

### Consolidation in Practice – Potential Pitfalls and Real-World Solutions

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# IFRS 16 – Leases: Consolidation in practice

March 2019



# Scope of IFRS 16

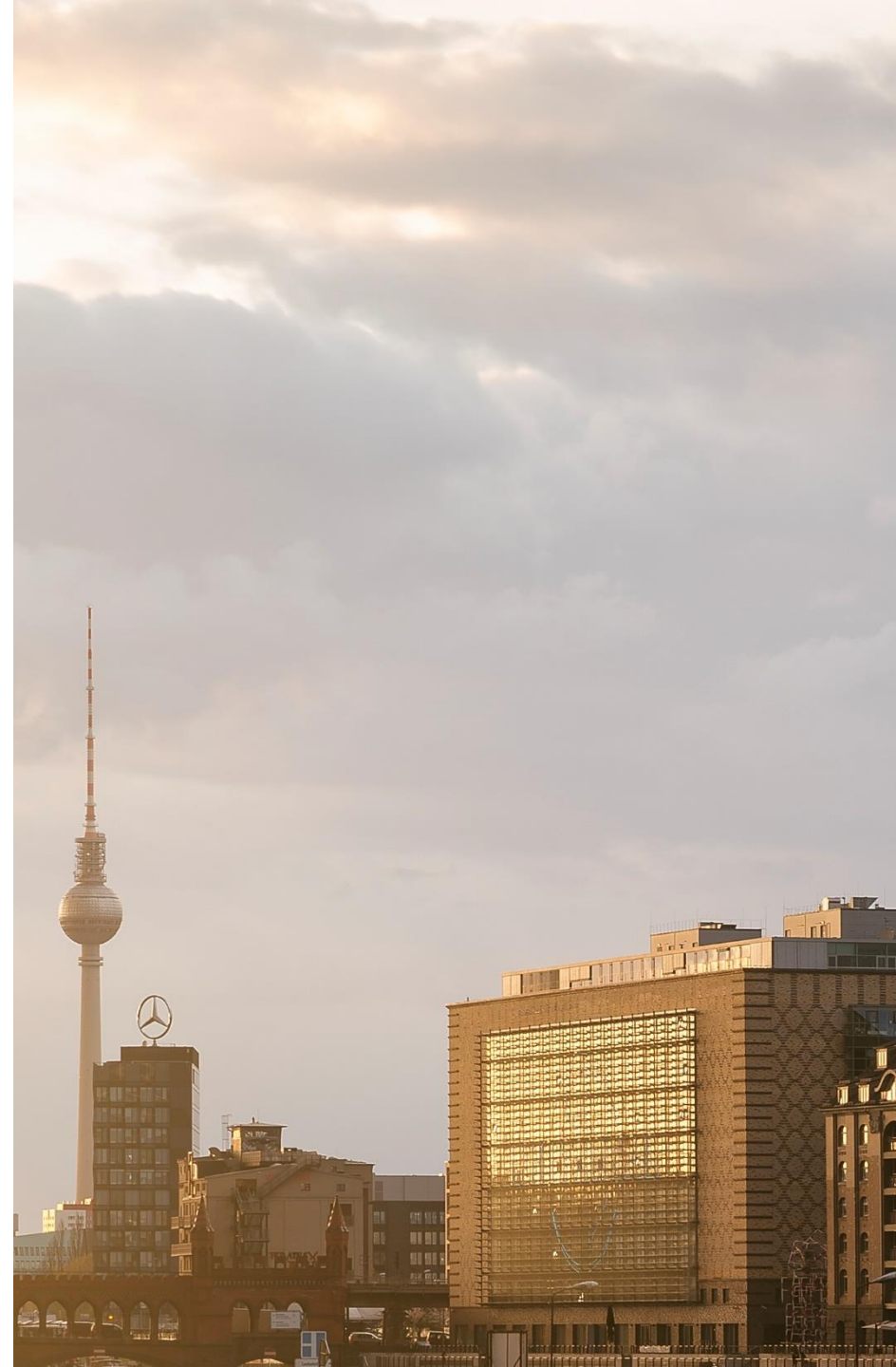
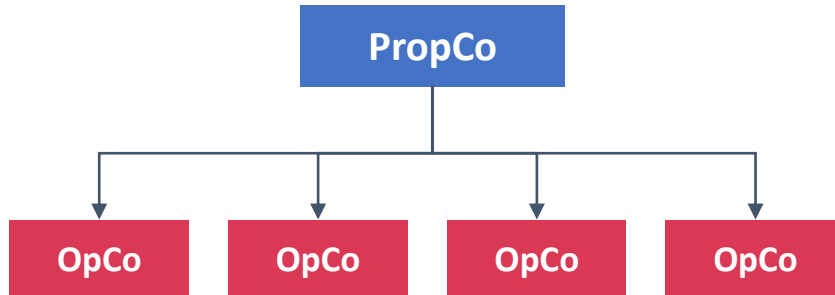
**Lease = A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration**

**All leases are in the scope of IFRS 16, except for**

- |   |   |
|---|---|
| <b>1</b> Lease to explore for or use non-regenerative resources | <b>4</b> Intellectual property licences in scope of IFRS 15   |
| <b>2</b> Biological assets within the scope of IAS 41           | <b>5</b> Rights held by lessees under certain licensing agreements (motion picture films, patents, copyrights etc.) |
| <b>3</b> Service concession arrangements in scope of IFRIC 12   | <b>6</b> Other intangible assets  |

**Lease arrangements within groups?**

# Group situations



# Accounting considerations for PropCo

## Lessor accounting

### Classification

Distinction based on  
risk and rewards

### Finance lease

Lease receivable  
(net investment in lease)

### Operating lease

Underlying asset



# Accounting considerations for PropCo

Lessor accounting (cont'd)

## Classification indicators

**Finance lease, if transfer of substantially all risks and rewards of ownership Indicators**

Transfer of ownership of underlying asset

Option to purchase that is reasonably certain

Lease term for major part of economic life of underlying asset

Present value of lease payments at least substantially all of underlying asset's fair value

Underlying asset is of specialised nature

Lessee bears lessor's losses if it cancels lease

Gains/losses from fluctuation of residual value accrue to lessee

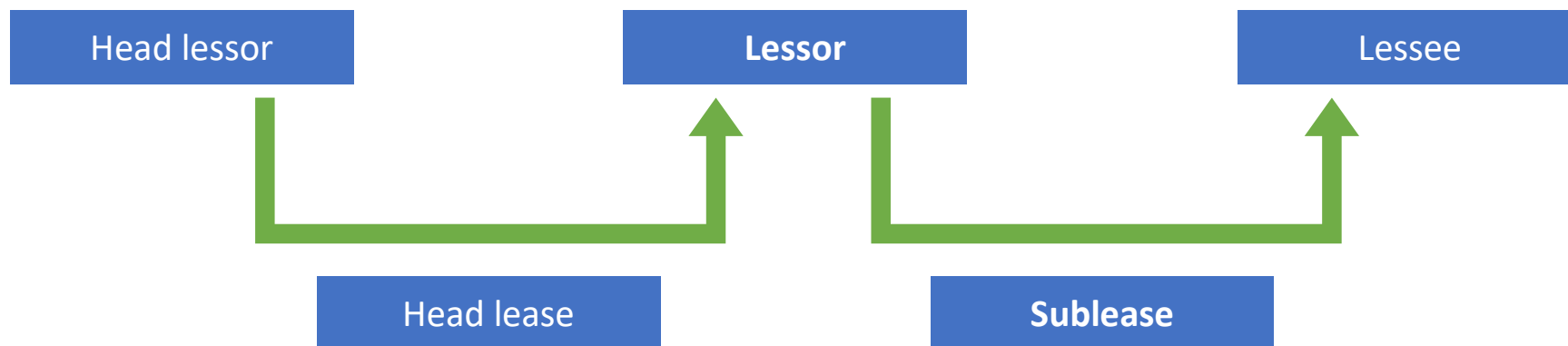
Lessee's option to continue lease at rent substantially lower than market rate

**Otherwise: operating lease**



# Accounting considerations for PropCo

## Lessor accounting – subleases



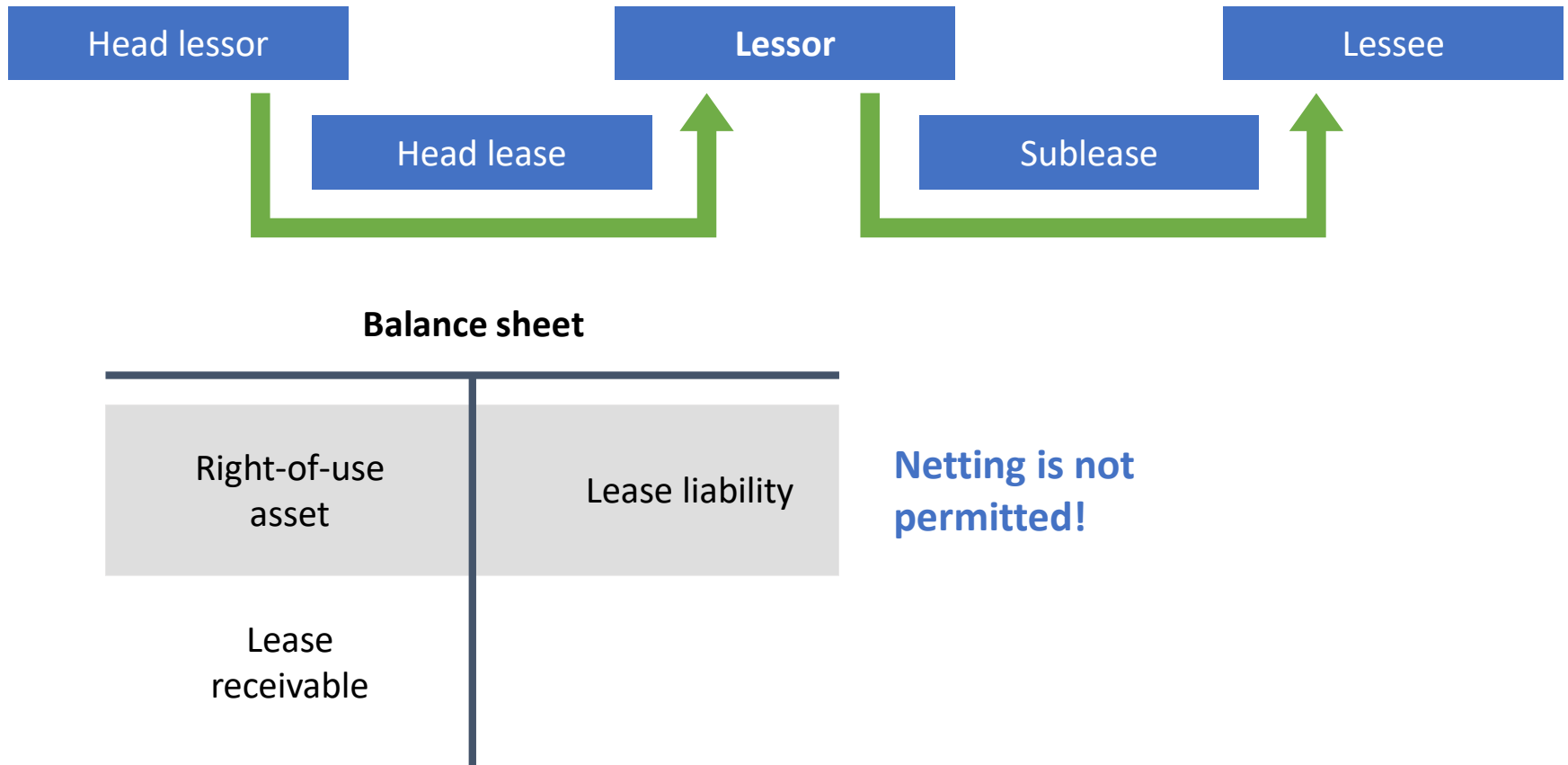
Lessor evaluates sublease with reference to **right-of-use asset**

Many subleases previously classified as operating lease probably now classified as **finance lease** (as fair value of right-of-use asset is in general below fair value of underlying asset)

If head lease is a short-term lease, sublease shall be classified as operating lease

# Accounting considerations for PropCo

## Lessor accounting – subleases (cont'd)





# Accounting considerations for PropCo

## Lessor accounting

Operating lease

Underlying asset

Is the underlying asset investment property?

‘Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to **earn rentals** or for capital appreciation or both’



# Accounting considerations for OpCo

## Lessee accounting – lease liability

‘At the commencement date, the lessee measures the lease liability at an amount equal to the **present value** of the **lease payments** during the **lease term** that are not paid at that date.’

### Lease liability



### Lease term



### Lease payments



### Discount rate

What if there is no formal lease contract?



# Accounting considerations for OpCo

## Lessee accounting – lease term

Non-cancellable  
period

Included in lease term



Period covered by  
option to extend

Lessee only

Lessor only

Both

Included in lease term,  
if exercise is  
**reasonably certain**

Included in lease term

Included in lease term



Period covered by  
option to terminate

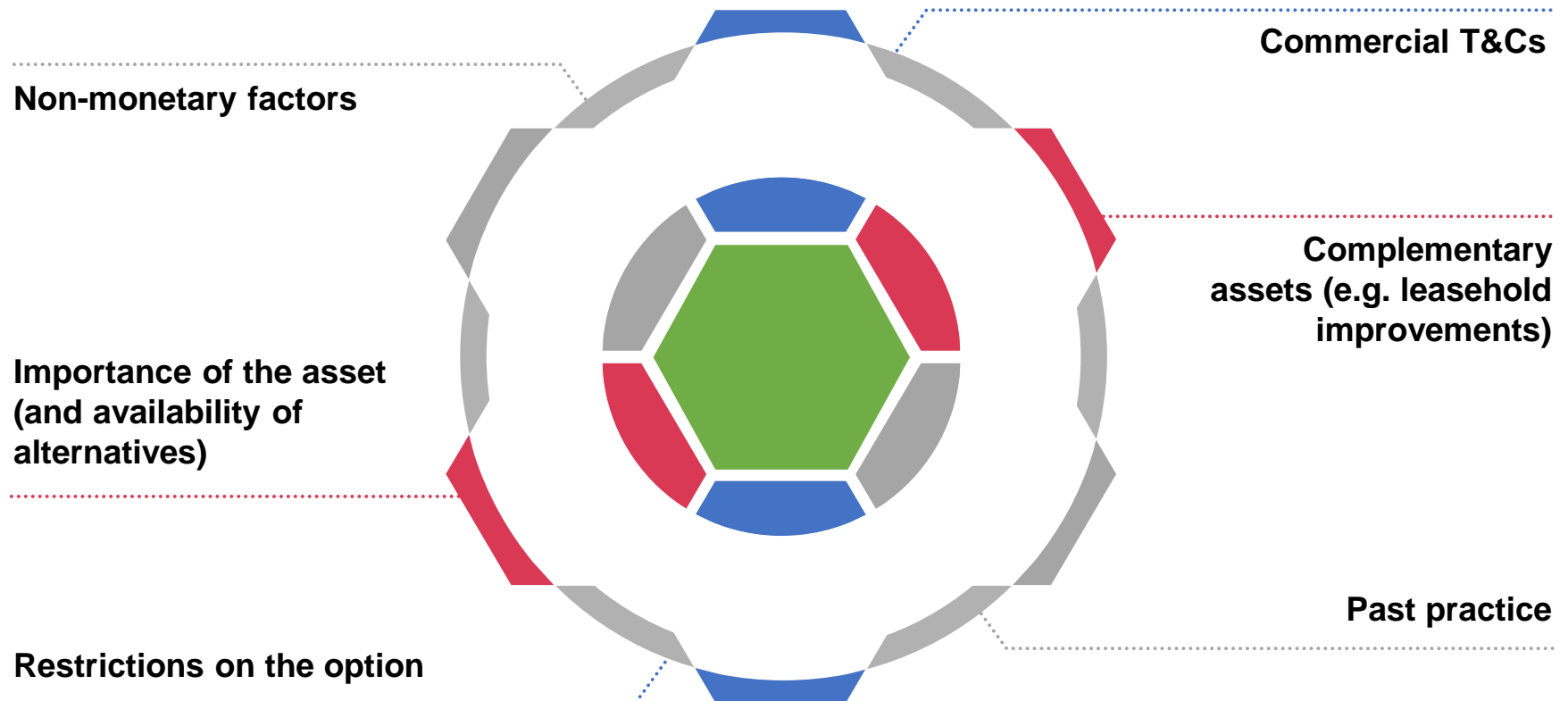
Included in lease term  
if non-exercise is  
**reasonably certain**

Included in lease term

Excluded, if both can  
terminate independently  
and with 'no more than  
an insignificant penalty'

# Accounting considerations for OpCo

Lessee accounting – lease term – assessment of reasonably certain



# Accounting considerations for OpCo

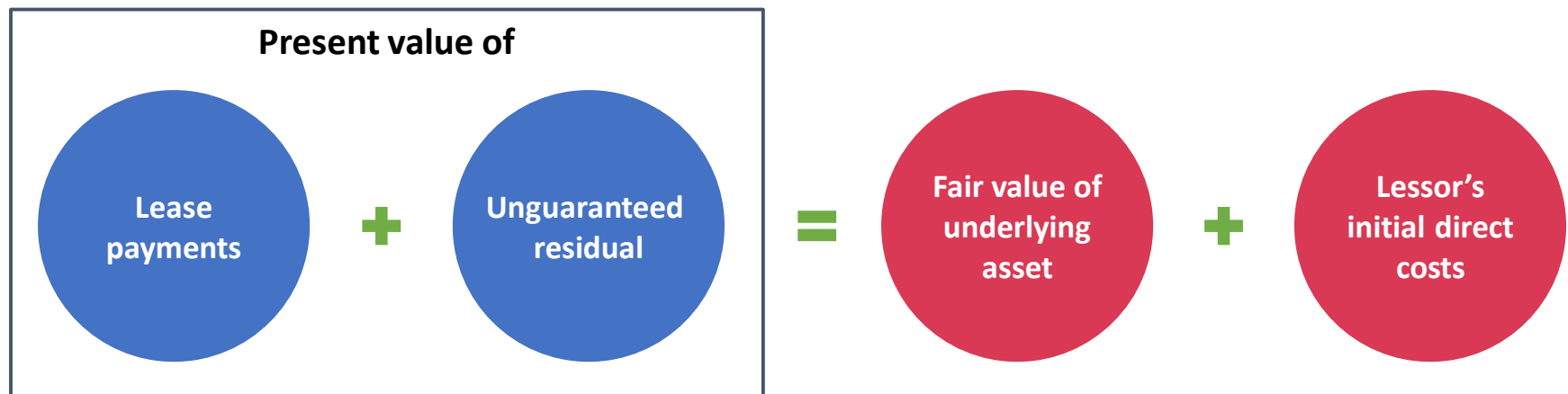
Lessee accounting – lease payments



# Accounting considerations for OpCo

## Lessee accounting – discount rate

The interest rate implicit in the lease is the rate that makes:



The **lessee only** uses the implicit rate if it is '**readily determinable**', otherwise it uses the **incremental borrowing rate**

Is the implicit rate '**readily determinable**' in a group situation?



# Accounting considerations for OpCo

## Lessee accounting – discount rate (cont'd)

The lessee's incremental borrowing rate (IBR) reflects:

'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**'

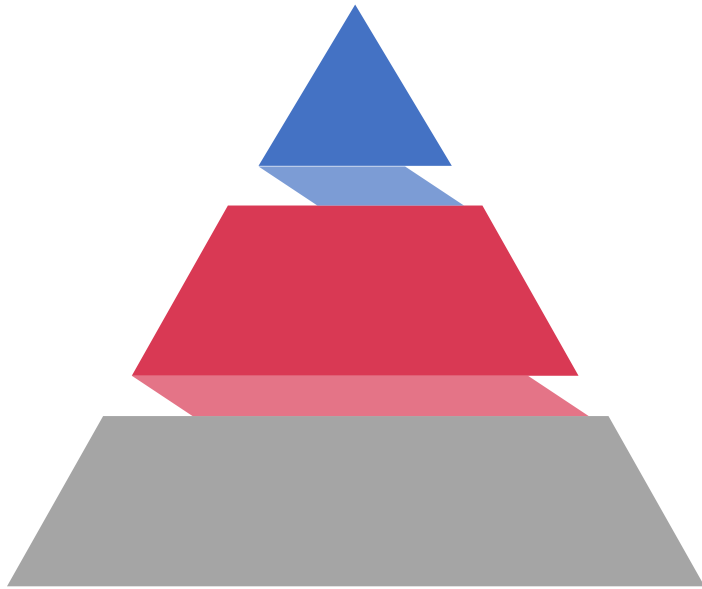
What if group financing arrangements are in place?





# Accounting considerations for OpCo

Lessee accounting – discount rate (cont'd)



## **Asset**

Security value of funds borrowed

## **Credit worthiness**

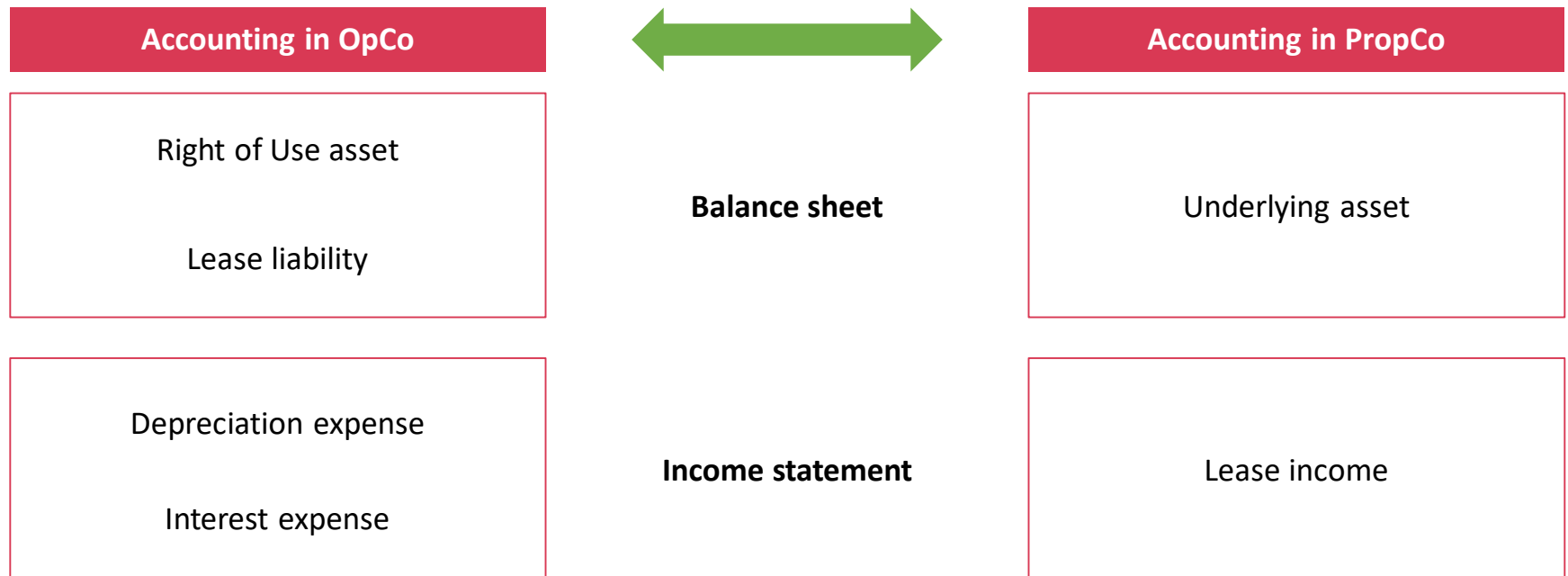
Lessee specific adjustments Lease term

## **Base rate**

Relevant economic environment Reference to available risk free rates

# Consolidation in practice

## Elimination entries on consolidation?



# Any questions?



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