possible for fixed payments (and e.g. not for utilities such as electricity, gas, water and fuel which are based on actual consumption – even if fixed advances are paid and then a periodic settlement is made).

3. So-called non-components that are payments by the lessee to the lessor for activities or costs that do not transfer a good or service to the lessee (IFRS 16.B33), e.g. administrative charges. Such payments do not give rise to a separate component of-the contract. These are to be allocated between the lease and the non-lease component based on the relative stand-alone prices (materiality to consider) and accounted for consistently with these components.

4. Levies (IFRIC 21) are taxes (other than income taxes and fines) for which the lessee is the primary taxpayer although the lessor may act as an agent of the authorities to collect the tax. A typical example is the non-recoverable VAT (see further below).

D. Measurement of lease liability – Discount rate

The discount rate to be used is:

- **the interest rate implicit in the lease** if that rate can be readily determined **–** this will often not be the case for the lessee because the computation of that rate requires inputs about the residual value of the underlying asset, its fair value and the initial direct costs of the lessor; otherwise
- **the lessee's incremental borrowing rate (IBR),** which is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

It is expected that most lessees will use the IBR, which is also a requirement in the context of the transition if the modified retrospective method is applied (see above). Although the standard is not explicit on this point and thus it is an accounting policy choice to be made, it is generally expected that most entities will use the IBR at the date of initial application (i.e. 1 January 2019) that reflects the remaining lease term at transition date rather than the full lease term as from the commencement date of the lease.
Even if the interest rate in the contract is known (e.g. for car leases some lessors communicate an interest rate), it will generally be inappropriate to use this rate at transition because the rate in the contract does not reflect a borrowing conditions at transition date.

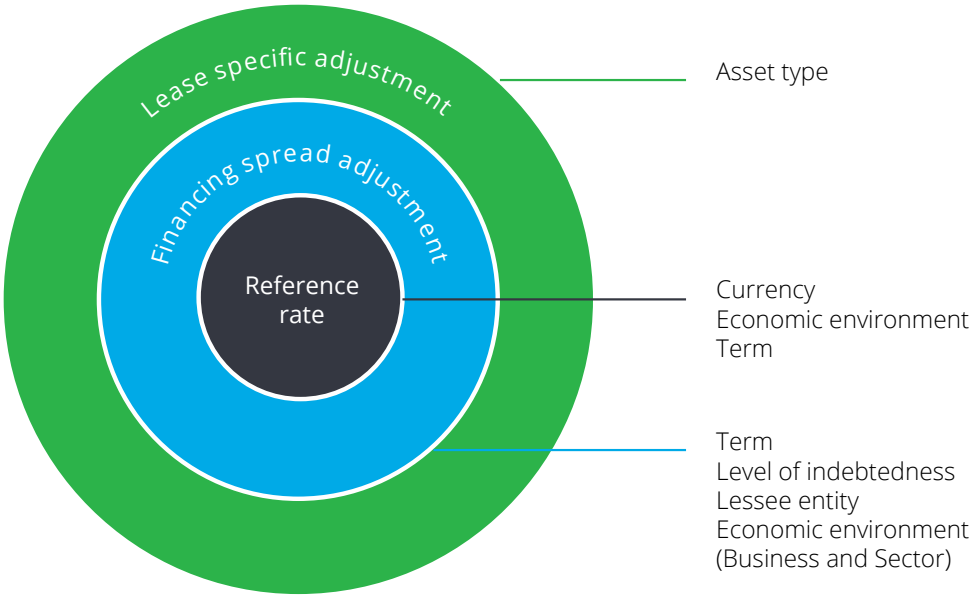
5 Typically, these are inflation adjustments included in the contract. This is very common in real estate contracts, which are e.g. indexed every year based on the evolution of the Consumer Price Index (CPI). The initial measurement of the lease liability is done with the index at commencement date of the lease. Each time the cash flow changes as result of an indexation, the entire remaining lease liability has to be adjusted assuming that the new index will apply till the end of the lease. Hence, there is no estimation of future indexation but the adjustment is only done once the index is known and the same index is kept till the end of the lease. In case of a positive index, this will lead to an increase in the lease liability and a corresponding increase in the right-of-use asset. Consequently, the amortization tables have to be adjusted on a prospective basis as well. This complex accounting requirements make it very challenging to account for these type of leases in a spreadsheet. There are specific lease software tools on the market that are better suited for this.

In addition, this contractual rate may comprise other factors that the ones that shall be considered in the IBR under IFRS 16, such as administrative costs of the lessor.

Without going into too much detail, a possible way to calculate the IBR is using these three layers[6]:

- **Risk free rate**: in practice most commonly used are Interest Rate Swaps (IRS) yield curves per currency or government bonds. As these benchmarks are references for bullet-type of loans with repayment at maturity date, it is recommended to adjust the duration to the weighted average outstanding capital of the lease agreement, which will typically have periodic instalments. Therefore, for a 10-year lease, a 10- year benchmark rate shall not be used, but rather 5 to 6 years benchmark as the average outstanding capital is around 50-60%.
- **Credit spread:** should be entity specific and reflect the creditworthiness of the lessee. Several inputs can be useful here: existing external debt but care is needed to assess whether these borrowing rates are still relevant at commencement date of the leases; external credit ratings and related credit spreads on the market; financial strength of the different entities within a group. Unless there is a central financing mechanism with a financial guarantee from the parent, it will generally be inappropriate to apply the same credit spread for all entities of the same group.
- **Lease specific adjustments.** This is typically the layer where most entities are struggling with and which seems to be often neglected in practice on materiality ground. The objective of this layer is to come to an IBR which is reflecting a) a secured borrowing rate (because the lease is secured by the underlying asset which is to be returned if the lessee cannot pay the lease payments anymore) and b) the liquidity of the underlying asset (for example a car may be easier to sell/transfer than industrial machinery).

In the next two chapters of this article, we will share practical considerations on the application of the above principles to the two most common leases in Belgium: company cars and real estate leases.



6 Based on the publication "A guide to the Incremental Borrowing Rate" published by Deloitte (available on https://www.iasplus.com/en/publications/global/guides/ifrs-16-discount-rates).

Company car leases

Although not necessarily the most significant source of IFRS 16 adjustments, the lease of company cars is a very widespread practice in Belgium for obvious tax reasons. Such leases are typically classified as operating leases under IAS 17 (off-balance sheet of the lessee) and do not meet the short-term and low value exemptions under IFRS 16.

Based on our experience, the most common accounting judgement in the application of IFRS 16 to leases of company cars relates to the appropriate classification of each component of the lease contract into the appropriate category, which directly affects the amount of the lease liability to be recognised on the balance sheet (see above).

If we refer to the different components elaborated above to a typical car lease contract, we would disaggregate the payments made by the lessee to the lessor as follows:

- **Lease component**: payments for the use of the car itself (capital and interest). We observe that in many lease contracts the monthly lease payment is based on an estimated usage (number of kilometres). Depending on the contract, the lease payments are adjusted either periodically during the lease term (increase/decrease) or at the end of the lease term (penalty/bonus) (**mileage adjustments**). This type of clause makes the lease payment partially variable and this variability is not depending on a rate or index. As a result, from a theoretical point of view, the lease payments to be included in the measurement of the lease liability is limited to the required lease payments under the assumption that the car is not used at all, even if this is very unlikely. It shall also be noted that this treatment is independent from the way mileage adjustments are settled (periodically or at the end) and IFRS 16 does not include an option to voluntarily include variable lease payments in the lease liability.
  In practice however, the maximum amount of the mileage adjustment (i.e. under the assumption the car is not used at all) is usually capped contractually and rather limited compared to the (fixed) leased payments to be made in all circumstances by the lessee. In that case, it can be argued that including the implicitly variable lease payments in the measurement of the lease liability is not materially affecting the presentation of the financial statements.
- **Non-lease components:** lease of company cars often includes a whole range of other services and consumables such as:
  - Repair and maintenance;
  - Summer/winter tyres;
  - Fuel and insurance of the lessee: typically outside the lease contract (with another vendor). If it would be included, payments would most likely be variable anyway.

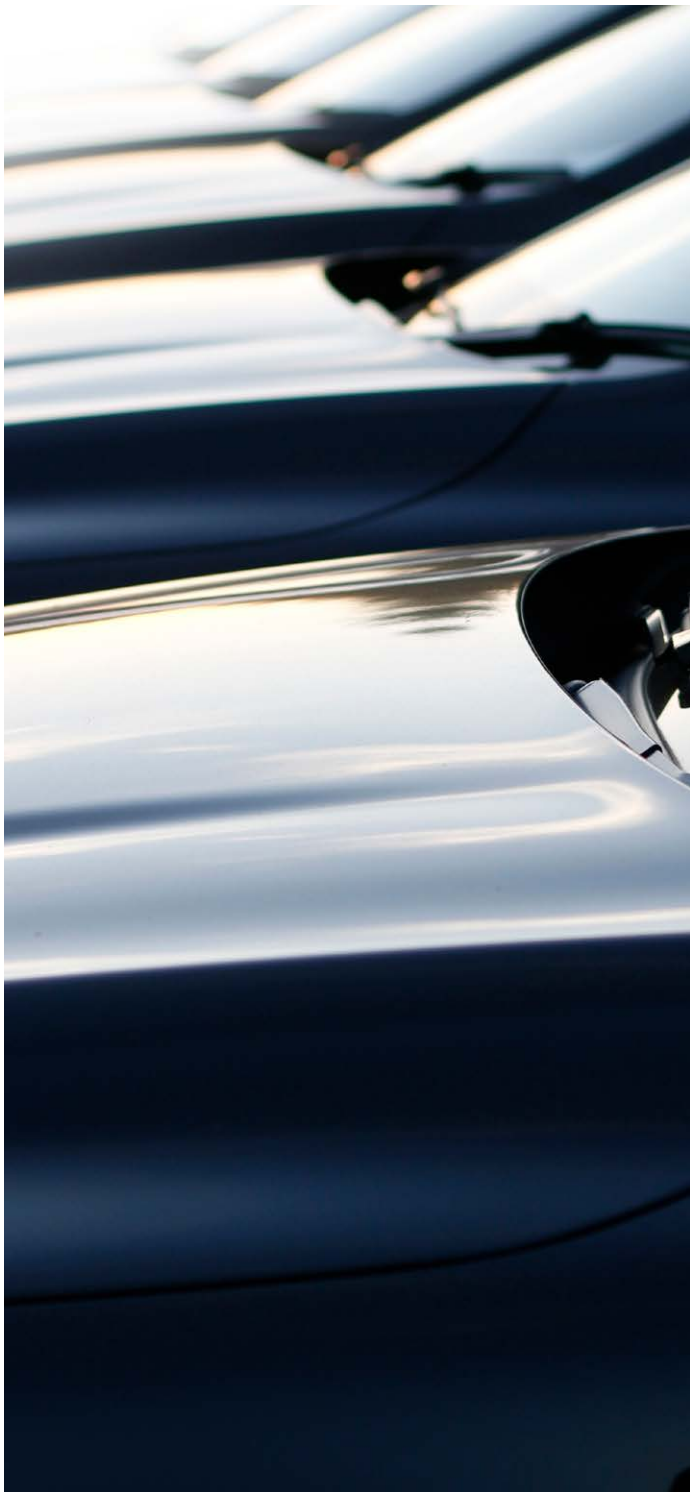
  For the non-lease components that are fixed the lessee can decide to apply the practical expedient under IFRS 16.15 to all leases of company cars and treat non-lease components similarly to fixed lease payments. In all other cases, such components shall be expensed as incurred.
- **Non-components**: some payments do not transfer a good or service from the lessor to the lessee and are also not payments for the use of the car, such as:
  - Initial registration tax and yearly traffic tax due if the lessor is the taxpayer but recharges it to lessee; and
  - Administration costs of the lessor.

  Although in principle these amounts have to be split on a proportionate basis between lease component and non-lease components and treated accordingly, it usually represents small amounts.
- **Levies**: value added tax (VAT) on car lease expenses is partly (or fully depending on the tax status of the lessee) non-deductible in Belgium. This VAT is due by the lessee and triggered by the issue of the periodic lease invoices of the lessor (i.e. VAT is not due by the signing of the car lease contract). The lessor actually acts as an agent for the tax authorities and just collects the VAT through the monthly lease invoice, but the VAT is not part of the lease payments as such. Therefore, the common view is to consider VAT to be in the scope of IFRIC 21 – ***Levies*** for the lessee, which means that it should only be recognised (expensed) at the moment the invoice is issued and not to be included in the lease liability.

Beyond the above accounting judgements, the application of IFRS to leases of company cars also raises a number of operational considerations, including with respect to **data sourcing**. In that respect we observe that many entities succeed in getting the list of all the necessary data inputs to periodically calculate the lease liability (sometimes even including the IBR). Although in theory a

portfolio approach as described in IFRS 16.B1 could be used for company cars by aggregating car leases with similar characteristics as one right-of-use asset, we see little appetite for this in practice. When a lease software is used, it seems easier to request an updated file of all open contracts at the end of each reporting period and upload this list into the lease tool, which will compare the list to the previous month and make the necessary calculations. This "mass upload" avoids or at least reduces reconciliation issues with the underlying invoices or when e.g. one car in a portfolio is to be removed because of an accident. For larger portfolios of very similar assets (e.g. railcars), the portfolio approach seems to be more frequently used in practice.

"Non-deductible VAT and property taxes are excluded from the lease liability"



Real estate leases

Real estate leases may relate to various types of land and buildings such as office buildings, retail space (shops), specified spots in a car park or residential property.

For most groups and especially those having a retail activity, leases of property is the most significant source of IFRS 16 adjustment considering the value of the underlying assets, the length of related contracts, and the fact that such leases are usually classified as operating leases under IAS 17.

Although many other contractual particularities may require specific accounting judgements, the main technical challenge in the application of IFRS 16 to real estate leases is the determination of the lease term, which has a direct multiplication effect on the amount of the lease liability.

The most popular type of real estate lease in Belgium is the so-called 3/6/9 contract or commercial lease agreement, which is regulated by the law of 30 May 1951[7]. This law is quite **protective for the lessee**. Due to the protective nature of this law, most dispositions are compulsory so that parties cannot deviate contractually from the law.

The typical clauses of real estate lease agreed in that context can be summarised as follows:

- The duration of the contract is 9 years;
- Lessee can terminate the contract every 3 years without penalty provide a six month notice is communicated to the lessor;
- After 9 years, the lessee has the right (but no obligation) to renew the lease. The lessor can only refuse the renewal in specific circumstances, including if the lessor:
  - Has received an offer from another party to lease the property at a higher rent;
  - Wants to directly occupy the building;
  - Wants to give another destination to the building; and
  - Wants to refurbish / reconstruct the building.

If the lessor would refuse the renewal of the lease for another reason, the lessor is required to pay a significant penalty to the lessee.

The question about the lease term for this type of contract is twofold:

- **Is there a maximum lease term?** The question is in fact about the enforceability of the extension right by the lessee after 9 years. In that respect IFRS 16.B34 states that a lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty. In the fact pattern outlined above, it seems appropriate to consider that the lessor also has the unilateral right to terminate the lease after 9 years without penalty and so that the lease is not enforceable beyond that period. Although this is judgmental and needs to be assessed based on the specific facts, the circumstances under which the lessor can terminate the contract after 9 years are so wide, including a better financial offer from another tenant, that we do not contemplate a rational basis for the lessor not to renew outside those circumstances. In other words, the circumstances foreseen in the law for the lessor to terminate after 9 years are sufficiently substantive to take the view that the lessee has no unilateral enforceable right to extend the lease beyond 9 years. Under that view, 9 years is the maximum lease term for this type of lease contract. This view is also consistent with the one expressed by the French accounting standard setter (ANC) for 3/6/9 lease contract under French law[8].
- **Is the lease term then 3, 6 or 9 years?** The fact that the lease is not enforceable beyond 9 years does not mean all such contracts have a lease term of 9 years considering that the lessee has the unilateral right to cancel the agreement after 3 or 6 years. The optional periods should only be included in the lease term when it is ***reasonably certain*** that the termination options will not be exercised by the lessee. This assessment will depend on various factors described in IFRS 16.B37-40. It is clear that significant judgement may be required and proper documentation of the reasoning followed needs to be drafted and disclosed. In a large group, central oversight on this is needed to ensure that the assessment is done consistently for all similar leases.

In addition to the lease term assessment, real estate leases also raise a number of questions on the proper classification of each

7 http://www.ejustice.just.fgov.be/cgi_loi/change_lg.pl?language=nl&la=N&cn=1951043030&table_name=wet

8 http://www.anc.gouv.fr/cms/news/releve-de-conclusions-de-lanc-relatif-aux-baux-commerciaux-en-france.
It shall however be noted that under French law, an indemnity is due to the lessee if the lessor refuses to renew the lease after 9 years even under circumstances similar to the ones described above, which is not the case under Belgian law. This element clearly reinforces the view that Belgian leases described above are not enforceable beyond 9 years under IFRS 16.

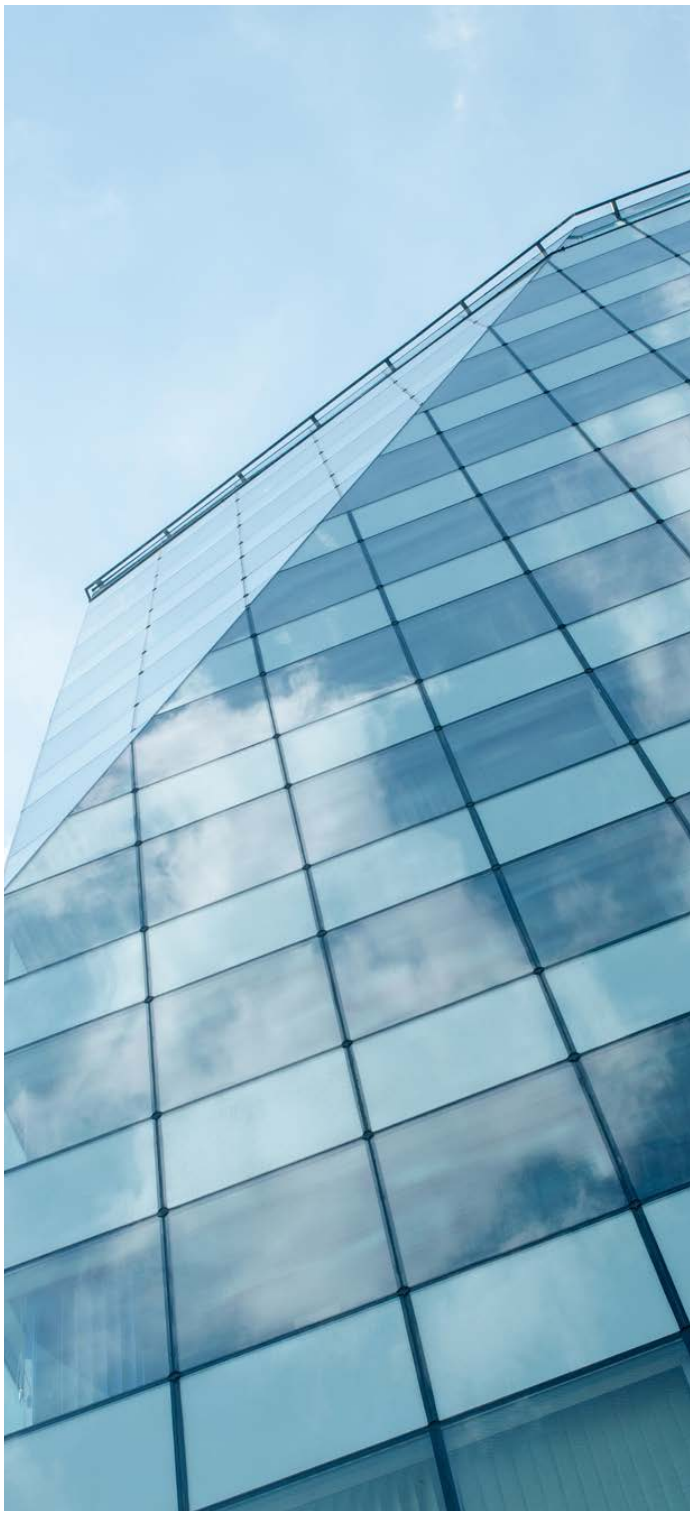
component of the lease into the appropriate category. Applying the principles developed above, we would disaggregate the payments made to the lessor as follows:

- **Lease components:** include the periodic rent (including the interests) for the use of the property to the extent it is a fixed payment or a variable lease payment that depend on an index or a rate.

In the retail sector, it can occur that all lease payments are depending e.g. on the turnover of the shop or on the number of visitors. If that is the case, the lease liability is nil at initial recognition and the variable lease payment is expensed as incurred. IFRS 16 does not require making any estimation of future sales/visitors. However, some contracts include a floor or minimum lease payment that can take various forms:

  - In case of lease payments linked to turnover, there can be minimum amounts payable (e.g. 1% of turnover with a minimum of 10.000 EUR per year). In that case, only the 10.000 EUR per year is to be included in the lease liability.
  - In case of indexation, instead of referring to the CPI, the contract could e.g. state that the lease payment is indexed with 2% per year or with a CPI but with a minimum of 2% per year. In both cases, the lease liability at commencement date will include the annual increases of 2% as they are unavoidable/fix in the future.
- **Non-lease components:**
  - Services such as cleaning, security guard and maintenance
  - Utilities such as water, gas, electricity, telecommunication costs: usually variable even if fixed advances are to be paid

  For the non-lease components that are fixed, the lessee can decide to apply the practical expedient under IFRS 16.15 to all real estate leases and treat them similarly to fixed lease payments. In all other cases, such components shall be expensed as incurred.



- **Non-components:**
  - **Property withholding tax** due by the lessor (as owner of the building) and recharged as such to the lessee. Such taxes are not in the scope of IFRIC 21 on levies as the lessee is not the taxpayer. Although this is a judgemental assessment, there are arguments to consider the Belgian property withholding tax recharged to the lessee as a variable payment not depending on an index or a rate[9], in which case the tax is excluded in the measurement of the lease liability and is expensed as incurred. Note that this assumes that the amount of property withholding tax is transparently recharged as such by the lessor to the lessee. If the rent would be all-in and the lessee does not know separately the amount of the property tax, it would implicitly be included in the lease liability.
  - **Insurance of the building** rebilled by the lessor to the lessee in case the lessor is the insured party: depending on the specific terms of the insurance contract, the related premium can also be viewed as a variable payment not depending on an index or a rate.

With respect to real estate lease, attention shall finally, be given to **sublease contracts** as the requirements have changed compared to IAS 17. Although the lease classification rules for lessors have essentially not changed in general (with the distinction between operating and finance lease maintained for lessors), the sublease shall be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset itself (IFRS 16.B58). This means that in case of back-to-back leases, most likely significantly all risks and rewards of the head lease will be transferred to the sublessee and the sublease will qualify as a finance sublease. In this case, the right-of-use asset will be replaced by a lease receivable. The liability for the head lease is not adjusted and also not offset with the lease receivable.

Summary
The application of IFRS 16 introduces significant changes and challenges for many companies, not only in terms of financial reporting but also from an operational point of view. As of 1 January 2019, the new lease standard requires to account for almost all leases on balance sheet of the lessee. This article first provides a high level summary of the key principles of IFRS 16, then elaborates on the significant accounting judgements to be made in applying IFRS 16 (namely the identification of lease contracts and lease components, the assessment of the lease term, and the measurement of the lease liability) and finally shares practical considerations and interpretations on the implementation of this new standard to the most common and significant lease contracts encountered in the Belgian environment: company car leases and real estate leases.

9 The property tax reflects a certain percentage on the "assessed" value of the property. Different governments can decide at irregular moments on the value of the properties and on the percentage of tax that is imposed (e.g. considering budgetary constraints).

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