
In brief

A look at current financial reporting issues

13 January 2016

It's finally here – the IASB publishes a new standard on lease accounting!

Issue

On 13 January 2016, the International Accounting Standards Board (IASB) finished its long-standing project on lease accounting and published IFRS 16, 'Leases', which replaces the current guidance in IAS 17. This will require far-reaching changes in accounting by lessees in particular.

The standard applies to annual periods beginning on or after 1 January 2019, with earlier application permitted if IFRS 15, 'Revenue from Contracts with Customers', is also applied.

Key provisions

Under IAS 17, lessees were required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now requires lessees to recognise a lease liability reflecting future lease payments and a 'right-of-use asset' for virtually all lease contracts. The IASB has included an optional exemption for certain short-term leases and leases of low-value assets; however, this exemption can only be applied by lessees.

For lessors, the accounting stays almost the same. However, as the IASB has updated the guidance on the definition of a lease (as well as the guidance on the combination and separation of contracts), lessors will also be affected by the new standard. At the very least, the new accounting model for lessees is expected to impact negotiations between lessors and lessees.

Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Impact

IFRS 16 is likely to have a significant impact on the financial statements of a number of lessees.

Statement of financial position

The new standard will affect both the balance sheet and related ratios, such as debt/equity ratios. Depending on the particular industry and the number of lease contracts previously classified as operating leases under IAS 17, the new approach will result in a significant increase in debt on the balance sheet.

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Statement of comprehensive income

Lessees will have to present interest expense on the lease liability and depreciation on the right-of-use asset in their income statement. In comparison with operating leases under IAS 17, this will change not only the allocation of expenses but also the total amount of expenses recognised for each period of the lease term. The combination of a straight-line depreciation of the right-of-use asset and the effective interest rate method applied to the lease liability will result in a higher total charge to profit or loss in the initial years of the lease, and decreasing expenses during the latter part of the lease term.

Statement of cash flows

The new guidance will also change the cash flow statement, because lease payments that relate to contracts that have previously been classified as operating leases are no longer presented as operating cash flows in full. Only the part of the lease payments that reflects interest on the lease liability can be presented as an operating cash flow (if it is the entity's policy to present interest payments as operating cash flows). Cash payments for the principal portion of the lease liability are classified within financing activities. Payments for short-term leases, for leases of low-value assets and variable lease payments not included in the measurement of the lease liability are presented within operating activities.

Transition

IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted, but only in conjunction with IFRS 15, 'Revenue from Contracts with Customers'. In order to facilitate transition, entities can choose a 'simplified approach' that includes certain reliefs related to the measurement of the right-of-use asset and the lease liability, rather than full retrospective application; furthermore, the 'simplified approach' does not require a restatement of comparatives. In addition, as a practical expedient entities are not required to reassess whether a contract is, or contains, a lease at the date of initial application (i.e. such contracts are "grandfathered").

Insight

Start preparing now

Entities should ensure that they have implemented systems and processes to identify all lease contracts, to capture the information needed to determine the measurement of the right-of-use asset and the lease liability, and to prepare the new disclosures.

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