



IFRS 16 - Addressing the FX mismatch issue



Killian Croke

Dubai October 2017

IFRS-16 - what does it mean

- IFRS – 16 Leases
 - Bigger impact for lessees than lessors
 - Requires lessees to bring all leases on balance sheet using common methodology

Balance sheet

Asset
= 'Right-of-use' of underlying asset

Liability
= Obligation to make lease payments

P&L

Lease expense
Depreciation
+ Interest
= Front-loaded total lease expense

- Commercial and other considerations
 - Buy v lease
 - Lease duration
 - Variable rentals – PBH
 - FX risk management**
 - Others



What is the FX mismatch issue?

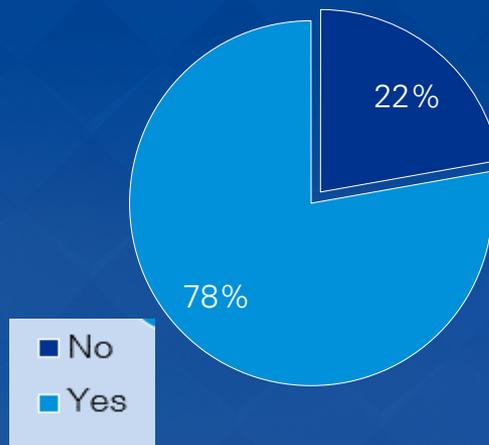


- Large part of lease commitments are in USD
- For non-USD functional currency airlines with USD leases the ROU asset will be recorded at the rate at the lease start date but the lease liability will revalue under IAS 21
- Results in significant volatility in financial result
- Entities where functional currency pegged to USD not impacted
- Economic risk always existed!

What is the FX mismatch issue?



- KPMG IFRS 16 benchmarking - 9 airlines from EMA, ASPAC, America area
- Are you impacted by foreign exchange on USD lease debt?
- If yes : have you considered a solution to reduce USD volatility exposition?



Possible solutions



How are airlines dealing with the issue?

- Cash flow hedge
- Derivatives
- Structuring options
- Other alternatives



Cash flow hedge?



How are airlines dealing with the issue?

- A cash flow hedge where the lease liability is the hedging instrument for highly probable future receipts of USD revenue
- This is an appropriate solution but is dependent upon having sufficient highly probable USD inflows.
- Most non-USD functional currency airlines do not have sufficient USD inflows to offset the lease payments.

Use of derivative products



- Can achieve hedge accounting result
- Cost implications to solution
- IFRS 16 doesn't change the actual economic risk
- Why would it change hedging strategy?
- Hedge designations would need to be documented at beginning of comparative period if using a full retrospective approach.

Structuring options?



- Can achieve hedge accounting result
- Cost implications to solution
- IFRS 16 doesn't change the actual economic risk
- Why would it change hedging strategy?
- Hedge designations would need to be documented at beginning of comparative period if using a full retrospective approach.

Structuring options?



- Creation of SPE
- External aircraft leases are in the books of a USD functional currency special purpose entity
- On-leases in the local currency to the parent company.
- This structure could cause lease liability revaluation to be recorded in FCTR in the consolidated financial statements.
- Does this pass the test of having commercial substance?

Other alternatives?



- Local currency leases
- Shorter duration leases
- Live with the volatility – the economic risk has not changed!

Questions?



KPMG





kpmg.ie

© 2017 KPMG, an Irish partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in Ireland.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name and logo are registered trademarks of KPMG International Cooperative ("KPMG International"), a Swiss entity.