The Institute of
Chartered Accountants
of Pakistan

CA
PAKISTAN

ACCOUNTING STANDARDS BOARD

IFRS 16: LEASES

Contents

Introduction

Background

- Joint-project of IASB & FASB
- Research from 1996 -2000
- Issued on 01 Jan 2016
- Effective from 01 Jan 2019

What will be superseded

- **IAS 17**
- IFRIC 4
- SIC 15
- SIC 27

What is out of scope

- Leases to explore minerals, oil & gas
- Leases of biological assets
- Licenses of intellectual property
- Licenses for intangibles
- Service concession agreements

Why new leasing standard

	Operating lease	Finance lease
Lessors	Lease assets	Lease receivables
Lessees	No asset No liability	Lease asset Lease liability

Off-balance sheet

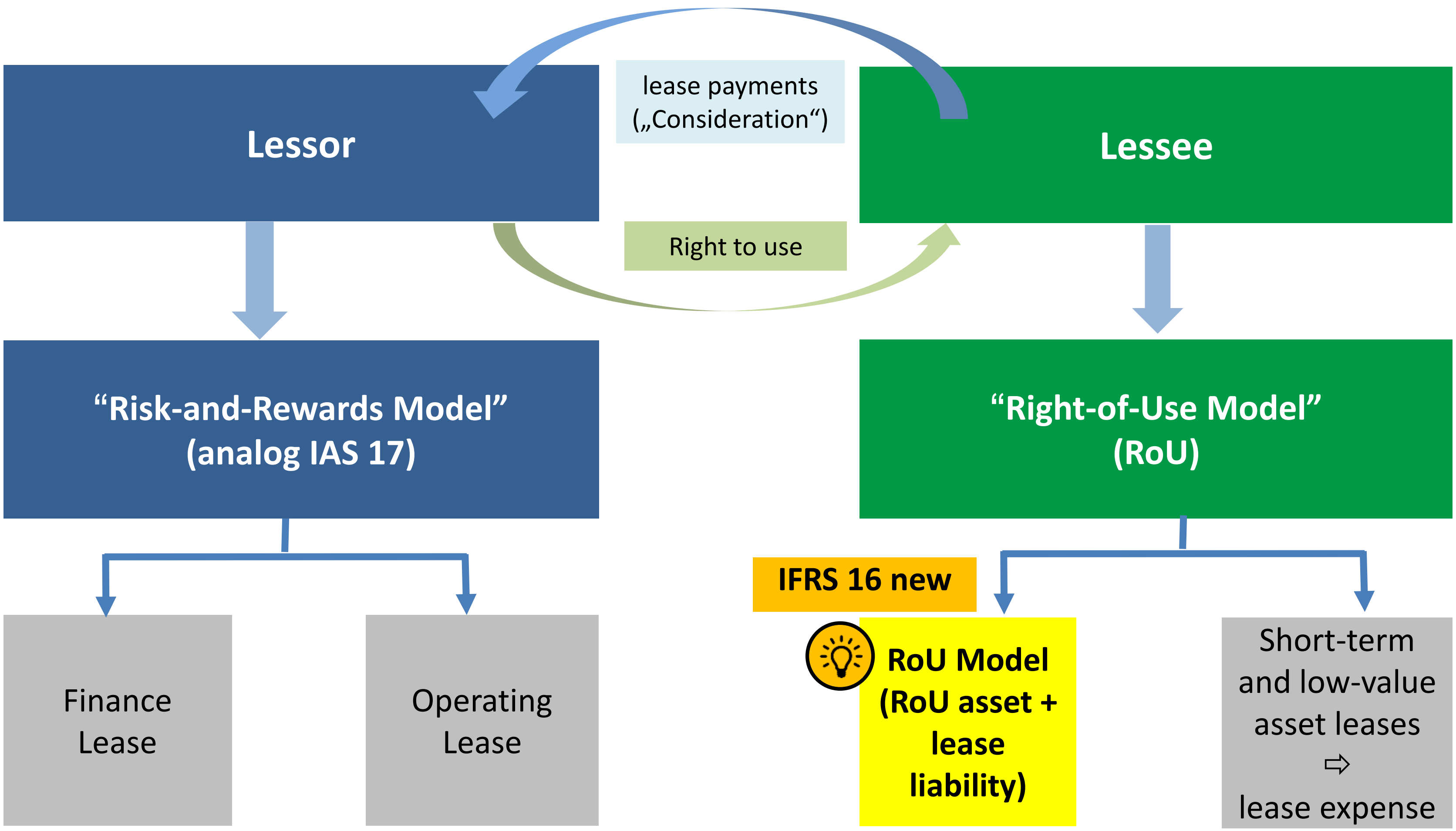
85% of lease commitments **Worth US$ 3.3 trillion**

Let's bring leases on the balance sheet

One of my great ambitions before I die is to fly in an aircraft that is on an airline's balance sheet. Why does this not occur?

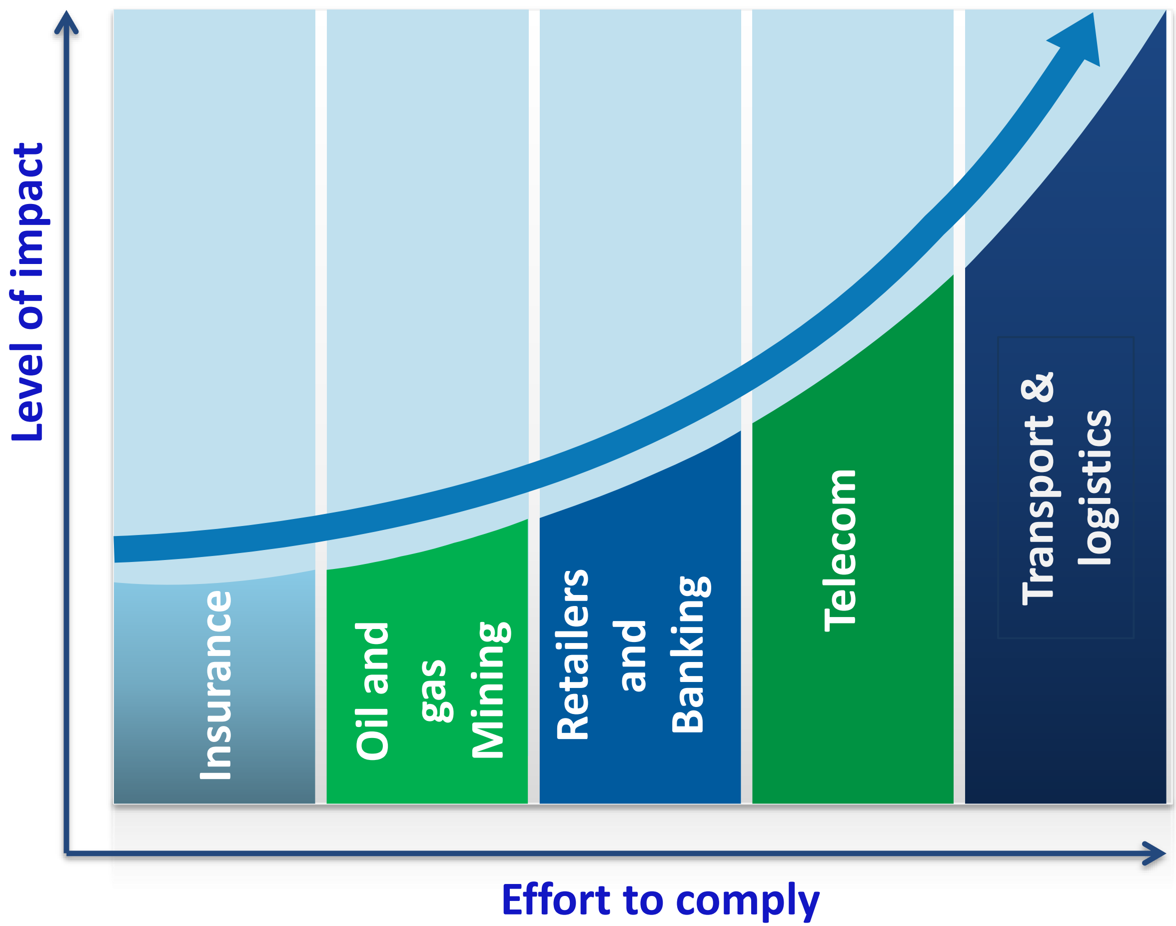
Sir David Tweedie - Chairman of the IASB (2008)

What is new


lease payments
(„Consideration“)
Lessor
Lessee
Right to use
“Risk-and-Rewards Model”
(analog IAS 17)
“Right-of-Use Model”
(RoU)
IFRS 16 new
Finance Lease
Operating Lease
RoU Model (RoU asset + lease liability)
Short-term and low-value asset leases ⇨ lease expense

Who is impacted

Entities most likely to be affected by the changes

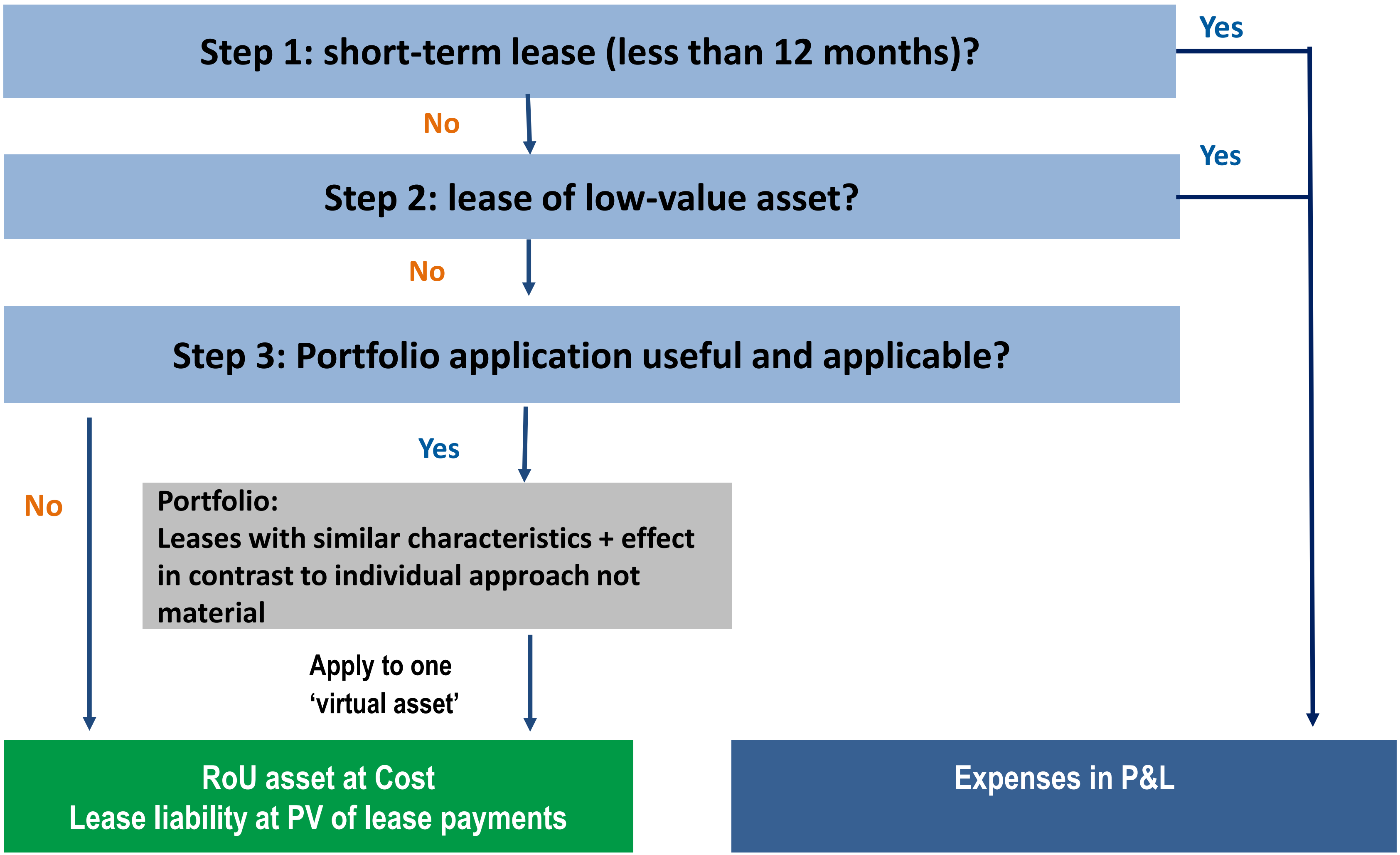


Transport	Aircrafts, Ships, Trains
Telecom	Tower & optic fiber arrangements, Equipment provided etc.
Retailers	leased retail space
Banking	Leased branches
Oil and gas	Land, building, vehicles
Mining	Land, building, vehicles
Insurance	Land, building, vehicles

Lessee accounting – RoU snapshot

Step	Description	Details
Step 1	Identify the **lease contract**	• Identifiable asset • Right to control the use of asset • Consideration for controlling the use
Step 2	Identify the **asset and service elements** in the contract	• Contract contains right to use asset and some other element (service, maintenance)
Step 3	**Allocate the contracted rental** to the asset and service elements	• Allocate the contracted rental to elements on standalone market price basis
Step 4	**Recognise** the right of use of asset and corresponding lease liability	• Recognise RoU at cost • Recognise lease liability at PV of lease payments
Step 5	Subsequent to initial recognition, use the basis as per IFRS (Asset, finance on etc)	• Recognise depreciation • Recognise finance cost • Recognise principal lease repayment

Lessee accounting – New leasing model



Lessee accounting - Recognition exemptions

A lessee may elect not to apply lease accounting to the following

- Short-term leases (12 months or less)

- Low value assets

Short-term leases	Low value assets
A lease that contains a purchase option is not a short-term lease	Assessment on an absolute basis
Has a lease term at commencement of 12 months or less	Not highly dependent on, or highly interrelated with other assets
Election by class of underlying asset	Election on a lease-by-lease basis

What to do? Recognise lease payments as an expense

Lessee accounting - Comparison with IAS 17

	Statement of financial position	Profit & loss account
IAS 17		
Finance Lease	Asset and Liability	Depreciation, Interest expense
Operating Lease	-	Lease expense
IFRS 16		
All leases	Asset and Liability	Depreciation, Interest expense. Lease expense (Low value, or Less than 12 months)

IAS 17

Statement of financial position	FY 20xx

Staement of profit and loss	FY 20xx
Lease rentals (All operating leases)	xxx
EBITDA	**xxx**
Profit before tax	**xxx**

IFRS 16

Statement of financial position	FY 20xx
Lease assets	xxx
Lease liabilities	xxx

Statement of profit and loss account	FY 20xx
Lease expense Low-value/short-term leases)	xxx
EBITDA	**xxx**
Depreciation and amortization of ROU assets	xxx
Finance cost to ROU assets	xxx
Profit before tax	**xxx**

Lessee accounting - Illustrative example

Yearly property rental and maintenance services of 10th floor of AM Tower	**Rs. 100,000**
Lease term	**3 years**
Discount rate	**3%**
Depreciation	**Straight line**
EBITDA	**Rs. 500,000**

Step 1: **Identify the lease contract**

10th floor of the property has been rented by the entity for three years period. The 10th floor is identifiable and will be used by the entity according to its requirements. Accordingly, the contract has a lease element.

Step 2: **Identify the asset and service elements in the contract**

The identifiable asset under the contract is the AM Tower's - 10th floor. The other element in the contract is the maintenance service

(The standalone value of the 10th floor and maintenance services are Rs. 90,000 per year and Rs. 15,000, respectively)

Step 3: **Allocate the contracted rental to the asset and service elements**

$$\frac{\text{Contract value x Standalone price of the element over lease term}}{\text{Total selling price of the contracted elements over lease term}}$$

		Rs.
10th floor rental	(300,000*270,000)/315,000	257,142
Maintenance	(300,000*45,000)/315,000	42,858
Total rental over lease period		300,000

Step 4: **Recognise the right of use of asset and corresponding lease liability**

(present value of the lease liability)

RoU of building	Rs. 233,340
Lease liability - (PV)	Rs. 233,340

Lessee accounting - Illustrative example

IFRS 16

Statement of financial position

	Period 0	Y1 end	Y2 end	Y3 end
Right of use of asset	233,340	155,540	77,800	-
Lease liability	233,340	150,937	81,630	-

Profit & loss account

	Period 0	Y1 end	Y2 end	Y3 end
Maintenance charges		14,286	14,286	14,286
EBITDA – after maintenance charges		485,714	485,714	485,714
Depreciation		77,800	77,800	77,800
EBIT		407,914	407,914	407,914
Lease finance charges		11,670	7,970	4,102
Net profit		**396,244**	**399,944**	**403,812**

Under IFRS 16 the entity would be asset rich, however, more indebted

Total expense
42,858
233,400
23,742
300,000

IAS 17

Statement of financial position - Nothing recorded

Profit & loss account

	Y1 end	Y2 end	Y3 end
EBITDA	500,000	500,000	500,000
Lease rental	100,000	100,000	100,000
Net profit	**400,000**	**400,000**	**400,000**

Total expense
300,000

Under IFRS 16 total expense and profit over the lease term remains the same.

However, the expense pattern changes

Lessee accounting - Impact analysis

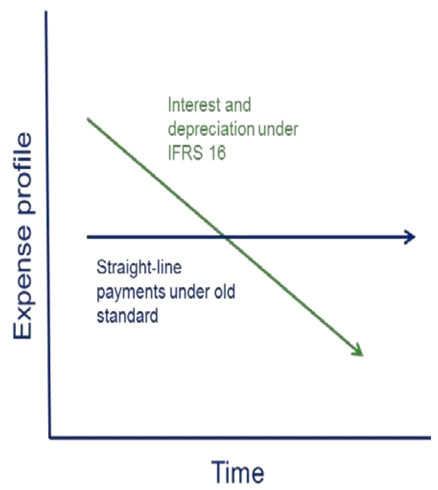
Statement of financial position

- ↑ Leased assets
- ↑ Financial liabilities
- ↓ Equity
- Impact on gearing

- Recognise lease assets and liabilities on balance sheet
- Initially measured at the present value of unavoidable lease payments
- Consider impact on KPIs, lending covenants, earn-outs, bonus programs, etc

Statement of profit and loss

- ↑ EBITDA
- ↑ Finance cost
- ↑ Depreciation
- Profit profile (lower in earlier years of lease)



Cash flow statement

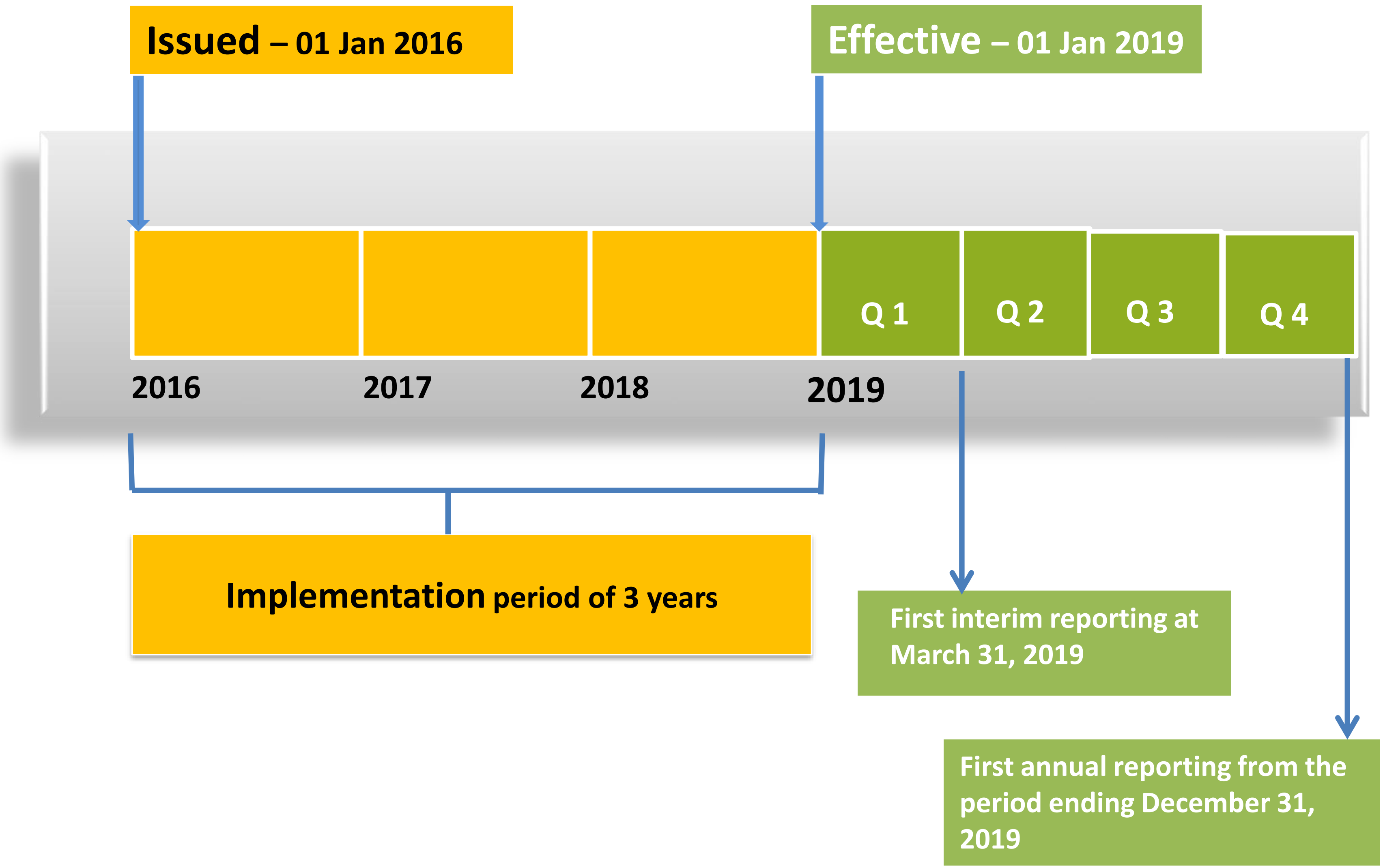
- ↓ Operating cash outflows
- ↑ Financing cash outflows

- Repayment of principal: **finance activities**
- Repayment of interest: **finance or operating activities**
- Payments from short-term leases and from assets of low value: **operating activities**

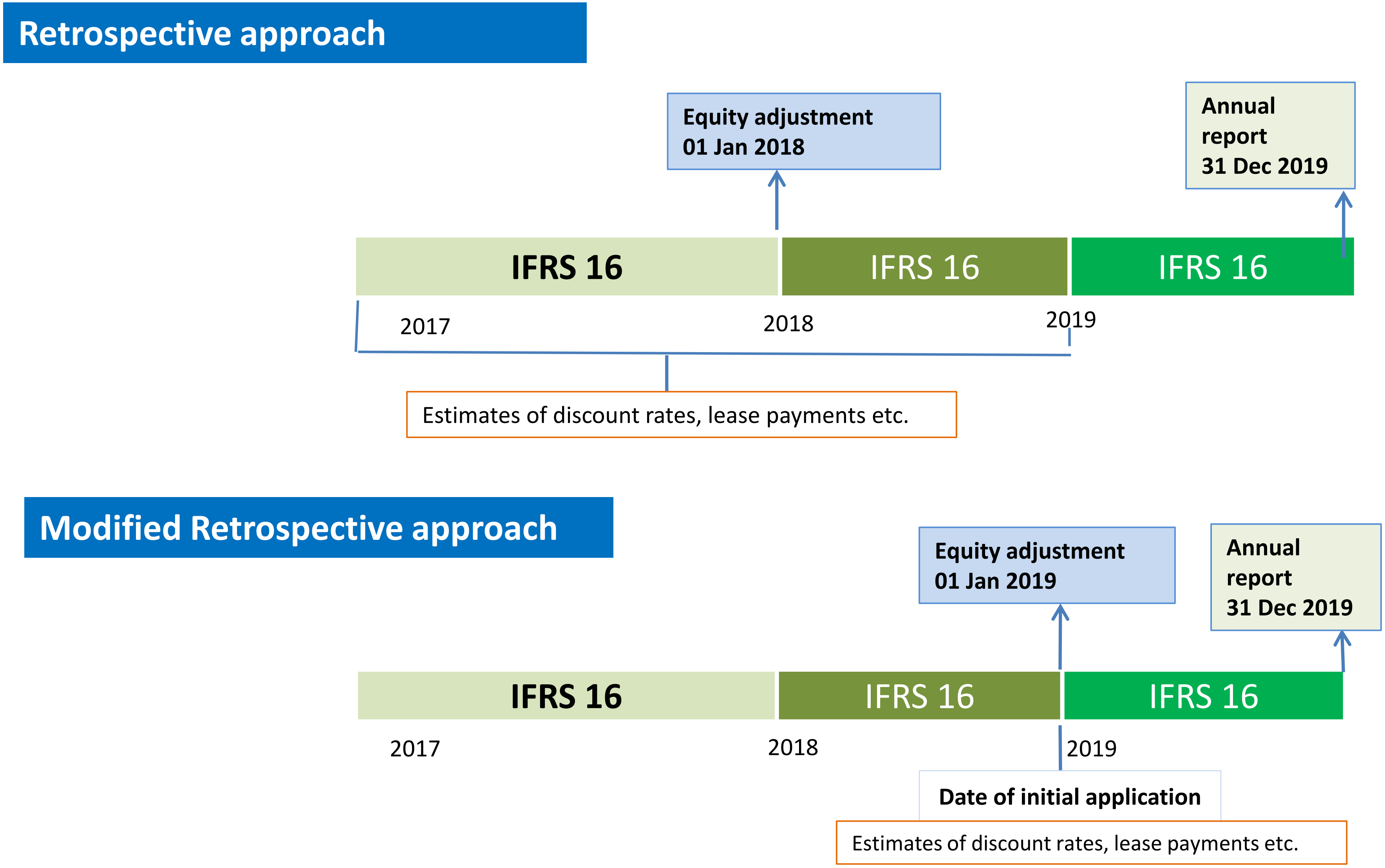
Lessor accounting - A snapshot

Classification	Classify a lease as either an **operating or finance** lease
Finance leases	• Recognize at the commencement date the **receivable at an amount equal to the net investment** in the lease • **Net investment measured as the sum** of both: – The lease receivable measured at the present value of the lease payments, and – The residual asset, measured at the present value of any residual value accruing to the lessor • Subsequently, **recognize finance income over the lease term**, based **on a pattern reflecting a constant periodic rate of return** on the lessor's net investment in the lease
Operating leases	• Recognize **lease receipts as income** on either a straight-line basis or another systematic basis
Presentation and disclosure	• Additional disclosures about a lessor's leasing activities

Effective date



Transition



Retrospective approach
Equity adjustment 01 Jan 2018
Annual report 31 Dec 2019
IFRS 16
IFRS 16
IFRS 16
2017
2018
2019
Estimates of discount rates, lease payments etc.
Modified Retrospective approach
Equity adjustment 01 Jan 2019
Annual report 31 Dec 2019
IFRS 16
IFRS 16
IFRS 16
2017
2018
2019
Date of initial application
Estimates of discount rates, lease payments etc.

Start now

Systems and processes in place

Which transition options to choose?

Database of all leases?

What about ratios, covenants & tax planning

Which contracts are leases?

How to create stakeholder awareness?