IFRS 16 "LEASES" – FINANCIAL STATEMENTS DISCLOSURES FOR CREDIT INSTITUTIONS

Denis Adrian LEVANTI
PricewaterhouseCoopers Romania, Romania
levantidenis@yahoo.com

Abstract
The IASB published IFRS 16 Leases in January 2016 with an effective date of 1 January 2019. Leasing is an important and widely used financing solution. It is a flexible solution that allows entities to access and use property and equipment without needing to incur large cash outflows and it enables lessees to address the issue of obsolescence and residual value risk. Leases are very common in the banking and capital markets sector and IFRS 16 implementation has had a significant impact on the credit institutions' operations and financial statements. In order to carry out their daily operations, banks have concluded a considerable number of lease contracts, mostly for spaces dedicated to their branches, ATM locations, vehicles and IT equipment.
The purpose of this article is to present the most important changes brought by IFRS 16, with the focus on the financial statements disclosures and to analyze the IFRS 16 disclosures from the financial statements of top five credit institutions operating in the Romanian banking sector. The results of the analysis highlighted that the majority of these institutions complied to a great extent with the disclosure requirements at transition date.

Key words: *credit institutions, disclosures, lease, right of use asset, lease liability*

JEL Classification: *M41*

I. INTRODUCTION

In January 2016, the International Accounting Standard Board ("IASB") issued the International Financial Reporting Standard ("IFRS") 16 Leases ("IFRS 16") and changed completely the lease accounting for lessees.

The distinction between operating and finance lease is eliminated for lessees and a new asset, representing the right to use the leased asset for the lease term, and a lease liability, representing the obligation to pay rentals, are recognized in the statement of financial position. The new lease model applies to all contracts, except for short-term leases and leases of low-value assets.

According to IASB (2016), IAS 17 Leases ("IAS 17") lease model was criticized for failing to meet the needs of users of financial statements because it did not always provide a faithful representation of leasing transactions. In particular, it did not require lessees to recognize assets and liabilities arising from operating leases. The previous lease model has been also criticized by academics, such as Reither (1998), practitioners (1994), and users (Beattie et al., 2006), who argued that lessees were not recognizing all lease obligations and assets in their balance sheets, which lead to a lack of comparability. The fact that many leases were accounted for as off-balance sheet commitments lead to difficulties when comparing financial statements and financial ratios between entities using metrics such as total debt level.

Berry and Robertson (2006) research revealed that foreign bankers active in the United Kingdom of Great Britain ("UK") consider that the most important aspect that can enhance the published accounting information is the incorporation of off balance sheet financing in the balance sheet. Barth and Shipper (2008) consider that recognition of operating leases in the balance sheet will capture the underlying economics and will increase transparency and thereby comparability.

Duck et al. (2009) indicated that entities have enjoyed the benefits of operating leases, since both leased assets and liabilities were kept off-balance sheet, with only footnote disclosures of future lease obligations. Some studies support the idea that market participants do, in some cases, consider the off-balance sheet commitments. Sakai (2010) stated that the market appeared not to react to lease capitalization, while Lindsey (2006) showed that investors consider the operating lease liabilities as real liabilities, and that market participants price them differently from finance leases. Furthermore, Lim et al. (2003) and Sengupta et al. (2011) state that, for credit investors, operating leases not disclosed in balance sheets are incorporated into debt ratings and bond yields.

Given the criticism received by the IAS 17 model, IASB and the US standard-setter, the Financial Accounting Standards Board ("FASB"), initiated a joint project to develop a new approach to lease accounting that requires a lessee to recognize assets and liabilities for the rights and obligations created by leases.

This approach will result in a more faithful representation of a lessee's assets and liabilities and, that together with enhanced disclosures, will provide greater transparency of a lessee's financial leverage and capital employed. Both Boards decided that a lessee should be required to recognize assets and liabilities for all leases

(with limited exceptions), and both Boards have defined leases in the same way. The Boards reached similar decisions regarding the measurement of lease liabilities, and how to account for leases that were formerly classified as finance leases. In addition, both Boards decided not to substantially change lessor accounting.

The new standard affects balance sheet and balance sheet ratios such as the debt to equity ratio. Aside from this, it also influences the income statement, because entities now have to recognize an interest expense on the lease liability and depreciation on the right of use asset. Due to this, for lease contracts previously classified as operating leases, the total amount of expenses at the beginning of the lease period will be higher than under IAS 17. Another consequence of the changes in presentation is that EBIT and EBITDA indicators will be higher for entities that have material operating lease.

In 2016, PricewaterhouseCoopers performed a study on the impact of lease capitalization based on the 2014 IFRS financial statements of 3,199 entities in 51 countries worldwide. The study revealed that credit institutions will record a 6% median increase in debt and EBITDA and also that 37% of the credit institutions analyzed will have a debt increase of over 25%. The median leverage change was from 1.94 to 1.68 and the median solvency remained stable.

In 2018, Ernst & Young conducted a survey with 36 European banks and insurers, in order to understand their current progress with IFRS 16 implementation, expected costs and operational impacts on the business. The results revealed that almost a third of respondents consider the impact of IFRS 16 material, mostly because of balance sheet gross up (25%) and capital consequences (19%). Furthermore, only 11% of respondents considered changes in the presentation of items in the income statements material to the financial statements as a whole.

The paper continues with the analysis of the financial statements disclosures related to IFRS 16 of the top five credit institutions operating in the Romanian banking sector and assesses the extent to which these institutions have complied with disclosure requirements. For the avoidance of any doubt, we mention that all credit institutions operating in the Romanian banking sector prepared the annual financial statements according to IFRS. The sample is based on the total asset as at 31 December 2018, retrieved from the 2018 financial statements.

II. FINANCIAL STATEMENTS DISCLOSURES

In order to provide users with information that allows them to assess the amount, timing and uncertainty of lease payments, IFRS 16 includes enhanced disclosure requirements for both lessors and lessees. Whilst some disclosures are specifically required at transition date, the majority of them need to be provided on an ongoing basis. We will continue to discuss the IFRS 16 disclosures from a lessee perspective.

Disclosures specifically required at transition date

According to the requirements of the International Accounting Standard (“IAS”) 8 Accounting policies, changes in accounting estimates and errors (“IAS 8”), paragraph 31, credit institutions should disclose known or reasonably estimable information relevant to assessing the possible impact of IFRS 16 in the period of initial application.

The following information is perceived as being relevant to assess the possible impact of IFRS 16 and that credit institutions should disclose in their 2018 financial statements:

Qualitative information, such as: adoption date and information about the status of implementation project, changes in accounting policy, including exemptions (e.g. “low value assets” exemption), Transition approach selected, including practical expedients, key judgments and estimates as to assessing whether an arrangement contains a lease, determining the lease terms and calculating the discount rates; and

Quantitative information, such as: expected impact - changes in assets, liabilities and adjustments to opening retained earnings and a reconciliation of the current operating lease commitments under IAS 17 and IFRS 16 lease liabilities balances with explanations.

On-going disclosures required in each reporting period after transition date

Starting with 2019 financial statements, the credit institutions have to disclose a significant amount of information in their capacity as lessee in a lease contract. These are presented in Table no. 1 below.

Table no. 1 On-going disclosures after the transition date for lessees

Right of use asset
Depreciation charge (by class of underlying asset)
Carrying amount (by class of underlying asset)
Additions during the year

Lease liabilities
Interest expense
Maturity analysis in accordance with paragraph 39 and B11 of IFRS 7 Financial instruments: disclosures
Recognition and measurement exemptions
Expense relating to short-term leases
Expense relating to leases of low-value
Other disclosures related to income statement
Expense related to variable lease payments not included in lease liabilities
Income from subleasing right of use assets
Gains or losses arising from sale and leaseback transactions
Total cash outflow for leases
Future cash outflows from:
Variable lease payments
Extension options and termination options
Residual value guarantees
Leases not yet commenced to which the entity is committed
Short-term lease commitments
Qualitative disclosures
Nature of the lessee's leasing activities
Restrictions or covenants imposed by leases
Sale and leaseback transactions

Source: PricewaterhouseCoopers, Paper "IFRS 16 – a new era of lease accounting!", page 31

III. ANALYSIS METHODOLOGY, RESULTS AND DISCUSSIONS

In order to achieve the analysis objective we used the qualitative research method. The sample consists of top five credit institutions operating in the Romanian banking sector based on total assets as at 31 December 2018, namely: Banca Transilvania ("BT"), Banca Comerciala Romana ("BCR"), BRD Groupe Societe Generale ("BRD"), UniCredit Bank ("UniCredit) and Raiffeisen Bank ("Raiffeisen").

We obtained the 2018 IFRS financial statements from public sources, namely the official websites of the banks included in the sample. We then analyzed the IFRS 16 disclosures and the extent to which each of the five institutions complied with the disclosure requirements.

To achieve the proposed goal, we completed the following steps:

- Sample establishment and identification of data sources;
- Obtaining the IFRS financial statements from public sources;
- Individual analysis of the financial statements and data collection with regards to IFRS 16 disclosures;
- Analysis of data collected; and
- Interpretation of results obtained.

Analysis of qualitative disclosures

In terms of qualitative disclosure, we observed that the level of details presented differ among the analyzed credit institutions. Firstly, we mention that all five credit institutions decided to apply IFRS 16 starting with 1 January 2019 (no early adoption).

Secondly, the analysis revealed that UniCredit disclosed the most qualitative information with regards to IFRS 16 implementation, namely: the status of the implementation project and the internal developments needed, the accounting policies with regards to lease of intangible assets, the use of permitted exemptions (both the short-term lease and low-value assets) and a high-level computation methodology for determining the discount rate that will be used to compute the net present value of lease liabilities.

In terms of transition approach, only BCR and Raiffeisen disclosed the selected transition approach, namely the modified retrospective approach, without restating comparative information. BRD did not disclose the transition approach but mentioned that it will elect not to apply IFRS 16 for lease of intangible assets and lease contracts for which the lease terms ends within twelve months after the date of initial application. Instead, it will account for these leases as short-term leases.

BT did not disclose any further qualitative information but the adoption date.

Table no. 2 Qualitative disclosures of top five credit institutions from the Romanian banking sector

Qualitative disclosure	BT	BCR	BRD	UniCredit	Raiffeisen
Adoption date	x	x	x	x	x
Status of implementation project				x	
Changes in accounting policies			x	x	
Selected transition approach and practical expedients		X			x
Key judgments and estimates				x	

Source: author's own analysis

Analysis of quantitative disclosures

In terms of quantitative disclosure, we observed that all credit institutions presented the estimated value of the lease liability and the right of use assets that will be recorded in the balance sheet as at transition date, except for UniCredit. This aspect is not in line with IAS 8, according to which entities should disclose known or reasonable information relevant to assessing the possible impact of new adopted standards in the period of initial application.

We also observed that BCR is the only bank that presented a reconciliation of the operating lease commitments under IAS 17 and estimated lease liabilities under IFRS 16.

Table no. 3 Quantitative disclosures of top five credit institutions from the Romanian banking sector

Quantitative disclosure	BT	BCR	BRD	UniCredit	Raiffeisen
Value of right of use assets	x	x	x		x
Value of lease liabilities	x	x	x		x
Reconciliation of operating lease commitments under IAS 17 and IFRS 16 lease liabilities		x			

Source: author's own analysis

In Tables no.4 and no. 5, we presented the estimated changes in total assets and total liabilities as a result of IFRS 16 adoption. The analysis revealed that, in relative terms, Raiffeisen will incur the highest increase among the analyzed banks, in both total assets and total liabilities. The Bank estimated a lease liability and a correspondent right of use asset in amount of 393 million RON, which will lead to a 1% increase in total assets and 1.1% increase in total liabilities. In terms of financial ratios, debt to equity ratio will also increase by 1.1%, reaching an estimated level of 8.85, the highest relative increase among all five banks.

BRD is the only analyzed credit institution that disclosed an estimated right of use asset that does not equal the estimated lease liability. The Bank disclosed an estimated right of use asset of 467 million RON, while the estimated lease liability amounts to 482 million RON, the highest lease liability value presented among the analyzed banks. In terms of balance sheet changes, BRD's total assets are expected to increase by 0.9%, while the total liabilities by 1%. The Bank's debt to equity ratio is expected to increase by 1%, reaching a level of 6.45.

BT reported the highest right of use asset value among the analyzed banks and expects a 0.6% increase in total assets and 0.7% increase in total liabilities. The debt to equity ratio is expected to increase by 0.7%.

BCR reported an estimated lease liability and a corresponding right of use asset in amount of 287 million RON. This is the lowest impact value among the analyzed banks. Furthermore, it also records the lowest impact in the total assets (0.4% increase) and also in total liabilities (0.5%). Debt to equity ratio will increase by 0.5%, reaching a level of 7.38.

Table no. 4 Estimated relative change in the total assets at transition date

Indicator	BT	BCR	BRD	UniCredit	Raiffeisen
Actual total assets as at 31 December 2018*	74,118,091	67,909,254	54,089,354	41,456,496	40,049,810
Estimated total assets as at 1 January 2019 (IFRS 16 impact included)*	74,589,091	68,196,333	54,556,354	41,456,496	40,442,810
Estimated increase in total assets (%)	0.6%	0.4%	0.9%	0%	1%

* the assets and liabilities are expressed in thousands RON

Source: author's own analysis

Table no. 5 Estimated relative change in the total liabilities at transition date

Indicator	BT	BCR	BRD	UniCredit	Raiffeisen
Actual total liabilities as at 31 December 2018*	66,707,698	59,771,179	46,761,945	36,998,085	35,945,885
Estimated total liabilities as at 1 January 2019 (IFRS 16 impact included)*	67,178,698	60,058,258	47,243,945	36,998,085	36,338,885
Estimated increase in total liabilities (%)	0.7%	0.5%	1%	0%	1.1%

* the assets and liabilities are expressed in thousands RON
Source: author's own analysis

Table no. 6 Debt to equity ratio at transition date

Indicator	BT	BCR	BRD	UniCredit	Raiffeisen
Estimated total liabilities as at 1 January 2019 (IFRS 16 impact included)*	67,178,698	60,058,258	47,243,945	36,998,085	36,338,885
Total equity as at 31 December 2018*	7,411,216	8,138,075	7,327,409	4,548,411	4,103,925
Debt/equity ratio	9.06	7.38	6.45	8.13	8.85

* the liabilities and equity are expressed in thousands RON
Source: author's own analysis

IV. CONCLUSION

IFRS 16 requirements eliminate nearly all off-balance sheet accounting for lessees and redefine many commonly used financial metrics such as gearing ratio and EBITDA. This will increase comparability, but may also affect covenants, credit ratings and borrowing costs. Changes to the lease accounting standard have a far-reaching impact on lessee's business processes, systems and controls. Lessees will require significantly more data around their leases than before, given the on balance sheet accounting for almost all leases.

The results of the analysis conducted revealed that the major part of the credit institutions included in the sample complied to a great extent with IFRS disclosures requirements as at transition date. In terms of qualitative disclosures, we observed that the level of the information disclosed differs significantly from one bank to another.

In terms of qualitative disclosures, four out of the five analyzed banks disclosed the estimated balance sheet impact as a result of IFRS 16 adoption, which is considered to be the most important disclosure for the financial statements users. Only one bank presented a reconciliation between the lease commitments under IAS 17 and the estimated lease liabilities under IFRS 16.

The results showed that the total assets and total liabilities of the analyzed banks will not incur significant increases in relative terms but the absolute values are deemed to be significant.

Regarding the analysis limitations, we consider that one of the limitations is represented by the lack of disclosure of the IFRS 16 impact by one of the banks included in the analysis. Furthermore, the sample is limited only to the top five credit institutions because, as at the date of our analysis, not all credit institutions have finalized the preparation of 2018 financial statements and therefore, we were not able to access this information from a public source.

With regards to future research directions, we aim to continue the study with analyzing the IFRS 16 impact for the other top twenty credit institutions from the Romanian banking sector.

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