

SLFRS 16 Leases



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DEVELOPMENT

July 1996:
G4+1 - Leases:
Implementation
of a New
Approach

March 2009:
Discussion
paper

August 2010:
Exposure
Draft

**January
2016:**
Final
standard

- **Effective date:** 1 January 2019
(early adoption permitted in
conjunction with IFRS 15)

The plane has landed!

SLFRS 16 Leases



AGENDA

- Comparison of SLFRS 16 with LKAS 17
- Disclosures

IDENTIFYING A LEASE

Definition of a lease

LKAS 17.4

An agreement whereby the lessor conveys to the lessee in return for a payment or a series of payments the right to use an asset for an agreed period of time

SLFRS 16 Appendix A

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

Defining characteristic of a lease (i.e. convey right to use an asset) has not changed

Definition of a lease

SLFRS 16 Appendix A

Terms defined in other standards and used in SLFRS 16 with the same meaning:

Consistent with the definition in SLFRS 15

CONTRACT: An agreement between two or more parties that creates enforceable rights and obligations

Effective date and withdrawal of other standards

- An entity shall apply this standard for annual reporting periods beginning on or after 1 January 2019. (SLFRS 16.C1)
- Date of initial application: Beginning of annual reporting period entity first applies SLFRS 16.
- Therefore, if not applied in advance, what is the “Date of Initial Application” of SLFRS 16?
 - A. 1 January 2019
 - B. 1 January 2018
 - C. I do not know

TRANSITION

Transition

- Adopt SLFRS 16 for all periods commencing **on or after 1 January 2019**.
- Earlier application permitted if entity :
 - (a) Discloses that fact
 - (b) Applies SLFRS 15 *Revenue from Contracts with Customers* at or before date of initial application of SLFRS 16.
- Date of initial application (“DOIA”) - **beginning** of the annual reporting period the entity **first applies SLFRS 16**.
- E.g. If entity adopts SLFRS 16 for first time in year commencing 01 January 2019, DOIA is 1 January 2019 irrespective of full retrospective application.

Transition

- **Practical expedient :**
 - (a) Both lessees & lessors are permitted to “grandfather” previous conclusions under LKAS 17 and IFRIC 4 for **all contracts existing as at DOIA.**
 - (b) SLFRS 16 requirements to be applied only for identification of leases of contracts entered into (or modified) **on or after DoIA.**

Previously identified as	Practical expedient applied as at DoIA?	
	Yes	No
An operating lease	Apply SLFRS 16	Re-examine to determine if contract contain a lease
An finance lease	Apply SLFRS 16	
A non - lease contract	SLFRS 16 is not applicable.	

Lessee

- ✓ **Retrospectively** in accordance with LKAS 8, or
- ✓ **Simplified approach**
 - Retrospectively with cumulative effect as adjustment to opening balance of retained earnings (or other component of equity, if appropriate) on DoLA;
 - No restatement of comparative information;

Previously operating lease

- **Lease liability** =
 - remaining lease payments,
 - discounted using incremental borrowing rate at date of initial application
- **Right-of-use asset** =
 - retrospective based on incremental borrowing rate at date of initial application, *or*
 - amount of lease liability
- Not required to apply if remaining lease term < 12 months

Previously finance lease

- **Lease liability** = carrying amount of lease liability immediately before date of initial application
- **Right-of-use asset** = carrying amount of lease asset immediately before date of initial application

Worked example

An entity (lessee) entered into 3-year lease of retail space beginning at 1 January 2017 with three annual lease payments of CU1,000,000 due on 31 December 2017, 2018 and 2019, respectively. The lease is classified as an operating lease under IAS 17.

The entity initially applies IFRS 16 for the first time in the annual period beginning at 1 January 2019 ["Date of initial application" or "DoIA"].

The incremental borrowing rate at the DoIA is 3% p.a.. The incremental borrowing rate at the commencement of the lease was 6% p.a.

The right-of-use asset is subject to straight-line depreciation. For simplicity let's assume, Lessee did not incur initial direct costs, there were no lease incentives and there were no requirements for the lessee to dismantle and remove the underlying asset, restore the site on which it is located or restore the underlying asset to the condition under the terms and conditions of the lease;

Worked example

Analysis:

Annual lease payment		1,000,000 CU
Lease term		3 years
Incremental borrowing rate		
1-Jan-19	i.e. DoIA	3% p.a.
1-Jan-17	i.e. commencement of lease	6% p.a.

Working 1: Calculation of discount factors

Yr	PVIF @ 3% p.a.	PVIF @ 6% p.a.
0	1.00	1.00
1	0.97	0.94
2	0.94	0.89
3	0.92	0.84

Worked example

(i) 1-Jan-17 @ 6% p.a.			
Yr	Discount Factor	Lease payment	PV
1	0.94	(1,000,000)	(943,396) CU
2	0.89	(1,000,000)	(889,996) CU
3	0.84	(1,000,000)	(839,619) CU
			<u>(2,673,012) CU</u>

Necessary for **Fully Retrospective** Approach

(ii) 1-Jan-17 @ 3% p.a.			
Yr	Discount Factor	Lease payment	PV
1	0.97	(1,000,000)	(970,874) CU
2	0.94	(1,000,000)	(942,596) CU
3	0.92	(1,000,000)	(915,142) CU
			<u>(2,828,611) CU</u>

Necessary for **Modified Retrospective** Approach – ALT 1

(iii) 1-Jan-19 @ 3% p.a.			
Y	Discount Factor	Lease payment	PV
1	0.97	(1,000,000)	(970,874) CU
			<u>(970,874) CU</u>

Necessary for **Modified Retrospective** Approach – ALT 2

Worked example – Fully Retrospective approach

	RoU Asset	Lease Liability	Interest expense	Depreciation expense	Retained earnings
1-Jan-17	2,673,012	(2,673,012)	-	-	-
31-Dec-17	1,782,008	(1,833,393)	160,381	891,004	51,385
31-Dec-18	891,004	(943,396)	110,004	891,004	
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1-Jan-19	891,004	(943,396)			
31-Dec-19	0	0	56,604	891,004	

LEASE LIABILITY				RoU ASSET		
B/F	Interest expense	Lease payments	C/D	B/F	Acc. Depn	C/D
(2,673,012)	(160,381)	1,000,000	(1,833,393)	2,673,012	(891,004)	1,782,008
(1,833,393)	(110,004)	1,000,000	(943,396)	1,782,008	(891,004)	891,004
(943,396)	(56,604)	1,000,000	0	891,004	(891,004)	0

Worked example - Modified Retrospective approach [Alt 1]

	RoU Asset	Lease Liability	Interest expense	Depreciation expense	Retained earnings
1-Jan-17	-	-	-	-	-
31-Dec-17	-	-	-	-	-
31-Dec-18	-	-	-	-	-
<hr style="border-top: 1px dashed orange;"/>					
1-Jan-19	942,870	(970,874)			28,003
31-Dec-19	0	0	29,126	942,870	

RoU Asset	Dr.	942,870	
Retained earnings	Dr.	28,003	
Lease liability			(970,874)

LEASE LIABILITY				RoU ASSET		
B/F	Interest expense	Lease payments	C/D	B/F	Acc. Depn	C/D
(970,874)	(29,126)	1,000,000	0	2,828,611	(942,870)	1,885,741
				1,885,741	(942,870)	942,870
				942,870	(942,870)	0

Worked example - Modified Retrospective approach [Alt 2]

	RoU Asset	Lease Liability	Interest expense	Depreciation expense	Retained earnings
1-Jan-17	-	-	-	-	-
31-Dec-17	-	-	-	-	-
31-Dec-18	-	-	-	-	-
<hr style="border-top: 1px dashed orange;"/>					
1-Jan-19	970,874	(970,874)			-
31-Dec-19	0	0	29,126	970,874	

LEASE LIABILITY				RoU ASSET		
B/F	Interest expense	Lease payments	C/D	B/F	Acc. Depn	C/D
(970,874)	(29,126)	1,000,000	0	970,874	(970,874)	0

Lessor

- Lessor in general not required to make adjustment on transition.

Intermediate lessor:

- Reassessment of ongoing operating subleases
- If operating subleases now have to be classified as finance leases, lessor shall account for sublease as new finance lease entered into on date of initial application

Illustrative disclosures

Deutsche Post Annual Report 2017 [Extract]

Effects of IFRS 16, Leases

In the context of the transition to IFRS 16, right-of-use assets of €9.1 billion and lease liabilities of €9.2 billion were recognised as at 1 January 2018. Of these lease liabilities, €1.6 billion was due within one year. The Group transitioned to IFRS 16 in accordance with the modified retrospective approach. The prior-year figures were not adjusted. As part of the initial application of IFRS 16, the Group chooses to apply the relief option, which allows it to adjust the right-of-use asset by the amount of any provision for onerous leases recognised in the balance sheet immediately before the date of initial application. In addition, the Group has decided not to apply the new guidance to leases whose term will end within twelve months of the date of initial application. In such cases, the leases are accounted for as short-term leases and the lease payments associated with them are recognised as an expense from short-term leases. The following reconciliation to the opening balance for the lease liabilities as at 1 January 2018 is based upon the operating lease obligations as at 31 December 2017:

Reconciliation

€m	1 Jan. 2018
Operating lease obligations at 31 December 2017	11,298
Minimum lease payments (notional amount) on finance lease liabilities at 31 December 2017	237
Relief option for short-term leases	-225
Relief option for low value asset leases	-27
Lease-type obligations (service components)	2
Other	50
Gross lease liabilities at 1 January 2018	11,335
Discounting	-1,919
Lease liabilities at 1 January 2018	9,416
Present value of finance lease liabilities at 31 December 2017	-181
Additional lease liabilities as a result of the initial application of IFRS 16 as at 1 January 2018	9,235

Illustrative disclosures

The lease liabilities were discounted at the incremental borrowing rate as at 1 January 2018. The weighted average discount rate was 3.8%. In order to calculate the incremental borrowing rate, reference interest rates were derived – for a period of up to 15 years – from the yields of corporate bonds in major countries and/or currencies, provided there was a deep market for corporate bonds. By contrast, government bond yields were used for countries without a deep market for corporate bonds. The reference interest rates were supplemented by a leasing risk premium.

Leases are presented as follows in the income statement:

Leases in the income statement

€ m

	2018
Revenue/other operating income	
Operating lease income	49
Sublease income	37
Income from sale and leaseback transactions	46
Materials expense	
Expenses from short-term leases	664
Expenses from low-value asset leases	46
Expenses from variable lease payments	33
Other lease expenses (incidental expenses)	56
Depreciation and impairment losses	
Depreciation of and impairment losses on right-of-use assets	1,862
Impairment losses on right-of-use assets	10
Net finance costs	
Interest expenses on lease liabilities	376
Currency translation gains on lease liabilities	27
Currency translation losses on lease liabilities	56

Effective date and withdrawal of other standards

What would SLFRS 16 supersede?

- **LKAS 17** *Leases*;
- **IFRIC 4** *Determining whether an arrangement contains a lease*;
- **SIC - 15** *Operating Leases - Incentive*;
- **SIC - 27** *Evaluating the Substance of Transactions involving the Legal Form of a Lease*;

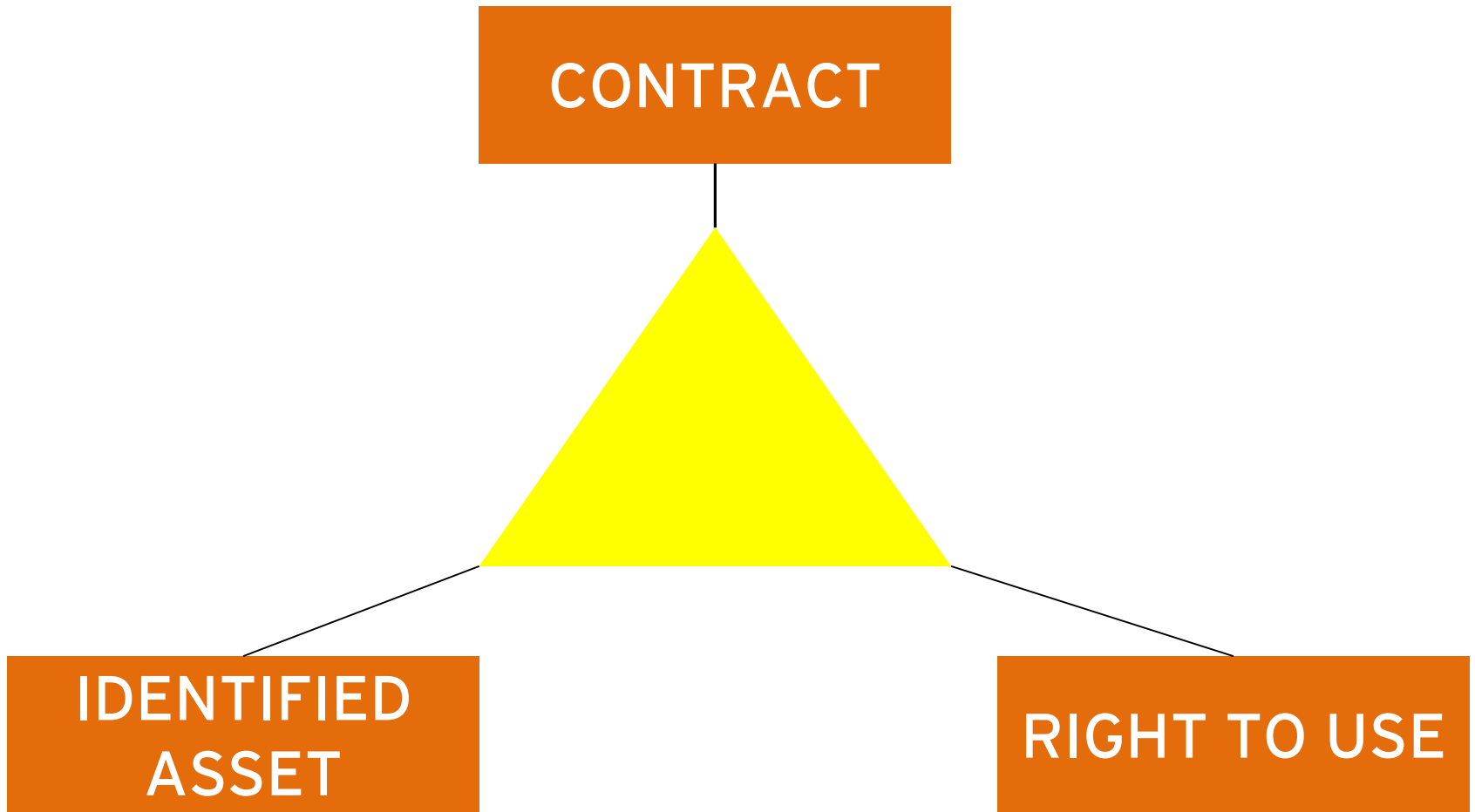
SoAT on Right to
Use of Land on
Lease

Objective of SLFRS 16

- SLFRS 16 contains principles for **recognition, measurement, presentation and disclosure** of leases.
- **Objective:** ensure that lessees and lessors provide **relevant information** in a manner that faithfully represents lease transactions. Therefore, users are provided a basis to assess effect leases have on **financial position, financial performance and cash flows** of an entity.
- Entity shall consider **terms & conditions of contracts** and all relevant facts and circumstances when applying the SLFRS 16.

All leases are in scope of SLFRS 16, EXCEPT for:	
Leases to explore for or use non - regenerative resources	Out - of - Scope
Biological assets within scope of LKAS 41	Out - of - scope
Service concession arrangements within scope of IFRIC 12	Out - of - scope
Licenses of intellectual property granted by lessor within scope of SLFRS 15	Out - of - scope
Rights held by lessees under licensing agreements (motion picture films, patents, copyrights,...etc.)	Out - of - scope
Other intangible assets	Policy choice for lessees

Lease



Specific identifiability

- **Explicitly** specified in contract, or **Implicitly** specified by customer;
- **Physically distinct**. If **not**, represents substantially all of the capacity of underlying asset.

- Explicitly specified in contract:

E.g. 1: Vehicle: *Honda CR - V 2018 VTi - L 2WD
brand - new brilliant blue 7 - seater bearing Vehicle
Identification Number (VIN) 3H3tXB69CWDY
967474 / Engine Number 72WXB70447.*



E.g. 2: Land: *".. All that allotment of land marked Lot 3B depicted in Survey Plan no. 7606 dated 30th October 2017 made by P. Silva Licensed Surveyor of the Land called MANGALAWATTA situated at Katukurunda in the Grama Niladari Division 630A Kalapuwa of the Kalutara Divisional Secretariat Area within the administrative limits of the Kalutara Urban Council in Kalutara Bedda of the Kalutara Thotamuna North in the District of Kalutara Western Province and bounded by the NORTH by LotC on the EAST by KORALAGODAWATTA on the SOUTH by DEHIGAHAWATTA and on the WEST by Lot 3A and Lot 3C and containing in extent of 3 Acres 1 Rood and Twenty Perches (A3 - R1 -P20.00).*

- **Implicitly** specified by customer:

E.g. Falcon Machine Tools Ltd. (FMT) is machine tool manufacturer. ACE Engineering Services (ACE) is a key customer of FMT.

FMT has only one Flat - Bed CNC Lathe machine model DMTG CKE 6150 - CKE 6166 capable of satisfying ACE's specific requirement for a particular type of precision tool. Such Lathes require a significant investment. The Lathe machine can produce only 5,000 units of that specific precision tool per set - up / day.

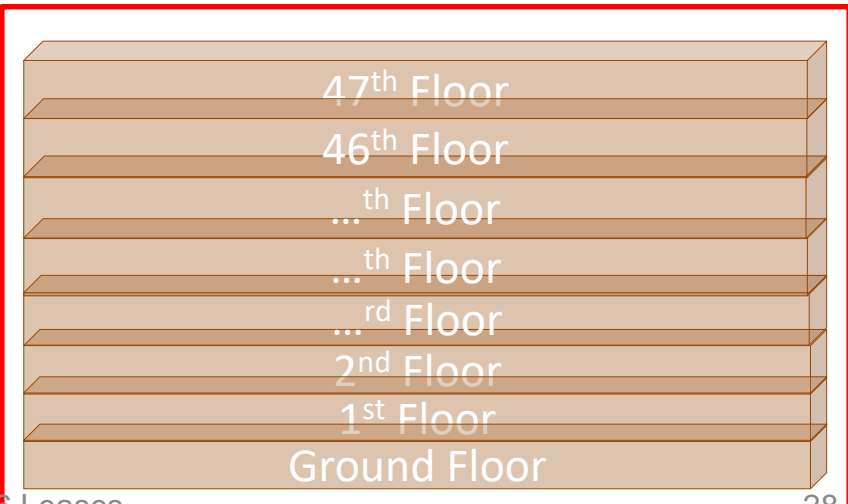
ACE requires 250,000 units of that precision tool by 4th November 2018. This requirement can be satisfied only if the Lathe machine is used on a full - time basis over a 50 - day period.



- Physically distinct:



Forty seven story mixed development located opposite Beira lake, Colombo 02.



Identified Asset

Identifying
a lease

- Physically distinct:

N th Floor



Identified Asset

Identifying
a lease

If not, represents **substantially all** of the capacity of underlying asset



Fiber Optic Cable



Gas Pipe line

Identified Asset

Identifying a
lease

**Supplier has no
substantive right to
substitute underlying
asset**

Assess as at **date of inception**
based on all facts and
circumstances.

IDENTIFIED ASSET

Identifying
a lease

Specified **explicitly** or
implicitly

IDENTIFIED
ASSET

Supplier has **no substantive
right of substitution**

Supplier's right to **substitution** is
substantive if -

- Supplier has **practical ability** to substitute
- and
- Supplier would **benefit economically** from substituting

Practical ability:

- *Supplier has **right to substitute asset***
- and
- *Alternative assets are **readily available** or could be sourced within a reasonable period of time*

E.g. The Case of a Medical Students' Hostel

The boy's hostel of the Faculty of Medicine, Colombo is situated at Ward Place, next to Carey College, Colombo. This is occupied by approx. 388 boys. It has easy access to the Colombo Medical Faculty and National Hospital of Sri Lanka. It is a property of the University of Colombo. For academic activities of the students there are many facilities such as a study area, a computer room etc. There is one TV room and a newspaper table for the leisure time of the students. There is also a gymnasium for the students to improve their physical fitness.



Food for the students is supplied by a chummery system and there's also a canteen which is functioning from 6.00 a.m. to 12 midnight. The hostel is maintained by the Bloem committee, which see to the development and maintenance of the hostel facilities.



SUPPLIER'S SUBSTITUTION RIGHTS

Identifying a lease

Supplier's substitution rights are **not substantive** where -


- Right relates to substituting asset for **technical upgrade or repair** (when asset is **not working properly**)
- Substitution right is exercisable **on or after a particular date** or on occurrence of a **future event**
- When lessee **cannot readily determine** whether right is substantive (Therefore, right is **presumed not substantive**)

Assessment whether substitution rights are substantive will **exclude future events not considered likely to occur**


1 There is an identified asset

AND

2 Contract conveys the *right to control the use* of an identified asset

 *Customer's right to obtain substantially all economic benefits from use* of the identified asset throughout the period of use,

AND

 *Customer's right to direct the use* of identified asset throughout the period of use

RIGHT TO CONTROL USE OF IDENTIFIED ASSET

Identifying
a lease

Customer shall have right to obtain **substantially all economic benefits** throughout **period of use**.

- Economic benefits from use of an asset include its **primary output** and **by-products** (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realized from a commercial transaction with a third party.
- **Example:**
Power purchase agreements often comprise the sale of multiple products, which may include energy, capacity, steam, renewable energy credits, and ancillary services.

RIGHT TO CONTROL USE OF IDENTIFIED ASSET

Identifying
 a lease

Customer has **right to direct use** throughout period of use if -

A. Customer has right to direct use of asset throughout the period of use if -

Protective rights
 of supplier do not prevent customer
 from having right to direct use

OR

B. Relevant decision

E.g. Rights to protect supplier's interest
 in asset or other assets, to protect its
 personnel, or to ensure the supplier's
 compliance with laws or regulations

- Customer has **right to control** the asset throughout period of use,
- Customer **designed** the asset (or specific aspects of asset) in a way that predetermines how and for what **purpose** the asset will be used

RIGHT TO CONTROL USE OF IDENTIFIED ASSET

Identifying
a lease

Customer has **right to direct use** throughout period of use if -

A. Customer has right to direct how and for what purpose asset is used throughout the period of use

*E.g. Mr. Perera operates a pop - corn stall at the foyer of CCC Multiplex. Pop - corn is produced by a **portable pop - corn vending machine** leased by Mr. Perera.*

Type of output produced

E.g. Sweet, Caramel, Cheesy, perfect Buttery, Spicy

When output is produced

E.g. 10.30 am, 1.30 am, 4.30 p.m., 7.30 p.m.

Where output is produced

E.g. At the foyer or at his residence

Whether output is produced and quantity of output

E.g. No of packets per type of popcorn

RIGHT TO CONTROL USE OF IDENTIFIED ASSET

Identifying
a lease

Customer has **right to direct use** throughout period of use if -

B. Relevant decisions are **predetermined**

AND

- Customer has **right to operate asset** throughout period of use,
- OR
- Customer **designed** the asset (or specific aspects of asset) in a way that predetermines how and for what **purpose** the asset will be used

Example: The case of Royal Lace Ceylon Ltd.

Royal Lace Inc. is a leading manufacturer of embroidered lace located in Rue Spontini, Paris, France.

*An application was made by its subsidiary in Sri Lanka, Royal Lace Ceylon Ltd ("Enterprise"), to the Board of Investment of Sri Lanka (BoI) requesting to **set up / conduct and operate a business to manufacture embroidered lace ("business")** in collaboration with Royal Lace Inc.*

RIGHT TO CONTROL USE OF IDENTIFIED ASSET

Identifying
a lease

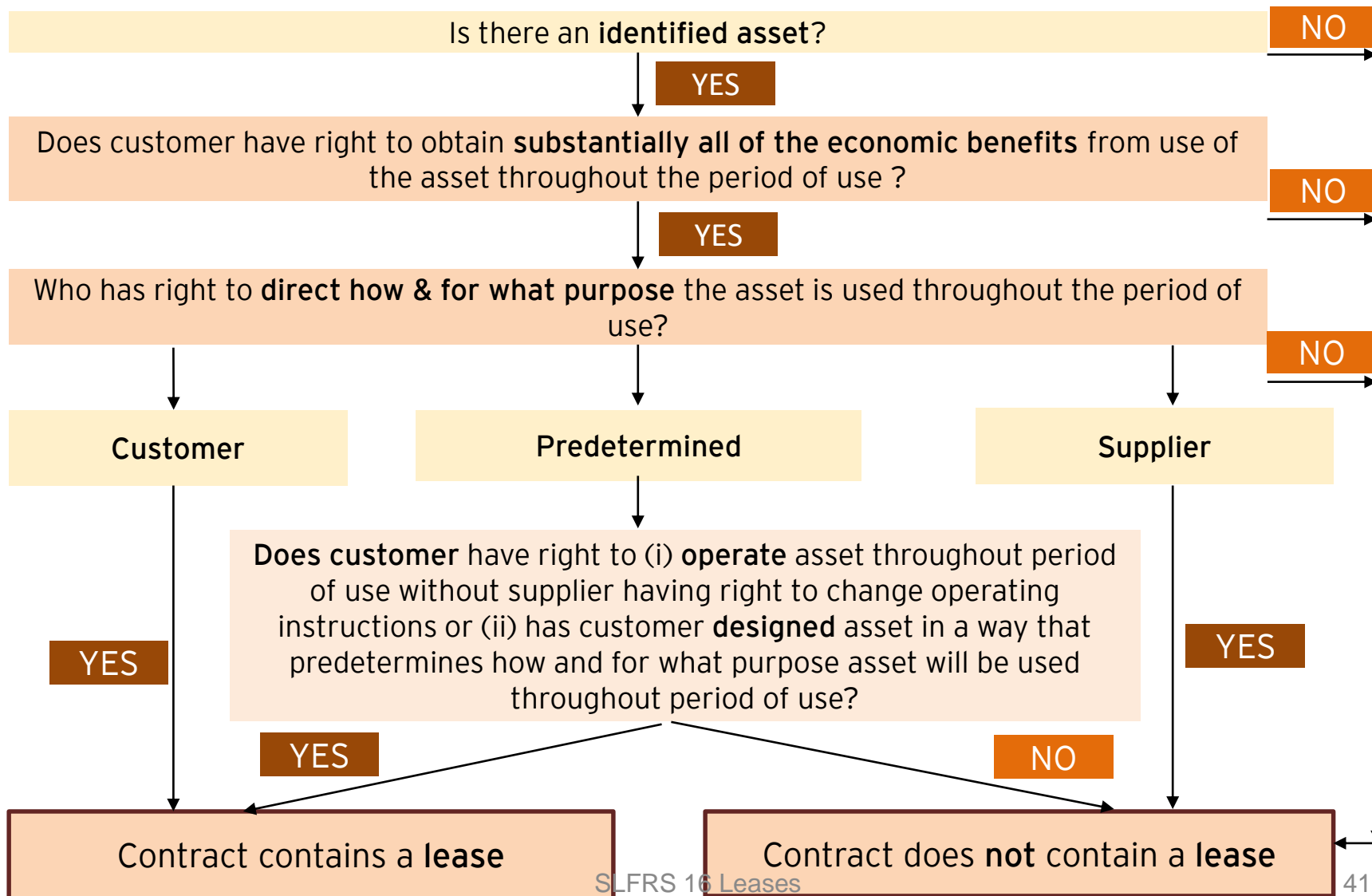
Example: The case of Royal Lace Ceylon Ltd (Contd) .

The Bol considered the application under its scheme for large scale developments and approved the application. Consequently, an agreement between Bol and RLC was entered into. According to the agreement,

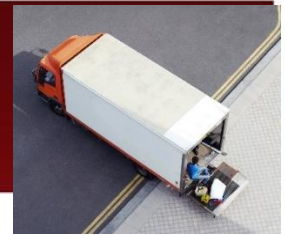
- The Enterprise was entitled to set up / conduct and operate the said business;*
- Enterprise has to pay to the Bol an annual fee of SL Rs. 120,000/- p.a.*
- The set up/conduct and operation of the said business should be on a land identified by the Enterprise with prior clearance and approval from Bol. For this purpose, the specific plot of land of A1 - R2 - P7.00 situated at 46B, BEPZ, Walgama, Malwana was identified. A manufacturing facility equipped with specialized lace - manufacturing machinery was constructed by the Enterprise on this land at a cost of SL Rs. 500 million.*
- The Enterprise was **contractually prohibited from conducting any other business on this land and premises.***
- At least **90% of output** from the Enterprise should be **marketed abroad.***

DECISION FLOW CHART

Identifying a lease



ILLUSTRATIVE EXAMPLE



- Customer enters into contract with Supplier for one week for exclusive use of a specified truck to transport cargo from New York to San Francisco. Contract prohibits Supplier from substituting alternative truck.
- Cargo to be transported, timing and location of pick-up in New York and delivery in San Francisco are specified in contract.
- Customer is responsible for driving truck from New York to San Francisco.

Does contract contain a lease?	
Identified asset?	✓
Substantially all of the economic benefits?	✓
Right to direct the use?	See next slide

ILLUSTRATIVE EXAMPLE



- Customer enters into a contract with Supplier for **one week.**
- Cargo to be transported, timing and location of pick-up in New York and delivery in San Francisco are **specified in contract.**
- Customer **is responsible for** driving truck from New York to San Francisco

Right to direct use?	
How and for what purpose?	Predetermined
Customer operates the asset	✓
Customer has designed the asset?	Not applicable

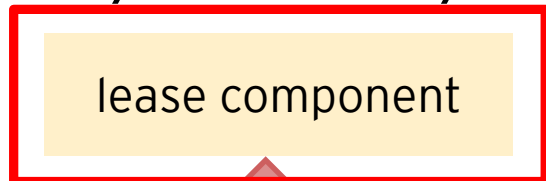
Contract contains a lease. However, it is a short term lease.

SEPARATING CONTRACT COMPONENTS

SEPARATING CONTRACT COMPONENTS

Identifying
a lease

Entity shall identify and account for each separate component



Criteria

Lessee can benefit from the component on its own or with other readily available resources

and

Components are neither dependent nor highly interrelated;

Allocation of consideration:

Lessee: Based on relative stand alone price

Lessor: Based on relative stand alone price in accordance with SLFRS 15. 73- 90

Apply other applicable standards

Policy choice:

A lessee may elect, by class of underlying asset, not to separate non - lease components from lease components, but instead to account for each lease and associated non - lease component as a single lease component.

Contract 1

Contract 2

Contract 3

Combine two or more contracts with
same counterparty if :

- Entered into at or near same time

And

Either -

- Negotiated as a package with overall commercial objective,

or

- Consideration in one contract depends on price / performance on other contract

or

- Assets involved are single lease component

LEASE TERM

Non - cancellable period of lease

Together with

Periods covered by **option to extend**

If

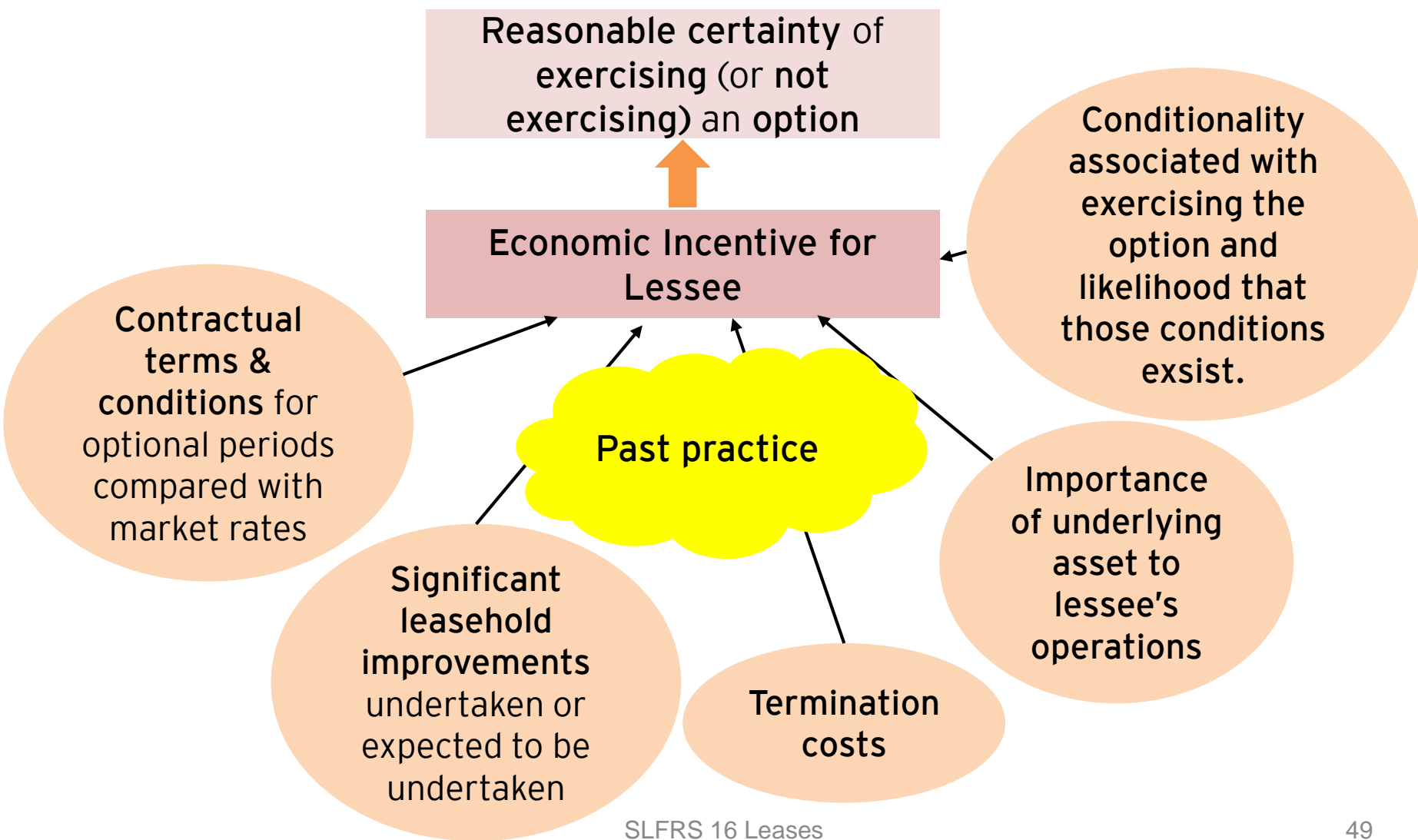
Lessee is **reasonably certain**
to exercise option

Periods covered by option to
terminate

If

Lessee is **reasonably certain**
not to exercise option

Reassess lease term upon the occurrence of a **significant event** or a **significant change in circumstances** that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. (paragraph B41)



E.g. The case of Perera and Sons.

Perera & Sons (PNS) is a bakery business with a network of over 140 outlets. PNS has a franchised outlet at No. 203, De Saram Place Colombo 10, operating daily from 6 a.m. to 7 p.m.

Given the outlet's strategic location at the heart of a high - density locality, this PNS outlet is one of the top 5 outlets with highest turnover & profitability. During the year 2019, it extended its dining area at a significant cost for the benefit of its patrons.

Assume its current lease agreement will expire on 31 December 2019. PNS will enter into a new lease agreement with the Landlord on 1 January 2020. The new lease agreement has a non - cancellable period of 5 years with an option to extend for another 5 years at a premium rate (over the market rate) at the end of the initial term.



RECOGNITION & MEASUREMENT EXEMPTIONS

Identifying a lease

Exemption for short - term leases:

- Short term lease has a lease term of 12 months or less; lease that contains a purchase option is not a short-term lease

- **Accounting policy choice** available

A lessee may elect not to apply the recognition exemption for short-term leases. If so, the lessee shall apply the recognition exemption associated with those leases unless the lessee can demonstrate the lease term or another characteristic of the lease is on a systematic basis if that benefits the lessee's benefit (paragraph 16.10)

- Exemption to be applied by lessee

- Also applies in **business combinations**

A Company has **10** leases for office equipment. Office Equipment is considered **same class of assets**. **7** leases have a lease term **< 12 months**.

Remaining 3 leases have a lease term > 12 months. If recognition exemption is applied, **exemption is applied**

to **ALL** leases

Lease term ends within 12 months and

- Acquirer can apply short-term leases exemption

Subsequent periods:

- Lease modification
- Change in lease term

} Consider lease to be a new lease



Exemption for leases of which underlying asset is of a low value:

- Assets with a value, when paragraph 100)
- **Accounting policy**
A lessee may elect paragraphs 22-49 to leases of which the underlying asset is of low value. Lease payments shall be recognized either a straight-line basis or on a systematic basis. The lessee shall apply the systematic basis if that basis is more representative of the pattern of the lessee's benefit
- Exemption to be applied on a **lease-by-lease** basis
- Also applies for contracts of Acquiree in a business combination (i.e. no asset (liability) for favourable (unfavourable) contracts)

A hospital enters into a lease of 100 hospital beds. Value per bed = USD 3,000/-. Can we apply low value exemption?

Portfolio approach: (paragraph B1)

- Lease contracts with **similar characteristics**

and

- Applying standard to portfolio does not **differ materially** from applying to individual leases within portfolio

Portfolio approach permitted for lessee and lessor

LESSEE ACCOUNTING

Overview

Rights & Obligations arising from a lease: LESSEE

Description of right	Control	Past Event	FEB s	Asset?
Right to use machinery during lease term	Legally enforceable right established by lease contract	Signing of lease contract and delivery of asset	Yes	Yes

Description of Obligation	Control	Past Event	FEB s	Liability?
Obligation to make specified payments over lease term.	Legally enforceable obligation established by lease contract	Delivery of asset	Yes	Yes

Obligation to return machinery at end of lease term.	Legally enforceable obligation established by lease contract	Delivery of asset	No	No
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Overview

Rights & Obligations arising from a lease: LESSOR

Description of right	Control	Past Event	FEB s	Asset?
Right to receive payments during lease term.	Legally enforceable right established by lease contract	Signing of lease contract and delivery of asset	Yes	Yes
Right to return of machinery at end of lease term.	Legally enforceable obligation established by lease contract	Delivery of asset	No	No

Description of Obligation	Control	Past Event	FEB s	Liability?
Obligation to permit use of machinery during lease term.	Legally enforceable obligation established by lease contract	Signing of contract	No outflow of FEB	No

Balance sheet

Right-of-use asset/
Lease liability

Right-of-use asset

DR

Lease liability

CR

Income statement

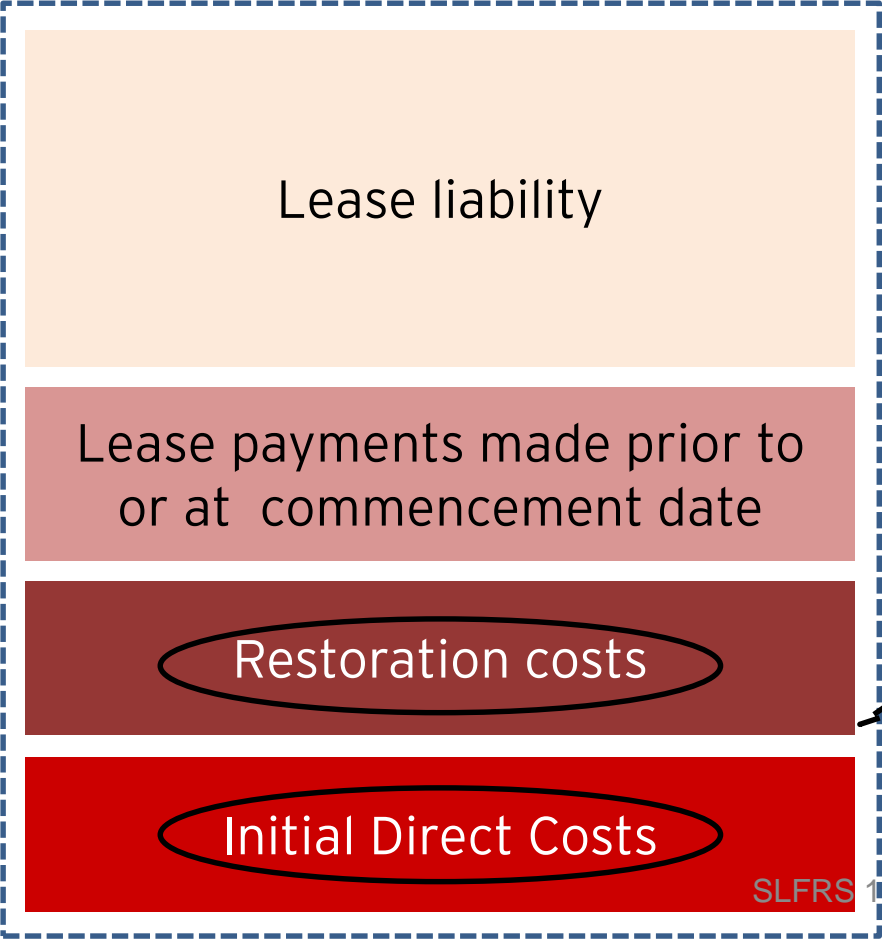
Depreciation/Impairment
(Right-of-use asset)

Interest expense
(Lease liability)

INITIAL MEASUREMENT

Right of Use Asset
 (paragraph 24)

Lease liability
 (paragraph 26)



Lease Payments

Discount Rate

Only when an obligation has been recognized in respect of these costs by applying LKAS 37

INITIAL MEASUREMENT - LEASE LIABILITY

Initial measurement: (paragraph 27)

Fixed payments

+

Variable payments

+

Residual value guarantees

+

Exercise price of purchase
options

+

Penalties for terminating

Includes **in - substance** fixed payments less any **lease incentives**

Only if it depends on an **index / rate**
Measured using **index / rate** as at **commencement date**

Expected payments lessee has to make under guarantee

If Lessee is **reasonably certain** to exercise option

If **Lease term** reflects the termination by the lessee

INITIAL MEASUREMENT - LEASE LIABILITY

Lessee
accounting

Variable lease payments

Dependent on

Index / rate

Other variable

*e.g. inflation/
interest rate or
market rental rates*

*Please refer illustrative
example*

*Please refer illustrative
example*



**Part
of lease liability**



**Not part of lease
liability**



**Part
of lease liability**

**In-substance fixed
payments**

Example 1 : Variable lease payments - other

PNS enters into a 10-year lease for commercial space at 203, De Saram Place, Colombo 01 with the Landlord. The annual lease payments are SL Rs. 6,000,000/- plus an amount equal to 5% of PNS sales. PNS's annual sales have exceeded SL Rs. 9,000,000/- since it began operations and are projected to grow at a rate of 10% annually. What are the lease payments for purposes of measuring the lease?

Answer:

The lease payments for purposes of classifying the lease are the fixed annual lease payments of SL Rs. 6,000,000/-.

Although there is a high probability of some variable lease payments being made in light of PNS's historical results and projections, the **variable lease payments are based exclusively on, and vary with, the performance of the underlying asset** . Therefore, should not be considered as lease payments for measuring the lease.

Example 2 : In substance fixed lease payments

PNS enters into a ten -year lease for commercial space with the Landlord. The initial base rent is SL Rs. 500,000/- per month. Rents increase by the greater of 1% of PNS's generated sales or 3% of the previous rental rate on each anniversary of the lease commencement date. What are the lease payments for purposes of measuring the lease?

Answer:

Lease payments for purposes of classifying lease are fixed monthly payments of SL Rs. 500,000/- plus minimum annual increase of 3%.

PNS is required to pay **no less than a 3% increase** regardless of the level of sales activity; therefore, this **minimum level of increase is an in substance fixed lease payment.**

INITIAL MEASUREMENT - LEASE LIABILITY

Lessee
accounting

Discount rate =
Interest rate implicit in lease

Can it be readily
determined?

No

Incremental borrowing rate
of lessee as at
commencement date

Any lease payments made at or before the commencement date, less any *lease incentives* received

Initial direct costs:

- *Incremental costs* of obtaining a lease that would have not been incurred if lease had not been obtained. E.g. commissions, payments to existing tenant to obtain lease

Restoration costs:

- Restoring underlying asset to conditions required by lease contract
- Dismantle and remove underlying asset
- Restore the site on which underlying asset is located
- Measured at estimated costs (LKAS 37)

Item	Subsequent measurement
Right - of - use asset	<p>Depreciation (in general on a straight - line basis)</p> <p>Assessment of impairment based on guidance of LKAS 36</p> <p>Adjustments for re-measurement of lease liability</p>
Lease liability	<p>Measured using effective interest rate method</p> <p>Re-measured to reflect reassessment, modifications or revised in-substance fixed payments</p>
Variable lease payments - not dependent on rate or index	<p>Recognised in profit/loss in period in which incurred</p>

SUBSEQUENT MEASUREMENT

Illustration : *Change in index/rate used to calculate variable lease payments*

Entity enters into a 10 year lease contract. Annual lease payments are CU 50,000 p.a. payable at commencement of each year. Lease payments increase every 2 years to reflect change in Consumer Price Index (CPI); at date of commencement, CPI = 125.



Commencement date

Beginning of second year

Beginning of third year

CPI = 125

New lease payment: CU 54,000
 (CU 50,000 × 135 / 125)

CPI = 135

Lease liability reflects nine payments of

50,000. **No reassessment as the change has not affected**

54,000 payments

Cash flow changes = Reassessment!

MODIFICATION OF LEASE

MODIFICATION OF LEASE

Does renegotiation change scope of lease?

YES

Decrease

Remeasurement of lease liability
and
 Decrease of carrying amount of right-of-use asset (partly profit/loss)

YES

Increase

Change to consideration is **commensurate** with the stand-alone price for the increase (plus appropriate adjustments)?

YES

Seperate lease contract

NO

NO

Remeasurement of lease liability
and
 Adjustment of right-of-use asset



OTHER MEASUREMENT MODELS

Property, plant & equipment:

Lessee may elect to apply revaluation model in LKAS 16 to right-of-use asset (by class) if

- (a) it relates to a class of property plant and equipment and
- (b) lessee applies revaluation model to all assets in that

Investment Property:

Lessee shall apply fair value model in LKAS 40 to right-of-use asset if

- (a) it meets definition of investment property in LKAS 40 and
- (b) lessee applies fair value model in LKAS 40 to its investment properties

Balance sheet

Right of use asset

Property, plant
and equipment

**Right-of-
use asset**

Lease liability

Financial liabilities

**Lease
liability**

Income statement

Revenue

(...)

Depreciation and amortisation

Depreciation expense on
the right-of-use asset

Finance cost

Interest expense on the
lease liability

Cash flow statement

Cash flows from operating activities

Short term lease payments

Payments for leases of low value

Variable lease payments not included in lease liability

Cash payments for the interest portion of the liability

Cash flows from financing activities

Cash payments for the principal portion of the liability

Cash payments for the interest portion of the liability

LESSOR ACCOUNTING

CLASSIFICATION INDICATORS - FINANCE LEASE

Lessor
 accounting

Transfer of **ownership** of
 underlying asset

Option to purchase that is
reasonably certain

Lease term is for a major part
 of economic life

If none of the
 indicators are
 present, it is an
OPERATING LEASE

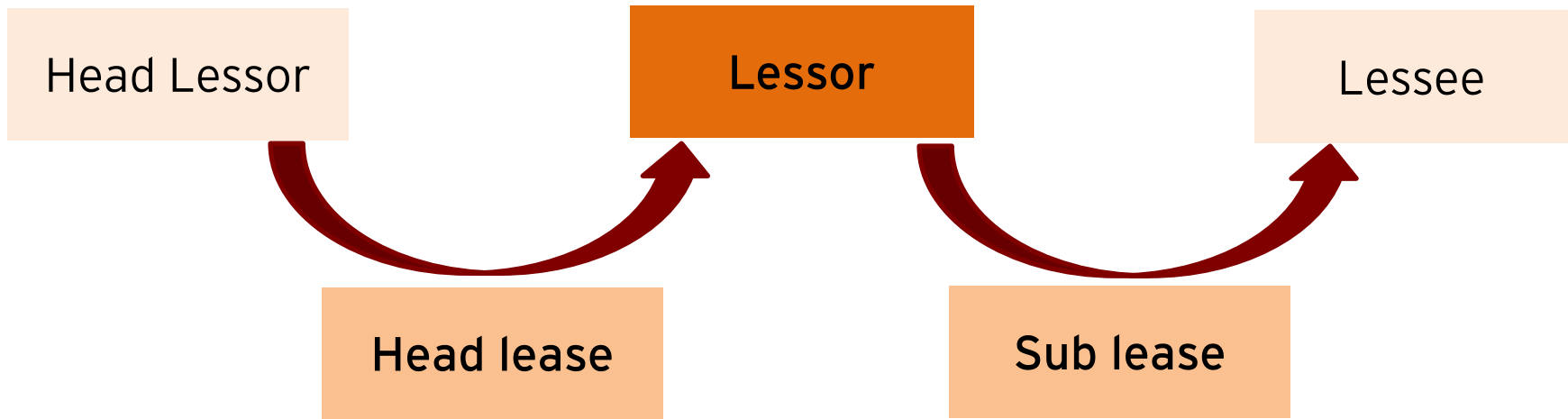
Present value of lease payments
 is **substantially all** of
 underlying asset's fair value

Underlying asset is of a
specialized nature

Lessee's option to continue
 lease at a rent **substantially**
lower than market rate

Gains or losses from fluctuation
 of residual value accrues to
 lessee

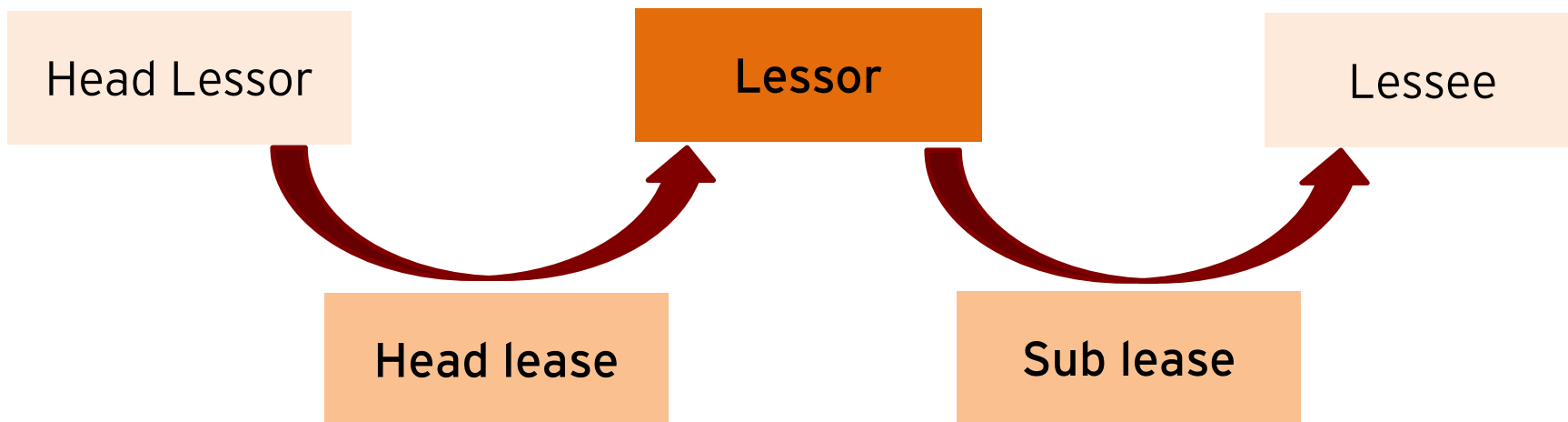
Lessee bears lessor's losses if it
 cancels lease



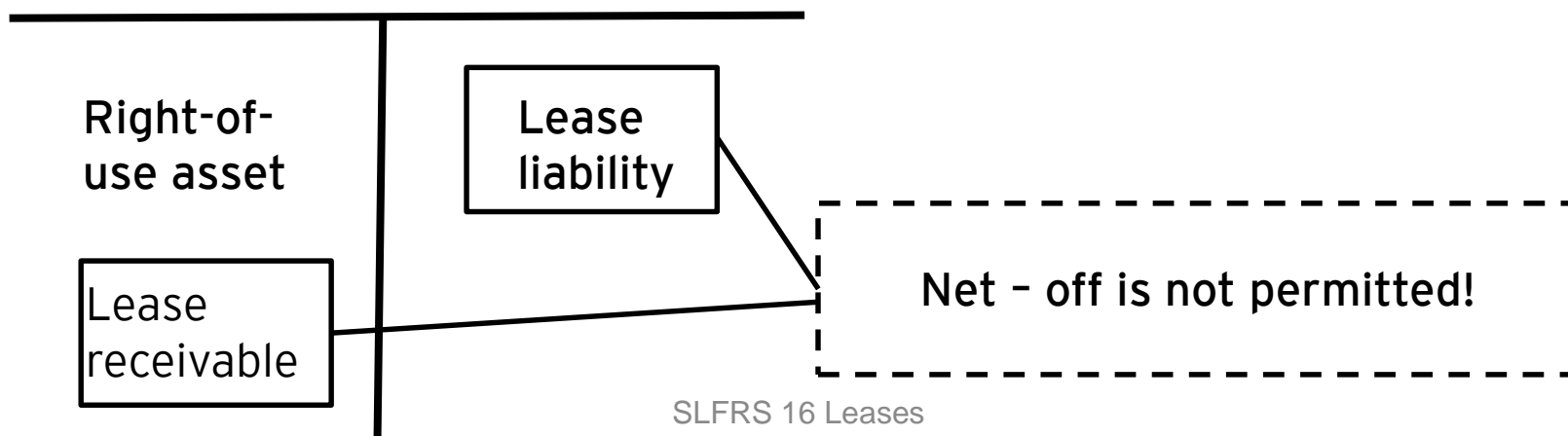
- Lessor evaluates sublease with reference to **right-of-use asset**
- If head lease is a short-term lease, sublease shall be classified as operating lease

SUBLEASES

Lessor
accounting



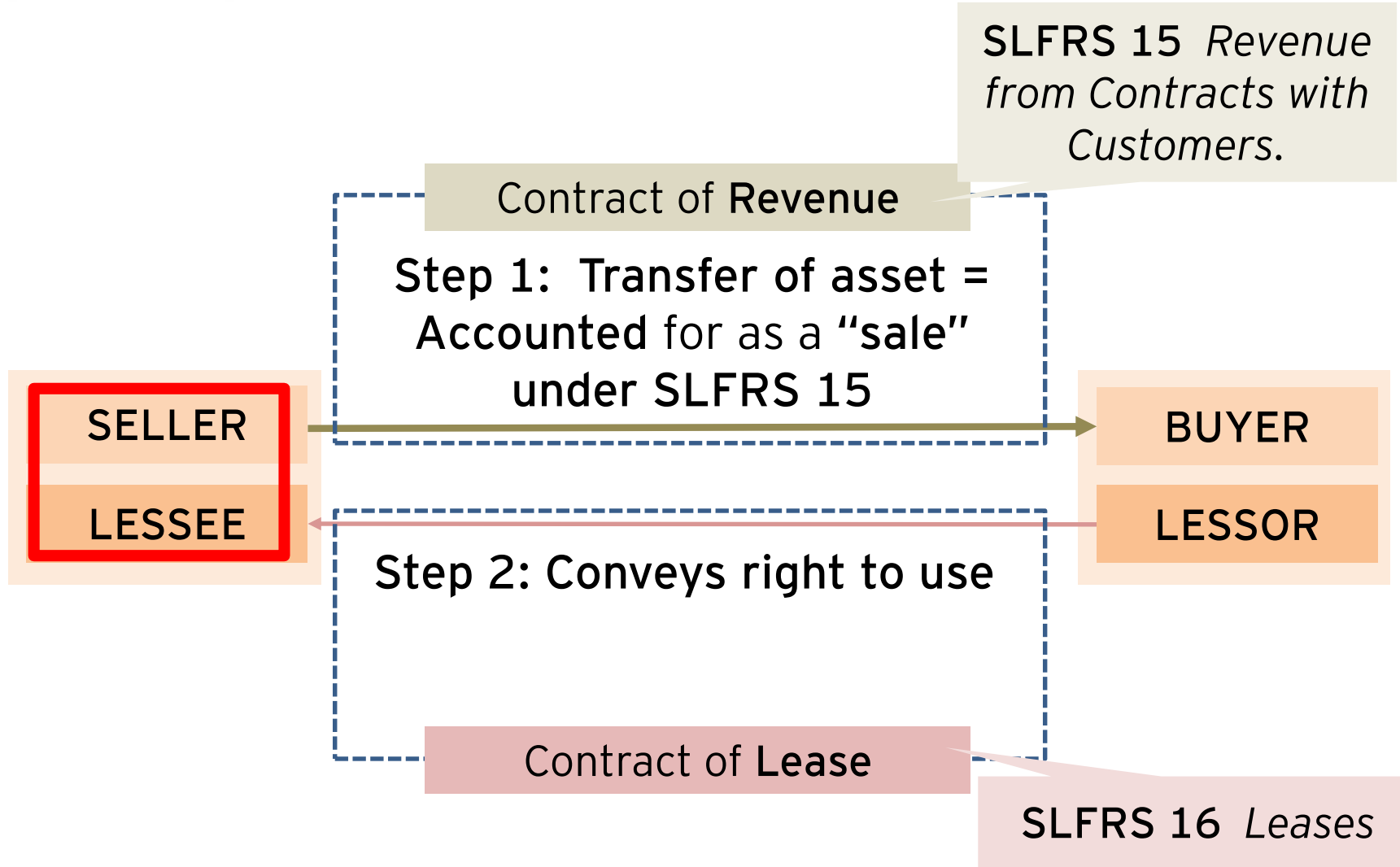
Balance sheet



SALE & LEASEBACK TRANSACTIONS

SLFRS 16.98 to 103

Sale & leaseback transactions



SALE & LEASEBACK TRANSACTIONS

Sale &
leaseback
transactions

Does transfer of the asset satisfy the requirements in SLFRS 15 to be accounted for as a sale?

Yes

Transfer is a **sale**

Scoped in to SLFRS 16

No

Transfer is **not** a sale

Scoped **out** of SLFRS 16

Transaction in substance is
a **financing arrangement**

SALE & LEASEBACK TRANSACTIONS

Sale &
leaseback
transactions

Measure sales proceeds at fair value.

Consideration for sale \neq Fair value of Underlying Asset

OR

Payments for lease \neq Market rate - based payments

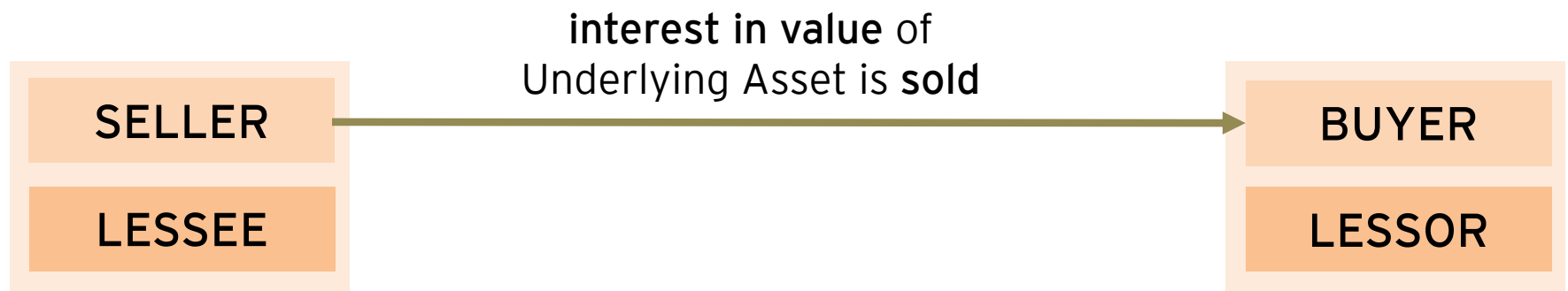
Adjust to measure proceeds at fair value

Terms	Accounting
Below - Market	Prepayment of lease payments
Above - Market	Additional Financing

SALE & LEASEBACK TRANSACTIONS

Sale &
 leaseback
 transactions

	Seller - Lessee	Buyer - Lessor
Transfer is a sale	<p>Right-of-use asset = proportion of the previous carrying amount that relates to the right of use retained.</p> <p>Gain/loss on sale = amount of gain or loss that relates to the rights transferred.</p>	No special requirements



Right to use Underlying
 Asset is retained

SALE & LEASEBACK TRANSACTIONS

Sale &
 leaseback
 transactions

➤ Sale

- Purchase price = CU 2,000,000
 - Fair value = CU 1,800,000
 - Carrying amount = CU 1,000,000
- } Sale is above **market price**
- } Unrecognised value = CU 800,000

➤ Leaseback

- Term: 18 years
 - Annual lease payments: CU 120,000
 - Discount rate: 4.5%
- } Present value = CU 1,459,200
- } Contains a **financing** component of CU 200,000



SALE & LEASEBACK TRANSACTIONS

Sale &
leaseback
transactions

(1) Financing transaction

Cash	CU 200,000
Financial liability	CU 200,000

(2) Sale and lease back

Cash	CU 1,800,000	$\frac{\text{CU } 1,259,200}{\text{CU } 1,800,000} \times \text{CU } 1,000,000$
Right-of-use asset	CU	= CU 699,555
Building		CU 1,000,000
Financial liability	$\text{CU } 1,459,200 - \text{CU } 200,000$	CU 1,259,200
	= CU 1,259,200	
Gain		CU 240,355
	$\frac{\text{CU } 1,800,000 - \text{CU } 1,259,200}{\text{CU } 1,800,000}$	$\times \text{CU } 800,000$
	= CU 240,355	

OTHER

SLFRS 16 Vs LKAS 17

Other

Issue	SLFRS 16	LKAS 17 / IFRIC 4
Definition of a lease	Right to use an asset, that is <ul style="list-style-type: none"> • identified asset, & • right to control the use 	In general similar to SLFRS 16, but different detailed guidance
Separating lease components	Separate component, if <ul style="list-style-type: none"> • separate benefit for lessee, & • not highly dependent on, or highly interrelated with, other component 	No specific guidance (except for lease of land and building)
Combination of contracts	<ul style="list-style-type: none"> • Combine contracts if certain criteria are met 	<ul style="list-style-type: none"> • No comprehensive guidance (see SIC 27)

Issue	SLFRS 16	LKAS 17 / IFRIC 4
Exemptions (lessee)		
Short term lease	Lease term \leq 12 months (provided no purchase option)	No
Low value assets	Value \leq USD 5,000	No
Lessee accounting		
Balance sheet	<u>Right-of-use asset and lease liability for all leases</u>	<ul style="list-style-type: none"> • <u>Operating lease</u>: No asset/liability (only accruals or prepayments) • <u>Finance lease</u>: Leased asset and lease liability

Issue	SLFRS 16	LKAS 17 / IFRIC 4
Variable lease payments	Part of the lease liability if they depend on index/rate	Not part of the lease liability
Income statement	<ul style="list-style-type: none"> • <u>Right-of-use asset</u>: depreciation • <u>Lease liability</u>: effective interest rate method • <u>Variable lease payments</u> not included in lease liability 	<ul style="list-style-type: none"> • <u>Operating lease</u>: Lease payments on a straight-line basis • <u>Finance lease</u>: <ul style="list-style-type: none"> • Leased asset: depreciation • Lease liability: effective interest rate method • Variable lease payments not included in lease liability

Issue	SLFRS 16	LKAS 17 / IFRIC 4
Cash flow statement	<ul style="list-style-type: none"> • <u>Part of lease payment that represents principal portion:</u> Cash flow resulting from financing activities • <u>Part of lease payment that represents interest portion:</u> operating cash flow or cash flow resulting from financing activities (depending on entity's policy) • <u>Payments for short-term leases, for lease of low-value assets and variable lease payments not included in lease liability:</u> operating cash flow 	<ul style="list-style-type: none"> • <u>Operating lease:</u> operating cash flow • <u>Finance lease:</u> Similar to SLFRS 16

Issue	SLFRS 16	LKAS 17 / IFRIC 4
Lessor accounting		
Balance sheet	<ul style="list-style-type: none"> • <u>Operating lease</u>: Assets subject to lease • <u>Finance lease</u>: Receivable at amount equal to the investment in the lease 	
Income statement	<ul style="list-style-type: none"> • <u>Operating lease</u>: lease payments on straight-line basis • <u>Finance lease</u>: interest on receivable measured using the effective interest method 	
Modifications	<ul style="list-style-type: none"> • Adjustment of existing lease, or • Accounted for as a separate lease, depending on kind of modification 	No specific guidance
Sale and leaseback transactions	Distinction based on whether transfer is sale	Distinction based on classification of leaseback
Subleases	Classification of sublease refers to right-of-use asset	Classification of sublease refers to leased asset

Right-of-use asset

Depreciation charge (by class of underlying asset)

Carrying amount (by class of underlying asset)

Additions

Lease liabilities

Interest expense

Maturity analysis in accordance with paragraph 39 and B11 of SLFRS 7

Recognition and measurement exemptions

Expense relating to short-term leases

Expense relating to leases of low-value assets

Other disclosures relating income statement

Expense relating to variable lease payments not included in lease liabilities

Income from subleasing right-of-use assets

Gains or losses arising from sale and leaseback transactions

**This table covers the major disclosure requirements; depending on the particular facts and circumstances additional disclosures might be necessary

Future cash outflows from -

Variable lease payments
(includes key variables on which payments depend and how they affect them)

Extension options and termination options

Residual value guarantees

Leases not yet commenced to which the entity is committed

Short-term lease commitments

Total cash outflows for leases

Qualitative disclosures

Nature of the lessee's leasing activities

Restrictions or covenants imposed by leases

Sale and leaseback transactions

**This table covers the major disclosure requirements; depending on the particular facts and circumstances additional disclosures might be necessary

Finance lease

Selling profit or loss

Finance income on the net investment in the lease

Lease income relating to variable lease payments not included in the measurement of the lease receivable

Qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in the lease

Maturity analysis of lease receivable for a minimum of each of the first five years plus a total amount for the remaining years; reconciliation to the net investment in the lease

**This table covers the major disclosure requirements; depending on the particular facts and circumstances additional disclosures might be necessary

Operating lease

Lease income, separately disclosing income relating to variable lease payments that do not depend on an index or rate

Maturity analysis of lease payments for a minimum of each of the first five years plus a total amount for the remaining years

Disclosure requirements in LKAS 36, LKAS 38, LKAS 40 and LKAS 41 for assets subject to operating leases

Disclosure requirements in LKAS 16 for items of property, plant and equipment subject to an operating lease

Qualitative disclosures for all leases

Nature of the lessor's leasing activities

Management of the risk associated with any rights it retains in underlying assets

******This table covers the major disclosure requirements; depending on the particular facts and circumstances additional disclosures might be necessary

THANK YOU

The views expressed in this presentation are those of the presenter

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