

IFRS 16 at a glance: A brief overview of the new standard



IFRS 16 AT A GLANCE

As the biggest change to lease accounting in 30 years, IFRS 16 revolutionises the way leases are accounted for.

The new standards bring greater clarity and comparability of companies’ financial statements by recognising all assets and liabilities arising from leases on balance sheet.

Under current IAS 17, operating leases are not required to feature ‘on balance sheet’, requiring investors to make adjustments often over-estimating financial reality.

As of 1st January 2019, IAS 17 will be replaced by IFRS 16.

IFRS 16 AT A GLANCE	
What is happening	All leases will be included on balance sheet, excluding short term leases and small ticket assets. This standard replaces IAS 17.
Who will be affected	All companies that lease assets; approximately 1 in 2 listed companies.
What will be affected	Gearing ratio, current ratio, asset turnover, interest cover, EBIT, EBITA, EBITAR, operating profit, net income, EPS, ROCE, ROE and operating cash flows
Implementation Deadline	1st January 2019 + retrospective reports Early adoption available alongside IFRS 15 ‘Revenue from Contracts with Customers’
Immediate Implications	An estimated US\$2.8 Trillion of lease commitments will come on to balance sheet affecting assets, liabilities, depreciation and cash flow. Entities need to gather and review all active leases in order to produce required reports.
Main Changes	<ul style="list-style-type: none"> Leases will no longer be categorised based on risk and reward, but rather on who controls the ROU asset. Definition of a lease may result in agreements formerly known as leases to be defined as services; and vice versa. Changes to cash flow presentation, measurements of lease liabilities and recognition of lease expenses. New guidance for lease variants including sale and leaseback and subleases. Retrospective reporting will require lessees to review all leases; although transition reliefs are available.

Main changes:

- Operating and finance leases will effectively cease to exist as all leases will be accounted for “on balance sheet”.
- New standard will impact a company's asset turnover, interest cover, EBIT(A/AR), operating profit, net income, cash flows and financial rations, among others.
- Short term leases and small ticket assets will be exempt from balance sheet reporting
- This new standard will replace IAS 17, however, lessor accounting remains mainly unchanged.
- The IASB estimate that 1 in 2 listed companies will be affected.
- The new standard will be effective from January 1st 2019. Some lessees will need to produce comparative balance sheet and P&L reports for financial years before this date.
- Early adoption is available, but only alongside IFRSS 15 ‘Revenue from Contracts with Customers’
- IASB has provided transition reliefs to reduce financial burdens.

THE DEFINITION OF A LEASE

As all leases will be accounted for “on balance sheet”, leases will no longer be classified as operating lease or finance lease as they currently are under IAS 17. Instead of being based on risk and reward, the classification of leases will focus on control of the right of use asset; namely the difference between a lease and a service.

In order to provide greater clarity on the definition of a lease vs. service, IFRS 16 states a lease as: ‘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’.

A lease exists when a customer controls the right to use an identified item, which is when the customer:

- has exclusive use of the item for a period of time; and
- can decide how to use it.

It is expected that agreements that were formerly considered leases under IAS 17 may no longer meet the IFRS 16 specification and vice versa.

TRANSITION RELIEFS

To reduce the costs and operational demands of this transition, IFRS 16 includes exceptions and modifications. IFRS 16 will introduce an estimated US\$2.8 trillion of lease commitments to global balance sheets, but will not include all leases as entities are not required to report:

- Short term leases that span 12 months or less
- Small ticket asset leases that are;
 - o not dependent on, or highly interrelated with, other leased assets
 - o within the suggested threshold of roughly \$5,000 as the value of the underlying asset when new.

The most complex aspect of this transition is the small window where lessees must account for leases that are currently using IAS 17 and extend into the implementation of IFRS 16. Lessees will need to produce retrospective reports for these agreements in order to provide a clear comparison of how their balance sheets have changed and ensure continued compliance.

They have two options:

- **Modified Retrospective approach**
This method allows entities to account for leases using IFRS 16 from a chosen date of initial application (DIA). This removes the need for comparative reports and republication of previous financial statements. However, this will likely result in less accurate financial statements and require more explanations alongside the modified figures.
- **Fully Retrospective approach**
This method requires entities to account for leases as if IFRS 16 had always been effect from lease inception. Although this requires more historic lease data, it will produce more accurate figures and does not require as many allowances and explanations as the modified approach.

LEASE ANALYSIS

Entities will be required to review their current active lease portfolio in order to begin their impact analysis. This process of lease collection and review has been highlighted as one of the biggest concerns amongst leading accountancy professionals. Although the IASB have provided reliefs to limit the time and cost burdens of this process, companies will most likely still be required to collect information on all their leases to identify the extent of which they will be affected and which reliefs would suit their leasing activity.

It is expected that this data review process will provide collateral benefits in long term lease management and optimisation as businesses gain a clearer visualisation of their lease expenses, lease records, audits and savings opportunities. Once identified, these can lead to better managerial decision making and cost savings, potentially providing a return on investment on the costs required to comply IFRS 16.

For more information on how to drive ROI and reduce the costs of the transition to IFRS 16 and to find out how your business will be affected:

[TALK TO A LEASING EXPERT HERE](#)

T: +44 (0) 20 7283 9422 W: www.innervision.co.uk
E: info@innervision.co.uk