

IMPLEMENTING AASB 16 *LEASES*: ARE PREPARERS READY?

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TABLE OF CONTENTS

1. EXECUTIVE SUMMARY	3
2. INTRODUCTION	4
3. BACKGROUND	5
4. RESULTS	6
4.1 SURVEY AND RESPONDENTS	6
4.2 IMPLEMENTATION PROGRESS AND PROJECT STRUCTURE	6
4.3 KEY IMPLEMENTATION ISSUES	8
4.4 ARE THE BENEFITS BEING REALISED?	10
4.6 OTHER IMPACTS AND ISSUES	11
6. CONCLUSION	13
AUTHORS	14

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1. EXECUTIVE SUMMARY

This is the first report of a project examining the introduction of AASB 16 *Leases* (AASB 16), the Australian equivalent of IFRS 16 *Leases*. It reports on a survey that provides a snapshot of the process of implementation of AASB 16 *Leases* by preparers. A subsequent report, to be released in 2020, will report on an interview-based study of users of financial reports prepared under AASB 16.

The results indicate that entities have made relatively good progress in implementing the standard, focusing their project structure on existing internal resources. Preparers have faced challenges in implementation, including the need for additional data collection and systems implementation. However, the results suggest that preparers are expecting to see the benefits of adopting the new standard highlighted by the standard-setters, including enhanced comparability and transparency.

Importantly, the need for recognition of (almost) all leases on the balance sheet is an improvement to the quality of the underlying lease data, and thus the quality of the reported information to users of financial statements.

This report aims to assist preparers in benchmarking their progress against peers, and for policy makers, including Australian and international standard-setters, to receive feedback as input to the post-implementation review process of AASB 16 and its international equivalent, IFRS 16.

2. INTRODUCTION

AASB 16 represents the biggest change to lease accounting since the introduction of operating and finance lease accounting almost 40 years ago (AARF, 1979).¹ The standard requires lessees to recognise all leases (with some limited exceptions) on the balance sheet and is effective for financial years beginning on or after 1 January 2019.

This report highlights the results of a survey examining the process of implementing AASB 16 to provide insights into the preparer perspective on the challenges, costs and benefits experienced in implementing a new, and potentially complex, accounting standard.

The report focusses on four aspects of AASB 16 implementation:

- Implementation progress and project structure;
- Challenges preparers are facing in implementation;
- Whether the advocated benefits of the new standard are perceived as being realised; and
- Other related issues and impacts (including application of exemptions and operational impacts).

This report aims to assist preparers in benchmarking their progress against peers, and to provide timely feedback to policy makers, including Australian and international standard-setters, for the post-implementation review process.

¹Australian Accounting Research Foundation (AARF, 1979), Discussion Paper No. 1, 'Accounting for Leases'.

3. BACKGROUND

Arriving at a single model for lease accounting was not an easy task for the accounting standard-setters, with the International Accounting Standards Board (IASB) project taking over ten years to complete – including the publication of a discussion paper and two exposure drafts.

Previous IASB Board Member, Warren McGregor, who served on the Board from 2001-2011 recalls the significant debate that happened around the IASB Board table during the project:

Board members were convinced that a new model of lease accounting was needed because of the demonstrable failure of the existing model to reflect the economic effect of leasing transactions on the financial statements of lessees. However, developing a workable model and convincing constituents, particularly the leasing industry, that a major overhaul of lease accounting was warranted was always going to be a challenging task. Further, on the technical front, the Board had to deal with many conceptually difficult and highly controversial issues relating to scope, lease term, measurement, disclosures and more.

The IASB debate was significant because, prior to the introduction of the new standard, the IASB found that listed companies using IFRS standards or US GAAP were estimated to have around US\$3.3 trillion of lease commitments, with over 85 per cent not appearing on their balance sheets². For those 85 per cent that did not appear on balance sheets, users treated the note disclosures of operating lease commitments differently. Many users, including institutional investors, analysts and credit rating agencies, adjusted a lessee's financial statements to capitalise operating leases

because they felt operating leases should be reflected on the balance sheet.

However, the adjustments made by analysts were not consistent – with analysts using alternative techniques to capitalise the lease value. One of the key issues the IASB had to consider was whether additional disclosure of lease information would be enough to enable users to continue to apply their own method of valuation, or whether to prescribe a single valuation approach.

Ultimately, the IASB decided to require (with some limited exceptions) all leases to be recognised on the balance sheet. However, highlighting the significance of the changes, the IASB provided a three-year implementation timeframe for the standard on the basis that companies would require the additional time to implement the requirements³.

Now that the implementation date has arrived – the question is: are preparers ready for the change that has been 40 years in the making? And, perhaps more importantly, are preparers realising the benefits of the changes that were subject to such significant debate?

² <https://www.ifrs.org/news-and-events/2016/01/iasb-shines-light-on-leases-by-bringing-them-onto-the-balance-sheet/> (Accessed 10 September 2019).³ https://www.aasb.gov.au/admin/file/content105/c9/IFRS16_BC_01-16.pdf

4. RESULTS

4.1 Survey and Respondents

The study surveyed 140 professionals in Australia during June/July 2019 with qualification status of either CPA or CA, involved in the implementation of AASB 16 – either directly as a preparer, or as an adviser to a preparer client⁴. A broad range of industries were represented in the responses. Of the companies represented, two thirds were audited by the Big 4 firms (Deloitte, EY, KPMG, PwC) (66.4%) and nearly one third (30.4%) had total assets in excess of \$1 billion. More than half the respondents described themselves as either CFO or Financial Controller/Finance Manager (52.1%).

4.2 Implementation Progress and Project Structure

Are preparers ready to implement AASB 16?

To assess whether preparers are ready to implement AASB 16, the survey asked entities to report their implementation progress. The results varied considerably across entities. However, overall, the results indicate that most entities appear to be “on track” for implementing the standard on a timely basis.

As shown in Figure 1 below:

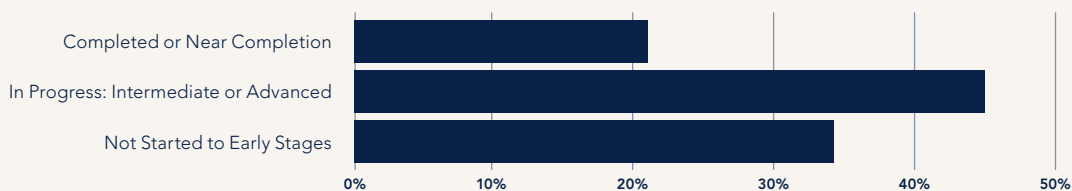
- 21% of entities report that they are near completion or completed implementation;
- Nearly half of entities surveyed are still in the intermediate to advanced stages of the implementation process; and

- 34% of entities report that they have not started or are at the early stages of implementation.

This result compares favourably with recent prior studies on the implementation of other accounting standards. For example, many preparers were lagging in the implementation of AASB 15 *Revenue from Contracts with Customers*⁵ (AASB 15). This outcome may be a result of earlier learning experiences of the challenges in prior implementation, or that preparers have found AASB 16 less challenging to implement as redefining leases is arguably narrower in scope than redefining revenue.

It is concerning, however, that around one third of entities report either that they have not started or are at the early stages of implementation, particularly given ASIC’s expectation that companies would be able to quantify the impact of the new lease standard for 30 June 2019 reporting⁶. The result also raises serious questions about the basis and validity of an impact assessment for those who are lagging in the implementation of the new standard. How can a company meaningfully quantify impact if it has not even begun an implementation project? Indeed, there is evidence from earlier standards’ implementation that disclosures of impact may lack veracity or authenticity⁷.

FIGURE 1
IMPLEMENTATION PROGRESS OF RESPONDENTS



⁴ 28% of the participants were solicited from the professional circle of the researchers, while the remaining 72% of the participant pool was hired using the online survey platform Qualtrics.

⁵ Davern, M., Gyles, N., Potter, B. and Yang, V. (2019), "Implementing AASB 15 revenue from contracts with customers: the preparer perspective", *Accounting Research Journal*, Vol. 32 No. 1, pp. 50-67.

⁶ <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-143mr-major-financial-reporting-changes-and-other-focuses/> (Accessed 10 September 2019).

⁷ [https://www.ey.com/Publication/vwLUAssets/EY-ifrs-15-no-impact-now-prove-it/\\$FILE/EY-ifrs-15-no-impact-now-prove-it.pdf](https://www.ey.com/Publication/vwLUAssets/EY-ifrs-15-no-impact-now-prove-it/$FILE/EY-ifrs-15-no-impact-now-prove-it.pdf)

What resources are preparers dedicating to their AASB 16 implementation projects?

To determine how preparers were resourcing their implementation projects, the survey asked preparers about the type of resources they were dedicating to the projects.

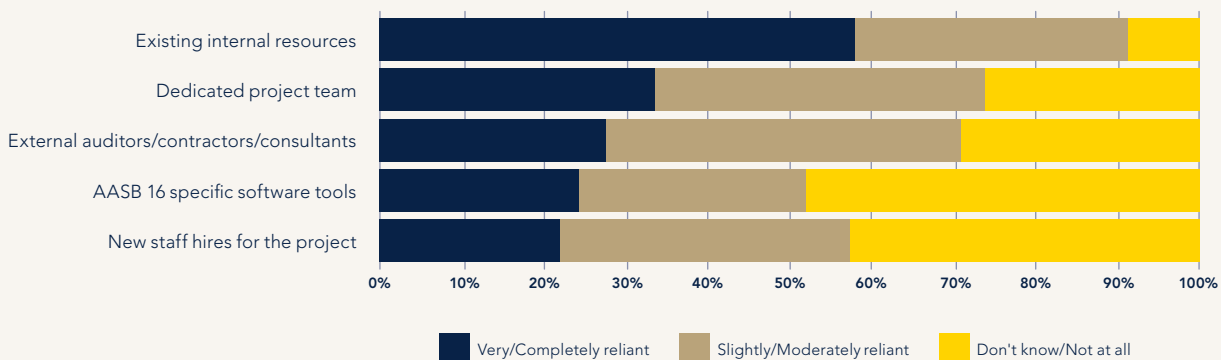
The results show that most entities are applying existing internal resources, rather than external or new staff hires, to complete the projects.

As shown in Figure 2 below:

- Nearly 60% of entities are heavily reliant on existing internal resources to complete the project;
- Over 70% of the respondents have a dedicated project team;
- Only 28% of entities rely on external consultants;
- Few entities (24%) indicated that they were very or completely reliant on AASB 16 specific software tools; and
- Respondents were more likely to rely on existing staff, with less than a quarter of the respondents heavily reliant on new staff to carry out the project.

The low reliance on external consultants and new hires suggests that the complexities of the implementation of AASB 16 was largely within the established capabilities of entities. This compares favourably with other recent implementations, such as AASB 15, in which reliance on external parties was much higher (although this could be because AASB 15 impacts a broader range of entities, or because entities retained staff resources from the AASB 15 implementation to assist in implementing AASB 16).

FIGURE 2
IMPLEMENTATION PROJECT RESOURCES



4.3 Key Implementation Issues

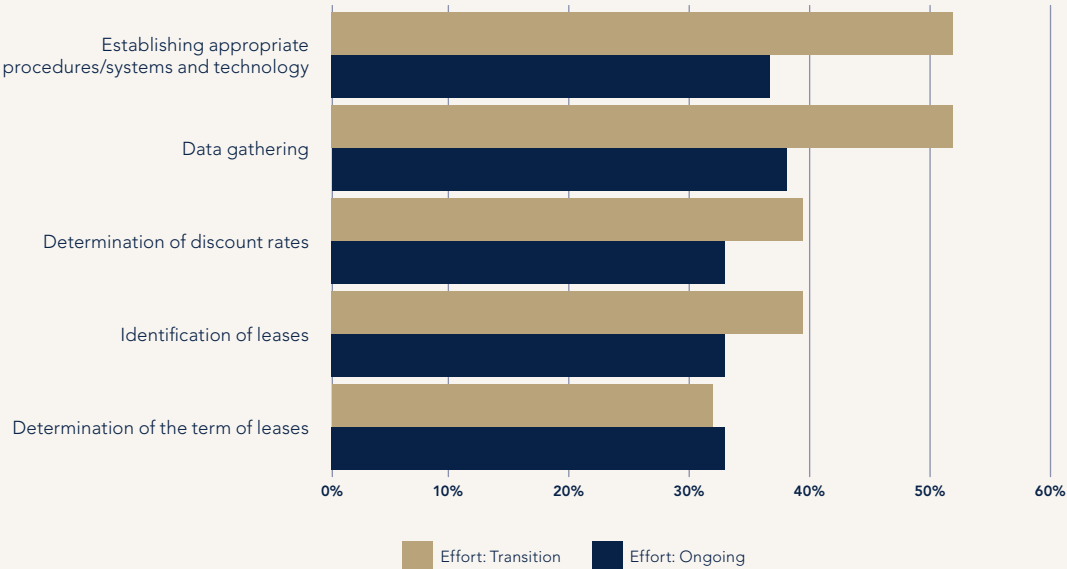
Data gathering and systems

One of the key issues expected to affect implementation of AASB 16 is the significant additional data required to be captured, and the establishment of systems to generate the data. To assess how significant this issue is for preparers the survey asked entities their perception of the effort required in data gathering and establishing systems.

The results show that the perception of the effort required in data gathering and establishing procedures/systems differed between the transition phase for AASB 16 and the ongoing application phase of AASB 16 (see Figure 3). While establishing appropriate procedures/systems and data gathering are expected to remain important in the ongoing application of AASB 16, they no longer dominate to the same extent as in the transition phase.

This result suggests that entities may not currently have a well maintained and accessible repository of data around various lease agreements, an issue supported by anecdotal evidence from discussions with numerous practitioners. The result highlights a potential additional benefit of AASB 16 for entities – better management of leases by providing better data about lease contracts and commitments.

FIGURE 3
ESTIMATED EFFORT REQUIRED: TRANSITION VS. ONGOING



Key implementation challenges

To identify the key implementation challenges for preparers the survey asked entities their perceptions of how challenging specific aspects of AASB 16 were for their entity. The results were then examined based on the implementation status as:

- ‘not started/early stages’; or
- ‘advanced stages/completed’.

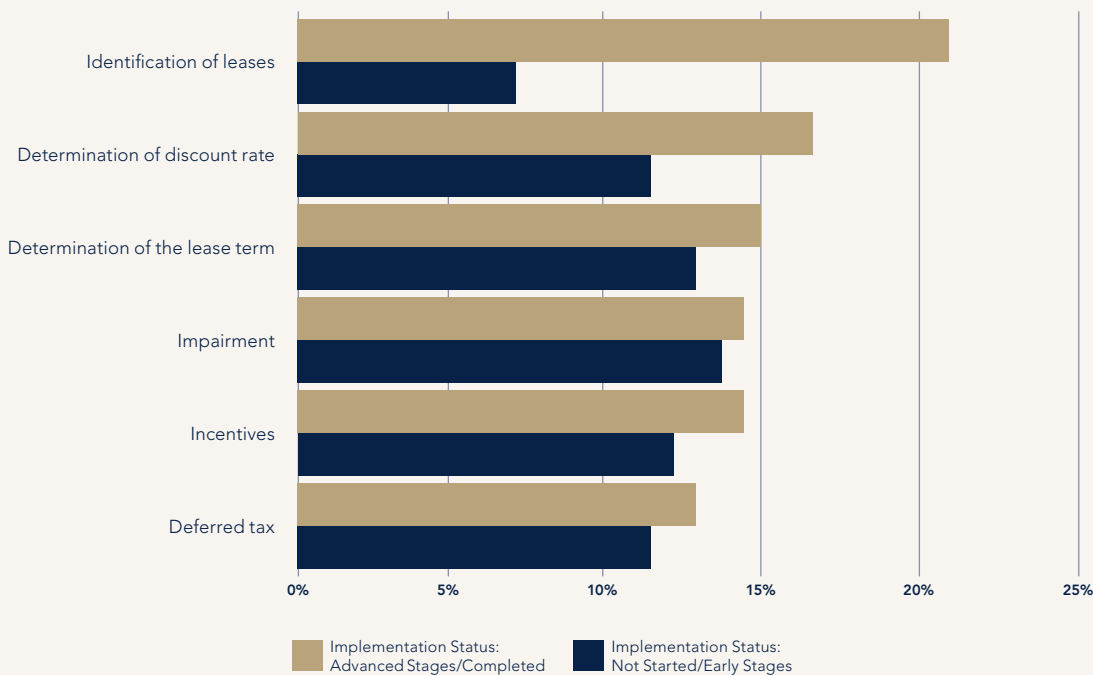
The results show that ‘advanced stages/completed’ preparers perceived all issues as more challenging than entities that have not started or are at the early stages of implementation.

As shown in Figure 4 below, in particular, identification of leases and determination of discount rates appear to be much more challenging for entities at advanced stages/ completion than for preparers that have not started or are at the early stages of implementation.

One interpretation of this result is that entities facing a greater challenge commenced their implementation projects earlier. However, if this were the case, the results would indicate some relationship between implementation progress and the number of leases, or size of an entity. No such relationship was observed.

A further potential interpretation of the result is that entities discover the complexities of the issues only once the implementation process is further advanced. This interpretation would explain, in part, the apparent challenges in lease identification. The result is also potentially a reflection of the technical complexity of lease identification, and similarly, the complexity of the determination of an appropriate discount rate.

FIGURE 4
MAJOR CHALLENGES BY IMPLEMENTATION STATUS



4.4 Are the benefits being realised?

In developing the new standard, the IASB highlighted a number of key benefits that were expected to be achieved, including⁸:

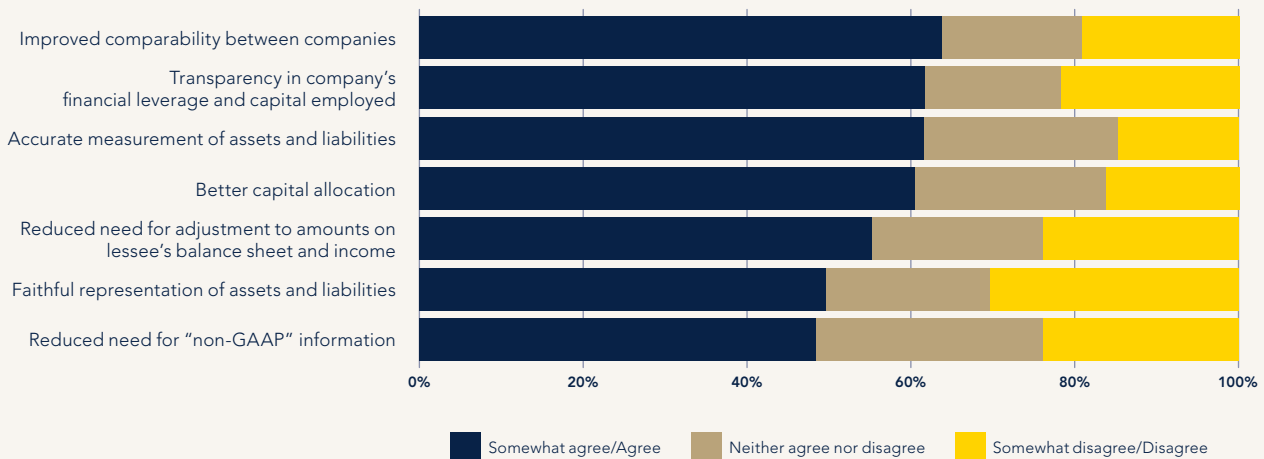
- Improved comparability between entities;
- Transparency in entity’s financial leverage and capital employed;
- Accurate measurement of assets and liabilities arising from leases;
- Better capital allocation;
- Reduced need for adjustments;
- A more faithful representation of the financial position; and
- Reduced need for non-GAAP disclosures.

To assess whether preparers perceived these benefits as being realised, the survey asked preparers the extent to which they agreed that these benefits were likely to be achieved by being AASB 16 compliant.

As shown in Figure 5 below:

- the responses were overall positive, with 50-60%, depending on the specific benefit, stating that they either agreed or somewhat agreed that the claimed benefits would be realised;
- the most widely supported benefits were enhanced comparability (64.3%) and transparency (62.1%); and
- the least widely supported benefits were a more faithful representation of assets and liabilities and the reduced need for non-GAAP disclosures. Indeed, both these claimed benefits were the most strongly opposed, with 25-30% stating they either disagreed or somewhat disagreed that the claimed benefit would be realised.

FIGURE 5
AGREEMENT WITH CLAIMED BENEFITS



⁸ <https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf>

Notably, preparers, if anything, are likely to understate the benefits of the new standard as they tend to bear the costs with its introduction, whereas the IASB claimed benefits tend to accrue to the financial statement users, namely investors. The key question is whether the benefits outweigh the costs – the survey results provide some useful insight into this trade-off. There seems to be considerable benefit in terms of enhanced comparability and transparency with the shift from a disclosure to a recognition approach for leases, supporting the IASB’s claim that “disclosure is not enough”. The greatest costs would seem to be the efforts in data gathering and the challenges of lease identification. The incremental costs in data gathering and lease identification should not be onerous if appropriate effort and attention were directed to these tasks in support of disclosures under the prior standard (AASB 117 *Leases*). To the extent that additional costs are necessarily incurred, this generates the added benefit of capturing better data about lease commitments that can enable improved lease management (for further details on this, see the discussion of Figure 7 on the next page).

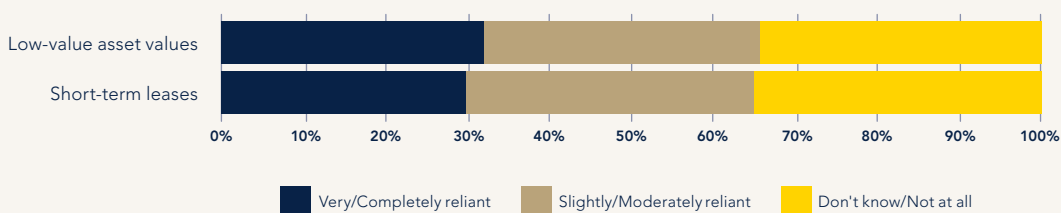
4.6 Other Impacts and Issues

To identify the impact of the exemptions for short-term leases⁹ and low-value assets¹⁰, the survey asked entities what impact these exemptions were expected to have on the financial statements.

As highlighted in Figure 6:

- Although the short-term lease and low-value asset exemptions do not appear to have a significant impact on the financial statements, more than half of the respondents indicated that they would benefit from the short-term lease exemption, and the low-value asset exemption (i.e., the blue and brown bars combined); and
- For some entities, these exemptions appear to be highly beneficial. For the low-value asset exemption, 13% of entities expected to benefit a great deal, with a further 19% indicating they would benefit a lot (i.e., in total the 32% represented by the blue bar). Similarly, for the short-term lease exemption, 9% indicated that they would benefit a great deal and a further 21% indicated they would benefit a lot (i.e., in total the 30% represented by the blue bar)

FIGURE 6
BENEFITS FROM APPLYING EXEMPTIONS



⁹ Short term lease is defined as a lease that at the commencement date has a lease term of 12 months or less.

¹⁰ The assessment of an asset as 'low value' is based on the value of the asset when new. IFRS 16 (BC 100) refers to assets of less than \$5000 as value as 'low value assets'.

What impact do preparers expect AASB 16 will have on their operations?

To assess the potential extent of change arising from the new standard, the survey asked entities what impact they expected AASB 16 to have on their operations.

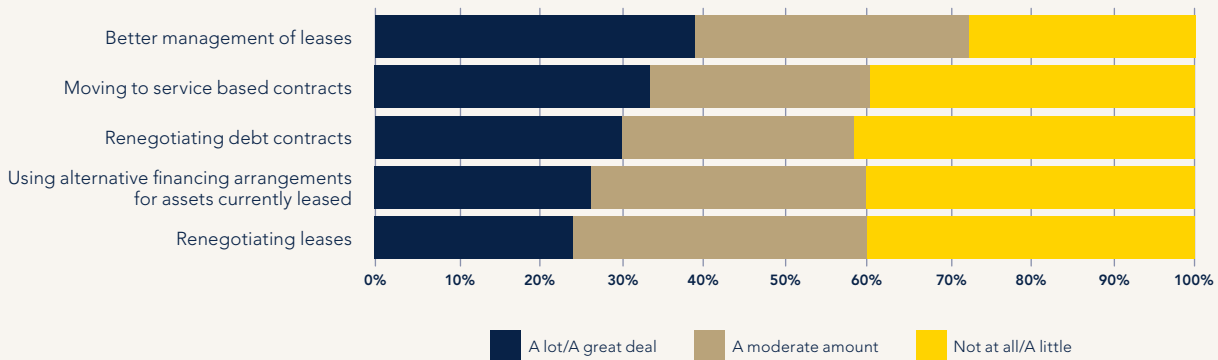
Overall, most respondents expected there to be at least a moderate amount of impact on operations.

As shown in Figure 7:

- over 70% of respondents indicated that implementing AASB 16 would result in at least a moderate improvement to lease management (i.e., the blue and brown bars combined); and
- Conversely, 40% of respondents expected little or no impact on a variety of different aspects of their operations (i.e., the yellow bar).

These results are particularly interesting in light of the previous findings regarding data gathering effort, lease identification and the shift from disclosure to recognition. In particular, these results provide further evidence that entities likely were not giving sufficient managerial attention to leases and lease commitments that were previously classified as operating leases and were, thus, not recognised in the financial statements.

FIGURE 7
EXPECTED IMPACTS ON OPERATIONS



6.0 CONCLUSION

Although our results indicate that entities are making relatively good progress in implementing the new standard, entities have identified particular challenges relating to additional data collection and systems implementation.

The survey results highlight an often-overlooked benefit of standard-setting – improved management of the business. Compliance with standards can compel entities to enhance their data and systems, in order to be able to meet the reporting requirements, and this enhanced data and information can lead to better operational decision-making.

Accordingly, overall, the survey results indicate that the implementation of AASB 16 can be viewed as an opportunity for entities to not just improve the quality of reported information, but to also drive internal data improvement for the underlying data and systems. In doing so, entities will hopefully achieve the benefits envisaged by the standard-setters in developing the new requirements.

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