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***Circular to All Chief Executives of Commercial Banks, Credit Institutions,
Micro Finance Deposit Taking Institutions and Forex Bureaus***

Guidance Note on Application of IFRS 16 - Leases

The International Accounting Standards Board revised the accounting requirements for lease transactions with the issuance of *IFRS 16 - Leases* on January 13, 2016 to replace IAS 17. The new Standard came into effect on January 01, 2019 and is expected to improve the transparency and comparability of information on off-balance sheet leases by bringing them onto the balance sheet.

1.0 Implications of IFRS 16 on Financial Institutions in Uganda

IFRS 16 significantly changes how a lessee accounts for operating leases. Under the previous IAS 17, a financial institution would rent an office building for several years, with such a rental agreement being off balance sheet. However, IFRS 16 does not require a lease classification test as all leases are on balance sheet.

IFRS 16 requires a bank to present lease assets arising from leases of properties as tangible assets. The financial institution recognizes a right-of-use (ROU) asset, i.e. the right to use the office building, and a lease liability, which treats the lease as a purchase of an asset on a financed basis. Financial institutions with material off-balance sheet leases applying IFRS 16 will report higher assets, which could affect their regulatory capital. The key question for financial institutions is how the ROU asset will be classified for regulatory purposes.

2.0 Treatment of Right of Use Assets for Regulatory purposes

1. Reporting in Statutory and Prudential returns

All SFIs shall report the Right of Use Assets under **Gross Fixed Assets** in the BS100 and MDI100 Monthly Statement of Assets and Liabilities, specifically under the line item "Motor vehicle and Other Fixed Assets" with the corresponding depreciation expense included under "Accumulated Depreciation".

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2. Computation of Risk Weighted Assets for Regulatory Capital purposes


For regulatory capital purposes, the ROU asset shall be reported under Fixed Assets as long as the underlying asset being leased is a tangible asset. Consequently, the ROU asset shall be risk weighted at 100% in accordance with the Financial Institutions and MDI (Capital Adequacy) Regulations, 2005 and 2004, respectively.

Where the ROU asset is based on an intangible asset, it shall be deducted from core capital in accordance with the aforementioned Regulations.

3.0 Technical Aspects related to the implementation of IFRS 16

- i) All financial institutions are expected to ensure that the requisite systems and processes are instituted to identify, document, monitor and report the leases held by the institution.
- ii) Each SFI should ensure that proper documentation and authorization is maintained for leases which qualify for exemption under IFRS 16.
- iii) The methodology used in arriving at the "rate implicit in the lease" used to discount the lease payments should be clearly documented and consistently applied.
- iv) A clear disclosure and communication strategy should be developed to communicate the impact of implementation of IFRS 16 to key stakeholders.

Each institution should submit to the Bank of Uganda a report of the potential quantitative impact of the implementation of IFRS 16 on its profit after tax and core capital as at June 30, 2019 by **July 31, 2019**.



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