

Aspects of Some Changes Regarding the Application of IFRS 16

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Abstract

As of January 1, 2019, economic entities that use as the basis the international financial reporting standards (IFRS) must apply IFRS 16 for the accounting of leasing contracts. This standard brings major changes to the accounting of the leasing contracts to the lessee. IFRS 16 standard simplifies the IAS 17 standard in which both the financial and operational leasing were provided. The lease will be operated only financially, respectively in the financial situation of the lessee. This standard has the following consequences: the value of the assets and liabilities will increase, the profit or loss will no longer be distributed linearly, which leads to the depreciation of the right of use and the financial cost depending on the payment conditions, the duration of the contract and of course, the depreciation method. of the right to use the asset, exemplified by the study carried out at an economic entity. This change has a significant impact because the market value of the invested capital will increase.

Key words: leasing contract, financial situation, financial leasing, loan value

J.E.L. classification: M40, M41, M68

1. Introduction

The International Accounting Standards Board (IASB) issued in January 2016 the IFRS 16 standard, regarding the accounting treatment of leasing contracts. IFRS 16 has replaced, starting with the year 2019, the current IAS 17. The main modification is that IFRS 16 provides for the User a single accounting treatment of the leasing contracts, eliminating the current “Operational Leasing” type registration.

Thus, for any leasing contract, the User will register assets ("right - of - use assets") and financial obligations to make future payments for leasing - similar to the current Financial Leasing. Exceptions in the case of small assets are expected in the case of short-term leasing contracts. The legislation refers to those contracts where the expiration period is less than one year. The application of IFRS 16 will require major changes in the financial statements of the user regarding the contracts that currently use the operational leasing by eliminating the off-balance sheet registration of these contracts as well as the recognition in the balance sheet and in the profit and loss account of the impairment of the assets in the new contracts.; dividing and treating separately the three components of the amounts that would currently be treated as a simple Operational Leasing cost in the profit and loss account, respectively: Principal (loan), Interest and, respectively, non-leasing Services elements ; re-processing the accounting of the Operational Leasing contracts active at the date of the transition to IFRS 16: bringing these amounts in the balance sheet, by identifying the components of Interest, Principal and other services that are not Leasing in nature.

2. Literature review

Over time, there has been more research into the accounting treatment of leases. The researchers analyzed the consequences of the impact of the value not recorded in the leasing contracts, the financial position and the financial reports of the companies.

Some authors consider that unregistered operating leases are important in terms of the profitability standard of economic agents. It is affected by the operating profit and the net profit as a result of the operational leasing contract capitalization having a significant impact on the company's revenues.

In England, in 1993, a study was conducted in which several companies listed on the stock exchange on the impact of the decapitalized operating rent were analyzed. The results of the study showed that the long-term liabilities are 6 times higher than the short-term assets, which leads to major changes in the profit margin ratio and the turnover, respectively the services sector.

Some specialists have researched the lease agreement from the point of view of liquidity and the tenant, regarding the rate of fixed assets, liquidity, profitability ratios, etc. The result was a negative and isolating one because the companies did not offer concrete answers.

In New Zealand, a study was conducted in which 38 economic entities listed on the stock exchange were analyzed and the impact of the valuations from the leasing contracts was analyzed. The result was the following: there will be an increase of liabilities by about 23%, a decrease in profitability of about 15% and an increase of about 11% of the total assets / total liabilities ratio.

Some researchers in England have analyzed the impact of the operational lease on the tenant's balance sheet. The consequence of this rent is that the situation of unrecorded liabilities is about 4 times greater than the one presented in the balance sheet, which leads to the decrease of the profit and implicitly of the taxes.

Some American studies have shown that unregistered rent represents about 30% of average reported debts and larger assets, and about 40% of reported assets.

In Stockholm, 60 companies listed on the stock exchange were analyzed regarding the way of exploiting the operational leasing at these companies. They have established that there is no negative relationship between equity and profitability, the profit margin of the company.

3. IFRS 16 treatment before modification

The (complete) approach (P. C5 (a)) consists of applying the retroactive standard, at each reporting period, applying IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". The main elements are:

- the values of the assets held in the lease and of the debts related to the lease are calculated retroactively, as if IFRS 16 would always have been applied;
- in the current financial statements, the Comparative Data of the previous periods are presented, resulting from the retroactive calculation.
- an adjustment is recorded (probably in the "Reported Result") in the "oldest" period presented (example: the adjustment is recorded on January 1, 2018 and the data thus adjusted for 2018 will be comparative data for 2019, the year of initial application of IFRS 16 .

The retroactive calculation of the values of the elements of the lease is made on the basis of the interest rate involved in the lease. However, since, in general, this rate is not known for operating leases, the effective interest rate is used, this is the interest rate that the Lessor would have incurred at the date of the contract's start, if they had financed the purchase on the market of the good leased.

IFRS 16 treatment after modification

The modified approach (P. C5 (b)) consists of the retroactive application of IFRS 16, with the registration of the results only at the date of first application of the standard. This approach allows simplifications, the most important being the following:

- the comparative data for the completed reports are not retroactively restored. At the date of transition, the Lessee will record the adjustments resulting in "Retained earnings".
- at the date of the first application of IFRS 16, the current values of the outstanding lease payments are calculated by the lessee applying a discount rate equal to the lease rate.
- Initially IAS 16 applied the value of the rented property from the beginning of the contract using a discount rate equal to the interest rate for the tenant and is calculated in the tenant's accounting. Establishing the remaining value of the asset as equal to the value of the lease debts, adjusted with the leasing payments made in advance.

I will make an example, put into practice, regarding the transition to IFRS 16 an operational lease that runs from the beginning of the year, January 1, 2019.

I present the following example:

Company X has an operational leasing agreement classified according to IAS 17. The contract stipulates the payment by the tenant of the amount of RON 100,000 annually, representing rent for a machine. The contract period is 10 years starting with 2014 and the rent is paid at the end of each year. The interest rate at the contract was at the date of the conclusion of 8%, and by applying IFRS 16 it decreased to 6%

At the date of transition to IFRS 16 (January 1, 2019) and thereafter, Company L carries out the following:

1. Leasing debt calculation, using the interest rate at the transition date (6%):

Annual rate (RON)	100,000
Discount rate	6 %
Periods (years)	5

PERIOD	(1)	(2)	(3)	(4)	(5)	TOTAL
	2019	2020	2021	2022	2023	
Leasing rate	100,000	100,000	100,000	100,000	100,000	500,000
Present value	94,340	89,000	83,962	79,209	74,726	421,236

2. Preparation of the leasing rates maturity for subsequent registrations, comprising dividing the leasing rates in the Loan and Interest Rate

Table no. 1 Leasing rates due

Period	Loan value	Loan rate	Interest rate	The payment
December 2018	421,236			
January 2019	415,347	5,890	2,444	8,333
February 2019	409,423	5,924	2,410	8,333
March 2019	403,465	5,958	2,375	8,333
April 2019	397,472	5,993	2,341	8,333
May 2019	391,445	6,028	2,306	8,333
June 2019	385,382	6,062	2,271	8,333
July 2019	379,284	6,098	2,236	8,333
August 2019	373,151	6,133	2,200	8,333
September 2019	366,983	6,169	2,165	8,333
October 2019	360,778	6,204	2,129	8,333
November 2019	354,538	6,240	2,093	8,333
December 2019	348,261	6,277	2,057	8,333
TOTAL		72,975	27,025	100,000
January 2020	341,948	6,313	2,020	8,333
February 2020	335,599	6,350	1,984	8,333
March 2020	329,212	6,386	1,947	8,333
April 2020	322,789	6,423	1,910	8,333
May 2020	316,328	6,461	1,873	8,333
June 2020	309,830	6,498	1,835	8,333
July 2020	303,294	6,536	1,797	8,333
August 2020	296,720	6,574	1,759	8,333

September 2020	290,108	6,612	1,721	8,333
October 2020	283,458	6,650	1,683	8,333
November 2020	276,769	6,689	1,644	8,333
December 2020	270,041	6,728	1,606	8,333
TOTAL		78,220	21,780	100,000
January 2021	263,274	6,767	1,567	8,333
February 2021	256,468	6,806	1,527	8,333
March 2021	249,623	6,845	1,488	8,333
April 2021	242,738	6,885	1,448	8,333
May 2021	235,813	6,925	1,408	8,333
June 2021	228,847	6,965	1,368	8,333
July 2021	221,841	7,006	1,328	8,333
August 2021	214,795	7,046	1,287	8,333
September 2021	207,708	7,087	1,246	8,333
October 2021	200,579	7,128	1,205	8,333
November 2021	193,410	7,170	1,164	8,333
December 2021	186,198	7,211	1,122	8,333
TOTAL		83,843	16,156	100,000
January 2022	178,945	7,253	1,080	8,333
February 2022	171,650	7,295	1,038	8,333
March 2022	164,312	7,338	996	8,333
April 2022	156,932	7,380	953	8,333
May 2022	149,509	7,423	910	8,333
June 2022	142,043	7,466	867	8,333
July 2022	134,534	7,509	824	8,333
August 2022	126,981	7,553	780	8,333
September 2022	119,385	7,597	737	8,333
October 2022	111,744	7,641	693	8,333
November 2022	104,059	7,685	648	8,333
December 2022	96,329	7,730	604	8,333
TOTAL		89,869	10,131	100,000
January 2023	88,555	7,775	559	8,333
February 2023	80,735	7,820	514	8,333
March 2023	72,870	7,865	468	8,333
Aprilie 2023	64,959	7,911	423	8,333
May 2023	57,003	7,956	377	8,333
June 2023	49,000	8,003	331	8,333
July 2023	40,951	8,049	284	8,333
August 2023	32,855	8,096	238	8,333
September 2023	24,713	8,143	191	8,333
October 2023	16,523	8,190	143	8,333
November023	8,285	8,237	96	8,333
December 2023	0	8,285	48	8,333
TOTAL		96,329	3,671	100,000

Source: own processing

3. Calculation of the value of the leased asset

Annual payments	100,000										
Discount rate	6%										
Total period (years)	10										
Period	1	2	3	4	5	6	7	8	9	10	TOTAL
Present value	93,340	89,000	83,962	79,209	74,726	70,596	66,506	62,741	59,190	55,839	736,009

RON:

Period	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
The initial value of the asset	736,009	662,408	588,807	515,206	441,605	368,004	294,403	220,803	147,202	73,601
Amortisation	73,601	73,601	73,601	73,601	73,601	73,601	73,601	73,601	73,601	73,601
The remaining value of the asset	662,408	588,807	515,206	441,605	368,004	294,403	220,803	147,202	73,601	0

Option 1: using discount rate at the date of transition, according to IFRS 16 - C8 (b) (i):

a) The rental contract is registered at the date of transition
Debt 2131: 368,004, Debt 1176: 53,232 Credit 167: 421,236, alternatively if IFRS 16- C8 (b) is applied, the following is recorded: Debt 2131: 421,236 Credit 167: 421,236

b) Registration of depreciation of the good in leasing in case of application of IFRS 16-C8 (b) (i)

	January 2019	2019	2020	2021	2022	2023	TOTAL
Debt: 6811	6,133	73,601	73,601	73,601	73,601	73,601	368,004
Credit : 7,021	6,133	73,601	73,601	73,601	73,601	73,601	

c) Registration of the leasing invoices from the supplier, from the date of the transaction until the end of the contract:

	2019	2020	2021	2022	2023	TOTAL
Debt 167 :	72,975	78,220	83,843	89,869	96,329	421,236
Debt 666:	27,025	21,780	16,157	10,131	3,671	78,764
Debt 4426:	19,000	19,000	19,000	19,000	19,000	95,000
Credit 404:	119,000	119,000	119,000	119,000	119,000	595,000

d) Registration of payments to the supplier:

	2019	2020	2021	2022	2023	TOTAL
Debt: 404	119,000	119,000	119,000	119,000	119,000	595,000
Credit : 5121	119,000	119,000	119,000	119,000	119,000	595,000

As IFRS 16 does not provide for changes in interpretation, substance or accounting treatment for the lessor in the case of Operational Leasing, it is assumed that the Lessor will continue to issue a single invoice, for rent, with VAT applied to the entire amount.

Option 2: according to IFRS 16 - C8 (b) (ii): at the date of the transaction, the value of the asset is considered to be equal to the value of the lease debts, RON 421.236, according to the calculation from item 1. Annual depreciation for the future will be $421,236 / 5 = 84,247$

It is observed that applying to option 2 reduces an overestimation of the values of the data transition asset (421,236 against RON 368,004), at the same time with the subsequent depreciation overvaluation. The method presents, however, the advantages of eliminating the calculation of the values of the right to use the asset, based on the reduction rate and reduces the compensation of adjustments through the "Reported Result", because it can fine-tune our assets for the dissemination of the lease debt.

4. Conclusions

The IFRS 16 standard simplifies the IAS 17 standard in which both the financial and operational leases were provided. The lease will be operated only financially, respectively in the financial situation of the tenant. This standard has the following consequences: the value of the assets and liabilities will increase, the profit or loss will no longer be distributed linearly, which leads to the depreciation of the right of use and the financial cost depending on the payment conditions, the duration of the contract and of course, the depreciation method. of the right to use the asset and the default interest rate or the marginal interest rate. Although the total net cash flow, in the case of cash flows, will not be influenced the value of the net cash flow related to the operating activities will increase, while the net cash flow generated by the financing activities will decrease by the same amount. The financial statements show a change in values will influence the financial indicators determined based on them.

Thus, debt, current liquidity and turnover rate of assets will decrease, while profitability indicators EBITDA and EBIT will increase. Regarding the influence on the net result, it will they are influenced by the depreciation of the right to use the asset, the effective interest rate of the contract, the marginal debt rate, the duration of the contract, etc.

IFRS will have a significant impact as it will involve identifying all leasing quotas and extracting leasing data, changing key financial indicators, volatility of balance sheet items, changes in contractual terms and how the business is conducted. Greater attention will be needed when evaluating business, investments in other companies in order not to underestimate or over-evaluate. Regarding the impact of applying IFRS 16 the invested capital will increase, and the market value of the capital remains the same, which leads to a balance in the evaluation of the business.

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