

Transition requirements for Lessees

This publication discusses some of the key matters to be considered by lessees when applying the transition requirements of IFRS 16, “Leases” (IFRS 16), in the financial year in which the standard first applies.

Principal requirements of the standard

IFRS 16 applies to annual reporting periods beginning on or after 1 January 2019. The standard introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of ‘low value’.

Lessees are required to account for the change in accounting policy arising from the initial application of IFRS 16 in accordance with the transitional provisions contained in Appendix C of the standard.

Choice of transition methods

The transitional provisions provide lessees with the choice of applying the standard either:

- a) retrospectively to each prior reporting period presented, by applying IAS 8, “Accounting Policies, Changes in Accounting Estimates and Errors” (the ‘retrospective method’), or
- b) retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application, by applying the available practical expedients (the ‘cumulative catch-up method’).

The lessee must apply the selected transition method consistently to all leases.

Election not to reassess past contracts

When applying either of the transition methods, lessees are not required to reassess whether a contract is, or contains, a lease at the date of initial application of the standard. As a result, lessees are permitted to apply IFRS 16 only to contracts that were previously identified as leases under IAS 17, “Leases” (IAS 17).

Short-term leases, and low value assets

When applying either of the transition methods:

- a lessee may elect (on a class of underlying asset basis) not to apply the lease recognition requirements to leases that, at the commencement date of the lease, have a lease term of 12-months or less and do not contain a purchase option, and
- a lessee may elect (on a lease-by-lease basis) not to apply the lease recognition requirements to leases for which the underlying asset is of ‘low value’.

Cumulative catch-up method

When applying the ‘cumulative catch-up method’, a lessee may use one or more of the available practical expedients when applying the transitional provisions to leases previously classified as ‘operating leases’ under the IAS 17.

These practical expedients are discussed on the next page.

Remaining lease term of less than 12-months

A lessee may elect (on a lease-by-lease basis) not to apply the lease recognition requirements to leases for which the lease term ends within 12-months of the date of initial application.

Basis of measuring the right-of-use asset

A lessee has the choice to initially measure the right-of-use asset at either:

- a) its carrying amount as if IFRS 16 had always been applied, but using the 'lessee's incremental borrowing rate' at the date of initial application (i.e., in order to measure the initial lease liability as a component of the initial carrying amount of the right-of-use asset); or
- b) an amount equal to the lease liability at the date of initial application, adjusted by the amount of any prepaid or accrued lease payments (for that lease) recognised immediately before the date of initial application.

Testing the right-of-use asset for impairment

A lessee has the choice to either:

- a) test the right-of-use asset for impairment under IAS 36, "Impairment of Assets" (excluding leases of investment property measured at fair value under IAS 40, "Investment Property", or
- b) rely on the 'onerous contracts' assessment performed immediately before the date of initial application under IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", and adjust the initial carrying amount of the right-of-use asset by the amount of any provision for onerous leases recognised immediately before the date of initial application.

Treatment of initial direct costs

A lessee may elect (on a lease-by-lease basis) to exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.

Use of hindsight

A lessee may elect (on a lease-by-lease basis) to use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

Discount rate

A lessee may elect (on a lease-by-lease basis) to apply a single discount rate to a portfolio of leases with reasonably similar characteristics.

Contact:



Nigel MacPhail
Director

T: +1 284 494 5800 x222

D: +1 284 852 2582

M: +1 284 541 6443

nmacphail@bakertilly.vg

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