Deloitte.

IFRS 16
The **TIME** is **NOW**

November 2019

IFRS 16 Overview 3
Impact Implications and Challenges 4
Challenges 5
The Deloitte Solution 6
Practical Approach 7
Contacts 8

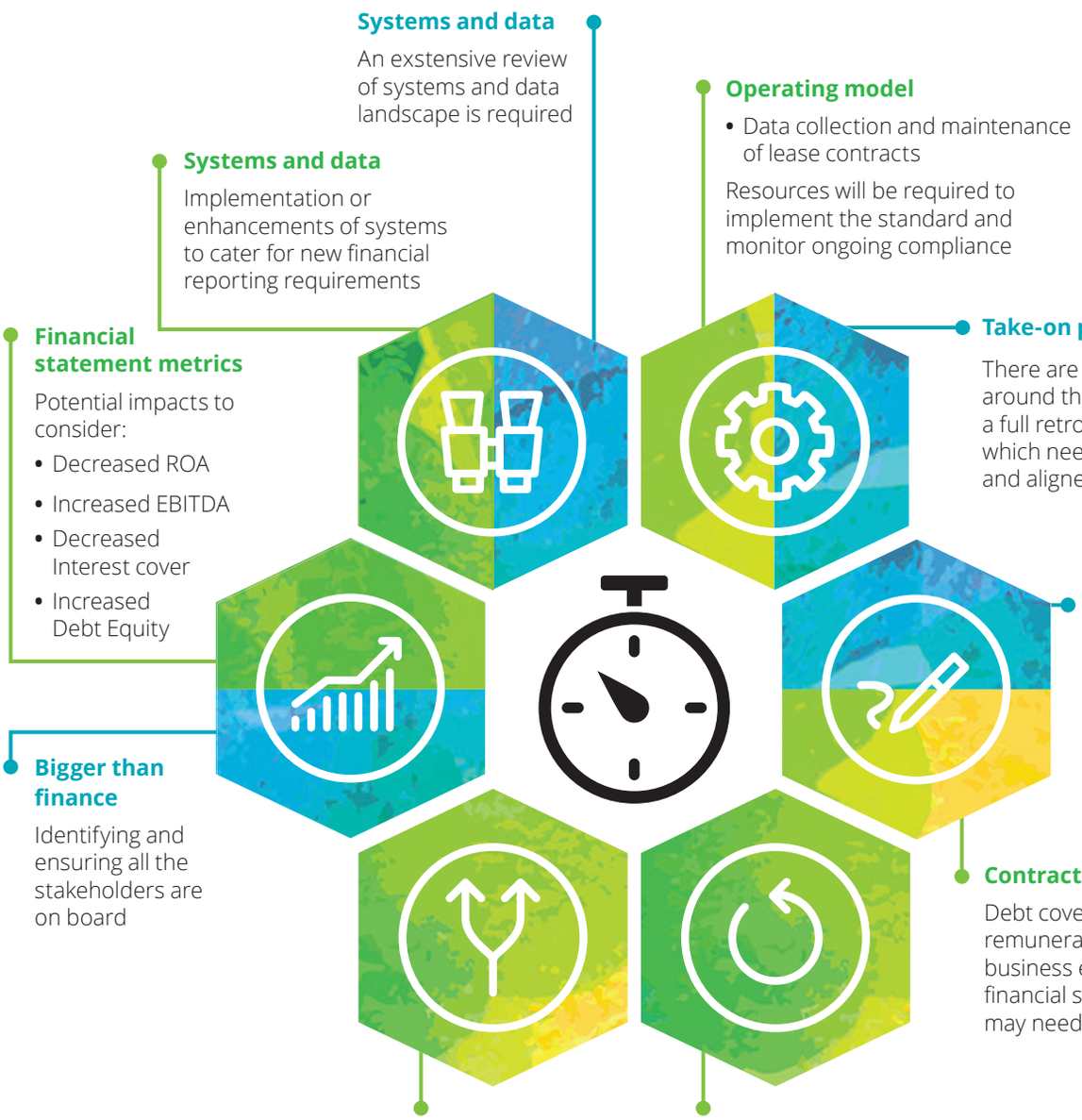
IFRS 16 Overview

IFRS 16 is in full effect! This means that your next financial statements will require that you disclose your lease obligations. Although you may be several months into your financial year, the opportunity still exists to tackle the challenges and satisfy the requirements of the standard.

Companies have long been permitted to exclude operating leases from their balance sheet. As a result, stakeholders have struggled to determine the true financial obligations of a company. IFRS 16 requires all operating leases to be recognised on balance sheet. The undertaking is a significant one, requiring a concerted effort from multiple business functions.

In this article we unpack the challenges and outline our practical approach to IFRS 16, which has been refined and tailored through extensive implementation experience gained in working with clients across a variety of industries.

Impact Implications and Challenges



Systems and data

An exstensive review of systems and data landscape is required

Systems and data

Implementation or enhancements of systems to cater for new financial reporting requirements

Operating model

- Data collection and maintenance of lease contracts

Resources will be required to implement the standard and monitor ongoing compliance

Financial statement metrics

Potential impacts to consider:

- Decreased ROA
- Increased EBITDA
- Decreased Interest cover
- Increased Debt Equity

Take-on policies and Audit

There are significant challenges around the requirements for a full retrospective approach which need to be considered and aligned with auditors

IT environment setup

IT environment setup for new software solutions can be extensive

Bigger than finance

Identifying and ensuring all the stakeholders are on board

Contractual Implications

Debt covenants, employee remuneration schemes and business earn-outs linked to financial statement metrics may need to be renegotiated

Disconnection to lessor model

Lessor and lessee accounting no longer mirrored, leading to complexity in reporting sublease and inter-group lease agreements

Impact considerations:

- Buy vs lease
- Lease vs service
- Lease payments restructuring
- Lease term

Impact Implications

Challenges

Challenges

Bigger than finance

The regulatory requirements for IFRS 16 will require companies to review their current leasing processes. This includes ensuring there are effectively designed and implemented controls in place and that these processes not only cater to the day to day operational needs of the entity, but also the new requirements introduced by IFRS 16.

Our experience shows that IFRS 16 is about more than finance and as such will involve more than just finance as a stakeholder to ensure the successful implementation of the standard.

Data

Many organisations are facing a complex lease environment and are experiencing difficulty in obtaining detailed sight of all relevant lease data. IFRS 16 adherence requires a more stringent level of lease data to be identified and captured, with existing contract databases and source systems often not catering for IFRS 16 requirements. In addition, source data may be stored on an array of business systems and manual records, adding to the complexity.

To improve your compliance with IFRS 16, an upfront and comprehensive focus on the data is key for success, ensuring the completeness and accuracy of the final in-scope lease population. As part of the data discovery phase, we recommend the establishment of data ownership along with business and accounting ownership while ensuring regular management review. When assessing your data focus should be placed on:

- The procurement process undertaken when entering into leases
- Source systems and data storage
- Information Management practices
- The role of external asset managers as well as internal procurement
- Dispersion of data, contract formats and key-man dependencies
- Billing reports and review mechanisms
- Alignment of legacy data to the new IFRS 16 data requirements
- Understanding regularly changing data fields such as escalations, extensions and terminations

Take-on policies and audit

Management has the option of two treatment methods:

1. Full retrospective or
2. Modified retrospective approach

Each approach has a number of factors which need to be considered, including:

- The availability of historic data if considering the full retrospective approach
- Cost and effort implications of each approach
- Implementation timelines; and
- The effect of each approach on the financial statements and the shareholder view thereof.
- Consultation with both internal and external auditors is advisable as IFRS 16 introduces the need for new business policies and processes to be designed and implemented; as such it is important to identify relevant process step owners early on and establish the required controls. Processes we recommend include:
- A monthly review of the lease population
- A robust process of management decisions and audit approvals
- Ongoing identification of lease additions, terminations or modifications
- The calculation of accounting impact and the recording thereof in the financial systems

Setting up an IT environment

Due to the inherent dependence on data, meeting the requirements of the standard will require tight integration between business and IT. Regardless of the solution you intend on implementing, the role of IT is critical and must be considered early on in the project.

We advise you start with the full picture in mind and uncover the complexities you will face. In building out the solution architecture consider these questions:

- Where does your input data originate and how is it stored?
- How will the data flow to your solution and at what intervals?
- Where is your solution housed and what IT security considerations need to be accounted for?
- Is data enrichment required and how is it performed?
- How will the processed data be output and reviewed?
- How are journal entries populated and ingested into your financial reporting system?
- What reconciliation requirements will need to be catered for?

The Deloitte Solution

Deloitte for Leasing is a Deloitte designed and developed lessee leasing solution built to ensure financial reporting compliance with the new IFRS 16 lease accounting standard

The solution calculates the required IFRS 16 journals for initial recognition and subsequent measurement. Along with the initial recognition and monthly journal calculations, the solution provides capabilities to perform lease modifications and error corrections. In addition, to assist our clients with IFRS 16 disclosure requirements, the solution's front-end reporting features allows clients to view or extract financial reports, audit logs and user defined reports.

Deloitte's offering is all encompassing and provides accounting and solution implementation expertise. We work together with clients to ensure a smooth, timely and successful IFRS 16 solution implementation. Beyond this we're seeing the value add derived from focusing on lease environments, with business optimisation and improved decision making being realised.

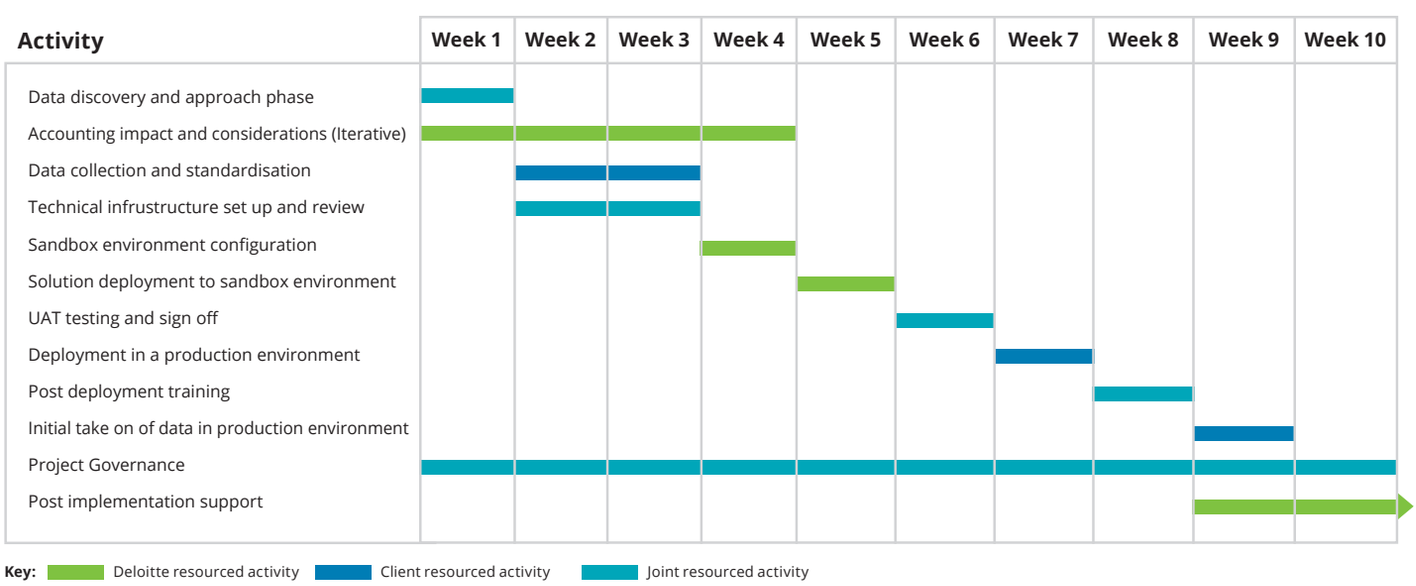
Deloitte provides an end-to-end solution for your IFRS 16 compliance requirements with our expertise in implementation and the Deloitte for Leasing solution. The time to act is now!

Practical approach

Deloitte has developed a practical approach to address IFRS 16 based on our practical experience on this standard:

- Determine key stakeholders and define the project roles and responsibilities of each party
- Form working committees with a regular cadence for feedback and decisions
- Set and track activity timelines with a project roadmap
- Undertake an in depth assessment of the lease environment, including data storage, data management and data governance
- Compile data to review templates, highlight gaps and determine management decisions
- Cognisant of the need to communicate and clarify with your external auditors
- Understand the technical requirements of the solution you are implementing and involve your IT stakeholders upfront
- As with all software, ensure a stringent Software Development Lifecycle (SDLC) process has been adhered to and institute best practise around the promotion of code. Develop a BAU process specific to your requirements to ensure post implementation success
- During implementation, ensure adequate training on the selected software solution is provided
- Consider the impact on your accounting systems. Determine the need for new accounts, ledger vs. sub-ledger considerations, aggregation needs and ingestion requirements

Deloitte's illustrative implementation roadmap is below. Each implementation plan is tailored per client based on our understanding of their requirements and environment.



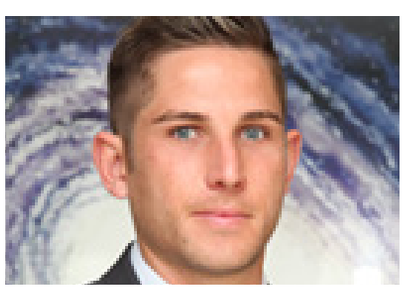
Contacts

Palesa Makobe
Director – Consulting
(Core Business Operations)
T: +27 (11) 304 5268
E: pmakobe@deloitte.co.za

Gary Holme
Consulting (Strategy)
T: +27 (11) 304 5085
E: gholme@deloitte.co.za

Kent Raines
Risk Advisory (Data Analytics)
T: +27 (11) 304 5085
E: kraines@deloitte.co.za

Marlene Snyman
Consulting (Core Business Operations)
T: +27 (11) 304 5085
E: marlsnyman@deloitte.co.za



Wesley Honey
Consulting (Finance and Enterprise Performance)
T: +27 (11) 304 5085
E: whoney@deloitte.co.za

Christina Polydorou
Consulting (Finance and Enterprise Performance)
T: +27 (11) 304 5085
E: cpolydorou@deloitte.co.za

Notes

Notes

Deloitte.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms and their related entities. DTTL (also referred to as “Deloitte Global”) and each of its member firms are legally separate and independent entities. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories serves four out of five Fortune Global 500® companies. Learn how Deloitte’s approximately 286 000 people make an impact that matters at www.deloitte.com.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms or their related entities (collectively, the “Deloitte network”) is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2019. For information, contact Deloitte Touche Tohmatsu Limited.

Designed and produced by Creative Solutions at Deloitte, Johannesburg. (000000/ant)