IFRS 16 LEASES – PRESENTATION AND DISCLOSURE ISSUES IN SHIPPING

UPDATE: SHIPPING

The new standard on leasing, IFRS 16 Leases, came into effect on 1 January 2019. Shipping companies preparing financial statements will need to consider the presentation requirements and plan for the additional disclosures.

IMPACT OVERVIEW

For lessees, the impact of the changes arising from leases which previously were accounted for as operating leases include:

- an increase in the assets and liabilities of the entity
- an improvement in the operating profitability over the duration of the lease, as part of the cost of a charter will be presented within finance costs
- a change in the profit effect profile, as a typical arrangement will have a higher cost in the early part of the life of the charter and a lower cost at the end
- an improvement in operating cash flows as amounts previously classified as operating will now be split between financing and interest
- a corresponding increase in reported financing cash outflows.

In addition, there will be an impact on financial ratios, including:

- a deterioration of gearing ratios as debt will go up without a proportionate increase in equity
- an increase in EBITDA as lease charges will be replaced by depreciation and interest.

PRESENTATION: LESSEES

Statement of financial position

Where an entity charters in vessels, they are required to recognise both a right of use asset and the related lease liability. The asset may either be shown separately on the face of the statement of financial position or combinedwith similar underlying assets as if they were owned. Where they are combined with owned assets on the face of the statement of financial position, the right of use assets must be shown separately in a note.

The related lease liability may also be presented separately on the face of the statement of financial position, or disclosure given of which line item(s) include these liabilities.

Income statement

The costs associated with the charters comprise the depreciation of the right of use asset and interest expense for the lease liability. The depreciation will form part of the total operating expenses, whilst the interest will be included as a finance expenses in the period.

Cash flows

In the statement of cash flows, payments to reduce the principal portion of the lease liability will be included as part of financing activities whilst interest amounts will be included with other interest payments. Entities have a policy choice for the classification of interest and may treat interest as part of operating, investing or financing activities. Interest on a lease would be classified in a consistent manner.

If the entity has short-term leases for which exemption is taken permitting then to be expensed as incurred, the total payments made thereunder would be included as part of operating activities.

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For more information and advice on IFRS 16, please get in touch.

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PRESENTATION: LESSORS

The presentation requirements for a lessor under the previous standard do not change under IFRS 16.

DISCLOSURES: LESSEES

The standard sets out an overall disclosure objective, "to disclose information for users to assess the effect that leases have on the financial position, financial performance and cash flows". This is supported by detailed specific requirements which would typically meet this. For businesses in shipping, the disclosures include:

- total depreciation charge for right of use assets
- interest expense on lease liabilities
- variable lease payments not included in the lease liability
- income from subleasing right of use assets
- total cash outflow for leases
- additions to right of use assets
- gain or losses from sale and leaseback arrangements
- the carrying amount of right of use assets at the end of the period by class of underlying asset
- a maturity analysis of lease liabilities. This must be shown separately from the maturity analysis required for other, non- lease, liabilities.

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Some of this may fall to be included within the disclosures given for non-current assets, for example disclosure for property, plant and equipment. However other items, such as total cash outflows from leasing and amounts in respect of subleases and sale and leasebacks, may require changes to the reporting entity's systems to ensure that information is captured in an effective manner. Where a shipping business both charters vessels in and charters vessels out this could be a significant additional requirement, especially where these may previously have been operating leases.

In addition, if either the short term or low value exemptions have been taken, separate disclosure is required of the expense for the period in respect of each exemption taken.

The disclosures above are supplemented by a need for further quantitative and qualitative analysis. These requirements are much less prescriptive and will require judgment about the extent of detail disclosed. These disclosures will only be needed if they are considered necessary to meet the objective and where it is relevant to users of the financial statements.

The financial statements must include details about the nature of the lessees leasing activities. This could include comments about the flexibility in leases arrangements, restrictions in leases, sensitivity to changes in key variables, such as variable payments, extension/termination options and the reasons for their inclusion, together with deviations from shipping industry practice or norms.

Where an entity has undertaken any sale and leaseback transactions the standard is strongly suggestive that disclosure is given of the reason for the sale and leaseback, key terms and conditions of individual transactions, any payments not included in the lease liability and the cash flow effect in the reporting period. Arguably, whilst much of this was required under the previous standard, it was less explicit.

DISCLOSURES: LESSORS

The standard has substantial disclosure requirements for lessors, but many of these are similar to the previous standard with only a few additions. As part of the overall disclosure objective for both finance and operating leases, there should be information about the nature of the leasing activities and how the risks associated with rights retained in the underlying assets are managed. This could be through, for example, the use of residual value guarantees, buy-back arrangements or variable lease payments for use in excess of specified amounts.

Finance leases

There must be disclosed for the year any selling profit or loss, finance income on the net investment in the lease and any variable amounts recognised as an expense in the year and not included in the lease liability.

Significant movements in the carrying amount of the changes in the net investment must be explained. The notes must also give a maturity analysis of lease payments receivable, undiscounted, for each year up to five years and in total thereafter. This analysis must be reconciled to the carrying amount of the net investment in leases through the identification of the amount of unearned income.

Operating leases

The financial statements must disclose the operating lease income, distinguishing any variable amounts that do not depend on an index or rate. The previous standard required disclosure of contingent rents, so whilst the words are different under IFRS 16 this is expected to capture the same amounts.

There remains the requirement with operating leases to disclose a maturity analysis of lease amounts receivable, showing undiscounted amounts to be received for each of the next five years and the total for amounts to be received after more than five years.

ACCOUNTING POLICIES

In addition to the above, accounting policies need to reflect IFRS 16 for all purposes.

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