The Advantages that IFRS 16 Brings to the Economic Environment

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Abstract

The International Accounting Standards Board issued in January 2016 IFRS 16 Standard "Lease Contracts" that will replace IAS 17, the current Standard on "Lease Contracts". The application of IFRS 16 is mandatory beginning with January 2019.

This standard evaluates all leasing commitments (financial or operational) as a possibility of the right to use all leased assets with the cost of the subsequent payments (leasing debt). Exception of the rule is made for low value goods or those goods that are leased for a period equal to or less than 12 months. The right of use and lease liability will be recorded in the balance sheet of the lessee applying IFRS, regardless the category of the lease financial or operational.

Key words: IFRS 16"Leases", Costs, Implementation effects;
J.E.L. classification: M41

1. Introduction

The Leasing is a service with a long history on international market, as well as in all European countries, being used by the most economic agents. According to Taylor (2011), the leasing is the largest foreign source of financing in America, higher than bank loans or commercial mortgages.

From the etymological point of view, the term leasing comes from French, related to the word "lease", which derives from the verb "laise" that came from the verb laisser, meaning "let" or "let go". Regarding this explanation, the American system began to use the contract called "lease" in order to designate the hiring of assets.

Lease Contracts have emerged as a new way of financing being seen as alternative source of financing for traditional methods. Leasing is used in all business sectors, providing support to businesses that want to acquire fixed assets but do not have financial liquidities. By leasing, the investment activity is carried out by companies that transfer their right of use of a good to physical or legal persons, on the basis of a contract, against a periodic payment.

IFRS 16 is the International Accounting Standard that replaces the existing lease model that was centered on IAS 17. IFRS 16 defines a lease as a contract that transfers to the customer (lessee) the right to use an asset on for a while, in exchange of a payment. The reason for adopting this new standard came from the desire to make a most accurate presentation of the rented property by the lessee regarding the registration in both sides: the right of use of the rented property (active) and the obligations arising from rental (liabilities).

The objective of IFRS 16 is to report information that:

• Represents the leasing transactions in a relevant manner;

• Provides for the users of financial statements a basis to assess the value of treasury flows produced by leasing contacts.

The purpose of this article is to provide a presentation of the new IFRS 16 by making a comparison between IAS 17 and IFRS 16, describing the main consequences that arise from its application. According to reports issued by (IASB, 2016a), listed companies applying IFRS or USGAAP did not have about $ 3300 billion in their balance sheet in 2014. These absentees on leasing contracts have led to erroneous pictures that investors or stakeholders have had about the financial position of an enterprise, failing to make a clear delimitation between the borrowing companies that buy assets from those that rent assets without adjustments.

2. Research methodology

In order to present the impact of the new international financial reporting standards (IFRS 16), an analysis related to the implementation costs was made and also a comparison between IAS 17 and IFRS 16. To achieve this purpose, a qualitative research was done by analyzing especially the IASB reports.

3. Results

3.1. Implementation costs

According to IASB, 2016, implementation costs can be met by those companies that have material values in the balance. The IASB does not provide increased costs for the leasing types defined as financial leases regarding IFRS16, as there have been no significant changes compared to IAS17

Among the costs that IASB has identified in the implementation of IFRS 16 are:
a) Costs related to the creation of new systems and processes for the new leasing model;
b) Costs due to the calculation of the discount rate;
c) Costs in terms of staff training;

Other issues that affect the cost of deploying IFRS 16 are given by the number of lease contracts in the company, as well as by the existing systems that take into account leases.

In the table below, you can see the impact of the characteristics of the leasing according to IFRS 16.

Table no. 1: Characteristics IAS17 – IFRS 16

Characteristics	**Required to apply IAS 17**	**Required to apply IFRS 16**	**Cost to apply IFRS 16**
Lease`s classification	Yes	No	Reduction in costs
Inventory of leases (the differences between the leases`s components)	Yes	Yes	No additional costs
Terms, conditions and lease payments for each contract	Yes	Yes	No additional costs
Discount rate	No – for operating leases Yes – for finance leases	Yes	Additional costs for former off balance sheet leases only
Initial direct costs	No – for operating leases Yes – for finance leases	Yes	Additional costs for former off balance sheet leases only
Revised contractual payments when a lease contains inflation-linked payments	Yes	Yes	Additional costs

Source: Author`s proccessing

3.2. Comparison between IFRS 16 – IAS17

One of the most important changes resulting from the application of IFRS 16, compared with IAS 17, is linked to the new accounting model which is applied by the tenants. Morales-Diaz & Zamora-Ramirez (2018) argue that there are many sectors of activity such as: Retail Sales (property leasing), Airlines (aircraft leasing), Hotels (hotel rentals), Telecommunications (networks and other goods) which have a large volume of operational leasing contracts that aren`t recognized in the balance sheet.

Table no. 2: Differences IAS17-IFRS 16

Diferences	**IAS 17**	**IFRS 16**
Finance lease	Certain criteria must be accomplished to be considered as financial leasing; such as substantially transfer of risks and rewards	IFRS 16 introduces a single accounting model for all leases with a term of more than 1 year, to recognize assets (right-of-use) and liabilities. The exception are the low-value assets.
Operating lease	Does not met any of the criteria for finance lease	For lessee: There's not concept of operating lease, however lessee may choose to expense out item of low value and lease with a term of less that 1 year. For lessor: Lease is recognized as operating lease if the recognition criteria for finance lease is not met.

Source: Author`s proccessing

According to IFRS 16, a new single lessee model is introduced and demands to the tenants to present their assets and liabilities for all leasing contracts, which are over a period of more than 12 months. The except from this rule, is represented by the low value assets, such as: laptops, tablets and smart phones.

The leasing rate is thus, presented at the updated value of future leasing payments in accordance with the duration of the leasing contract. The right of use will be calculated totaling all the initial costs of the lessee and all the anticipated payments made to the locator, etc. In order to analyze the subsequent value of the leasing debt, the company should calculate with the upgrade rate the interest related to the leasing period, and reduce the payment debt with the value of the payments made.

The concepts that the new model brings into discussion and which may affect the presentation of the asset and the passive are represented by the leasing term and the update rate.

The leasing term represents an estimate of the due leasing period which provide the possibility to exercise cancellation or extension options (if exercise is "reasonably safe"). This is the reason why, there are certain situations where the use of minimum leasing payments established in accordance with IAS 17 is not valid to help estimate future leasing payments in accordance with IFRS 16. If a change in the term of leasing occurs during the contract, the entity must register a reduction linked to the new cash flow (taking into account the new term), based on the use of the updated rate.

The update rate is the interest rate set in the leasing contract. If the interest rate on the leasing contract can not be determined, the tenants should use the incremental rate. This is the rate at which the lessee would receive a loan for the purchase of the rented asset, taking into account various aspects, such as: lessee's credit quality or leasing term.

3.3. Estimated results of IFRS 16 implementation

The first effect will be the recognition of the rights of use and the debt of the leasing contract in the lessee's balance sheet. It expects to have a significant impact for companies with material off balance sheet leases.

Also, the tenant's profit and loss should contain the depreciation of the rights of use and the interest applied to the leasing contract. This means that instead of a leasing payment according to IAS 17, the cost of leasing contracts will be recognized, according to IFRS 16, through a linear depreciation and a degresiva interest in time.

Another effect will be that the new standard will have a positive impact on the EBITDA financial indicator (Earnings before interest, taxes, depreciation and amortization). The new accounting method, which involves the registration of a depreciation and interest instead of current general expenses, will mechanically improve this financial indicator. Finally, the costs will be the same during the contracts, but their registration will be different in time due to the gradual decrease in interest expenses. In addition to this inconvenience it should be noted that all the benefits of long-term leasing operations will remain the same.

The benefits that IFRS 16 produces are:

- The quality of financial statements for companies recording off-balance sheet leasing contracts will increase.

- The comparability of the financial statements will improve.

With a better recognition of assets and liabilities in the balance sheet, a more transparent image of the company is presented. On this basis, investors or stakeholders can evaluate in a qualitative way the position and the financial performance of a company. This is due to the fact that a complete picture of assets controlled and used by a tenant is created for his activity.

Improving comparability is based on recognizing assets and liabilities for all leases, assessing them in a similar manner and recognizing only acquired rights and obligations arising from the lease.

4. Conclusions

For many companies, leasing plays a key role in their business operations. However, the most leasing transactions (e.g. rental contracts) are off-balance today and according to the current standard IAS 17 do not require a significantly effort.

The new standard will require to a company to do more than simply converting the operational leasing with the new model of leases for showing the assets and liabilities. Its implementation could result in changes in the policies, processes, controls and computer systems that support the accounting leasing and eventually leasing and tax administration. Companies may also want to take into account the implication for financial statements. These activities will require the involvement of a variety of departments within the company.

According to IASB, 2016 companies that will be most affected by IFRS 16 will be from the field of air transport and retail trade.

5. References

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