

IFRS 16 Leases: Could the New Standard Herald a New Era of Property Ownership?

Tenants, the new lease accounting standard has implications for your balance sheet and you may not like them. Make sure you are ready.

IFRS¹ 16 is a new lease accounting standard, replacing IAS 17 and effective as of 1 January 2019. That may sound a fair way off, but just like the 31 January tax deadline, it is usually upon you before you know it.

The new accounting standard has the potential to detrimentally affect tenants' financial health, so if you have not yet become comfortable with the new approach, it is worth giving the new standard some thought well in advance of the effective date (although a company can choose to apply IFRS 16 before the 2019 effective date if it complies with the conditions for doing so²).

Current Standards

IAS 17 currently distinguishes between operating leases and finance leases. This is significant because, whilst operating leases are "off balance sheet", finance leases require companies to record both assets and liabilities for the assets that they lease³.

The stated objective of IFRS 16, on the other hand:

"is to report information that (a) faithfully represents lease transactions and (b) provides a basis for users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. To meet that objective, a lessee should recognise assets and liabilities arising from a lease.

IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments."⁴

In other words, lease liabilities will now appear on your balance sheet.

What Will IFRS 16 Mean for You?

Whilst the new standard is not limited to property leases, any company which is currently reliant on leasing business premises off balance sheet will face some significant implications. Identified as being amongst those particularly affected are retail, telecommunications and financial organisations, all of which will have to come to grips with:

- Potential impact on borrowing ability to comply with financial covenants in finance agreements due to an increase in reported leverage. The result of a public survey⁵ in 2015 indicated that the majority of lenders expect to revisit terms and conditions of debt covenants when IFRS 16 is effective.
- Changes in accounting treatment: lease transactions are currently structured as finance or operating leases which will determine the accounting treatment. The application of consistent accounting principles across both will make this practice an unnecessary exercise (if done for accounting purposes).

⁵ Led by International Accounting Standards Board, together with other national accounting standard setters.

¹ International Financial Reporting Standards.

² Companies applying IFRS 16 prior to the compulsory effective date must also apply IFRS 15 Revenue from Contracts with Customers.

³ GVA: [IFRS 16 Lease accounting changes](#).

⁴ [IFRS 16 Leases](#).



- Changing investor perception of solvency due to a reduction in liquidity ratios with a proportionate decrease in profitability ratios.
- Considerations around property strategy and whether to buy or rent.
- Need for increased data around leases.

Market activity indicators are that strategic decisions are being made on the basis of the new standard, so if you have not already embraced it, now is the time to do so. IFRS 16 may well make buying, rather than leasing an attractive proposition, but however your strategy is formulated, it is critical that you fully appreciate the impact of IFRS 16 on your business.

Contacts

Nick Green

Partner

T +44 121 222 3519

E nick.green@squirepb.com

Sally Coleman

Professional Support Lawyer

T +44 121 222 3136

E sally.coleman@squirepb.com

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