

IFRS16

HOW TO MAINTAIN OFF BALANCE SHEET FUNDING

by Andrew Craggs

What is IFRS16

Overview

IFRS 16 is a financial accounting standard issued by the International Accounting Standards Board (IASB) in January 2016, which took effect for financial periods beginning on or after January 1, 2019. The standard replaces the previous leasing standard, IAS 17, and represents a significant change in the way leases are accounted for under International Financial Reporting Standards (IFRS).

Under IFRS 16, companies are required to recognise most leases on their balance sheets as assets and liabilities, regardless of whether they are classified as operating or finance leases. This means that lessees are required to recognise a right-of-use asset representing their right to use the leased asset and a corresponding lease liability representing their obligation to make lease payments.

IFRS 16 also introduces a single model for lease accounting, which requires lessees to recognise interest and depreciation expenses separately. Interest expense is recognised based on the lease liability at the incremental borrowing rate, while depreciation expense is recognised based on the right-of-use asset over the lease term.

The standard defines a lease as a contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for consideration. The asset may be tangible or intangible and may include property, plant, and equipment, vehicles, or other equipment. The consideration may be fixed or variable and may include lease payments, residual value guarantees, and other payments.

IFRS 16 applies to all companies that prepare financial statements in accordance with IFRS, including listed and unlisted companies, and covers all types of leases, except for leases with a term of 12 months or less and leases of low-value assets.

The introduction of IFRS 16 has significant implications for companies, as it affects the way they account for leases in their financial statements and can impact financial ratios and key performance indicators. Additionally, IFRS 16 compliance requires significant changes to systems and processes, as well as increased data management and reporting requirements.

In summary, IFRS 16 is a significant change in lease accounting standards, requiring lessees to recognise most leases on their balance sheets as assets and liabilities, regardless of their classification. The standard has implications for financial reporting, systems and processes, and data management and reporting requirements.



So what is the solution?

Introduction

Acquiring assets is an essential part of any organisations operations, but it can be a significant challenge specifically for the UK Public Sector and large corporate businesses, particularly when it comes to large-scale projects. Budgetary constraints and capital budget authorisations can cause significant delays in the implementation of such projects.

In this white paper, we will explore the benefits of acquiring assets under a "pay as you use" managed service contract for UK, North American and Western European based organisations. We will also discuss how the use of such a service is helping UK Public Sector bodies overcome the issues they face under the IFRS16 accounting standard.

There will continue to be restricted allocation of capital budgets for the foreseeable future so by obtaining assets under a service agreement the cost is classed as an operating expense rather than capital expenditure. As an operational expense, the asset is not subject to IFRS16 scrutiny.

What is a "Pay as You Use" Managed Service Contract?

A "pay as you use" managed service contract is an agreement between an organisation and a service provider in which the service provider supplies and manages the assets required by the organisation. The organisation pays for the assets based on their usage, rather than purchasing them outright. The service provider is responsible for maintaining and upgrading the assets, and the organisation benefits from the latest technology without having to worry about the cost of acquiring or maintaining the assets.

Benefits of a "Pay as You Use" Managed Service Contract

There are several benefits of acquiring assets under a "pay as you use" managed service contract, particularly for the UK Public Sector and large corporate businesses. These benefits include:

- Cost Savings

One of the primary benefits of a "pay as you use" managed service contract is the cost savings it can provide. Instead of purchasing assets outright, the organisation only pays for the assets based on their usage. This can result in significant cost savings, particularly for large-scale projects that would normally be held up by capital budget authorisations.

- Flexibility

A "pay as you use" managed service contract also provides flexibility for the organisation. The organisation can scale up or down the use of the assets as required, without worrying about the cost of purchasing or disposing of assets. This flexibility is particularly important for the UK Public Sector, where the needs of the organisation can change rapidly.

- Latest Technology

Another benefit of a "pay as you use" managed service contract is access to the latest technology. The service provider is responsible for maintaining and upgrading the assets, ensuring that the organisation has access to the latest technology without having to worry about the cost of acquiring or maintaining the assets. This can provide a significant competitive advantage for the organisation.

- Reduced Administration

A "pay as you use" managed service contract can also reduce the administrative burden on the organisation. The service provider is responsible for maintaining and upgrading the assets, as well as managing the associated paperwork. This can free up valuable resources within the organisation to focus on other tasks.



IFRS16 and Managed Service Contracts

The International Financial Reporting Standard 16 (IFRS16) requires organisations to recognise all leases on their balance sheet. This can be a significant challenge for the UK Public Sector, particularly when it comes to large-scale projects. Acquiring assets under a "pay as you use" managed service contract can help UK Public Sector bodies overcome the issues they face under the IFRS16 accounting standard.

Under a "pay as you use" managed service contract, the service provider retains ownership of the assets and is responsible for the associated lease payments. This means that the assets do not need to be recognised on the organisation's balance sheet, reducing the impact of IFRS16 on the organisation's financial statements.

Conclusion

Acquiring assets under a "pay as you use" managed service contract can provide significant benefits for the large corporate businesses and the UK Public Sector, particularly for large-scale projects that would normally be held up by capital budget authorisations. These benefits include cost savings, flexibility, access to the latest technology, and reduced administration. In addition, the use of such a service can help UK Public Sector bodies overcome the issues they face under the IFRS16 introduction and

About the Author

Andrew Craggs is the Managing Director of ECS Management Services Limited, trading as ECS Group, who are a UK based Finance Advisory and Commercial Finance Brokerage. Andrew has spend nearly 40 years in the commercial finance arena working for major financial institutions before establishing ECS Group in 1999. He has substantial knowledge of the

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