
STATEMENT OF ALTERNATIVE TREATMENT (SoAT)

Right-to-use of Land on Lease

The Statement of Recommended Practice (SoRP) for Right-to-use of Land on Lease was approved by the Council of the Institute of Chartered Accountants of Sri Lanka on 19th December 2012. Subsequently, the amendments to the SoRP along with the modification to the title as Statement of Alternative Treatment (SoAT) were approved by the Council on 21st August 2013.

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Although the provisions for this Statement of Alternative Treatment (SoAT) are not mandatory, entities falling within their scope are encouraged to comply with the recommendations set out in this SoAT.

Objective:

1. The objective of this SoAT is to prescribe for lessees an allowed alternative treatment and related disclosure **to apply in relation to right to use of land on leases**.

Scope:

2. This SoAT may be applied in **accounting for leases on land**, right-of-use of land, that were entered into prior to the date of transition to SLFRS and were accounted as finance leases by applying Sri Lanka Accounting Standards Application Guidance no: 01 issued and published by the UITF ruling dated 31st May 2007.

Definitions:

3. The following terms are used in this SoAT with the meanings specified:

Contingent rentals are the lease payments that arise under the contractual terms of a lease because of changes in facts or circumstances occurring after the date of inception of the lease, other than the passage of time.

Date of commencement of the lease is the date on which the lessor makes the underlying asset available for use by the lessee.

Date of inception of the lease is the earlier of the date of the lease agreement and the date of commitment by the parties to the lease agreement.

Initial direct costs are recoverable costs that are directly attributable to negotiating and arranging a lease that would not have been incurred had the lease transaction not been made.

Lease is a contract in which the **right to use a land** (the underlying asset) is conveyed for a period of time in exchange for consideration.

Lease liability is the lessor's obligation to permit the lessee to use the underlying asset over the lease term.

Lease payments are the payments arising under a lease including fixed rentals and rentals subject to uncertainty including but not limited to contingent rentals and amounts payable by the lessee under residual value guarantees and term option penalties.

Lease term is the longest possible term that is more likely than not to occur.

Lessee is an entity that enters into a contract to provide another entity with consideration in return for the right to use the underlying asset for a period of time.

Lessee's incremental borrowing rate is a rate of interest that at the date of inception of the lease, the lessee would have to pay to borrow over a similar term and with a similar security, the funds necessary to purchase a similar underlying asset.

Rate the lessor charges the lessee is a discount rate that takes into account the nature of the transaction as well as the specific terms of the lease such as lease payments, lease term and contingent rentals.

Residual value guarantee is a guarantee made by the lessee that the fair value of the underlying asset that the lessee will return to the lessor will be at least a specified amount. If the fair value is less than that amount, the lessee is obliged to pay the difference to the lessor.

Right-of-use land is a land that represents the lessee's right to use or control the use of a specified asset for the lease term.

Short-term lease is a lease that at the date of commencement of the lease has a maximum possible lease term including options to renew or extend of twelve months or less.

Sublease is a transaction in which an underlying asset is re-leased by the original lessee (or intermediate lessor) to a third party and the lease agreement (or head lease) between the original lessor and lessee remains in effect.

Underlying asset is the land for which a right of use is conveyed in a lease.

Effective interest method is defined in LKAS 39 *Financial Instruments: Recognition and Measurement* and is used in the SoAT.

Recognition:

4. At the date of commencement of a lease, a lessee shall recognise in the statement of financial position a **right-of-use land** and a **liability to make lease payments**.
5. A lessee shall recognise the following items in the statement of comprehensive income, except to the extent that another LKAS requires or permits its inclusion in the cost of an asset:
 - (a) **interest expense** on the liability to make lease payments (see paragraph 10(a))
 - (b) **amortisation** of the right-of-use land (see paragraphs 10(b) and 15).
 - (c) any **changes in the liability to make lease payments** resulting from reassessment of the expected amount of contingent rentals or expected payments under term option penalties and residual value guarantees relating to current or prior periods (see paragraph 12(a)).
 - (d) any **impairment losses** on a right-of-use land (see paragraph 16).

Measurement:

Initial measurement:

6. At the date of inception of the lease, a lessee shall measure:
 - (a) the **liability to make lease payments** at the present value of the lease payments (see paragraphs 7-9), discounted using the lessee's incremental borrowing rate or, if it can be readily determined, the rate the lessor charges the lessee.
 - (b) the **right-of-use land** at the amount of the liability to make lease payments, plus any initial direct costs incurred by the lessee.

Present value of lease payments:

7. A lessee shall determine the lease term by **estimating the probability of occurrence** for each possible term, taking into account the effect of any options to extend or terminate the lease.
8. A lessee shall **determine the present value of lease payments** payable during the lease term on the basis of expected outcome, determined using all relevant information. The expected outcome is the present value of the probability-weighted average of the cash flows for a reasonable number of outcomes. In determining the present value of lease payments payable, a lessee shall include:
 - (a) an estimate of contingent rentals payable. If the contingent rentals depend on an index or a rate, the lessee shall determine the expected lease payments using readily available forward rates or indices. If forward rates or indices are not readily available, the lessee shall use the prevailing rates or indices.
 - (b) an estimate of amounts payable to the lessor under residual value guarantees. Residual value guarantees that are provided by an unrelated third party are not lease payments.
 - (c) an estimate of expected payments to the lessor under term option penalties.
9. The exercise price of a purchase option included in a lease is not a lease payment and the purchase option is not included in determining the present value of lease payments payable.

Subsequent measurement:

10. After the date of commencement of the lease, a lessee shall measure:
 - (a) the **liability to make lease payments** at amortised cost using the effective interest method subject to the requirements in paragraphs 11-13.

- (b) the **right-of-use land** at amortised cost unless paragraph 16 apply.

Reassessment of the liability to make lease payments:

11. After the date of commencement of the lease, the lessee shall reassess the carrying amount of the liability to make lease payments arising from each lease if facts or circumstances indicate that there would be a significant change in the liability since the previous reporting period. When such indications exist, a lessee shall:
- (a) reassess the length of the lease term in accordance with paragraph 7 and adjust the right-of-use land to reflect any resulting change to the liability to make lease payments arising from changes to the lease term.
 - (b) reassess the expected amount of any contingent rentals and expected payments under term option penalties and residual value guarantees in accordance with paragraph 8. A lessee shall recognise any resulting changes to the liability to make lease payments.
12. A lessee shall distinguish changes in contingent rentals and expected payments under term option penalties and residual value guarantees that relate to current or prior periods from those that relate to future periods. A lessee shall recognise changes in the expected amount of such payments:
- (a) in profit or loss, to the extent that those changes relate to current or prior periods.
 - (b) as an adjustment to the right-of-use land to the extent that those changes relate to future periods.

For example, when lease payments depend on the amount of the lessee's sales, changes relating to sales in the current or prior periods are recognised in profit or loss, whereas changes relating to expectations of future sales are recognised as an adjustment to the right-of-use land.

13. A lessee shall not change the rate used to discount the lease payments except to reflect changes in reference interest rates when contingent rentals are based on those reference interest rates. When contingent rentals are based on reference interest rates, a lessee shall recognise any changes to the liability to make lease payments arising from changes in the discount rate in profit or loss.
14. **No further revaluation is permitted** on or after the effective date of this SoAT.

Amortisation of the right-of-use land:

15. If a lessee measures the right-of-use land at amortised cost, it shall amortise the asset on a systematic basis **from the date of commencement of the lease to the end of the lease term or over the useful life of the underlying asset if shorter**. The lessee shall select the amortization method and review the amortisation period and amortisation method in accordance with LKAS 38.

Impairment of the right-of-use land:

16. A lessee shall apply LKAS 36 *Impairment of Assets* at each reporting date to determine whether the right-of-use land is impaired and shall **recognise any impairment loss** in accordance with LKAS 36.

Presentation:

17. A lessee shall present the following items in the statement of financial position:
- (a) **liabilities to make lease payments**, separately from other financial liabilities.
 - (b) **right-of-use land** as if they were tangible assets within property, plant and equipment or investment property as appropriate separately from assets that the lessee does not lease.
18. A lessee shall present **amortisation** of the right-of-use land and **interest expense** on the liability to make lease payments separately from other amortisation and interest expense, either in profit or loss or in the notes.
19. A lessee shall classify **cash payments for leases as financing activities** in the statement of cash flows and present them separately from other financing cash flows.

Short-term leases:

20. At the date of inception of a lease, a lessee that has a short-term lease may select on a lease-by-lease basis to measure, both at initial measurement and subsequently,
- (a) the **liability to make lease payments** at the undiscounted amount of the lease payments and
 - (b) the **right-of-use land** at the undiscounted amount of lease payments plus initial direct costs.

Such lessees shall recognise **lease payments in profit or loss** over the lease term.

Disclosure:

21. An entity shall disclose quantitative and qualitative financial information that:
- (a) identifies and explains the **amounts recognised in the financial statements** arising from leases; and
 - (b) describes how leases may affect the **amount, timing and uncertainty of the entity's future cash flows**.

22. An entity shall consider the level of detail necessary to satisfy the disclosure requirements in paragraphs 24-30 and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.
23. If the disclosures required by this and other SLFRS do not meet the objectives in paragraph 21, an entity shall disclose the additional information necessary to meet the objectives.

Information that identifies and explains the amounts in the financial statements:

24. An entity shall disclose:
- (a) the **nature of its lease arrangements**, including:
 - (i) a general description of those lease arrangements.
 - (ii) the basis and terms on which contingent rentals are determined.
 - (iii) the existence and terms of options, including for renewal and termination. A lessee shall provide narrative disclosure about the options that were recognised as part of the right-of-use land and those that were not.
 - (iv) the existence and principal terms of any options for the lessee to purchase the underlying asset.
 - (v) information about assumptions and judgements relating to amortisation methods and changes to those assumptions and judgements.
 - (vi) the existence and terms of residual value guarantees.
 - (vii) initial direct costs incurred during the reporting period and included in the measurement of the right-of-use asset or right to receive lease payments.
 - (viii) the restrictions imposed by lease arrangements, such as those relating to dividends, additional debt and further leasing.
 - (b) information about the **principal terms of any lease** that has not yet commenced if the lease creates significant rights and obligations for the entity.
25. An entity shall identify the **nature and amount of significant subleases** included in the disclosures provided in accordance with paragraph 24.
26. An entity that accounts for **short-term leases** in accordance with paragraphs 20 shall disclose that fact and, for lessees, the amount recognised in the statement of financial position for such short-term leases.

27. A lessee shall disclose a **reconciliation of opening and closing balances** of right-of-use land and liabilities to make lease payments, disaggregated by class of underlying asset. The reconciliation shall show separately the total cash lease payments paid during the period.

Information about the amount, timing and uncertainty of cash flows arising from leases:

28. An entity shall disclose information **about significant assumptions and judgements** and **any changes** in assumptions and judgements relating to renewal options, contingent rentals, term option penalties, residual value guarantees and the discount rate used when determining the present value of lease payments.
29. Except as described in paragraphs 30, an entity shall disclose information relating to **risks** arising from a lease required by paragraphs 32–43 of SLFRS 7 *Financial Instruments: Disclosures*.
30. In place of the maturity analyses required by paragraph 39(a) and (b) of SLFRS 7, a lessee shall disclose a **maturity analysis of the liabilities** to make lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years. The maturity analysis shall distinguish the minimum obligations specified in the lease (i.e. excluding contingent rentals and expected payments under term option penalties and residual value guarantees) and the amounts recognised in the statement of financial position.

Effective date:

31. An entity shall apply this SoAT in its annual financial statements for periods beginning **on or after 01 January 2012**.

Transition:

32. For the purposes of the transition provisions in paragraphs 31–38, the date of initial application is the **beginning of the first comparative period** presented in the first financial statements in which the entity applies this SoAT. An entity shall recognise and measure all outstanding contracts within the scope of the SoAT as of the date of initial application **using a simplified retrospective approach** as described in paragraphs 34–38.
33. An entity **shall adjust the opening balance** of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had been applied from the beginning of the earliest period presented.

Lessees:

34. Unless paragraphs 35–37 apply, at the date of initial application, a lessee shall:

- (a) **recognise a liability to make lease payments** for each outstanding lease, measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate on the date of initial application.
 - (b) **recognise a right-of-use land** for each outstanding lease, measured at the amount of the related liability to make lease payments, subject to any adjustments required to reflect impairment.
35. **When lease payments are uneven over the lease term**, a lessee shall adjust the right-of-use land recognised at the date of initial application by the amount of any recognised prepaid or accrued lease payments.
36. For leases that were classified and accounted in accordance with Sri Lanka Accounting Standards Application Guidance no: 01, issued and published by the UITF dated 31st May 2007, the carrying amount at the date of initial application of the right-of-use land should be the carrying amount of that asset after making an adjustment for the increase in liability according to this SoAT.
37. For each short-term lease that the lessee accounts for, at the date of initial application a lessee shall recognise a liability to make lease payments measured at the undiscounted amount of the remaining lease payments and a right-of-use land at the amount of the liability recognised.

Disclosure:

38. An entity shall provide the transition disclosures required by LKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, without the disclosure of adjusted basic and diluted earnings per share.
39. This SoAT supersedes the following SLFRSs:
- (a) LKAS 17 *Leases*
 - (b) IFRIC 4 *Determining whether an Arrangement contains a Lease*
 - (c) SIC-15 *Operating Leases—Incentives*
 - (d) SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.