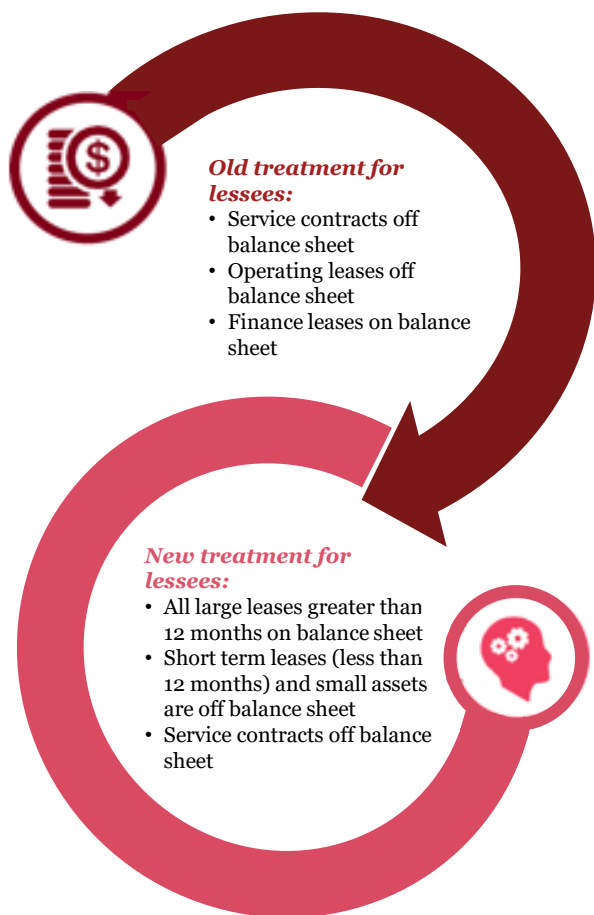


IFRS 16 Leases The new standard is ready, are you?

Leasing is an important financial solution used by many organisations. It enables companies to use property, plant, and equipment without needing to incur large initial cash outflows. Under existing rules, lessees generally account for lease transactions either as off-balance sheet operating or as on balance sheet finance leases. The new standard requires lessees to recognise nearly all leases on the balance sheet.



What's the issue?



Why is it an issue?

General

- Adoption from 1 January 2019
- Companies with operating leases affected
- Leases greater than 12 months on balance sheet
- Exemption for small asset leases
- Different to US GAAP proposals for leases

Accounting and financial

- Financial statements:
 - Change in profit and loss timing and expense recognition pattern (depreciation and interest instead of rental expense)
 - Balance sheet gross-up
 - Measurement changes
 - Change in cash flow presentation
 - Extensive disclosures
 - Transition – practical expedients exist (consider financial and practical impacts)
- Most key ratios and metrics reset:
 - Gearing/leverage EBITDA/EBIT
 - Return on equity/ROCE
 - EPS/Net income
 - Operating and financing cash flows

Main type of leases impacted

- Real estate
- Vehicle (cars, trains, aircraft, trucks, ships)
- Plant and equipment

Cross-functional impacts

- Treasury (debt covenants and credit rating)
- HR (remuneration and bonus schemes)
- IT (systems, processes and controls)
- Taxes (tax structures and deferred tax)
- Real Estate (contract management)
- Sales/procurement (new lease terms)

Who does it impact?

Global lease capitalisation impact by industry*

Lessees	Average increase in interest bearing debt	Median increase in total assets	Average increase in EBITDA
All companies	22%	5%	13%
Retail and Trade	98%	22%	41%
Professional Services	42%	5%	15%
Accommodation and food services	14%	3%	8%
Transport and Warehousing	24%	7%	20%
Construction	14%	2%	8%
Manufacturing	21%	3%	14%
Financial Services	6%	1%	6%

* Global PwC Lease Capitalisation Research 2015

Getting your house in order

Key changes

Lessors

- There are no significant changes to lessor accounting
- However, you need to check that the service component of lease contracts can be separately identified. You need to account for the service separately under IFRS 15 and your customers are likely to ask how much of the lease charge relates to services
- Lessees may re-evaluate lease arrangements and hence customer behaviour may change to assess if these provide the optimal financing arrangement
- Lessees may also require further information from you, such as the implicit interest rate

Lessees

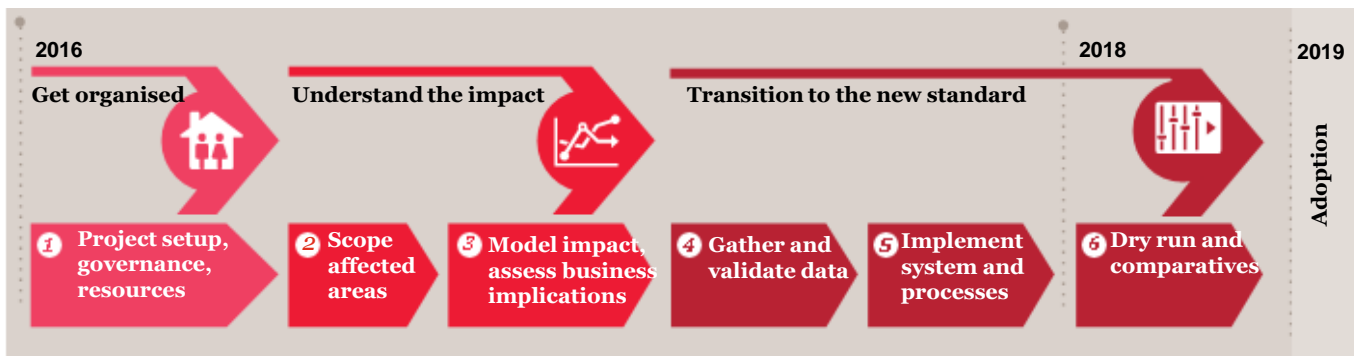
- Implementing this standard will require a significant effort in cataloguing existing leases and data sourcing for large volumes of non-standardised leases if contracts and data not centrally managed
- If you have a large volume of leases, you'll need to investigate lease management system solutions to store lease data and perform new calculations
- You can use this as an opportunity to re-evaluate commercial decisions behind lease arrangements, particularly with better understanding of full lease population
- Your internal and external stakeholders may need some help understanding the changes to your accounting (shareholders, analysts, rating agencies, debt covenants)
- HMRC is still to determine how IFRS 16 will impact tax

Why consider this now?

Factors to consider

- Reducing the number of changes in your financial reporting – consider making all the changes from the new wave of IFRS (9, 15 and 16) in one go for 2018
- Lease data is likely to be scattered across your organisation and may take some time to source
- Choosing the right system for the future – system implementations can take a number of years to get right
- There are a number of complex judgement areas to get right and prevent rework
- Any organisations looking to IPO or attract capital will need to provide consistent historical financial track records

Next steps



For more information visit: www.pwc.bg/ifrs16

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