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The December issue includes:
New IFRS 16 - Leases

NEW IFRS 16 - LEASES

After nearly ten years, a new IFRS related to leases has been issued. It will come into force **on 1 January 2019**. Based on the EFRAG (European Financial Reporting Advisory Group) schedule, its approval for use in the EU is expected in 2017. The aim of this new **IFRS 16** is to ensure convergence between IFRS and US GAAP (United States Generally Accepted Accounting Principles).

As of the transition date (1 January 2019) from old leasing regulation (IAS 17, IFRIC 4, SIC-15, SIC-27) to the new regulation (IFRS 16), **it is not necessary** to reassess old contracts whether or not they meet the definition of a lease under IFRS 16. Recognition of leases under IFRS 16 will be applicable only to new leasing contracts and/or for contracts amended after the date of transition to the new standard.

Lease is defined as a contract or a part of contract which provides the right **to control** the use of certain identifiable assets over a certain period and for consideration.

IFRS 16 **fundamentally** changes the approach to reporting of leasing contracts **on part of the lessee** and refines the regulations related to leases on part of the lessor.

The lessee

- Does not distinguish leasing contracts to finance and operating leases anymore
- Assesses whether or not rental contracts contains a lease
- All leases will be included in the balance sheet

The lessor

- Distinguishes leasing contracts to finance and operating leases
- Examples of classification and indicators included in IAS 17 are applicable

How do these changes impact the lessee?

Statement of financial position (the balance sheet)

the leased asset shall be recognized as an asset with the right to use ("right of use asset") and at the same time as a lease liability

	IAS 17		IFRS 16
	Financial leases	Operating leases	All leases
Assets	YES	NO	YES
Liabilities	YES	NO	YES
Balance sheet total			INCREASE
Off-balance sheet items	NO	YES	NO



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Based on the above table, this change will impact those entities that currently report significant off-balance sheet leases (i.e. that have operating leases).

Profit or loss statement and other comprehensive income report

the current cost of operating leases will be replaced by asset depreciations with the right to use and by interest calculated from the lease liability.

	IAS 17		IFRS 16
	Financial leases	Operating leases	All leases
Operating costs	NO	YES	NO
EBITDA			INCREASE
Depreciation	YES	NO	YES
Operating profit			INCREASE
Financial expenses	YES	NO	YES

Based on the above table, the financial indicators will change – the loan burden and the interest coverage indicators will worsen (due to an increase in financial costs) and, on the other hand, the profitability indicators will improve due to the reduction in operating costs (e.g. EBITDA - earnings before interest, taxes and depreciation of tangible and intangible assets). Many clients have reward schemes for its managers linked precisely to the positive trend of this indicator.

Cash Flow statement

the payment of the lease liability and the interest expenses paid will be reported as financial or operating activity.

The new IFRS 16 offers the lessee with the possibility of using optional exemptions (not mandatory exemptions), under which the defined asset can be assessed as currently defined operating lease under IAS 17:

Short-term leases

- Leases with a duration of less than 12 months without a purchase option (i.e. the option to buy)
- They will be assessed based on the class of the underlying assets, i.e. grouping of similar assets
- Modification of the lease or the alteration of the lease term is considered as a new lease



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NEW IFRS 16 - LEASES

**Leasing of assets of small value
(the so-called minor assets)**

- This concerns assets worth less than EUR 5,000 (this is a recommended value, but each reporting entity has to adopt own value in its internal directive)
- Small value is assessed individually based on the valuation of individual leases
- E.g. tablets, computers, phones, copiers, furniture
- If these assets are leased further this exemption cannot be used
- Utilization of the low-value assets should not be dependent on the utilization of other assets

**Evaluation of leases on part of the lessee in
accordance with IFRS 16****Asset with the right to use**

At the beginning of the lease term, at the acquisition cost ("at cost"):

- The present value of lease payments outstanding as at the beginning of the lease
- **Plus** lease payments paid before the start of the lease
- **Minus** any lease incentives received
- **Plus** ancillary transaction costs
- **Plus** the estimated costs of removal, dismantling and disposal of the assets

Subsequent valuation:

The asset is depreciated over its useful life. Any impairment must be taken into account (i.e. the "impairment test") as well as any value adjustment due to revaluation of the liability

Lease liability

At the commencement of the lease, at the present value of the lease payments outstanding as at the given date (implicit and/or incremental interest rate is used for discounting)

Subsequent valuation:

- Initial valuation of the lease liability
- **Plus** interest expenses
- **Minus** lease payments paid
- **Plus/minus** revaluation of the liability resulting from a modification of the lease (e.g. the extension of the lease term)



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NEW IFRS 16 - LEASES

How should a company prepare for the transition to IFRS 16?

We recommend that companies assess the impact of the new standard on any contracts that are currently being negotiated and/or contemplated. It is essential to develop the so-called project plan for the revaluation of operating leases and ensure a training of the staff of the financial department on the new accounting requirements.

We are aware that this issue is so complex that it is not possible to deal with it in Mandat News in a comprehensive manner. Our goal is to prepare the affected clients for the upcoming changes in international accounting standards before they become effective. Our experts are always available to help you in solving practical issues with the application of IFRS 16.



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NOT TO BE MISSED

Important dates

Overview of important dates in the December 2016 can be found on our website: <http://www.mandat.sk>



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ABOUT US

The companies **MANDAT CONSULTING, k.s.** and **MANDAT AUDIT, s.r.o.** were founded in 2004 as tax advisory and auditing companies. Since their establishment, they have been providing small, medium-sized and companies active in Slovakia with services in the field of tax consultancy, audit and accounting. Long-lasting cooperation with foreign advisory companies hand in hand with the competence of Slovakian tax advisors and auditors enables us rendering our service to the clients originated from abroad.

In present time, 41 well trained members of our staff are at the disposal to our clients.

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Thank you for mutual cooperation
and we wish you Merry Christmas
and successful new year

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