

IFRS AT A GLANCE

IFRS 16 *Leases*



IFRS 16 Leases

BACKGROUND (PROJECT TO REPLACE IAS 17 AND RELATED INTERPRETATIONS)

The development of a new leases standard was originally a joint project between the IASB and FASB, and though they will not issue converged standards, both will bring leases on balance sheet for lessees. IFRS 16 removes the distinction between operating (“off balance sheet”) and finance (“on balance sheet”) leases for lessees. This will result in significant changes for lessees’ financial statements, including:

- All leases being recorded on balance sheet (except, as an option, for low value and short-term leases)
- Increased disclosure about the entity’s leasing activities including tables for the types of assets leased

For lessors, the recognition and measurement principles of IAS 17 have been brought forward mostly unchanged. However, lessors will be subject to significantly increased disclosure requirements relating to assets under operating leases and residual value risks.

DEFINITIONS

Lease - a contract, or part of a contract, that conveys the right to use an asset (the **underlying asset**) for a period of time in exchange for consideration.

Lease term - the non-cancellable period for which a lessee has the right to use an underlying asset, together with both (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

SCOPE

All arrangements that meet the definition of a lease except for:

- (a) Leases to explore for minerals, oil, natural gas and similar non-regenerative resources
- (b) Leases of biological assets within the scope of IAS 41 Agriculture held by a lessee
- (c) Service concession arrangements within the scope of IFRIC 12
- (d) Licenses of intellectual property granted by a lessor within the scope of IFRS 15 Revenue from Contracts with Customers
- (e) Rights held by a lessee under a licensing agreement within the scope of IAS 38 Intangible Assets (eg. Rights to motion pictures, video recordings, plays, patents and copyrights, etc.)

A lessee is also permitted, but not required, to apply IFRS 16 to leases of intangible assets other than those described in (e) above.

LESSEES

INITIAL RECOGNITION AND MEASUREMENT

The following measurement requirements apply to all leases, unless a lessee makes use of optional exemptions for short-term leases (those having a term of 12 months or less, including the effect of extension options) and leases for which the underlying asset is of low value (eg telephones, laptop computers, and office furniture). The election for short term leases is by class of asset, and for low value leases can be made on a lease-by-lease basis

LEASE LIABILITY

At the commencement date of the lease, a lessee recognises a lease liability for the unpaid portion of payments, discounted at the rate implicit in the lease or, if this is not readily determinable, the incremental rate of borrowing, comprising:

- (a) Fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- (b) Variable lease payments dependant on an index or rate;
- (c) Residual value guarantees;
- (d) The exercise price of a reasonably certain purchase options; and
- (e) Lease termination penalties, if a lessee termination option was considered in setting the lease term.

RIGHT-OF-USE ASSET

At the commencement date of the lease, a lessee recognises a right-of-use asset at cost, comprising:

- (a) The amount of the lease liability recognised;
- (b) Any lease payments made at or before the commencement date, less any lease incentives;
- (c) Any initial direct costs incurred; and
- (d) An estimate of costs to be incurred to dismantle and remove an asset and restore the site based on the terms and conditions of the lease.

SUBSEQUENT MEASUREMENT			
LEASE LIABILITY	RIGHT-OF-USE ASSET (THREE OPTIONS)		
<p>After the commencement date, a lessee remeasures the lease liability by:</p> <p>(a) Increasing the carrying amount to reflect interest on the lease liability; (b) Reducing the carrying amount to reflect the lease payments made; and (c) Remeasuring the carrying amount to reflect any reassessment, lease modifications or revised in-substance fixed lease payments.</p> <p>The lease term is updated if there is a change in the non-cancellable period of the lease when the lessee:</p> <p>(a) Exercises an existing option not previously included in the determination of the lease term; (b) Does not exercise an option that was previously included in the determination of the lease term; (c) An event occurs that obliges the lessee to exercise an option not previously included in the determination of the lease term; or (d) An event occurs that contractually prohibits the lessee from exercising an option previously included in the previous determination of the lease term.</p> <p>Variable lease payments that have not been included in the initial measurement of the lease liability are recognised in the period in which the event or condition that triggers the payments occurs.</p> <p>Lease modifications: a lessee accounts for a lease modification as a separate lease if (a) the modification increases the scope of the lease by adding the right to use one or more additional underlying assets; and (b) the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope (including any appropriate adjustments to reflect the circumstances of that contract).</p>	<p style="text-align: center;"><u>COST MODEL (IAS 16)</u></p> <ul style="list-style-type: none"> Apply IAS 16 <i>Property, Plant and Equipment</i> to record depreciation. Depreciation period is the useful life of the asset if the lease transfers ownership of the underlying asset; otherwise earlier of the asset's useful life and lease term. Adjust carrying value based on any remeasurements as required from reassessment of the lease liability. Apply IAS 36 <i>Impairment of Assets</i> to measure impairment. 	<p style="text-align: center;"><u>REVALUATION MODEL (IAS 16)</u></p> <ul style="list-style-type: none"> If lessee applies the revaluation model to a class of asset, it may elect to apply that model to the same class of right-of-use assets. 	<p style="text-align: center;"><u>INVESTMENT PROPERTY (IAS 40)</u></p> <ul style="list-style-type: none"> If a lessee applies the fair value model to its investment property, the lessee is required to apply that model to right-of-use assets that meet the definition of investment property in IAS 40.
SALE AND LEASEBACK TRANSACTIONS			
Follow IFRS 15 guidance to determine if the transaction is a sale of the underlying asset or not.			
<p style="text-align: center;"><u>TRANSFER IS A SALE</u></p> <ul style="list-style-type: none"> The right-of-use asset is recorded in proportion to the previous carrying amount of the asset that relates to the right of use retained. Gains and losses are limited to the amount relating to the rights transferred. Adjustments required if sale is not at fair value or lease payments are not at market rates 		<p style="text-align: center;"><u>TRANSFER IS NOT A SALE</u></p> <ul style="list-style-type: none"> The asset continues to be recognised and a financial liability is recognised equal to the proceeds transferred. The financial liability is accounted for in accordance with IFRS 9. 	
PRESENTATION			
<u>Statement of Financial Position</u>			
<p>Right-of-use assets:</p> <p>(a) Present right-of-use assets separately from other assets; or (b) Include right-of-use assets within the same line item as the underlying asset</p> <p>The requirement in a) does not apply to right-of-use-assets that meet the definition of investment property, which shall be presented in the statement of financial position as investment property.</p> <p>Lease liabilities: present separately from other liabilities or disclose the line item in which they are included.</p>			
<u>Statement of Profit or Loss and Other Comprehensive Income</u>			
<p>Interest expense on the lease liability is presented separately from depreciation of the right-of-use asset, as a component of finance costs.</p>			
<u>Statement of Cash Flows - classification</u>			
<ul style="list-style-type: none"> Principal payments on the lease liability as financing activities. Payments of interest in accordance with guidance for interest paid in IAS 7 <i>Statement of Cash Flow</i>. Short-term and low-value asset leases and variable lease payments that are not included in the measurement of lease liabilities are classified within operating activities. 			
DISCLOSURE			
<p>Extensive disclosure requirements including qualitative information on the lessee's leasing activities and the rights and obligations arising from its major lease contracts, as well as significant quantitative disclosure on lease commitments, variable lease payments, extension and termination options, residual value guarantees, and whether the option to exclude short-term and low-value leases has been used.</p>			
TRANSITION			
<p>Effective for periods beginning on or after January 1, 2019. Early adoption is permitted, but if done, an entity must also early adopt IFRS 15. A lessee applies IFRS 16 either:</p> <p>(a) Retrospectively to each prior reporting period in accordance with IAS 8; or (b) Retrospectively with the cumulative effect of applying the standard recognised at the date of initial application by way of an adjustment to retained earnings or other component of equity as appropriate.</p> <p>IFRS 16 contains optional transitional exemptions including simplification for the initial measurement of existing leases, not requiring leases ending within 12 months of the effective date to be recognised and a number of other practical expedients.</p>			

LESSORS

DEFINITIONS

Finance Lease - a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.
Operating lease - lease other than a finance lease.

CLASSIFICATION

Indicators that would normally lead to a lease being classified as a finance lease are:
 (a) The lease transfers ownership of the underlying asset to the lessee by the end of the lease term; (b) The lessee has a bargain purchase option;
 (c) The lease term is for a major part of the economic life of the asset; (d) The present value of the lease payments amounts to at least substantially all of the asset's fair value;
 (e) The underlying asset is of such a specialized nature that only the lessee can use it without modification;
 Other indicators that could also lead to a lease being classified as a finance lease are:
 (f) If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee; (g) Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee; or
 (h) The lessee has the ability to continue the lease for a secondary period at a rent substantially lower than market.

ACCOUNTING TREATMENT - OPERATING LEASE

- Lease contracts accounted for on an executory basis
- Lessor retains leased asset on its statement of financial position
- Lease income is normally recognised on a straight line basis over the lease term

ACCOUNTING TREATMENT - FINANCE LEASE

- The leased asset is derecognised and a gain or loss is recognised
- Lessor recognises a receivable equal to the net investment in the lease
- Finance income is recognised based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

SALE AND LEASEBACK TRANSACTIONS

Follow IFRS 15 guidance to determine if the transaction is a sale of the underlying asset or not.

TRANSFER IS A SALE

- Account for the purchase of the asset applying the applicable IFRS.
- Account for the lease under the lessor accounting requirements of IFRS 16.

TRANSFER IS NOT A SALE

- Do not recognise the transferred asset and recognise a financial asset equal to the transfer proceeds.
- The financial asset is accounted for in accordance with IFRS 9.

DISCLOSURE

IFRS 16 requires significantly enhanced disclosure compared to IAS 17. A lessor must disclose qualitative and quantitative information about its leasing activities including the nature of the lessor's leasing activities, how the lessor manages risks associated with any retained rights in assets, a maturity analysis of lease payments receivable and a reconciliation of the discounted lease payments receivable to the net investment in the lease.

TRANSITION

Except for intermediate lessors, lessors are not required to record transitional adjustments on adoption of IFRS 16, as the lessor guidance is substantially unchanged from IAS 17. However, an intermediate lessor:

- (a) Reassesses subleases that were classified as operating leases under IAS 17 and are ongoing at the date of initial application of IFRS 16, to determine whether each sublease should be classified as operating or finance under IFRS 16. The intermediate lessor makes this assessment at the time of transition based on the remaining contractual terms and conditions of the head lease and sublease.
- (b) For any lease reclassified as a finance lease, account for the sublease as a new finance lease entered into at the date of initial application of IFRS 16.

CONTACT

For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below.

Alternatively, please visit www.bdo.global where you can find full lists of regional and country contacts.

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