

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)



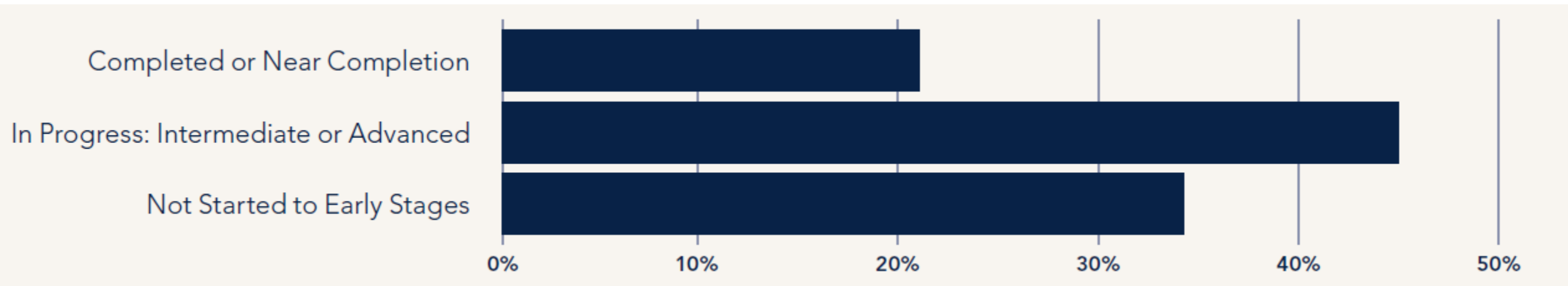
The Sample:

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

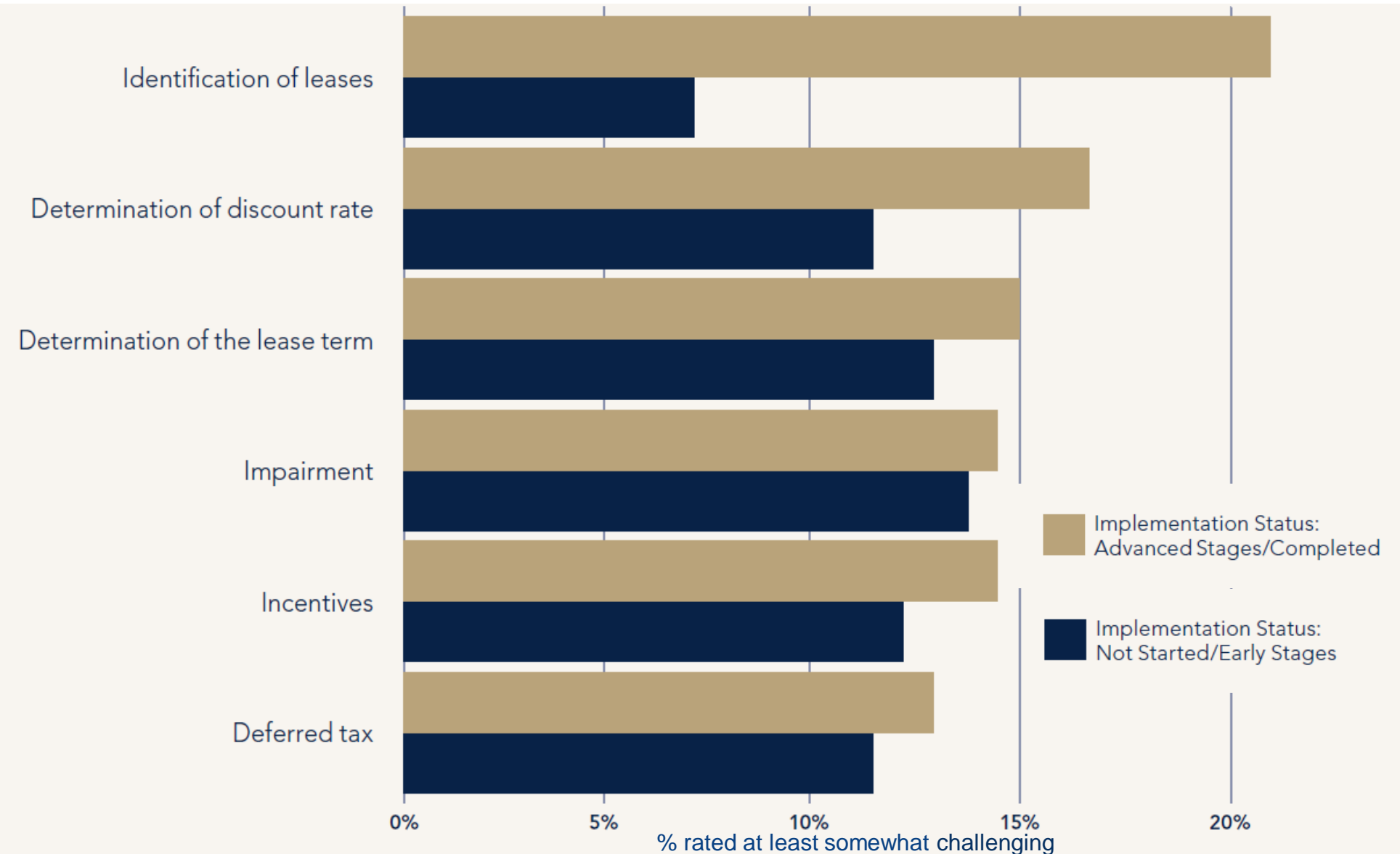
Auditors: 66.4% Big 4

Implementation Progress: (as at June/July 2019)





Key Challenges by Implementation Status:



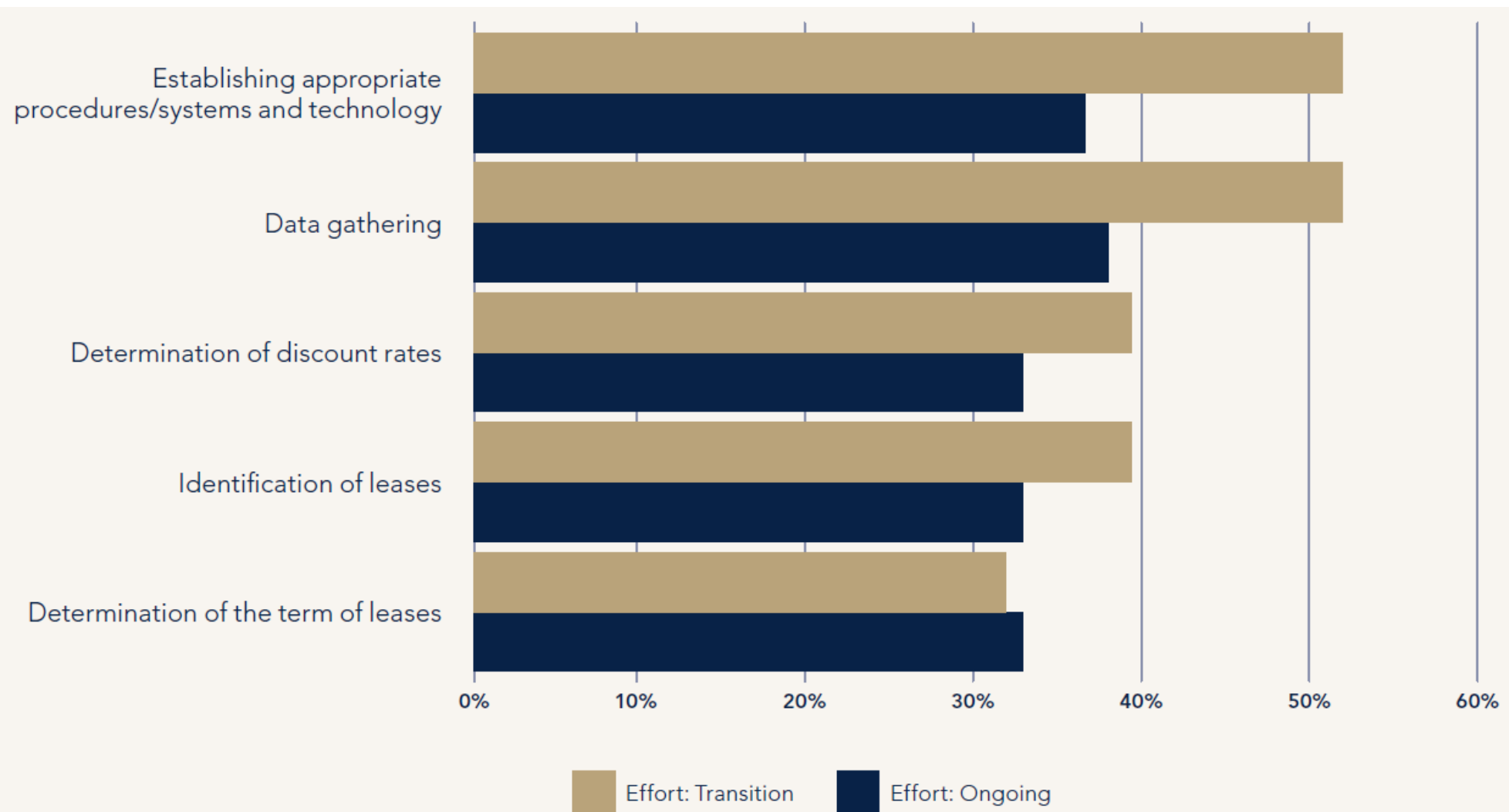
Evidently firms did not have an enterprise wide register of lease contracts => recognition vs. disclosure implications?

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.



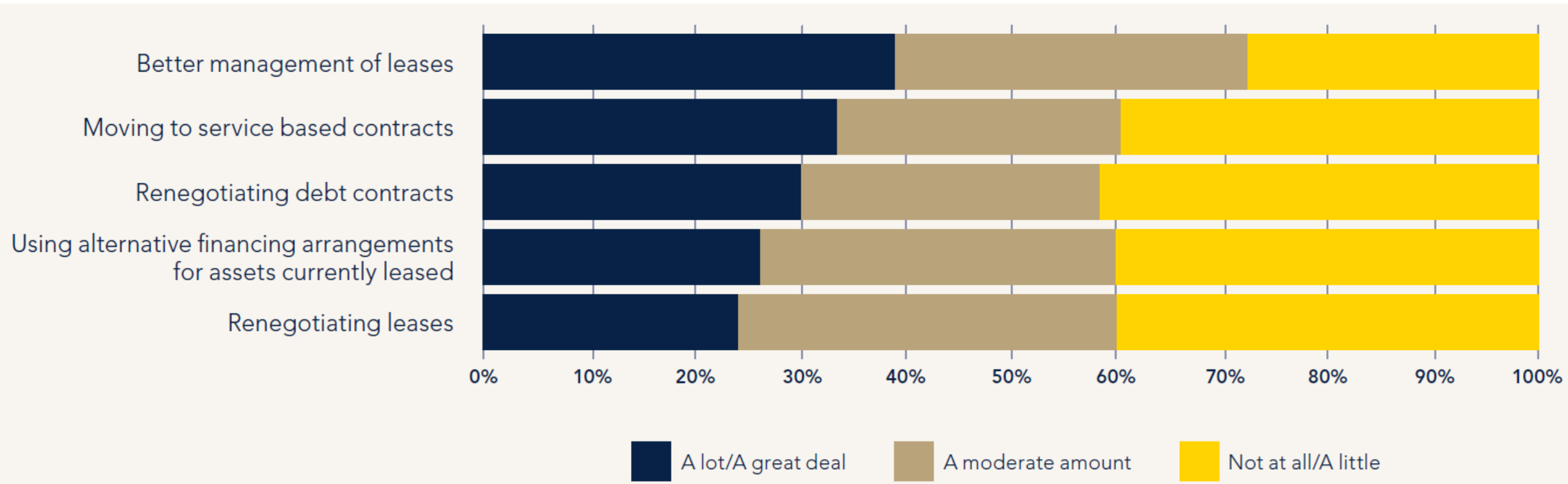
Key Claimed Benefits: A Preparer Perspective

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)

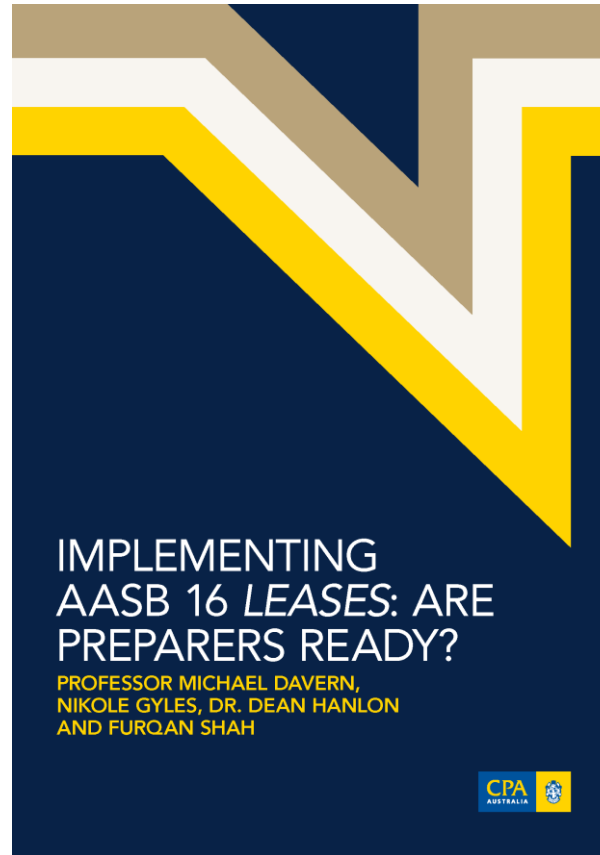


For Further Details:

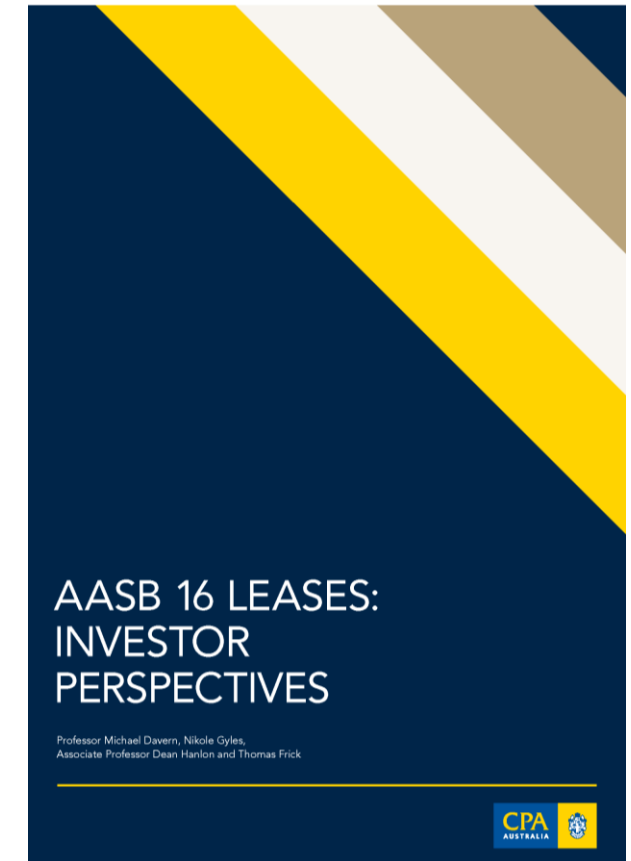
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