

# Implementing AASB 16 *Leases*: The Investor and Preparer Perspectives



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# Changing Lease Accounting:

## Why?

*“The demonstrable failure of the existing model to reflect the economic effect of leasing transactions on the financial statements of lessees.”*

Warren McGregor, former IASB member.

## Why Not?

*“I think the threshold for changing [a standard] should be very high because period on period comparability is extremely important”*

## The Challenge:

*“... developing a workable model and convincing constituents ... that a major overhaul of lease accounting was warranted was always going to be a challenging task.”*

Warren McGregor, former IASB member



# Perspectives and Approach

## PREPARERS:

**What:** Enablers, impediments, and challenges in implementing AASB 16.

**Why:** Peer benchmarking, inform PIRs, understand implementation processes.

**How:** Survey of 140 CPA/CA qualified professionals implementing AASB 16 (June/July 2019)

## INVESTORS:

**What:** Costs/benefits & challenges in interpreting financial statements prepared under AASB 16

**Why:** Guide disclosure choices, Inform PIRs, understand investor decision-making

**How:** Interviews of professional investors/analysts (April-June 2020; transcripts of 20,000 words)



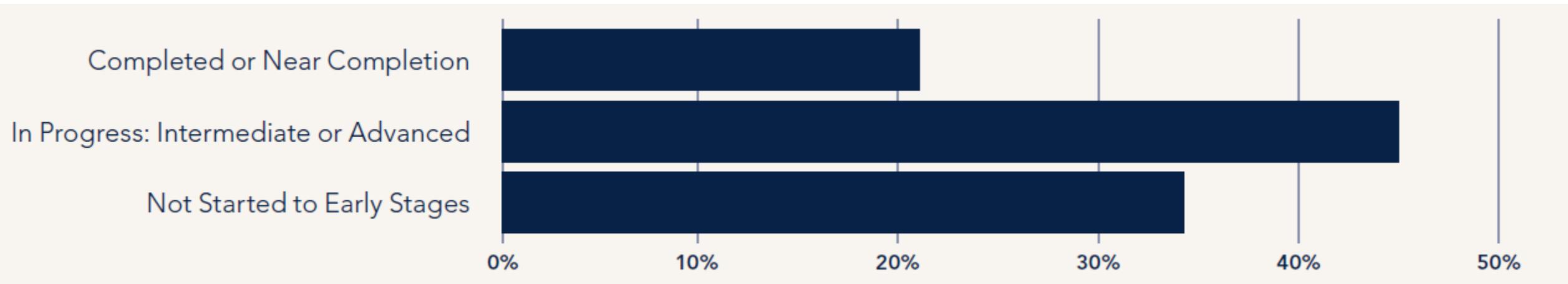
# The Sample:

**Respondents:** 140 CA/CPA Qualified, 52.1% CFO/Controller/Finance Manager

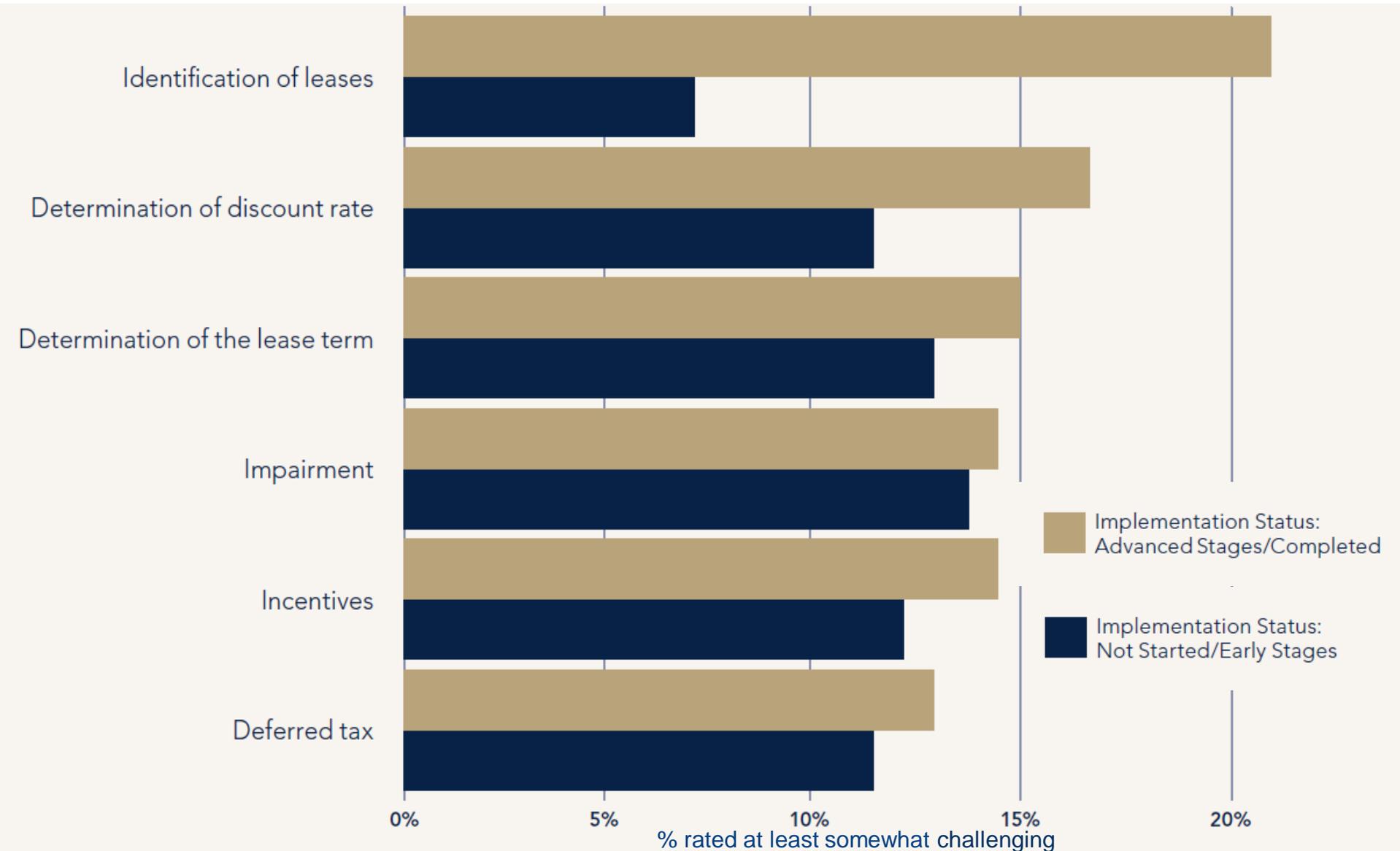
**Organisation:** Broad range of industries  
30.4% with Assets in excess of \$1 billion

**Auditors:** 66.4% Big 4

**Implementation Progress:** (as at June/July 2019)



# Key Challenges by Implementation Status:



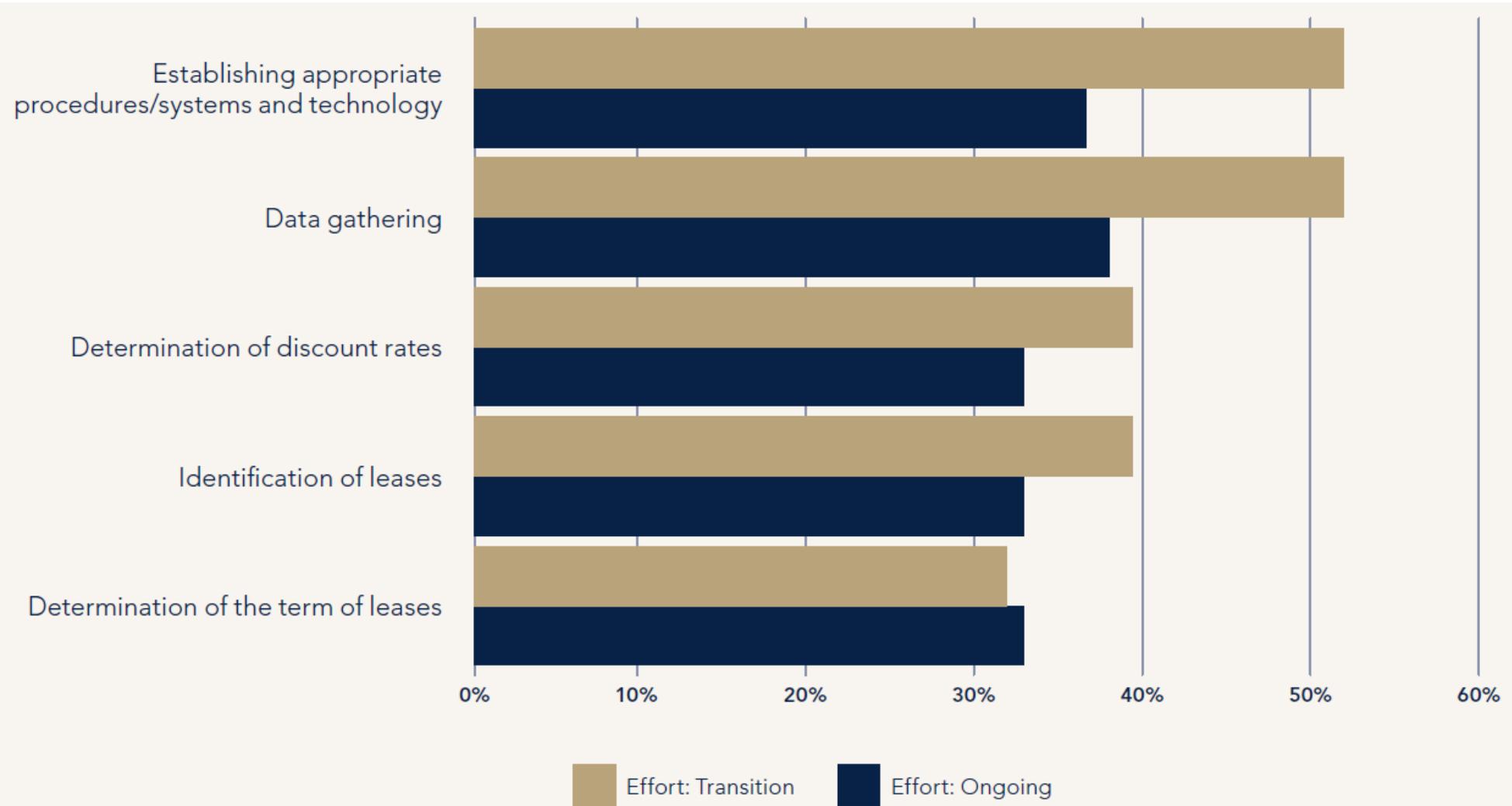
Evidently firms did not have an enterprise wide register of lease contracts => recognition vs. disclosure implications?

Impairment is likely more of a future challenge.

~30% of respondents were highly reliant on applying exemptions for low asset values/short-term leases



# AASB 16 Requires “Substantial Effort”



Data and Systems require much work in transition AND on ongoing basis.



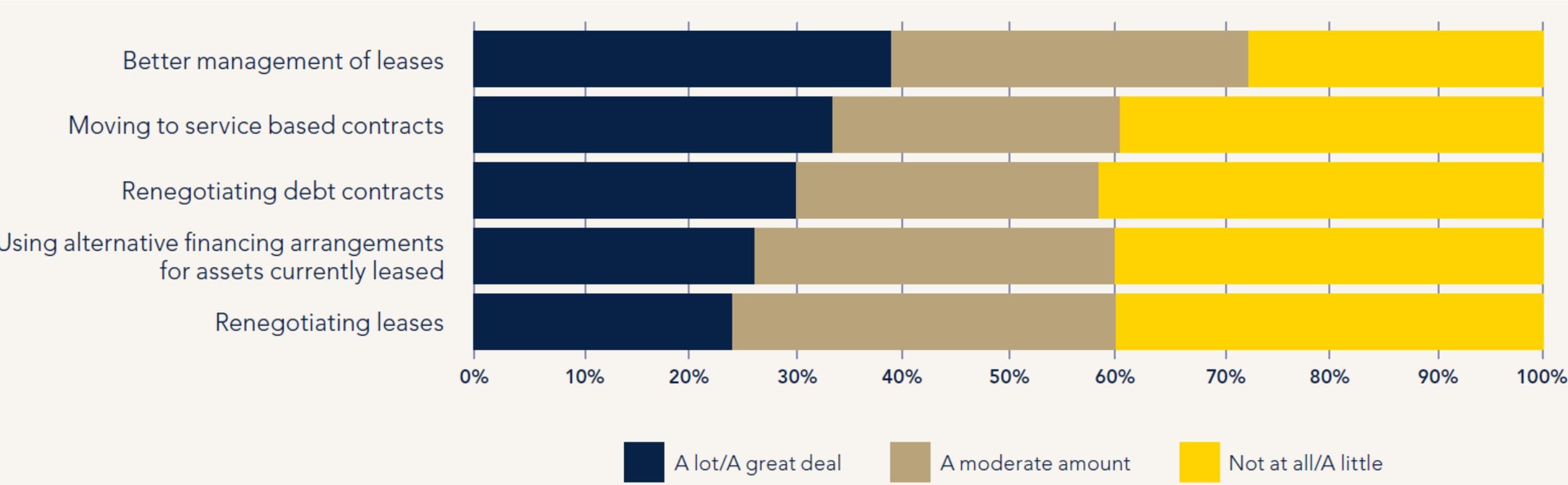
# Key Claimed Benefits: A Preparer Perspective

Key Benefits	Preparer's View
Comparability	Majority agree with the claim
Transparency	Majority agree with the claim
Reduced need for "non-GAAP" Information	More than 20% of respondents disagreed with the claim
Faithful Representation of Assets & Liabilities	Largely Ambivalent: respondents were split

Note: Preparers are more likely to be biased against agreeing claimed benefits are achieved.



# Operational Impacts: AASB 16 has real economic effects on the business!





# AASB 16 and Investor Decision Making: Context Matters

- Investor views varied considerably:
  - “absolutely no impact”
  - A significant impact on all investors
- Impact is industry and firm specific
  - Extent of reliance on leased assets
  - Long-term vs short-term leases
  - Aviation and retail sectors particularly impacted

*“So, I think there’s a strong appreciation...that in an economic sense things aren’t changing about these businesses, but the way that we analyse these businesses. It is significantly impacted by the standard”*



# Recognition to Disclosure of Leases: The Debate Continues?

*...a solution for a problem the investment market didn't have.*

## For

*better transparency, comparability, those sorts of things that might help their cost of capital if they're doing the right thing.*

*it is helpful for comparability, particularly for companies that own most of their properties versus companies that lease most of them*

*It has been a net positive...I would actually say it's been a net benefit because you start seeing all the skulduggery ... a private equity company doing sale and leaseback transactions immediately prior to IPO*

## Against

*it makes no difference at all as long as the disclosure is somewhere – as long as it's clear.*

*I wouldn't say the market has perfectly adjusted for it prior to implementation but... it doesn't really matter.'*

*the businesses look a lot more geared than they used to be, but in reality they're no more geared than they used to be, it's just that the numbers are now better disclosed.'*

*[In the future] they're going to wonder about this debate that we're having today*

# Change is Never Easy:

- Historical Comparability is Hurt

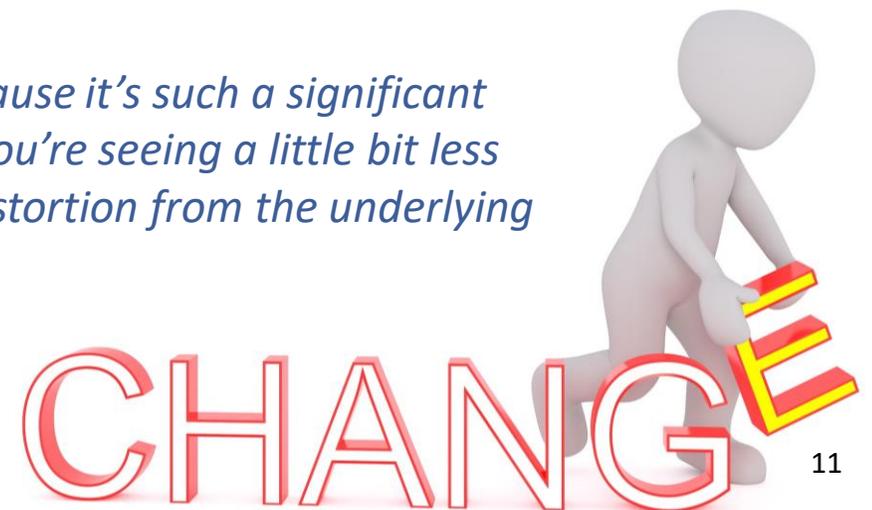
*historical databases become useless or they lose their comparability over time because there's obviously a massive break in the series starting from this year.*

*Being able to understand how a business performs over a long period of time is extremely important.*

- The Investor Burden

*There are costs to Investor the standard's created, I think, an additional layer of complexity in financial statements... It's just made everyone's life quite a bit harder*

*the costs are probably more significant than the benefits at this stage...because it's such a significant change to the financial statements and it's causing so much...distortion ... you're seeing a little bit less efficiency ... because the market as a whole is struggling to separate the distortion from the underlying operational performance of the company.*





# Non-GAAP Metrics: Have we created more problems?

- More Management “spin”?

*My big fear is that... management manages to convince [analysts] to rely on some proforma number based on an unaudited EBITDA equivalent. That's my big fear and we'll see what happens*

- Reduced Usefulness?

*EBITDA as a proxy for cashflow relative to liabilities is a classic rule of thumb and suddenly both the numerator and the denominator have just become less useful or changed*

*...the market does gravitate towards EBITDA as a financial metric and [it is] probably not appropriate for a whole range of reasons ... that's where the distortion is most significant.*

- Cost vs Benefits: Transition vs Post-Transition

*it's everyone grappling to work out that what has displaced a really longstanding rule of thumb and so how do we adjust [for that]?'*

*it's going to take a couple of years for people to, I think, fully appreciate the benefits they get from it .... once they have thought through how to come up with a solution to the EBITDA problem.*

- Real Effects:

*Likely to see more leases for entities that consider EBITDA to be a key metric because the impact of AASB 16, overall, is to increase EBITDA in comparison to an entity that purchases, rather than leases, assets*



# Key Findings and Implications

- Data/Systems Problems are a big challenge in Implementation
- Recognition vs. Disclosure Matters:
  - Recognition appears to lead to greater management/auditor attention
  - Appropriately adjusting based on unrecognized lease disclosures (capitalising operating leases), is problematic if the disclosed information is of a lower quality.
- Transition Costs are for both Preparers and Investors
  - Comparability and usefulness may be harmed in the short-term
- Non-GAAP measures likely need to be regulated
  - *“the number that it has most impacted is a number that is actually not defined, which is EBITDA”*
- Standards have real effects!
  - Better management of leases
  - Changing contractual arrangements, because of impacts on key metrics (including non-GAAP measures)



# For Further Details:

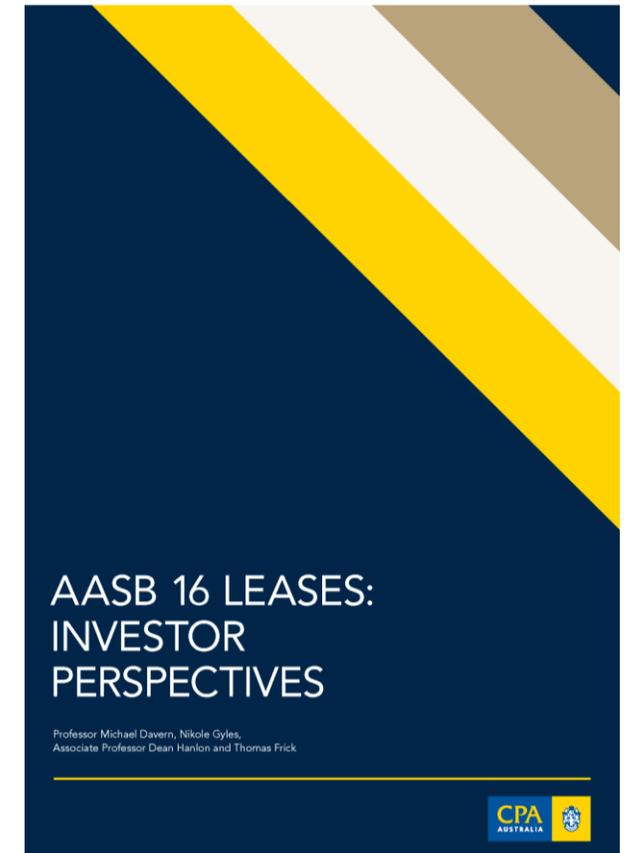
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