

SLFRS 16 : Leases

Chartered Accountancy Strategic Level Advanced Business Reporting (ABR)

Imraz Iqbal
FCA, ACMA, MBA, ASA

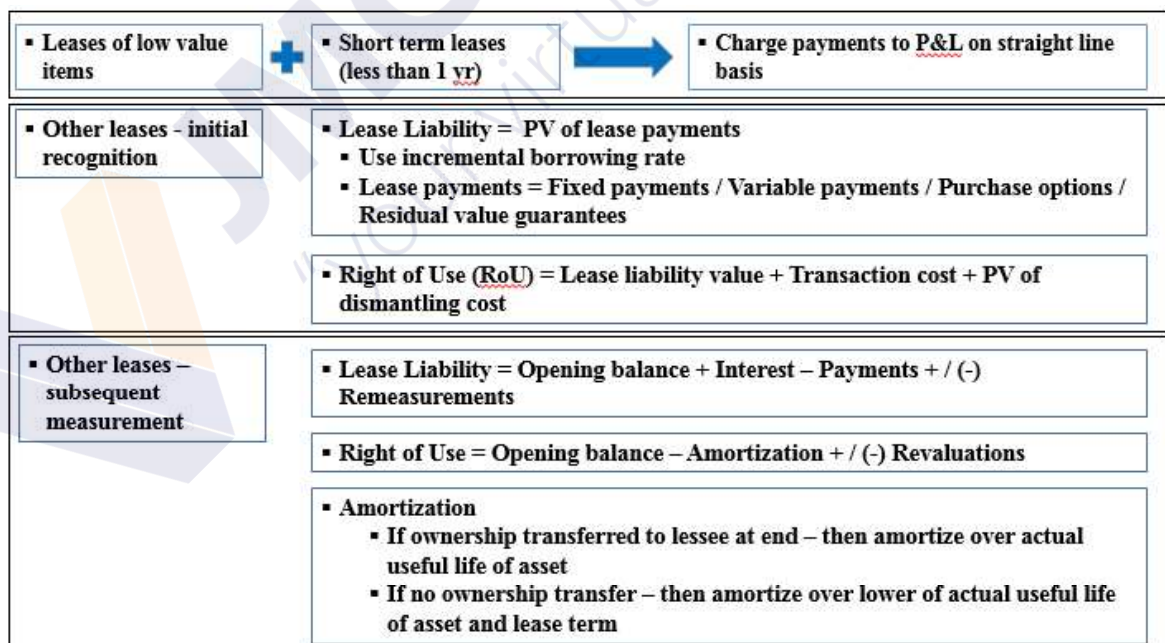
SLFRS 16 – LEASES



1.) Definition

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.

2.) Accounting – Lessee



2.1) Measuring the lease liability



- Discount rate – rate implicit in the lease. If not available incremental borrowing rate

Lease payments



2.2) Measuring the right to use the asset



2.3) Lease recognition exemptions

Two major optional exemptions make the standard easier to apply



Short term leases

≤ 12 months



Leases of low value items

≤ USD 5,000 for example

Example

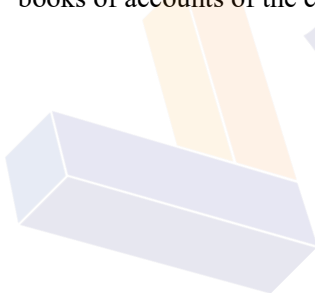
On 1 April 2018, the company entered into a lease agreement and leased out a property on a 30 year lease. As per the lease agreement, the company paid the first lease rental of Rs. 50 million on 1 April 2018. In addition to that terms of the lease agreement require the company to pay an annual lease rental of Rs. 4 million in arrears for a period of 30 years. Accordingly, the first installment of the above was paid on 31 March 2019 and shown as expenditure in the books of accounts of the company. The fair value of the land and building components of the property as at 31 March 2018 were as follows.

Land - Rs. 40 million

Building - Rs. 60 million

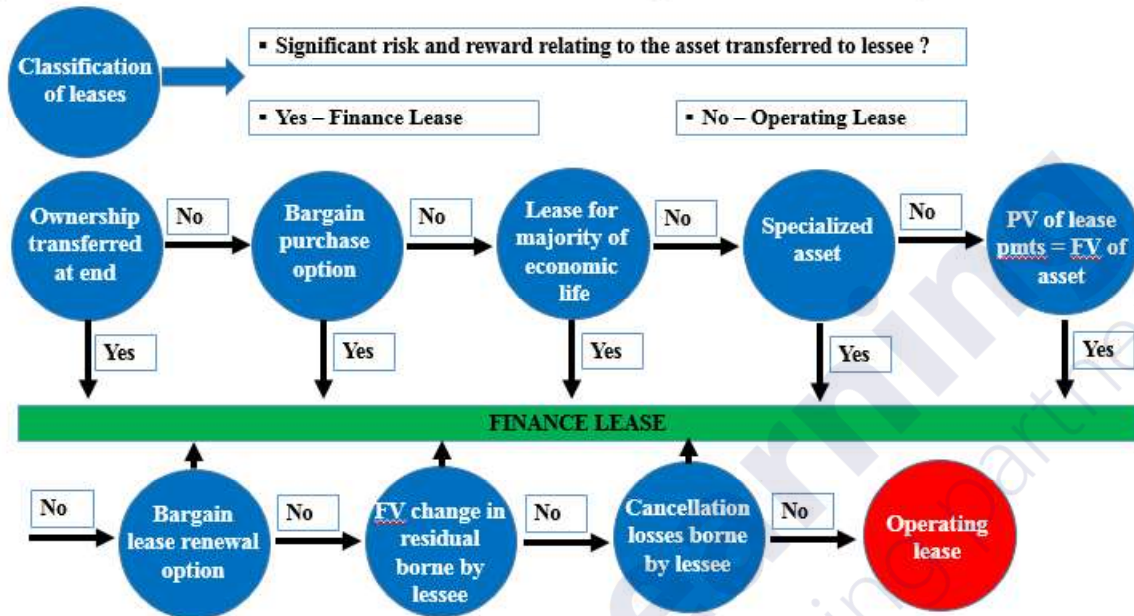
Useful life time of the building was 30 years as at 31 March 2018. Further as per the lease agreement, the lease period cannot be extended beyond 30 years under any circumstances. The current weighted average cost of funds of the entity is 10% and the incremental borrowing cost is 11%.

The accountant seeks your advice as to how to record and present the above transaction in the 2018/2019 books of accounts of the company

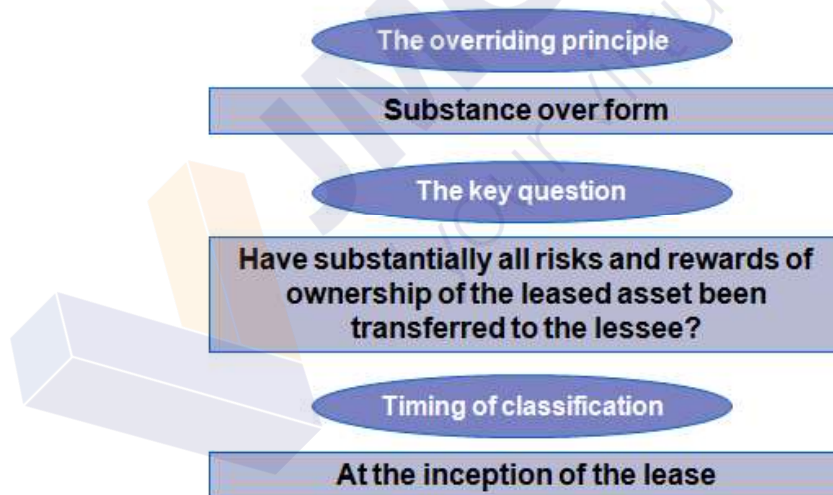


3.) Lessor accounting

SLFRS 16 Leases – Accounting for Lessors

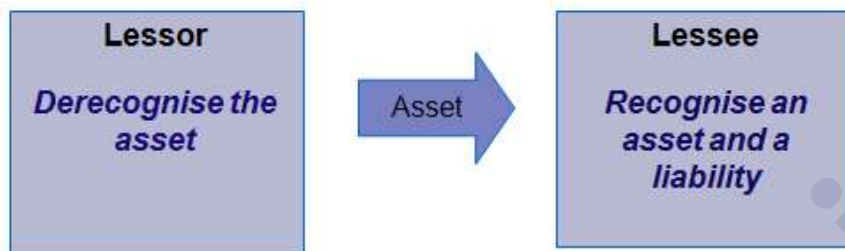


3.1) Classification of leases



3.2) Finance lease

- ◆ Lease that transfers substantially all of the risks and rewards to the lessee



3.3) Operating lease

- ◆ Lease that does not transfer substantially all of the risks and rewards to the lessee



3.4) Accounting for Finance lease

	Lessor
Statement of financial position	Receivable (PV of gross investment)
Statement of comprehensive income	◆ Profit on sale? ◆ Finance income

3.4.1) Understanding the statement of financial position terminology for lessors



3.4.2) Understanding the statement of financial position amounts for lessors



3.4.3) Finance lease – Important considerations

◆ **Lessee/Lessor:**

- Finance income or expense is calculated using effective interest rate method (using rate implicit in lease)

3.5) Accounting for Operating lease

	Lessor
Statement of financial position	<ul style="list-style-type: none"> ◆ Leased asset ◆ Accrued/deferred lease rental receivable
Statement of comprehensive income	<ul style="list-style-type: none"> ◆ Depreciation expense ◆ Lease rental income

3.5.1) Other considerations: operating leases

- ◆ **Uneven lease payment profile**
 - Spread on straight line basis over lease term
 - Statement of financial position will reflect deferral or prepayment
- ◆ **Lease incentives**
 - Spread on straight line basis over lease term

3.6) Statement of financial position impact – Summary

	Operating lease	Finance lease
Lessor	Leased asset	Lease receivable (PV of gross investment)

3.7) Initial direct costs

	Operating lease	Finance lease
Lessor	Add to carrying amount of leased asset (and recognise on same basis as lease income)	Included <i>automatically</i> in lease receivable (net investment) (via definition of interest rate implicit in the lease, unless manufacturer/dealer lessor)

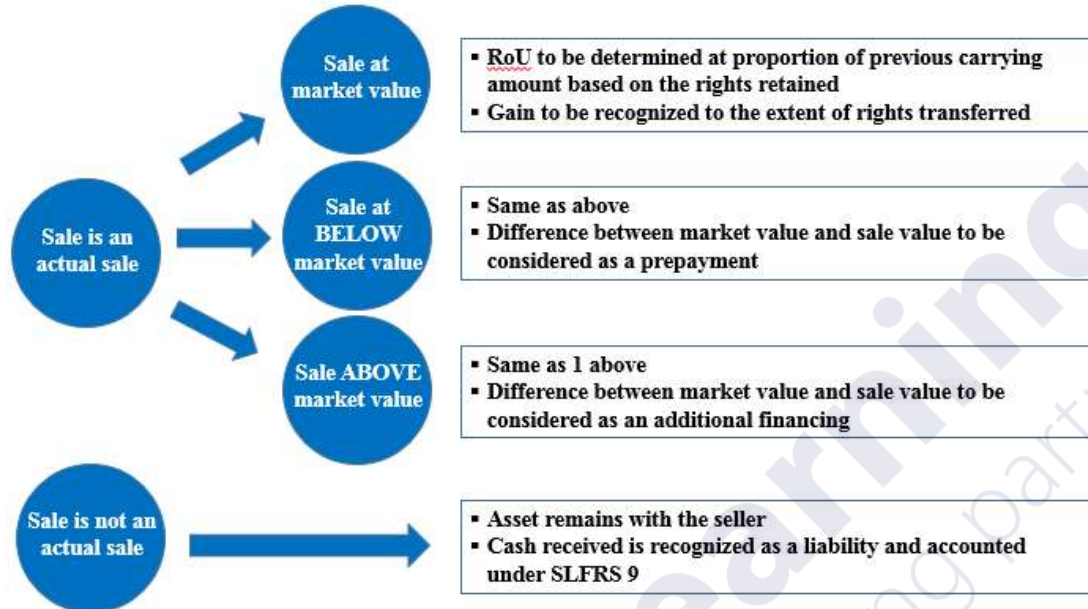
3.8) Manufacturers/dealers as lessors

- ◆ **Manufacturer/dealer accounts for commencement of a finance lease as if it were an outright sale:**
 - Recognise sales revenue according to the policy followed for outright sales
 - Revenue is measured at the lower of fair value or PV of minimum lease payments (using market interest rate)
 - Recognise cost of sales as difference between carrying amount of leased asset and present value of unguaranteed residual value
 - Expense initial direct costs when the selling profit is recognised (i.e. normally immediately)
 - Revenue is recognised at the commencement date of the lease

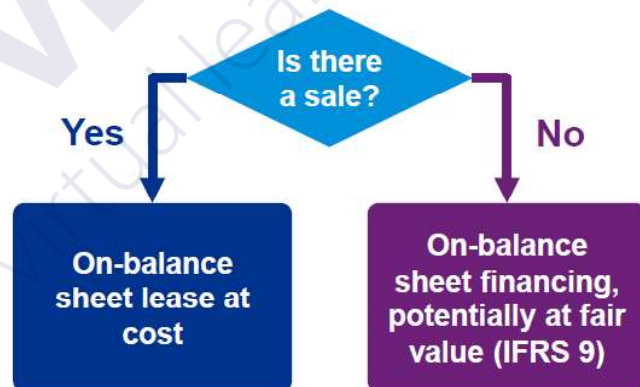


4.) Sale and lease back

SLFRS 16 Leases – Sale and lease back



IFRS 16 essentially kills sale-and-leaseback as an off-balance sheet financing structure



4.1) Transfer of the asset is a sale

- The seller-lessee shall measure the right-of-use asset arising from the leaseback. The seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

- the buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this Standard.

- If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:

(a) any below-market terms shall be accounted for as a prepayment of lease payments; (measured as the difference between fair value of the consideration for the sale and the fair value of the asset)

and

(b) any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee. (measured as the difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.)

4.2) Transfer is not a sale

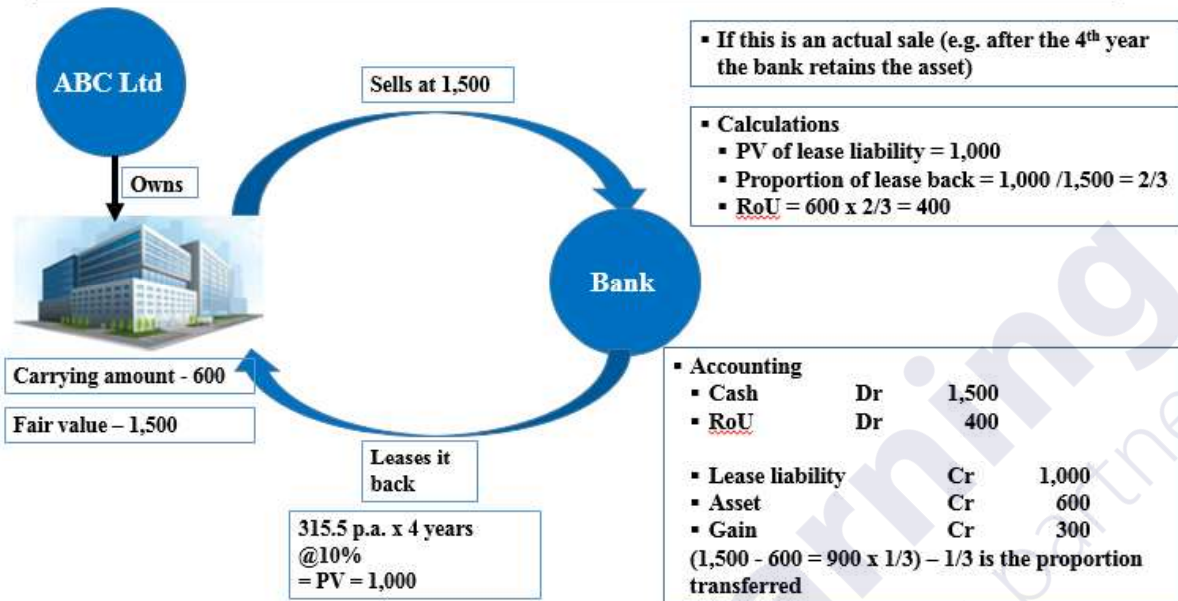
If the transfer of an asset by the seller-lessee does not satisfy the requirements of SLFRS 15 to be accounted for as a sale of the asset:

(a) the seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying SLFRS 9.

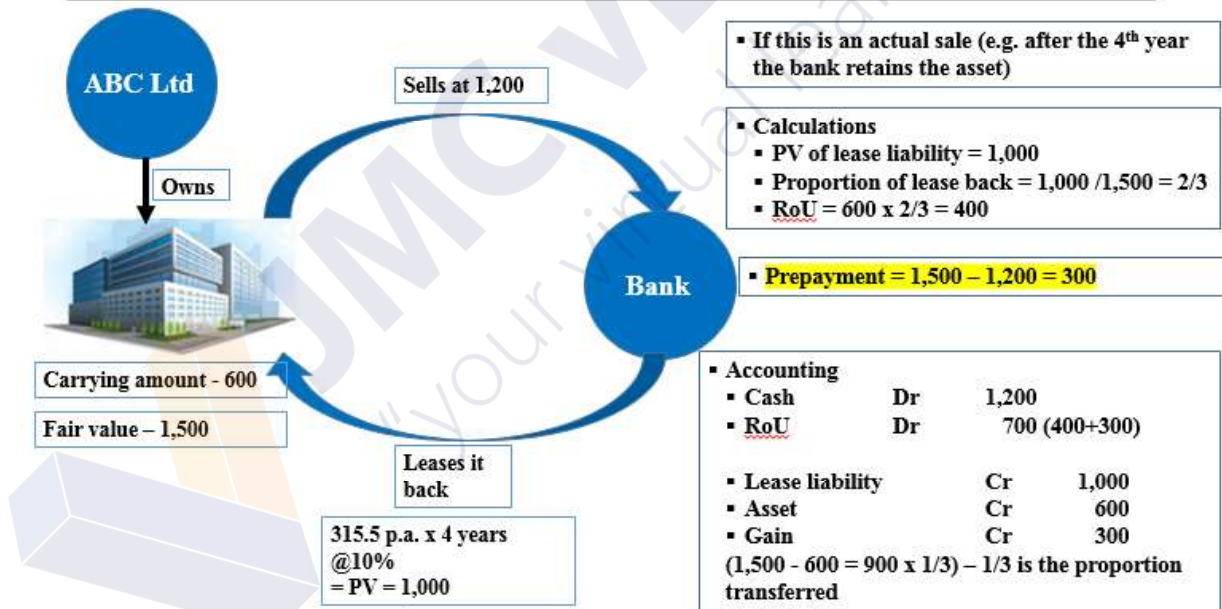
(b) the buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying SLFRS 9.



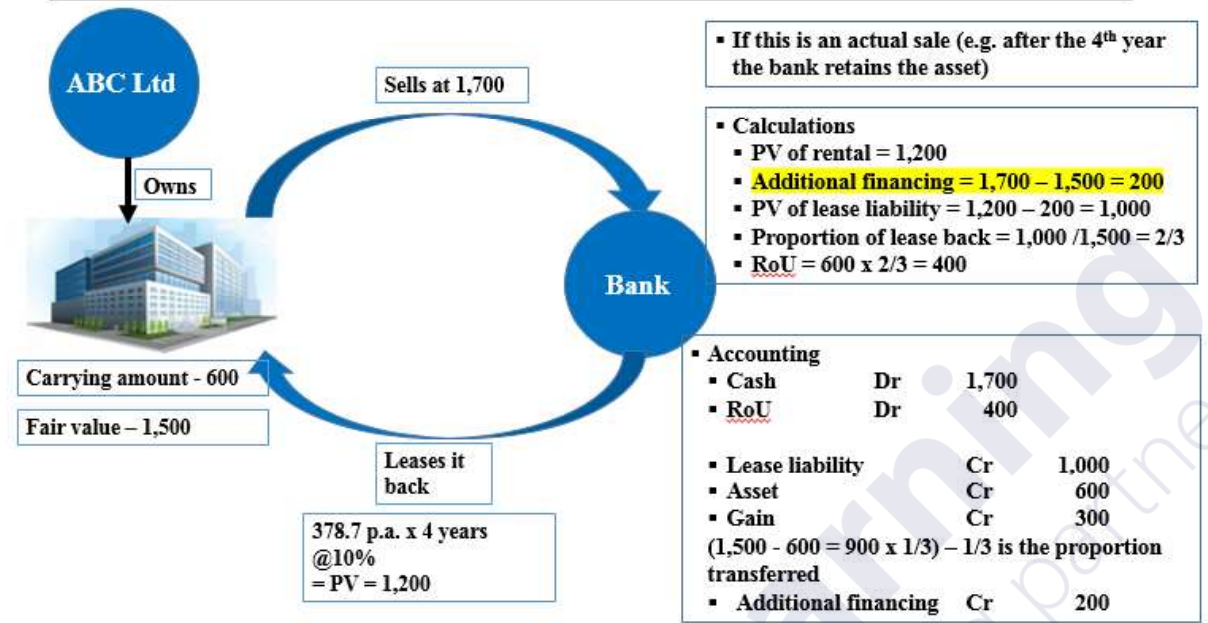
Sale and lease back transactions – at market value



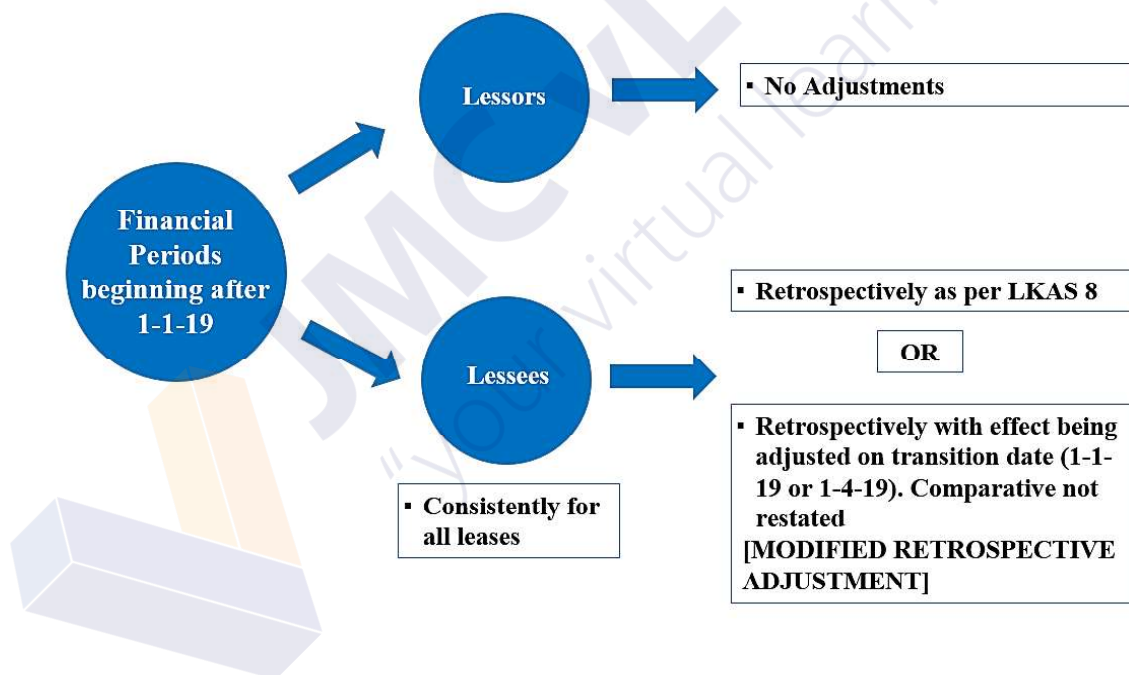
Sale and lease back transactions – below market value



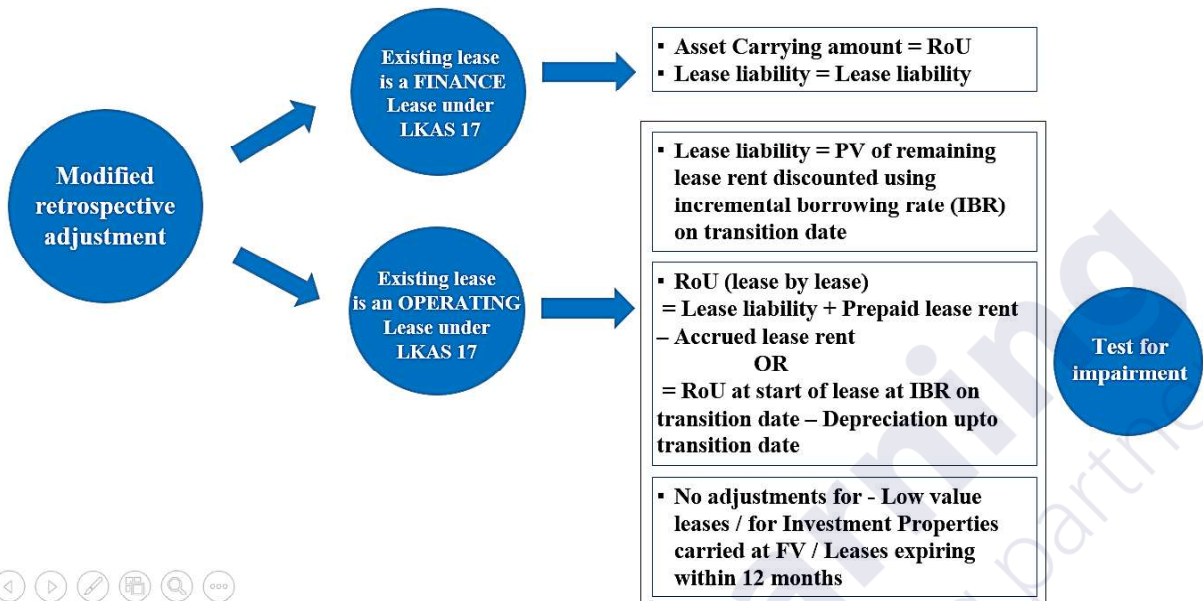
Sale and lease back transactions – Above market value



5.) Transitional Provisions



Transitional Provisions (cont.)



CFR – Past papers

June 2018 Q3 (c)

The group has approximately 660 property leases around the country, consisting of land and buildings mainly for showrooms, service centers, etc. The lease period is usually 4 – 6 years, and some are as long as 10 years.

Explain to the board on the impact of such leases arising from SLFRS 16 Leases.

(5 marks)

