Accounting advisory

IFRS 16 Leases Substantial change in lease accounting

- Effective from 1 January 2019
- Major change for lessees with operating leases - these will be treated as financial leases, i.e., recognised on balance sheet
- Lessor accounting model stays substantially the same
- Enhanced disclosures

How the financial statements of the lessee will look like:

Balance sheet

- Increased lease assets
- Increased financial liabilities
- Decreased equity

Income statement

- Increased EBITDA
- Increased operating profit/finance costs
- Same profit before tax

Cash flow statement

- Increased cash from operating activities
- Decreased cash from financing activities
- Same total cash flow

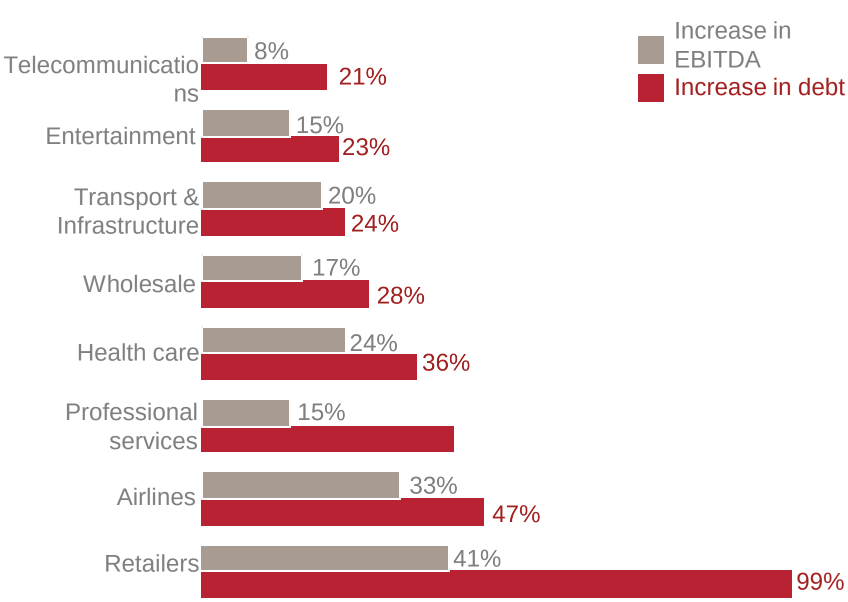
Note

- Maturity analysis of the lease liabilities
- Additional disclosures

How the key financial metrics and KPIs are affected…

Metric *What it measured*	Expected effect	Explanation
Leverage (gearing) *Long-term solvency*	↑	**Liabilities/Equity** *Increase because financial liabilities increase (and equity is expected to decrease)*
Current ratio *Liquidity*	↓	**Current assets/Current liabilities** *Decrease because current lease liabilities increase while current assets do not*
Asset turnover *Profitability*	↓	**Sales/Total assets** *Decrease because lease assets will be recognized as part of total assets*
Interest cover *Long-term solvency*	↔	**EBITDA/Interest expense** *EBITDA will increase as interest expense increases. The change in the ratio will depend on the characteristics of the lease portfolio*
EBIT/ *Operating profit* *Profitability*	↑	**Various methods** *Increase because the depreciation charge added is lower than the expense for off balance sheet leases excluded*
EBITDA *Profitability*	↑	**Profit before interest, tax, depreciation and amortization** *Increase because expenses for off balance sheet leases are excluded*
Operating cash flow *Profitability*	↑	**Various methods** *Increase because at least part of the lease payments (those payments relating to the principal) will be moved to the financing section of the cash flow statement*

How industries are affected…



Source: PwC Global Lease Capitalization study of 3,199 listed IFRS reporters

Get ready

- ***Understand the issue and identify in-scope contracts***
- ***Understand the impact on your key ratios and KPIs***
- ***Reconsider your business and financing model***
- ***Extract data elements for IFRS 16 and validate quality, accuracy and reliability***
- ***Assess and optimize effects on arrangements and stakeholders***
- ***Establish and define policies***
- ***Train and support users***

PwC can help in all stages.

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