WELCOME

HOUSE KEEPING

- All attendees will be put on mute throughout the session
- Should participants have any questions you are encouraged to send it through Q&A and we will address them at the end of the presentation with the time remaining
- Kindly select to “All Panelists” when you are posting your questions, to avoid multiple/similar questions
- For any technical or trouble shooting questions, please direct them to the Host via the chat function

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IFRS 16… Important year-round.
Not just year end.

LAMMERT VOS – DIRECTOR: TREASURY & CAPITAL MARKETS, DELOITTE
STEFAN IGGO – CFO, QUADRENT
DAMON KENNEDY – BUSINESS DEVELOPMENT DRECTOR, QUADRENT

Tuesday 27 July 2021

Panel members

Stefan Iggo – CFO, Quadrent

Stefan is the CFO of Quadrent, an equipment Lessor. He also drives the LOIS Team (Quadrent's IFRS 16 lease accounting SaaS solution). His experience in assisting clients across a multitude of industries with their transition to IFRS 16 combined with his background in leasing allows him to have a unique perspective on the market.

Lammert Vos – Director, Treasury & Capital Markets at Deloitte Australia

Lammert leads the Quantitative Financial Risk Management and Asset Enablement offerings out of Deloitte's Assurance practice. This includes Deloitte's online IBR tool, an application which enables Deloitte's clients to accurately calculate discount rates required to fair value leasing arrangements under IFRS 16.

Damon Kennedy – Business Development Director, Quadrent

Damon has over 20 years' commercial leasing experience and has been at the forefront of industry innovations that help businesses deal with IFRS 16 compliance – specifically via LOIS.

What is an IBR?

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 (IFRS 16, *Leases*).

What organisations find challenging:

- Data accessibility
- Appropriate calculation methodology
- Dealing with corporate structure and subsidiaries
- Determining a shadow credit rating
- Alignment between *Treasury*, *Finance* and *Leasing Managers*

Quick poll

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How confident are you that your IBR is correct?

A. Extremely confident

B. Confident

C. 50/50

D. Not confident

E. Help! Not very confident

F. Not thought about it

G. What is an IBR?

Deloitte.

Why an IBR is important to lease accounting?

- The IBR is the single most important variable in IFRS 16 as it is involved in the calculation of the balance sheet and profit and loss components of lease accounting including; lease liability, ROU Asset and in turn related interest and depreciation, as these are all based on the PV calculation of lease payments.

- Under the standard an IBR can be used as the discount rate for determining the PV of the lease payments when the implicit rate is not available. Generally for “operating leases” there will not be an implicit rate.

- This rate will be used to discount future cash flows to reflect the impact of time on the remaining lease payments.

- The discount rate of a lease (and hence the IBR), needs to be reviewed at every point a modification is made which would again have an impact on all the lease accounts.

- As a result of the above, your choice of IBR can materially impact some large numbers on your balance sheet which in turn effects all stakeholders.

Why determining the correct IBR is important?

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Scrutiny and compliance requirements from regulators, auditors and investors

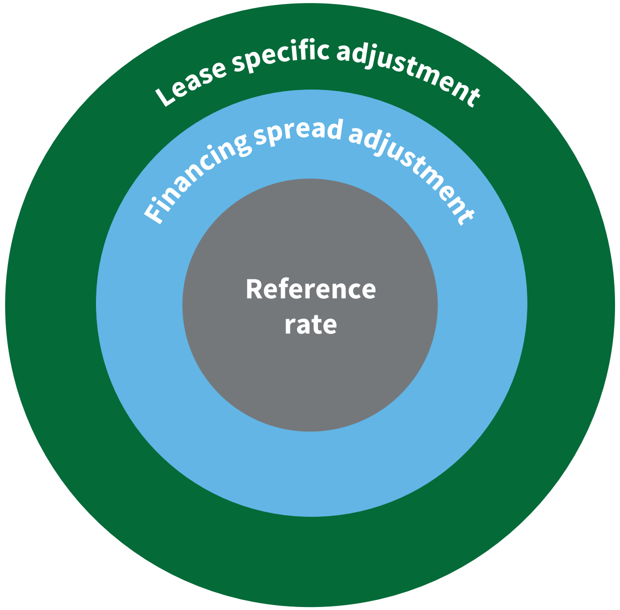
Financial impact (for the average middle market lease book, **1%** increase in IBR)

↓ Lease liability (5%)	↑ Asset turnover
↑ Interest expense (39%)	↑ Current ratio
↓ Depreciation expense (5%)	↑ EBIT
↓ Gearing/leverage	↓ Interest cover

Consistency and relevance of approach in each market the company operates

Deloitte.

How IBR is calculated



= IBR

- Property leases
- Retail leases
- Equipment and plant leases
- Advertising leases
- Marine leases

Extract: Deloitte Publication- A Guide to Incremental Borrowing Rates

Quick poll

How does your company calculate IBR?

A. We have an internal process/methodology that we use.

B. We have an external company calculating it for us.

C. We just guess it.

D. We don’t calculate IBR.

E. Don’t know/NA

Reference Rate

Determining an appropriate reference rate through the use of risk free rates (e.g. government bond yields or interest yield curves such as Bank Bill Swap Rate) is a relatively well understood and comprehensively documented process, but companies adopting IFRS 16 have to ensure they consider the factors outlined below.

Factors to consider	Issues and challenges	Possible solutions
Currency	• It is not uncommon for a lease to have cash flows denominated in a different currency to the functional currency of a lessee. • Different jurisdictions have different risk free rates and so borrowing rates can vary significantly between countries.	• Borrowings are typically matched with the currency of the cash outflows expected in order to remove foreign exchange risk. • The IBR should be the rate at which the lessee could obtain funding for the asset in the foreign currency, see following page. • For example, lease cash flows denominated in USD or GBP (or any other currency) should be matched with the appropriate risk free rates, such as those determined from US Treasury Bills or UK Gilts.
Term	• As risk free rates exist for various different durations, the chosen rate should be matched with the lease term, as defined by IFRS 16. • While a risk free rate determined from government bonds or interest rate yield curves assumes repayment of the capital at maturity, for an operating lease the repayments are typically spread over the lease period.	• The relevant duration of government bonds to consider is not the total lease term (including any extension options) but a weighted average lease term.

Extract: Deloitte Publication- A Guide to Incremental Borrowing Rates

Financing Spread Adjustment

The data available to companies to calculate their financing spread adjustment will depend on the type of organisation and the financing structures they have chosen to use. We have outlined below three examples of possible financing structures; for each debt structure there are differences in the data points available to calculate the component of the IFRS 16 discount rate.

Types of debt financing	Typical types of companies	Data points available
Multiple debt financing arrangements, including bonds, loan notes and bank facilities	Large Public Interest Entity	Multiple data points
One primary debt financing arrangement, most likely to be a bank facility	Public Interest Entity/Private Company	Single data point
No significant debt financing arrangements	Private Company	None

Extract: Deloitte Publication- A Guide to Incremental Borrowing Rates

Asset Specific Adjustment

The key requirement of IFRS 16 is that the discount rate is directly linked to the asset itself, rather than being a general incremental borrowing rate. In theory, the risk of default is mitigated for the lessor as they have the right to reclaim the underlying asset itself. With the right of use asset effectively being pledged as collateral against the risk of default, this is a secured lending arrangement.

This can be achieved with two approaches:

Loss Given Default Approach

Credit Spread = Probability of Default x Loss Given Default

Credit Notching Approach

Adjusting the credit rating of the entity to reflect the difference in security between a leasing arrangement and market borrowings curves (unsecured lending arrangements).

Updating your IBR

- All newly incepted leases must have an updated IBR or IRR (if possible) applied to them. Entities are required to update their IBR for an existing lease liability whenever there is a change in the lease terms (a modification) or if the lessee is reasonably certain they are going to exercise an option to purchase the underlying leased asset.

- Additionally, a lessee should use a revised IBR for assessing floating rate leases when there is a change to the underlying floating rate.

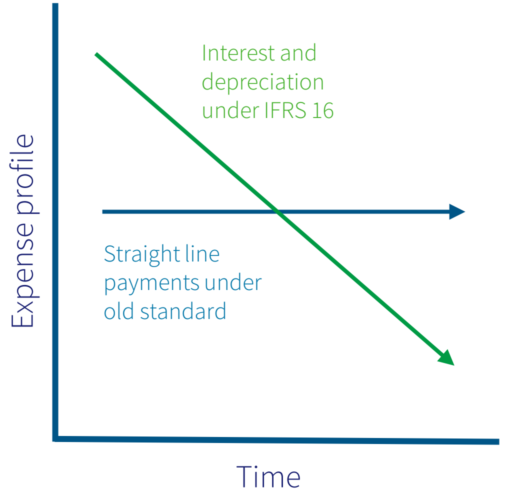
- With the 2nd full year of IFRS 16, rather than simply looking at calculations (which are low risk with a system), auditors are looking at key judgements such as IBR.

- Modifications can be a difficult calculation due to complexity, so again auditors are starting to focus on large modifications (i.e. Head office lease renewals).

The commercial impact

Balance Sheet	Income Statement	Cash flow statement
Assets and liabilities	EBITDA	Operating cash inflows
Impact on gearing	Profit profile (lower in earlier years of lease)	Financing cash outflows

- Recognise lease assets and liabilities on balance sheet.
- Initially measured at the present value of unavoidable lese payments.



- Repayment of principal finance activities
- Repayment of interest finance or operating activities (depends on accounting policy for interest).
- Some variable payments, payments for short-term leases and from assets of low value: operating activities

Quick poll

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What IFRS 16 solution does your company use?

A. Lease accounting SaaS

B. Spreadsheets

C. ERP add on

D. Big 4 managed service

E. Don’t know/NA

Deloitte.

What auditors want and how to look good…

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Is your IBR correct and how did you calculate it?

A basic question driven out of what we have discussed today for the auditors but it is the impact that the answer may drive that your boss will be interested in.

How would an increase or decrease of your IBR effect your:

a) Balance Sheet

b) Debt Ratios

This has ramifications on your funding lines, banking covenants, credit ratings and strategic decision making.

Let's look at your modifications and please explain what you have done.

- Make sure you understand all the large modifications, the inputs and the judgement.
- Having a system makes the calculation question(s) go away and it frees up time.

Are you using leasing correctly?

- Are you running your current leases efficiently?
- Are you opening up yourselves to unnecessary risk through spreadsheets and mis-calculations?

Deloitte.

Help or advice

Questions, queries, help, advice?

If you have questions please feel free to direct them to our panel members directly via the link below or their emails;

Stefan Iggo – CFO, Quadrent
stefan.iggo@quadrent.co.nz or connect on

For more information go to: www.quadrent.com.au/lois

Lammert Vos – Director, Treasury & Capital Markets at Deloitte Australia
lamvos@deloitte.com.au or connect on

For more information go to: https://ibr.deloitte.com/

QUESTIONS

Are there any questions or clarification on today's subject matter?

NB: Quadrent will be putting together all the answers to these questions in one place here for you to review, by Wednesday lunch time.

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