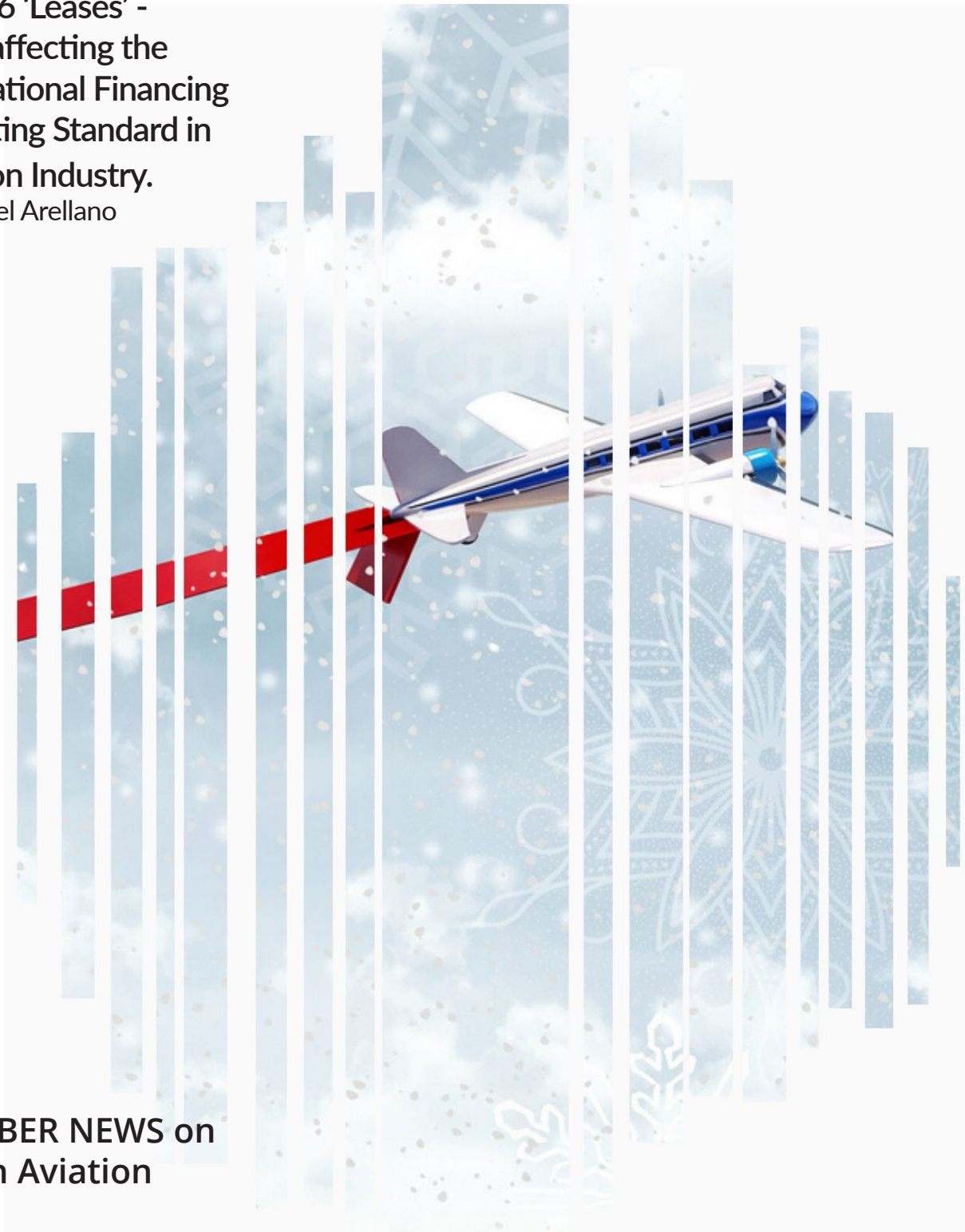


# COELUM.

**IFRS 16 'Leases' -  
Rules affecting the  
International Financing  
Reporting Standard in  
Aviation Industry.**  
by Misael Arellano



## **NOVEMBER NEWS on Mexican Aviation**

COELUM: Pronunciation: 'che-l&m, is Latin for airspace or sky. The Romans began questioning the rights they had in the space above the land they owned and to how high above did that right extended to. Ad coelum et ad inferos, they discussed, meaning that their right of property would extend as high up to the heavens and down to hell.

**sierra** **25**

celebrating twenty-five years of paramount aviation legal services in Mexico

by Misael Arellano.

This edition makes a brief review of the IFRS 16 'Leases' published by the International Accounting Standards Board (IASB) in January 2016. The IFRS 16 replace the IAS 17 'Leases' for those accounting reports starting on or after January 1, 2019.

We will discuss the effects of IFRS 16 from a lessee's perspective because even when its purpose is to guarantee that lessees and lessors financial statements be accurate about their lease transactions, the changes on lessors' accounting are not relevant and, except for those related to subleases, the lessor is not required to make major changes pursuant to this standard's transition with regard to the leases acting.

***“Before the IFRS 16, the expenses related to heavy maintenance and structural checks performed on aircraft under operating lease were recognized as operating expense. Now, the lease obligations will be charged in advance and stated as depreciation and interest instead as an operative expense.”***

On the contrary, for lessees, the criteria is essentially different and it is expected that the IFRS 16 have relevant impact, mainly to those entities with a big portion of its financing 'out of balance' in the way of operating leases. The IFRS 16 requires to recognize assets and liabilities for all leases except: i) short-term leases (up to twelve months); and ii) leases of low value assets (with a value of, as new, up to five thousand US dollars). The control model is based on the

identification of leases, eliminating the distinction between financial leases and operating leases; requiring the recognition of the asset by the right of use.

In that sense, all leases within the scope of the IFRS 16 must be stated in the general balance of the lessees and replacing the straight-line operating lease expense for those leases reported under IAS 17 with a depreciation charge for the lease asset and interest expenses on the lease liability. Through these changes, the users of the financial statements will have a full perspective about the leases with regards to financial status, financial performance and the cash flow of the company.

The IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases<sup>1</sup>:

	IAS 17		IFRS 16
	FINANCE LEASES	OPERATING LEASES	ALL LEASES
ASSETS	✈️ 🏢	---	✈️ 🏢 ✈️ ✈️ 🚗
LIABILITIES	\$\$\$\$	---	\$\$\$\$\$\$\$\$\$\$\$\$\$\$\$\$
OFF BALANCE SHEET (RIGHTS/OBLIGATIONS)	---	✈️ ✈️ 🚗 \$\$\$\$\$\$\$\$\$\$\$\$	---

Under IAS 17 the cash flow from operating activities would be lower due to operational lease payments which used to be included as a negative effect. Before the IFRS 16, the expenses related to heavy maintenance and structural checks performed on aircraft under operating lease were recognized as operating expense. Now, the lease obligations will be charged in advance and stated as depreciation and interest

1.- www.ifrs.org

instead as an operative expense. Under IFRS 16 the payment of interest is included as financing costs.

Applying IFRS 16, in essence for all leases, a lessee is required to:

- recognize lease assets and lease liabilities in the balance sheet, initially measured at the present value of unavoidable future lease payments;
- recognize depreciation of lease assets and interest on lease liabilities in the income statement over the lease term; and
- separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (typically presented within either operating or financing activities) in the cash flow statement.

***“...recognize lease assets and lease liabilities in the balance sheet, initially measured at the present value of unavoidable future lease payments.”***

Finally, a special attention must be made to section B2 of the Appendix B of the IFRS 16; which states the following:

### **Combination of contracts**

**B2.** *In applying this Standard, an entity shall combine two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty), and account for the contracts as a single contract if one or more of the following criteria are met:*

- *the contracts are negotiated as a package*

*with an overall commercial objective that cannot be understood without considering the contracts together;*

- *the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or*
- *the rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component as described in paragraph B32.*

The requirements of section B2 of the IFRS 16 are intended to capture the circumstances in which a lessee participates in a series of leases considering each of them so the transactions, in substance, constitutes a single agreement to achieves a general business objective which cannot be understood without considering the contracts together. For example, if a lessee enters in a three-year lease of a B737 but also in the lease of another B737 starting in one year and in a forward similar lease starting in two years; terms and conditions for all three agreements are negotiated in contemplation of each other so that the general economic effect cannot be understood without reference to the series of transactions as a whole. The effect, so to speak, would be to consider the lessee has participated in a five-year accumulated lease. In such situations, accounting for the leases independently of each other may not result in a faithful representation of the combined transaction.

Accordingly, the scenario in Mexico for carriers as Volaris, with more than the 50% of its assets as “Right of Use Assets”<sup>2</sup> by having a fleet under financial leases with a long average lease duration, is translated into a critical impact on operating cash flow and free cash flow.

2.- The Airline Analyst and company reports.

## **Aerospace industry seeks Brexit reassurance.**

There is growing concern among key aerospace manufacturers about regulatory alignment and the ability to bring products to market after Brexit. The firms have sought reassurance that the UK would continue to be a member of the European Aviation Safety Agency after any Brexit deal. They also warned that alignment with chemicals regulations is “vital” for the sector. The government said it would pursue agreements where necessary. [www.bbc.com/news/business-50008268](http://www.bbc.com/news/business-50008268) November 11, 2019.

## **Military personnel trained in air safety.**

The Air College reported that its staff will be trained by the College of Aviator Pilots of Mexico (CPAM) on the Safety Management System (SMS). As part of the Mexican Air Force strategy to strengthen the safety culture, strategic alliances are being created with different industry organizations to share knowledge, said Saily Salvador Gallardo, pedagogical director of the Air College. [www.a21.com.mx/fuerza-aerea/2019/11/12/capacitan-militares-en-seguridad-aerea](http://www.a21.com.mx/fuerza-aerea/2019/11/12/capacitan-militares-en-seguridad-aerea) November 12, 2019.

## **The International Civil Aviation Organization (ICAO) seeks zero fatalities for 2030.**

The International Civil Aviation Organization proposed the goal on having zero aviation fatalities regarding commercial aviation for the year 2030. For which the agency, will work on a series of measures to reinforce safety, said Julio Siu, representative of the ICAO regional office. Furthermore, within the framework of the Third International Air Safety Congress, the expert pointed out that ICAO, through the Global Operational Safety Plan 2020-2022 (GASP), will increase collaboration at a regional level, and ensure the necessary infrastructure to reinforce security in Latin America. [www.a21.com.mx/organismos/2019/11/12/busca-oaci-cero-fatalidades-para-el-2030](http://www.a21.com.mx/organismos/2019/11/12/busca-oaci-cero-fatalidades-para-el-2030) November 12, 2019.

## **Mexico restricts foreign drone operation in national territory.**

The Ministry of the Interior (Segob) will restrict the operation of remotely piloted aircraft (RPAS), known as drones, with foreign registration and / or managed by foreign operators from January 13, 2020, with the entry into force of the Standard Mexican Official NOM-107-SCT3-2019, which was published today in the Official Gazette of the Federation. Currently, Mexico has bilateral Air Services Agreements with 52 countries around the world: 2 in North America, 7 in Central America and the Caribbean, 10 in South America, 16 in Europe and 17 in Asia. The only exception for point 4.10.16 is that RPAS be used for scientific research, said Segob. [www.a21.com.mx/normatividad/2019/11/14/restringe-mexico-operacion-de-drones-extranjeros-en-territorio-nacional](http://www.a21.com.mx/normatividad/2019/11/14/restringe-mexico-operacion-de-drones-extranjeros-en-territorio-nacional) November 14, 2019.

## **Airlines begin to offset the carbon they emit.**

Airlines are trying to be less and less polluting but for the moment they are limited to offsetting their CO2 emissions, waiting for airplanes from a future that is still distant when it is possible to fly without fossil fuels. Aviation accounts for about 2% of global carbon dioxide (CO2) emissions, according to the International Civil Aviation Organization (ICAO). [www.aviaciondia.com/2019/11/a-la-espera-del-avion-del-futuro-las-aerolineas-empiezan-a-compensar-el-carbono-que-emiten.html](http://www.aviaciondia.com/2019/11/a-la-espera-del-avion-del-futuro-las-aerolineas-empiezan-a-compensar-el-carbono-que-emiten.html) November 20, 2019.

*In this month extract was prepared by J. Estrada, J. Muñoz, J. Dorantes, A. De la Fuente, P. Arandia, R. Nerio, R. López, R. Mancilla.*

### **Dubai Air Show: The challenges for us all in flying green.**

Sustainable, renewable, green: the buzz words of the environmentalists figured large at this week's Dubai Air Show. At the last show two years ago, such things barely registered. This time we've had airline Etihad rename a Boeing 787 Dreamliner a "greenliner" and Airbus unveiling an experiment in which aircraft follow each other to reduce drag and save fuel. It mimics bird flight. No press conference seems complete without a reference to aviation efficiency, and the president of Emirates airline even praised activist Greta Thunberg for helping focus minds on what they had to do. [www.bbc.com/news/topics/crr7mlg0dewt/aerospace&link\\_location=live-reporting-story](http://www.bbc.com/news/topics/crr7mlg0dewt/aerospace&link_location=live-reporting-story) November 22, 2019.

### **The International Civil Aviation Organization (ICAO) will elect a new President.**

For a period of three years with the possibility of re-election, a new President will be elected for the International Civil Aviation Organization (ICAO). Between the candidates there is Salvatore Sciacchitano who has been working on the industry for over 39 years where he stands out as the Director of the Italian National Civil Aviation Authority. In the other hand, there is Aysha Al Hameli, who if chosen, would be the first women to be head of the board. In fact, she was the first women pilot of the United Arab Emirates, represented her country at the United Nations council and has fully participated in the decision making regarding international aviation, transport and security. And finally, Bakyt Dzhunushaliev who has coordinated The International Air Transport Association (IATA) and the European Union Aviation Safety Agency (EASA) in order to resolve issues in the matter. [www.a21.com.mx/organismos/2019/11/25/hoy-oaci-elige-nuevo-presidente](http://www.a21.com.mx/organismos/2019/11/25/hoy-oaci-elige-nuevo-presidente) November 25, 2019.

### **Aerospace industry, spearhead of growth.**

Mexico currently has about 2.8% of exports in aerospace matters worldwide, so the market potential is very large, said Luis Lizcano, general director of the Mexican Federation of Aerospace Industry (FEMIA). Within the framework of the Mexico Aerospace Forum 2019, Lizcano said that if the national industry could grow at 5% of the world level of exports, it would be more than enough to double the profits of the companies in the sector. "We would go from 8.6 billion dollars that we export in 2018 to about 17 or 18 billion dollars," he said. [www.a21.com.mx/aeronautica/2019/11/27/industria-aeroespacial-punta-de-lanza-de-crecimiento](http://www.a21.com.mx/aeronautica/2019/11/27/industria-aeroespacial-punta-de-lanza-de-crecimiento) November 27, 2019.

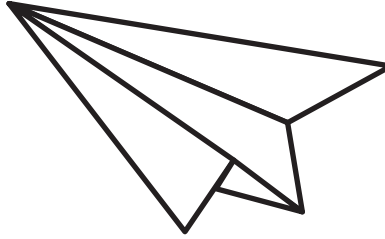
### **Aerospace industry must be considered national security: Aerocluster de Querétaro.**

The aerospace industry must be considered as national security to promote its development and strengthening in the country, said Antonio Velázquez, director of the Querétaro Aerocluster on Wednesday. Within the framework of the 'Mexico Aerospace Forum' 2019, Velázquez said that the development in the manufacture, maintenance and design of aircraft for commercial, as well as military, use must be a priority for the Government. "The aerospace industry is not an ordinary issue, it should be considered a national security issue," said the director of one of the most important space development centers in the country. Querétaro is the fifth entity in Mexico with the largest number of suppliers and manufacturers of aircraft components with 50 firms, among which Safran stands out. [www.elfinanciero.com.mx/empresas/industria-aeroespacial-debe-ser-considerada-de-seguridad-nacional-aerocluster-de-queretaro](http://www.elfinanciero.com.mx/empresas/industria-aeroespacial-debe-ser-considerada-de-seguridad-nacional-aerocluster-de-queretaro) November 27, 2019.

### **OACI Appoints New Chairman of the Air Navigation Commission.**

The Council of the International Civil Aviation Organization (ICAO) approved Captain Nabil Naoumi as the chairman of the agency's Air Navigation Commission, for a renewable term of one year. Captain Naoumi was nominated by the government of Germany and his term will begin on January 1, 2020. In his history, Naoumi has worked as commissioner and vice president of the ICAO Air Navigation Commission since 2016 and 2019, respectively. [www.a21.com.mx/organismos/2019/11/28/nombra-oaci-nuevo-presidente-de-comision-de-navegacion-aerea](http://www.a21.com.mx/organismos/2019/11/28/nombra-oaci-nuevo-presidente-de-comision-de-navegacion-aerea) November 28, 2019.

*In this month extract was prepared by J. Estrada, J. Muñoz, J. Dorantes, A. De la Fuente, P. Arandia, R. Nerio, R. López, R. Mancilla.*



## MISAE LARELLANO

Attorney at Law: Admitted to practice law in 2006. Mr. Misael Arellano, of Mexican nationality obtained his law degree at Instituto Tecnológico y de Estudios Superiores de Monterrey, Mexico City; attended studies in Social Sciences Program 2003 by Universidad Antonio de Nebrija, Madrid, Spain; and holds, earned with distinction, the International Air Law Diploma; Certificate of International Air Law for Lawyers and Legal Professionals; Certificate of Aircraft Acquisition and Financing; Certificate of Airline Contract Law; and Certificate of Law of Aviation Insurance by the International Air Transport Association (IATA).

LANGUAGES: Spanish and English.

PRACTICE AREAS: Aviation Law, Aviation Industry Affairs, Repossession of Aircraft, Airport Law and Corporate Law.

e-mail: [marellano@asyv.com](mailto:marellano@asyv.com)