



Impact of International Financial Reporting Standards 16 -Leases on China Unicom

Yimeng Sun*

Dalian University of Technology, Dalian China

*E-mail: sunyimeng@dlut.edu.cn

Abstract .his paper compares IFRS 16 Leases Standard with IAS 17 Leases, analyses the main problems of IAS 17 Leases and the main changes of IFRS 16 Leases Standard, as well as the impact on the enterprises after the implementation of IFRS 16 Leases Standard , takes China Unicom, which accounts for a large amount of leasing, as an example, and analyses the impact on the company from 3 angles, and comes to the conclusion that the implementation of IFRS 16 Leases Standard leads to the increase of assets and liabilities of the company in the balance sheet, and the liquidity of assets is reduced, and the profit is diminished and finally puts forward corresponding improvement suggestions for these impacts from 3 aspects.

Keywords: IFRS 16 Leases Standard; Financial Indicators; impact studies

1 Introduction

1.1 Literature Review

It has changed with the introduction of IFRS 16 Leases. The International Accounting Standards Board (IASB) issued IFRS 16 Leases on 13 January 2016. The standard is effective from 1 January 2019, with early application permitted. From that date, IFRS 16 - Leases replaces the previous provisions on lease accounting -IAS 17 Leases. Prior to this, operating leases were not recognised in the balance sheet until 2019[1], the potential impact of lease manipulation on business credit risk. Whereas leasing has been an important part of the corporate species, changes in core financial indicators may have a meaningful impact on the company, such as financing covenants, communication with the market, cost of debt, and capital, financial and economic indicators[2]. It has been shown that the leasing standards affecting listed companies in Spain and the United Kingdom, two countries with different accounting cultures, are highly influenced[3].Fahad [4] also discusses that leases would have a greater impact on the New Zealand Parliament, with the effect of leases on the ratio of total liabilities to total assets and the ratio of surplus to total assets. The study found a significant increase in both ratios and a change in expenses[5].Morales-Díaz [6] found a significant systematic effect of lease on key financial ratios of balance sheet in which the firm is located, particularly in the airline, retail, media, hospitality, and energy industries[7][8][9][10].

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Veverková et al[11] focused on the impact of IFRS 16 on selected financial statement items and financial analysis ratios of airlines.

Following the introduction of IFRS 16 Leases Standard, Gruber [12] concluded that only a small percentage of companies intend to change their behaviour, for example by preferring to buy rather than lease or by adjusting the terms of their contracts in order to reduce or avoid the impact of IFRS 16 on the balance sheet [13]. The study found that listed companies in Indonesia experienced a decrease in financial performance (ROE and ROA) and an increase in debt financing (DAR) after the implementation of the new accounting standards. Utami [14] demonstrated the impact of IFRS 16 on the information quality, requiring the regulator to adapt to these issues.

1.2 Innovations

The current literature related to IFRS 16 Leases Standard is lacking. At present, the majority of literature related to IFRS 16 Leases Standard is concentrated in the aviation industry and retail industry, but the telecommunications industry, as a pillar industry in China, the proportion of leasing business can not be ignored. As a result, there is an urgent need to analyse the financial impact of China's telecommunication industry, and the research in this paper can effectively enrich the results in this field.

2 Impact of IFRS 16 Leases Standard

The impact of IFRS 16 Leases Standard on companies is mainly divided into the following aspects: (1) Before the release of the new leasing standards, many enterprises chose to lease rather than purchase in order not to reflect the true liabilities on the balance sheet. After the release of the new leasing standards, enterprises need to re-adjust the asset structure and re-decide whether to purchase or lease; (2) on the balance sheet of the enterprise, as most of the leases are included in it, the balance sheet of the industry with a large proportion of leasing amount will also undergo a large change, and the various financial indicators will also undergo a corresponding change; (3) there are some impacts on the enterprise in the deduction of taxes and fees, which results in the enterprise's tax payment amount or tax payment time has changed; (4) if the enterprise's salary assessment index is formulated based on the financial index, then due to the financial index has changed to different degrees, the salary index is also affected, the enterprise should adjust the salary assessment index; (5) due to the leases are all included in the balance sheet after all the assets and liabilities have changed, so the enterprise in the formulation of the budget should also take into account the corresponding changes; (6) When signing contracts with other enterprises, issues involving credit terms and other aspects should take into account the changes in the enterprise's financial indicators.

3 Analysis of the financial impact of IFRS 16 Leases Standard on China Unicom

3.1 Asset Structure

Based on the data in Table 1, the changes in the leasing standards mainly occurred in fixed assets, current assets did not change. "Right-of-use assets" has been added to fixed assets under non-current assets, and "lease liabilities" has been added to non-current liabilities. It is due to this change that the liabilities and assets of China Unicom have shown an increase, and based on their values it can be concluded that the liabilities have increased by 7.08 per cent, and the assets have increased by 4.15 per cent, and comparing the increase in the liabilities and the assets it has been found that the new accounting standards will result in a simultaneous increase in both assets and liabilities of China Unicom. but that the increase in the assets will be slightly less than the increase in the Liabilities. The gearing ratio also changed to 42.7 per cent from 41.5 per cent at the end of the previous year.

Table 1. Simplified Balance Sheet of China Unicom(Unit: billion yuan)

	2019/12/31	2018/12/31	Range of change
Current assets	836.04	759.25	10.11%
Non-current assets	4806.27	4658.38	3.17%
Of which: Right-of-use assets	339.00	-	
Total assets	5642.31	5417.62	4.15%
Current liabilities	2068.13	2137.16	-3.23%
Of which: Non-current liabilities			
due within one year	112.38	176.85	-36.45%
Non-current liabilities	2068.13	2137.16	-3.23%
Of which: Lease liabilities	215.35	-	
Total liabilities	2407.35	2248.22	7.08%
Owners' equity	3234.96	3169.40	2.07%
Total liabilities and owners' equity	5642.31	5417.62	4.15%

Based on the financial data collated to obtain the results shown in Table 2 it can be seen that the current assets of China Unicom as a percentage of the total assets of China Unicom has increased, while the liabilities as a percentage of the total assets of China Unicom is also on an upward trend, which is mainly due to the fact that IFRS 16 Leases Standard has included the rentals of operating lease expenditures as the accounting for China Unicom's non-current assets. Assets and liabilities increased at the same time.

Table 2. Comparison of the capital source structure (Unit: billion yuan)

Project	2019	2018
Current assets	836.04	759.25
Total assets	5642.31	5417.62
Total liabilities	2407.35	2248.22
Liabilities/Total Assets	45.72%	45.46%

Owners' Equity	3234.96	3169.40
Owners' Equity/Total Assets	0.57	0.59
Current Assets/Total Assets	14.82%	14.01%

3.2 Solvency

In Table 3. It can be seen that the rent paid by China Unicom has been changed from the original administrative expenses and selling expenses to depreciation and financial expenses, which has led to an increase of 1.965 billion yuan in China Unicom's total profit, an increase of 16.23 per cent, and an increase of 21.11 per cent in the enterprise's net profit. increased by 21.11%. Meanwhile, due to the inclusion of operating leases in the statement of China Unicom under IFRS 16 Leases Standard, the performance of right-of-use assets and lease liabilities in the gearing ratio increased. In addition, lease liabilities are classified as non-current liabilities and non-current liabilities due within one year, which will also put pressure on the short-term solvency of the company, thus affecting the solvency of Unicom. It can be seen that due to the change in the standard, both gross profit and net profit have increased.

Table 3. Summary Income Statement 2019 (Unit: billion yuan)

	Amounts reported under IFRS 16 Leases Standard	Comparative amounts presented under IAS 17 Leases
Operating Costs	(2141.33)	(2135.85)
Administrative Expenses	(229.77)	(229.25)
Finance costs	(7.17)	1.38
Investment income	21.75	24.76
Total Profit	140.35	120.75
Net Profit	112.64	93.01

Liability/Asset Ratio

As shown in Table 4, due to the impact of IFRS 16 Leases Standard, the interest rate has increased, resulting in a decrease in the interest coverage multiple by 26.72%. Interest coverage multiple is an important indicator of the strength of the enterprise's long-term debt servicing ability, and the decrease in interest coverage multiple reflects the enterprise's lower degree of security for repaying the maturing debt.

Table 4. Solvency Indicators of China Unicom under Different Standards (Unit: billion yuan)

	2019	2018	rate of change
EBITDA All Debt Ratio	36.91%	34.79%	2.12%
Interest Coverage Multiple	3.84	5.24	-26.72%
Cash interest cover multiple	34.64	39.37	-12.01%
EBITDA interest cover multiple	34.15	35.13	-2.79%

Equity Ratio and Equity Multiplier

It can be seen from Table 5, due to changes in accounting standards, the gearing ratio of China Unicom increased from 41.5 per cent to 42.67 per cent. The corresponding equity ratio also increased from 0.71 to 0.74, an increase of 4.23 per cent, which indicates that China Unicom's long-term solvency has been negatively affected.

Table 5. Equity ratios and equity multipliers of China Unicom (Unit: billion yuan)

2019equity ratio	2018equity ratio	Rate of change	2019equity mul-tipliers	2018equity mul-tipliers	Rate of change
0.74	0.71	4.23%	1.74	1.71	1.75%

Long-Term Capital Gearing

Long-term capital debt ratio is a reflection of repayment ability. The higher the period capital debt ratio, the more difficult it is for the company to repay its debt. As shown in Table 6, China Unicom's long-term capital debt ratio changed from 3.39 per cent to 10.49 per cent, which shows that IFRS 16 Leases Standard has a negative impact on China Unicom's long-term solvency.

Table 6. Capital Debt Ratio at Maturity under Different Standards(Unit: billion yuan)

2019 non-current liability	2018 non-current liability	2019 Long-term capital gearing	2018 Long-term capital gearing
339.22	111.06	10.49%	3.39%

3.3 Operating Ability

The cash flows of China Unicom under the old and new standards are shown in Table 7. It can be seen that due to the change in standards, the enterprise's cash flow from operating activities, cash flow from debt repayment have decreased, and cash from financing activities have increased.

Table 7. Summary of Cash Flow in 2019(Unit: billion yuan)

	IFRS 16	IAS 17
Cash paid for purchases of goods and services	(1483.09)	(1605.31)
Net cash flows from operating activities	962.08	839.86
Cash paid for debt repayment	(668.79)	(559.96)
Cash paid for dividend distribution or interest repayment	(6.32)	(4.98)
Net cash flows from financing activities	(324.70)	(202.47)

Non-Current Asset Turnover

As shown in Table 8, under the IFRS 16 Leases Standard, China Unicom's non-current asset turnover ratio decreased from 62.44 per cent to 60.44 per cent, which indicates that Unicom's asset utilisation rate has decreased.

Table 8. Non-current asset turnover ratio (Unit: billion yuan)

2019 revenues	2019 Non-current asset turnover	2018 revenues	2018 Non-current asset turnover	rate of change
2905.15	60.44%	2908.77	62.44%	-1.55%

Total Asset Turnover

The smaller the total asset turnover ratio, the slower the asset flow. As shown in Table 9, Unicom's total asset turnover ratio decreased by an average of 4.10 per cent, respectively, from the original 53.69 per cent to 51.49 per cent, which shows that the IFRS 16 Leases Standard has adversely affected China Unicom's total asset turnover ratio.

Table 9. Total Asset Turnover Ratio of China Unicom under Different Standards

2019 Total asset turnover	2018 Total asset turnover	magnitude of change
51.49%	53.69	-4.10%

4 Concluding Study and Implications

The impact of IFRS 16 Leases Standard on Unicom was analysed from three perspectives, and the following conclusions were drawn: the implementation of IFRS 16 Leases Standard led to a simultaneous increase in Unicom's assets and liabilities in the balance sheet, and a decrease in the liquidity of its assets; a significant decrease in its profits, a decrease in its solvency, and a decrease in the multiple of its interest cover; and a decrease in its asset utilisation in the financial statements, showing a negative impact on the financial statements. Asset utilisation has decreased in the financial statements, which has a negative impact on the financial statements.

Relevant personnel of the enterprise should re-rationalise the asset structure to ensure sufficient cash flow, such as issuing perpetual bonds. At the same time, we can consider modifying or re-signing the enterprise's lease contract, such as signing a short-term lease contract, or drawing on some foreign leasing model to create a new leasing model suitable for our country, so as to ensure that the enterprise is affected by the minimum and to ensure that the balance between the cost of the enterprise and the revenue. Finally, the accounting personnel of the enterprise also faces a big challenge in this standard change, carry out the external training of the staff as well as the internal communication, to ensure that the relevant accounting personnel of the enterprise can be familiar with and can handle the relevant changes of leasing in practice.

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