INTERNATIONAL FINANCIAL REPORTING STANDARD 16

Introduction

Accounting treatment of leases by lessees has changed fundamentally. The major objective of IFRS 16 is to ensure that lessees and lessors provide relevant information that faithfully represents their transactions. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, it introduces a single, on-balance sheet accounting model that is similar to current finance lease accounting.

Scope

Leases of certain assets not in scope
May be applied to leases of some intangible assets

Exemptions

A lessee can elect not to apply IFRS 16 to the following:

a) Short term leases; and
b) Leases for which the underlying asset is of a low value.

Short-term leases

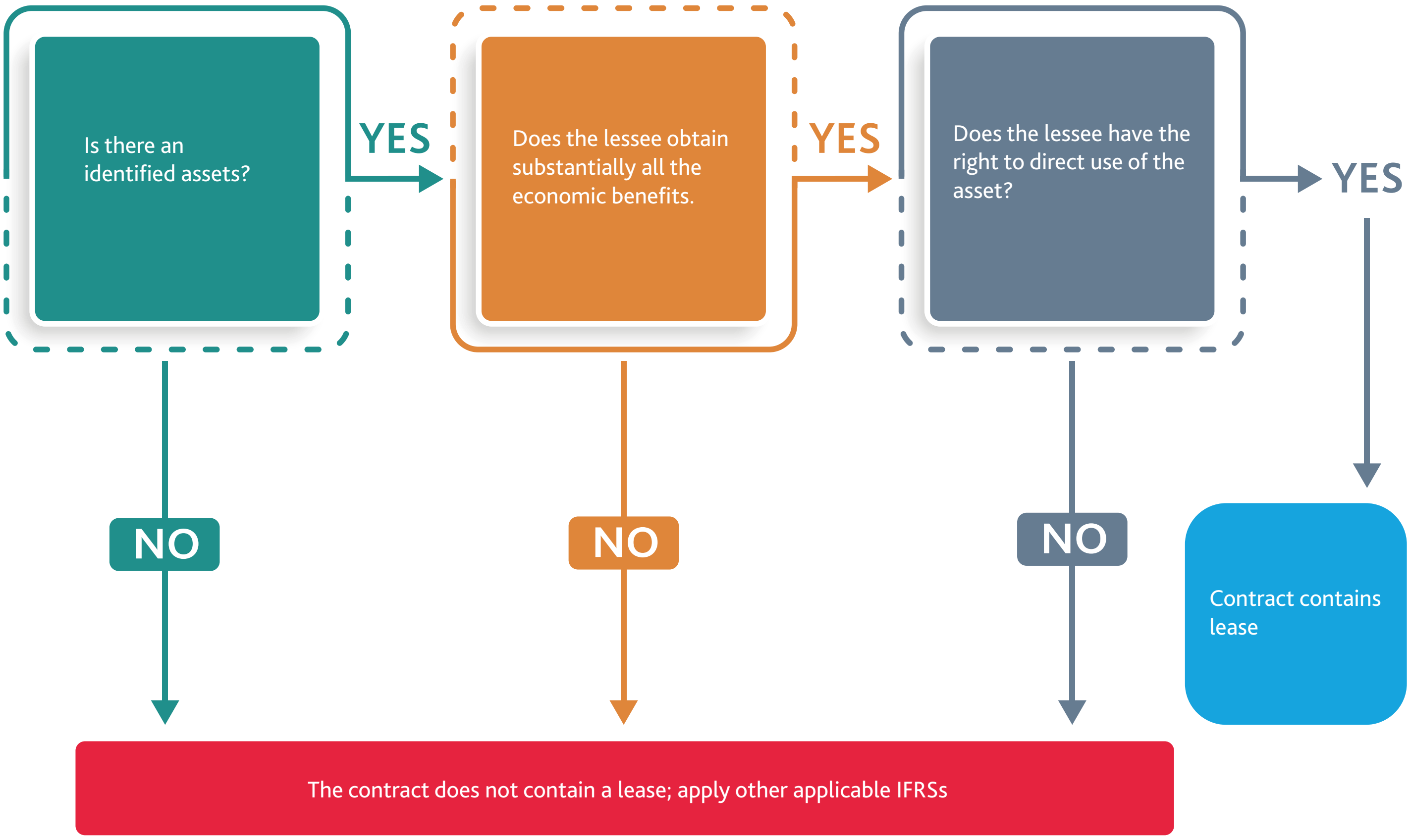
Short-term leases are leases that, at the commencement date, have a lease term of 12 months or less.

Low value assets

The assessment of 'low value' for a leased asset is to be made on the basis of the value of an asset when it is (or was) new, regardless of whether the actual asset being leased is new. Additionally, the assessment is made regardless of whether the leased asset is material to the lessee.
An underlying asset in a lease can be of low value only if:

(a) The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
(b) The underlying asset is not highly dependent on, or highly interrelated with, other assets.
IFRS 16 provides examples of low value leases, which include tablets and personal computers, small items of office furniture and telephones.

Identifying a lease



In applying IFRS 16 a company is required to:

(a) Recognise lease assets and lease liabilities on the balance sheet, initially measured at the present value of unavoidable future lease payments;

(b) Recognise depreciation of lease assets and interest on lease liabilities in the income statement over the lease term; and

(c) Separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (typically presented within either operating or financing activities) in the cash flow statement.

Presentation of leases

Statement of Financial Position

Right-of-use asset: present in its own line item or combine with property plant and equipment, with separate disclosure

Lease liabilities: present separately or include with other liabilities and disclose which line item they have been included in

Statement of Comprehensive Income

Interest expense with other finance costs
Amortisation of right-of-use assets

Statement of Cash Flows

Cash payments for lease liabilities as financing activities.

Cash payments for interest in accordance with IAS 7's requirements for interest paid.

Short-term, low-value and variable lease payments within operating activities.

Impact on balance sheet

- IFRS 16 eliminates the classification of leases as either operating leases or finance leases for a lessee.
- For companies that have material off balance sheet leases, IFRS 16 is expected to result in an increase in lease assets and financial liabilities.
- The most significant effect of the new requirements will be an increase in lease assets and financial liabilities as IFRS16 requires lessees to recognize most operating leases on their balance sheets as a right of use (ROU) asset and a corresponding lease liability.
- Companies with operating leases will appear to be more asset-rich, but also more heavily indebted.
- This is similar to the effect on reported equity that arises from financing the purchase of an asset, either through a balance sheet lease or a loan.

Impact on profit or loss

- Lessees will subsequently recognize amortization expense on the ROU asset and interest expense on the lease liability.
- For companies that have material off balance sheet leases, IFRS 16 is expected to result in higher profit before interest (for example, operating profit) compared to the amounts reported applying IAS 17.
- This is because, applying IFRS 16, a company presents the implicit interest in lease payments for former off balance sheet leases as part of finance costs.
- In contrast, applying IAS 17, the entire expense related to off balance sheet leases was included as part of operating expenses.
- In short, IFRS 16 is expected to result in higher EBITDA and operating profit for companies that have material off balance sheet leases.

Effective date and transition

- IFRS 16 is effective for periods beginning on or after 1 January 2019.