

IFRS Proposed Changes – Accounting for Operating Leases Impact for Rental Companies

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IFRS Proposed Changes – Accounting for Leases

- Background on reporting
 - How to report, GAAP or IFRS
- The way it was
- Proposed changes – STILL BEING DEBATED
 - Balance Sheet
 - Right to use asset
 - Lease liability
- Impact of changes on Rental Companies
 - Financing
 - Ratios – Solvency Ratio
 - Valuations
- I don't report under IFRS – what does this mean to me?

IFRS and GAAP reporting

- IFRS = International Financial Reporting Standard
 - Why does it exist?
 - Differences between accounting systems for different countries
 - Compare apples with apples
- GAAP = Generally Accepted Accounting Principles
 - Can be different for each country
- Often countries look at IFRS as they update their accounting standards; but not always

The Way It Was – IFRS accounting for Leases – IAS 17

- Finance Leases (sometimes called Capital Leases)
 - Asset on balance sheet
 - Liability on balance sheet
 - P&L expenses are depreciation and interest
 - “risks and rewards of ownership to Lessee (customer)”
- Operating Lease
 - Anything that is not a finance lease
 - Cost of lease “rental” is a P&L expense
 - Examples – one day rental of a car from Avis
 - Not on balance sheet, just expense the €50 invoice
 - 5 year full service operating lease
 - Not on balance sheet, even though there is a substantial commitment to make payments for multiple years

Proposed Changes – IFRS Lease Accounting

- Changes discussed and consulted
 - Detail available on IFRS website
- Motivations for change
 - Disclosure of often large liabilities taken by Lessee
 - “same payments for same assets” disappear off balance sheet, just by relatively small changes in lease documentation
 - More accurate picture of lessee’s liabilities (and obligations, overheads, volatility and business risk)

IFRS proposed changes II

- Finance Leases (capital leases) = no change
- Operating Leases:
 - Show the asset “right to use”
 - Show the lease liability
 - Examples:



	Before changes		After proposed changes	
Profit and Loss				
Total Revenue	27		27	
Rental Revenue	25		25	
Trasport and parts revenue	2		2	
Cost of Goods Sold	(13)		(5)	
Parts and transport expense	(3)		(3)	
Rental Expense	(10)		(2)	
Selling General and Administrative Expenses	(4)		(4)	
EBITDA (earnings before....)	10	37.0%	18	66.7%
Depreciation	(5)		(12)	
Interest	(1)		(2)	
Profit before Tax	4		4	





EUROPEAN
RENTAL
ASSOCIATION

Balance Sheet

Fixed Assets	25		50
Rental Equipment	25		25
Right to Use (leased equipment)	-	→	25
Current Assets	9		9
Trade Accounts Receivable	7		7
Cash	2		2
Capital and Reserves	8		8
Retained Earnings	5		5
Share Capital	3		3
Short term Liabilities	6		6
Trade Accounts Payable	5		5
Bank Loans - short term	1		1
Long term Liabilities	20		45
Equipment Leases	20	→	45
checksum	-		-
Debt to Equity Ratio	3.3	→	6.4
	to 1		to 1

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We don't report under IFRS, so does this affect us?

- Many rental companies report under local country GAAP
- However, your bank may adjust to IFRS
 - Especially if it's a multinational bank
- You may seek investment (venture capital? Stock exchange? Joint venture partner?) from financial sources who report under IFRS
- Your (future) acquirer may report under IFRS
- Your local country GAAP may adopt the same treatment as IFRS
- **Keep this in mind if:**
 - You have Operating Leases
 - You are considering Operating Leases
 - Or re-negotiating any existing financing
 - Or acquiring a company with Operating Leases