IFRS 16 CALLS FOR NEW RULES IN AVIATION FINANCE GAME

News / Finance

Starting January, 2019, the currently effective International Accounting Standard (IAS) 17 is to be replaced by the International Financial Reporting Standard (IFRS) 16. And although on paper the legislators declare “only minor changes from the current standards”, in reality some sectors, such as aviation, might have to adapt to completely new game rules.

The new standard introduces a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless their term is 12 months or less or the underlying asset has a low value. In other words, any rental obligation which now falls under the line of operations shall be treated as debt.

According to legislators, the new Standard is aimed at increasing transparency with regard to cost-structure and long-term liabilities. However, experts argue that the requirement to treat leases as long-term liabilities will cause some major headaches to all parties.

“Firstly, more than 50% of currently operating aviation companies will find themselves in breach of the existing covenants to various finance institutions in terms of the allowed level of debt and the authorized size of liabilities. Secondly, most airlines will have to figure out how to present leases, which are usually calculated in USD, on their balance sheets,

which, outside of US, are typically presented in local currencies," commented the Board Chairman of Avia Solutions Group and ZIA Valda Gediminas Ziemelis.

According to the executive, for some airlines the new Standard will bring up to 100% increase in long-term liabilities. Taking into account the fact that one aircraft is leased to at least 2-3 operators over its lifecycle, a single carrier may demonstrate poor results on paper in the end of one accounting period, but suffer no serious loss in the long run.

"Of course, some may argue that IFRS 16 will allow banks to form a clearer picture when it comes to airline cost structure. This should increase the confidence of investors and thus reduce borrowing cost. However, this will only be possible subject to certain adjustments to the allowed debt/equity ratio," shared G. Ziemelis.

Although the upcoming change is to have an impact on more than 20 industries from retail to utilities, aviation will see the second biggest impact. Moreover, the most considerable effects of the switch would be on asset-light low-fare airlines which largely rely on lease-rentals for their operations.

"Some even argue that the adoption of IFRS 16 may lead to the defeat of operating lease as a concept entirely, stating that many airlines may decide to shift to finance leases or outright aircraft purchases. I, however, think that with time the industry will find ways to adapt to the changing rules of the game and discover new solutions which will be favoured by both airlines and financial institutions," concluded the executive.

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