

C.5.1 Statistical Impact of the Change in Treatment of Operating Leases in Business Accounting

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The introduction of a new International Financial Reporting Standard on Leases (IFRS 16) from January 2019, which is no longer aligned with current recording standards in the System of National Accounts (2008 SNA) and the Balance of Payments and International Investment Position Manual, sixth edition (BPM6) regarding the concept of economic ownership, poses some serious challenges for compilers to separately record cross border operating and financial leasing activities. This Guidance Note provides an overview of the potential implications for the statistical community from the asymmetric implementation of IFRS 16 in business accounting. It also gives arguments supporting a recommendation to adjust reported data on leasing activities and preserve the fundamental concepts of the 2008 SNA and the BPM6.

SECTION I: THE ISSUE

BACKGROUND

- 1. In January 2016, the International Accounting Standards Board (IASB) published an International Financial Reporting Standard on leases (hereafter referred to as IFRS 16).** The new standard was effective from January 1, 2019, replacing the previous leasing standard, IAS 17.2. All companies using rentals or leasing as a means to obtain access to assets, and that report under IFRS 16, are affected (see Annex I for more information on IFRS 16).
- 2. The right to control the use of an identified asset approach, as introduced by IFRS 16 in relation to leases, where the customer has the right to obtain all economic benefits from the use of the asset and to decide how and for what purpose it is used, deviates from the *System of National Accounts (2008 SNA)* and the *Balance of Payments and International Investment Position Manual, sixth edition (BPM6)* model of risks and rewards incidental to economic ownership (finance versus operating leases).³** A potential change of the *2008 SNA* and *BPM6* in line with this IFRS, would therefore challenge this fundamental principle in the statistical manuals.
- 3. However, even if the 2008 SNA and BPM6 remain unchanged, the new leasing standard poses challenges for the statistical recording of leases.** This note also looks into how such challenges could be addressed.
- 4. This issue has also been identified for discussion in the Government Finance Statistics (GFS) community, where there is an ongoing process of interaction with the International Public**

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² IAS 17 has been criticized for failing to meet the needs of users of the financial statements, particularly because IAS 17 does not require lessees to recognize assets and liabilities arising from operating leases. IFRS 16 addresses those criticisms by requiring lessees to recognize most leases on their balance sheets and providing enhanced disclosures. Further, lessees' financial obligations and leasing activities are now presented in a more transparent way.

³ Paragraphs 9 and 20 as well as 26–29 in Annex I provide more information on recording of leases under IFRS 16.

Sector Accounting Standards Board (IPSASB), and it is likely that the issue will be discussed at the next GFS Advisory Committee meeting and also at an Eurostat task force on the recording and compilation of maritime transactions in National Accounts and Balance of Payments.

Current International Standards for the Treatment of the Issue:

2008 SNA and BPM6

5. **The 2008 SNA (paragraphs §17.301–§17.309) and the BPM6 (paragraphs §5.56–§5.60 and §10.153–§10.157) maintain a distinction between operating and financial leases for both lessors and lessees, and lay down that assets are recorded by the economic owner following the concept of risks and rewards.**

6. **Under the 2008 SNA and the BPM6, there is a distinction between the assets that are used under operating leases and financial leases respectively.** According to 2008 SNA §17.301 and the BPM6 §10.153 under an operating lease, the legal owner (lessor) is also the economic owner and accepts risks and receives the benefits from the asset, while the asset remains on its balance sheet. The payments from a lessee to the lessor under an operating lease are considered as rentals and recorded as payments for a service. One indicative criterion of an operating lease is the legal owner's responsibility to provide and pay for any necessary repair and maintenance of the asset (2008 SNA §17.302 and BPM6 §10.154 (c)).

7. **On the contrary, a financial lease (2008 SNA §17.304 and BPM6 §5.56), passes the economic ownership of an asset to the lessee, who accepts the risks and receives the economic benefits from the exploitation of the asset.** The legal owner (lessor) is shown as granting a loan to the lessee and the lessee receives the asset. The asset is shown on the balance sheet of the lessee and not the lessor. The corresponding loan is shown as an asset of the lessor and a liability of the lessee. The 2008 SNA and BPM6 treat the payments from a lessee to the lessor as interest payments and repayment of principal. In case the lessor is a financial institution, FISIM has to be imputed (BPM6 §5.59).

8. **A more in-depth methodological elaboration on relevant criteria that can be used to identify operational and financial leasing transactions and modalities to clearly distinguish between the two types, will be presented in the Guidance Note C.5.2 “Economic Ownership in the Context of Financial and Operating Lease Transactions Pertaining, in Particular, to Aircrafts”.**

IAS 17 and IFRS 16

9. **Classification and treatment of leases in the 2008 SNA and the BPM6 and in the old accounting standard IAS 17 are closely aligned.** However, lessees preparing accounts according to the new IFRS 16 standard will not distinguish between operating and financial leases but account for all leases over 12 months in the same way, similar to the treatment of financial leases under IAS 17. Recording under IFRS 16 differs in the following way compared to IAS 17:

- Lessees have to recognize on its balance sheet assets and liabilities for all leases with a term of more than 12 months (except low value assets).
- Lessees have to recognize an asset and associated liability for all lease arrangements—including those that were classified as operating leases under IAS 17.

- Lessor accounting under IFRS 16 does not change compared to IAS 17.
- Lessor accounting will be different from Lessees accounting under IFRS 16.

For more information please refer to paragraphs 26–29 in the Annex I.

Concerns/Shortcomings of the Current Statistical Standards:

10. **By maintaining the recording standards of the 2008 SNA and BPM6 for the compilation of national accounts and the balance of payments data, respectively, the implementation of IFRS 16 will potentially create the risks of misclassifications, inconsistencies, and asymmetric recordings in countries' current and financial accounts in regard to the recording of leasing activities.**

11. **For balance of payments, a bilateral potential misreporting is possible if the leasing activity of a lessor resident of country A and a lessee resident in country B is recorded.** Country A may record correctly an operational lease provided by the lessor to the lessee in country B as an export of service. Country B however no longer has the information from the lessee to distinguish between operational and financial leasing and may record a financial lease, with an import of the capital good, related interest payments for the provided loan under primary income, repayment of the principal and a corresponding entry in the financial account. If the lessor is a financial institution, part of the payment is also treated as a service charge. This asymmetric recording would create bilateral discrepancies in goods, services, primary income, and also the financial account. Moreover, a not harmonized and comprehensive implementation of IFRS 16 by enterprises may add even more complexity and potential misclassifications. Statistical compilers of BOP and NA need therefore to engage extensively with their key data providers, especially when it comes to assessing if economic ownership has been passed to the lessee or not in order to separate operational from financial leasing.

12. **Already under the IAS17 standard there could have been bilateral discrepancies existing in relation to different treatments of traded goods under leasing. Most countries use international merchandise trade statistics (IMTS) as their benchmark for BOP trade in goods.** In practice, it may be difficult to differentiate between these two types of leases. Therefore, in some cases, the duration of the lease can be used as an indication of whether the lease is financial (one year or more) or operating (less than one year).⁴

ISSUES FOR DISCUSSION

13. **To address the changes brought by the implementation of the IFRS 16 in business accounting, the following two options are considered:**

Option 1: Revision of the 2008 SNA and BPM6 to eliminate the distinction between operating and financial leasing (in line with the lessee recording in IFRS 16)

14. **Changing the recording standards of the 2008 SNA and BPM6 would enable enterprises to report their leasing activities for their accounts and statistics in a similar way.** By assuming a harmonized introduction of IFRS 16 by all enterprises there would be no need for specific adjustments,

⁴ The economic lifetime of the asset should also be taken into account because a lease can be considered as a financial lease if it covers most of the economic lifetime of the asset.

estimations or assumptions to obtain balance of payments values from business accounts data. Due to the asymmetric reporting under IFRS 16 between the lessor and the lessee even under this option some further adaption of the reported business account data would still be necessary in order to avoid specific discrepancies related to leasing in national accounts and balance of payments.

15. **However, the 2008 SNA and BPM6 identify two different types of leasing arrangements (operational and financial).** The legal owner contracts with other unit in a financial lease to shift the use, benefits and related risks related to the use of the asset to that other unit (lessee) in exchange for an agreed fee. In this case, legal and economic ownership no longer coincide as the lessee becomes the economic owner of the asset, instead of the lessor who is the legal owner. A lease can also be set up as operational lease. In that case, the legal owner rents out the asset, but still accepts the operating risks and rewards related to the use of it and remains the economic owner of the asset (for references see Annex II to this document). Both manuals record transactions according to the change of economic ownership principle that can be considered also as the fundamental recording principle in other related manuals (for example, *GFSM, ESA 2010, MSITS 2010*). Applying a different recording principle for leasing activities in order to be in line with IFRS 16 would therefore create a severe inconsistency with a fundamental recording principle in both manuals. Changes to the approach to leasing would therefore need to be included within a broader consideration of the use of the economic ownership principle in the manuals.

Option 2: Adjusting Reported Data According to the Underlying IFRS 16 and Maintaining the Change of Economic Ownership Principle in the BPM6 and 2008 SNA.

16. **The 2008 SNA and the BPM6 require symmetrical counterparty transactions.** The distinction between operating and financial leasing and the notion of economic ownership and the risk-and-reward concept is important in the existing accounting frameworks. Therefore, all recorded flows should reflect the distinction between operating and finance leasing. This could be achieved by bridging of IFRS 16 indicators, invoice-reporting and changes of national compilers' surveys' questionnaires.

17. **Surveys of lessees applying IFRS 16 probably need to be adjusted for use by national accountants and balance of payment compilers.** The adjustments will vary depending on how closely the survey is related to business accounting concepts. One option is to ask respondents to maintain the distinction according to *2008 SNA* and the *BPM6* between operational and financial leasing. The downside of this option is it is unlikely that the reporting companies will maintain two sets of accounting only for statistical purpose. Therefore, a more likely option is to make adjustments after data collection, based on additional information collected either in the survey or from other sources, such as direct contact with companies. There is also the possibility to exchange bilateral data from lessors to obtain the corresponding mirror data for lessees, where the counterparties are known.

18. **Adjustments may be based on the 'invoice' when available, for example, in the business accounting system of the lessee or on a model of the data related to 'right-of-use' assets.** The model would ideally be based on available detailed financial leases data; the stocks/flows for the captured leases would be estimated through the end of their current lease term. New financial leases could be added to the model over time, when a new right-of-use asset is identified which aligns with the *2008 SNA* definition of a financial lease. All residual leases would be considered as operating leases.

19. **The lease debt maturity breakdown may be used as an indicator to estimate principal and interest.** Separating components, for example, of an aircraft group fleet presented as operating lease, could be the starting point to partition the reimbursement (repayment of the principal) of a lease debt and interest on lease debt according to the share of operating leasing to total leasing. A source could be the information available in the IAS 17 Statement of Cash Flows.

SECTION II: OUTCOMES

20. **Recommendation:** the position is NOT to change the international guides the *2008 SNA* and *BPM6* regarding the concept of economic ownership but to provide additional practical advice on how to compile financial and operating lease and explain the differences between the two recording standards IFRS 16 and *2008 SNA/BPM6* (option 2).

Proposed Treatment and Its Rationale:

21. **The question of a potential future change of the *2008 SNA* and the *BPM6* to be more in line with the IFRS 16 treatment for leasing (lessees) raises some important horizontal issues and should be further discussed.**

22. **Aside from the overall conceptual implications of moving away from a risks and rewards approach, IFRS 16 also introduces the ‘right to control the use’ of an asset.** The customer has the right to control the use of an identified asset if he has the right to obtain substantially all of the economic benefits from the use of the asset and the right to direct the use of the asset, i.e. to decide how and for what purpose it is used.

23. **The changes introduced by the international accounting standards might create imbalances in macroeconomic statistics due to the asymmetric nature of the reporting by the statistical units.** Currently, statistics are compiled in accordance with the *2008 SNA* and *BPM6*, which recognize the operating/finance leasing distinction and concept of risks-and-reward for economic ownership. IFRS 16 focuses on the notion of control.

24. **By just using business account data based on IFRS 16 without further corrections or adjustments, reporters and compilers will be faced with the following challenge:** lessees might report the transactions related to leases (interest, services, etc.) in a different way that they used to and therefore there is a risk that compilers will not be able to account for these adjustments and that financial and operating leases will be misclassified.

25. **There are several ways to handle the accounting changes.** One option is to modify statistical surveys’ questionnaires. Further options are to use the ‘invoice’ when available, for example, in the business accounting system or to model the flows on available stocks/flows data related to ‘right-of-use’ assets. There is also the possibility to exchange bilateral data from lessors to obtain corresponding mirror data for lessees, where the counterparties are known.

Rejected Alternatives with Reasons:

26. **The alternative would be to implement the right to control the use of an identified asset related to leases in the *2008 SNA/BPM6* in order to accommodate changes brought by the IFRS 16**

to the business accounting. This would require a broader consideration of the use of the economic ownership (risk-and-reward) principle in SNA/BPM, and therefore would need to be included within a wider scope of work. It would also require a change to the current asset classification to handle the 'right of use' asset in IFRS16.

Required Changes in the Current Standards:

27. **According to the recommendation there is no need to change the recording standards of the 2008 SNA and BPM6 concerning the principle of economic ownership.** However, Guidance Note C.5.2 will provide a deeper methodological discussion regarding the relevant criteria of separating operational from financial leasing activities. The updated BPM should provide clear guidance to compilers on how to split up reported leasing activities under IFRS 16 into operational and financial leasing and make them aware about potential bilateral asymmetries.

Questions for Discussion:

1. *Do members agree with the option recommended in the GN to maintain status quo and not to make any changes to the 2008 SNA and BPM6 recording standards on leases to align it with the IFRS 16?*
2. *Do members agree with the proposed practical approaches for addressing the challenges with the implementation of IFRS 16 in business accounting and is there a need for providing additional guidance in the BPM6 Compilation Guide?*
3. *Do members have any other views/suggestions on dealing with the implementation IFRS 16 and the recording of leasing activities in 2008 SNA and BPM6?*

Annex I. New Accounting Standard IFRS 16 ⁵

1. **IFRS 16 introduces a single lessee accounting model, which requires a lessee to recognize on its balance sheet assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value.** At the inception of a lease, a lessee is required to recognize the 'right-of-use' asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. The lessee records depreciation of the right-of-use asset and interest on the lease liability in its profit and loss statement.
2. **Contrary to the previous standard IAS 17, lessees have to recognize an asset and associated liability for all lease arrangements, including those that were classified as operating leases under IAS 17.** A recognition and measurement exemption for short term leases and leases of low value assets is available as a policy choice. However, this is only available to the lessee.
3. **Lessor accounting under IFRS 16 did not change compared to IAS 17.** The lessor continues to classify its leasing arrangements as operating leasing or financial leasing, and to account for those two types of leasing arrangements differently. Operating leasing income received by the lessor is reported in income items, for example, 'rent, leasing and hiring income.' Regarding financial leasing, payments received by the lessor are treated as finance payments. The interest on financial leasing is reported in income items, 'interest income.' The repayment of the principal is not recorded in profit and loss accounts. The change in lease debt due to reimbursement is reported in the cash flow statement.
4. **IFRS 16 allows entities (particularly lessees) some options as they transition from IAS 17, and the choice of options may vary substantially across entities.** In addition, changes in IFRS are not necessarily implemented in other business accounting standards (at least initially), so national General Agreed Accounting Policies (GAAP) may remain unchanged, at least for some time. Depending on the country, the application of IFRS 16 standards may not be required for all companies, in particular the smaller ones.
5. The main change introduced by the IFRS 16 is the recognition of assets and liabilities from operating leases by the lessee, improving thus the financial statements accuracy. This implies that all leases, irrespective of their nature (operating or financial), will be recognised at the inception of the contract, the aim being to show all lease liabilities, regardless of type, on the lessee's balance sheet.
6. The main reason behind this change is to respond to concerns about the lack of transparency of information about lease obligations with respect to high value assets, such as aircrafts or ships (low value assets and leases under 12 months are excluded), which prevents investors and analysts to properly compare companies that borrow to buy assets with those that lease assets, without making adjustments.⁶

⁵https://ec.europa.eu/eurostat/documents/39118/10303150/Impact_on_macro-economic_statistics_of_IFRS_16_on_leases.pdf

⁶ See for further details in the Eurostat's [Handbook on the compilation of statistics on sea and air transport in national accounts and balance of payments, Luxembourg 2020](#).

Annex II. Risk and Reward Principle as Laid Down in International Guides

2008 SNA

1. **§10.57 A financial lease is a contract between a lessor and a lessee whereby the lessor legally owns the good**, but the terms of the lease are such that the lessee takes over both the economic risks and rewards of using the asset in production.
2. **§11.78 When goods are acquired under a financial lease, a change of economic ownership of the goods from the lessor to the lessee is deemed to take place.** The change of economic ownership may be distinguished by the fact that all the risks and rewards of ownership are transferred from the legal owner of the good, the lessor, to the user of the good, the lessee.

BPM6

3. **§5.2 Economic assets are resources over which ownership rights are enforced and from which future economic benefits may flow to the owner.** They include fixed assets, such as equipment and research and development, that are used repeatedly or continuously in production over more than one year. They also include inventories, valuables, non-produced assets, and financial assets.
4. **§5.3 Every economic asset has an owner.** The economic owner of the asset is the party who has the risks and rewards of ownership... Usually, the economic owner is the same as the legal owner, but they may differ in cases such as financial leases. Under some legal arrangements, elements of the risks and rewards are split between different parties, so it is necessary to identify which party has the bulk of risks and rewards to identify the economic ownership... Different kinds of economic benefits that may be derived from an asset include:
 - (a) the ability to use assets, such as buildings or machinery, in production.