WHAT IS IFRS?

The International Accounting Standards Board (IASB) announced in January 2016 that they were issuing an updated set of accounting standards superseding **IAS 17 Leases**, called **IFRS 16 Leases**.

The International Financial Reporting Standards (IFRS) are accounting rules that govern publically listed companies and are intended to create greater transparency by treating all leases in the same way and making financial statements as comparable as possible.

WHO WILL IFRS 16 APPLY TO?

IFRS 16 refers to the accounting of leasing contracts and contains a number of changes compared to the current IAS 17 Leases, which may apply to your business if you use IFRS when publishing your accounts. This includes PLCs, foreign owned companies, and some public sector bodies. The new rules are expected to be implemented in 2022 for UK limited companies.

The new standards will have to be effective for annual periods beginning on or after January 1 2019, but may be used up to 1 year in advance. This applies to all 12+ month leases with initial investment value above $5,000US, and includes those who lease cars and vans.

WHAT DOES THIS MEAN FOR ACCOUNTING?

In future, a lessee will have to account for a right-of-use asset, based on future remaining finance rentals, discounted at the interest rate implicit in the lease or incremental borrowing rate, and a corresponding lease liability on their balance sheet, meaning that they have to take the financial components of the lease contract on their books as an asset and liability.

This means that lessees will have to:

- Depreciate the (right of use) asset
- Reduce the lease liability and
- Account for the interest on the lease liability

SHOULD YOU STILL LEASE YOUR VEHICLES?

Leasing your vehicles with Pendragon Vehicle Management still has a number of financial benefits:

- Substantially lower effect on balance sheet compared to outright purchase
- 50% VAT recovery on qualifying cars
- Risk positioning and incorporate asset responsibilities are still lower than with ownership of vehicles
- Procurement and disposal services
- Potential investment into additional internal resources (e.g. purchase function or risk function) is not required
- Fixed maintenance costs
- One set of invoices
- Price competitiveness with thanks to our ability to leverage the purchasing power of our parent group Pendragon PLC to build economies of scale and our industry expertise
- No residual value risk
- No cash outlay on purchase of vehicles.

WHAT IS IFRS?

ARE THERE FURTHER IMPLICATIONS FOR IFRS 16?

Adhering to IFRS 16 will also affect key financial performance ratios, including:

- Gearing ratio (Debt to equity): This will increase because financial liabilities increase.
- EBITDA (Earnings before Interest Tax & Depreciation): As lease costs become treated as depreciation and interest, this will increase
- Operating cash flow: This will increase as lease payments become treated as financing activities.
- Interest cover: This will decrease due to the effect of higher reported interest costs.
- Reporting requirement: This will increase as each vehicle lease will be treated as a fixed asset, and any subsequent revaluation of the asset may require possible adjustment. Organisations will also need to consider how to account for vehicle transfer within a group structure.

PREPARING FOR IFRS 16

In order to prepare for the implementation of IFRS 16 we recommend you seek professional support with the required industry experience. You will also need to have an overview of all leasing contracts.

Sue Daldorph, Finance Director for Pendragon Vehicle Management, commented:

“Whilst not impacting on the day to day operational aspects of your fleet IFRS 16 could have an impact on reported earnings and /or banking covenant tests. Early preparation for implementation will be key to ensure any impact is minimised.”