ELF

الاتحاد المصرى للتأجير التمويلى
Egyptian Leasing Federation

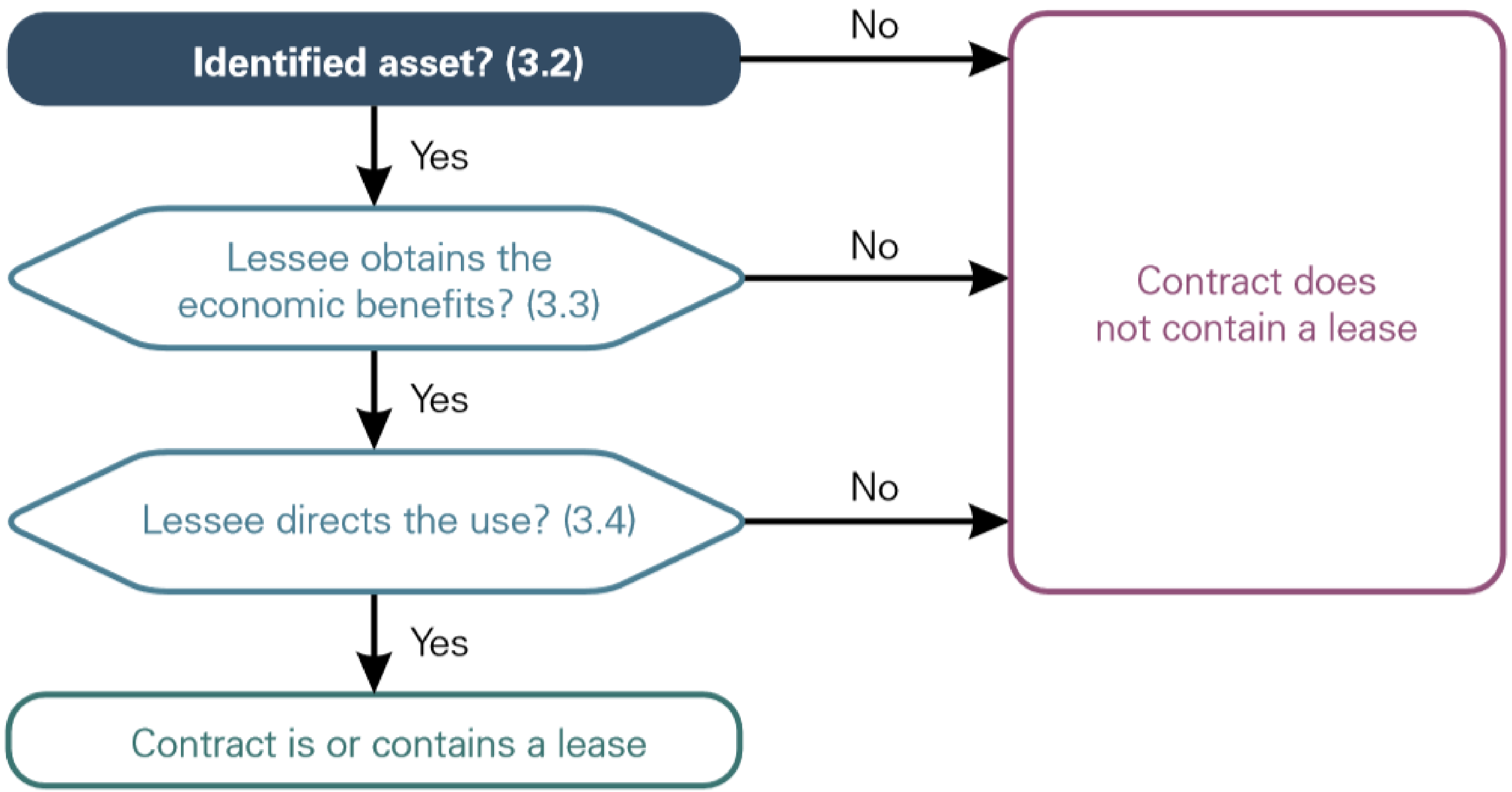
bakertilly

IFRS 16

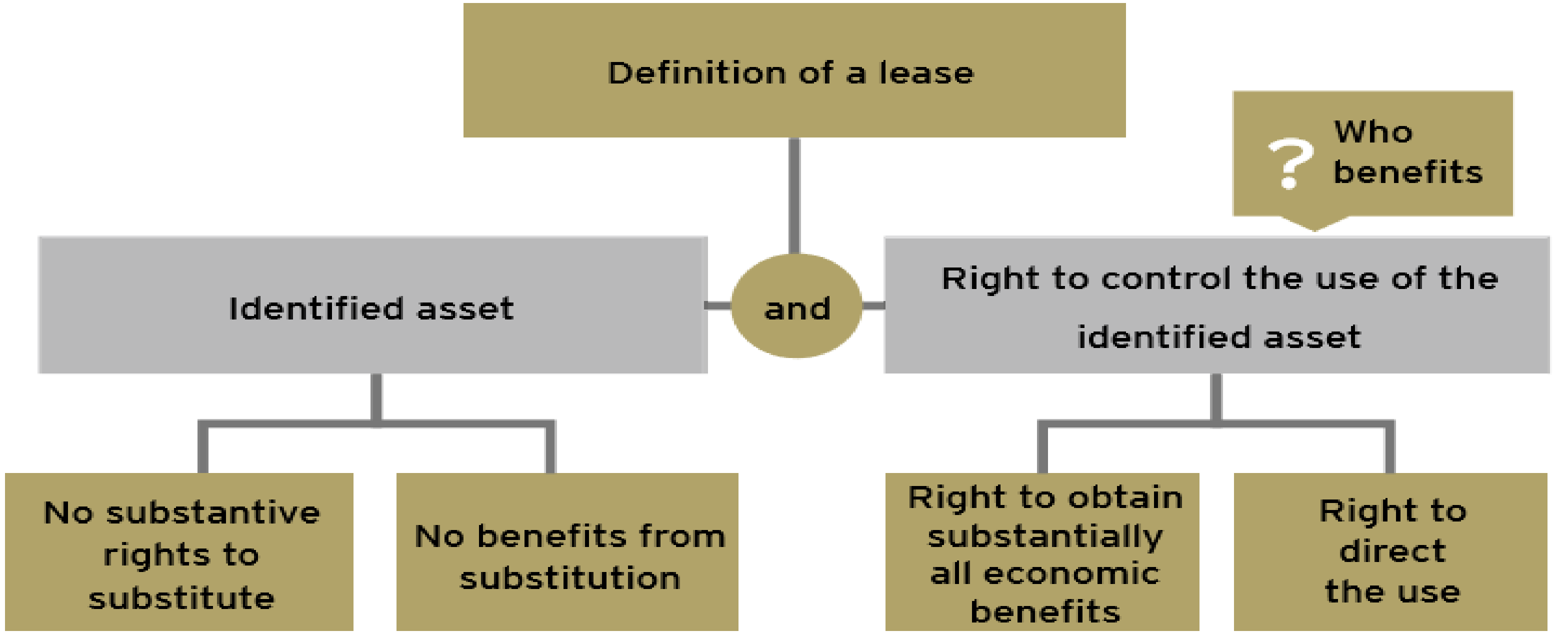
Assessing whether a contract contains a lease

A company assesses at inception of a contract whether that contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

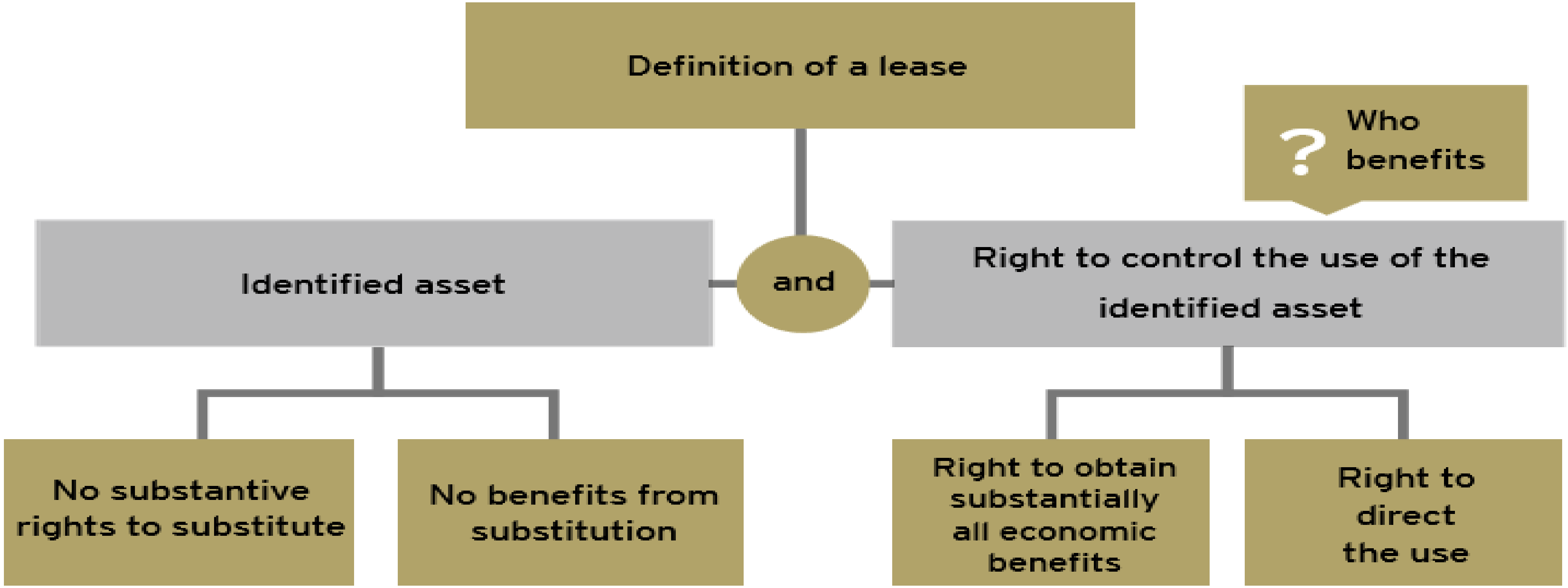
Contract that represents a lease



Lease Roadmap



Definition of a lease



Lease accounting

Initial recognition and measurement		Measure right of use (ROU) asset[1] and lease liability at present value of lease payments
Subsequent measurement	ROU Asset	Depreciate ROU asset based on IAS 16, or use alternative measurement basis under IAS 16 and IAS 40
	Liability	Accrete liability based on the interest method, using a discount rate determined at lease commencement[2]. Reduce the liability by payments made
Profit and loss		Generally front loaded expense for an individual lease. Interest and depreciation are separated.

Changes made by IFRS 16

IFRS 16 eliminates the current operating/finance lease dual accounting model for lessees. Instead, there is a single, on-balance sheet accounting model, similar to current finance lease accounting. The question of whether a contract contains a lease determines whether the arrangement is recognised on- or off-balance sheet (as a service contract).

Changes made by IFRS 16

KPMG insight – Right-of-use asset is neither an intangible asset nor an item of property, plant and equipment

IFRS 16 does not specify that a right-of-use asset is in the scope of either IAS 16 or IAS 38. Instead, it appears that a right-of-use asset is a new category of asset in the scope of IFRS 16 itself.

This could have important consequences for assessing some of the impacts of the new standard. Companies won't have the full picture until other accounting and regulatory bodies have responded. For example, the new accounting could prompt changes in the tax treatment of leases. A key question for the financial sector is how the prudential regulators will treat the new assets and liabilities for regulatory capital purposes.

Worked example

Entity H (lessee) enters into a three-year lease of equipment. Entity H agrees to make the following annual payments at the end of each year: CU10,000 in year one, CU12,000 in year two and CU14,000 in year three. For simplicity, there are no other elements to the lease payments (e.g., purchase options, lease incentives from the lessor or initial direct costs). The initial measurement of the right-of-use asset and lease liability is CU33,000 (present value of lease payments using a discount rate of approximately 4.235%). Entity H uses its incremental borrowing rate because the interest rate implicit in the lease cannot be readily determined. Entity H depreciates the right-of-use asset on a straight-line basis over the lease term.

Worked example

Analysis: At lease commencement, Entity H would recognise the lease-related asset and liability:

Right-of-use asset	CU33,000	
Lease liability		CU33,000

To initially recognise the lease-related asset and liability

The following journal entries would be recorded in the first year:

Interest expense	CU1,398	
Lease liability		CU1,398

Worked example

To record interest expense and accrete the lease liability using the interest method (CU33,000 x 4.235%)

Depreciation expense	CU11,000	
Right-of-use asset		CU11,000

To record depreciation expense on the right-of-use asset (CU33,000 ÷ 3 years)

Lease liability	CU10,000	
Cash		CU10,000

To record lease payment

Worked Example (Cont'd)

A summary of the lease contract's accounting (assuming no changes due to reassessment) is, as follows:

	Initial	Year 1	Year 2	Year 3
Cash lease payments		CU10,000	CU12,000	CU14,000
Lease expense recognised				
Interest expense		CU1,398	CU1,033	CU569
Depreciation expense		11,000	11,000	11,000
Total periodic expense		CU12,398	CU12,033	CU11,569
Balance sheet				
Right-of-use asset	CU33,000	CU22,000	CU11,000	–
Lease liability	CU(33,000)	CU(24,398)	CU(13,431)	–

New definition of lease

	Lease liability				Right-of-use asset		
	Beginning balance	6% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
Year	CU	CU	CU	CU	CU	CU	CU
1	736,009	44,160	(100,000)	680,169	736,009	(73,601)	662,408
2	680,169	40,810	(100,000)	620,979	662,408	(73,601)	588,807
3	620,979	37,259	(100,000)	558,238	588,807	(73,601)	515,206
4	558,238	33,494	(100,000)	491,732	515,206	(73,601)	441,605
5	491,732	29,504	(100,000)	421,236	441,605	(73,601)	368,004
6	421,236				368,004		

New definition of lease

A contract contains a lease only if it relates to an identified asset. An asset can be either explicitly specified in a contract or implicitly specified at the time it is made available for use by the lessee.

However, even if an asset is specified, a lessee does not control the use of an identified asset if the lessor has a *substantive right to substitute* the asset for an alternative asset during the lease term. A lessor's substitution right is 'substantive' if the lessor:

– has the practical ability to substitute the asset; and

– would benefit economically from exercising its right to substitute the asset.

Economic Benefits

To determine whether a contract conveys the right to control the use of an identified asset, a company assesses whether the customer has the rights to:

– obtain substantially all of the economic benefits from use of the identified asset throughout the period of use; and

– direct the use of the identified asset (see 3.4).

Directing the right to use

A lessee has the right to direct the use of an identified asset in either of the following situations:

– if the lessee has the right to direct how and for what purpose the asset is used throughout the period of use; or

– if the relevant decisions about how and for what purpose the asset is used are predetermined and:

  - the lessee has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the lessor having the right to change those operating instructions; or

  - the lessee designed the asset in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

Practical expedients

A lessee can elect not to apply the lessee accounting model to:

Short term leases

$\leq$ 12 months

Leases of low-value items

$\leq$ USD 5,000 for example

Lessee Accounting

A lessee applies a single lease accounting model under which it recognises all major leases on-balance sheet.

Balance sheet

Asset
= 'Right-of-use' of underlying asset

Liability
= Obligation to make lease payments

Profit or loss

Lease expense
Depreciation
+
Interest
=
Front-loaded total lease expense

Initial Measurement of Lease Liability

At the commencement date, a lessee measures the lease liability at the present value of the future lease payments.

Lease liability = **Present value of lease rentals** + **Present value of expected payments at end of lease**

Lease Term

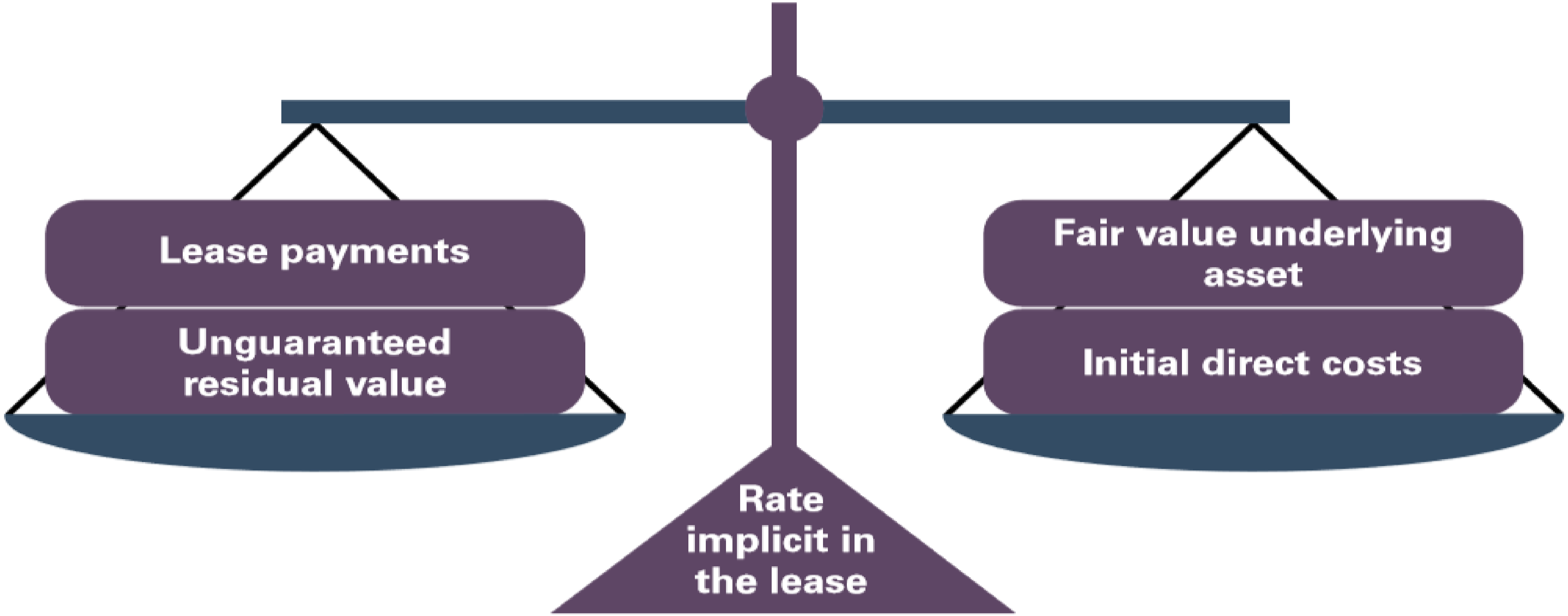
The lease term is the non-cancellable period of the lease, together with:

- optional renewable periods if the lessee is reasonably certain to extend; and
- periods after an optional termination date if the lessee is reasonably certain not to terminate early.

Termination options held only by the lessor are not considered when determining the lease term.

The lease term starts when the lessor makes the underlying asset available for use by the lessee. It includes any rent-free periods provided.

Discount Rate



Initial Measurement of the Right -of -Use asset

Lease liability

+

Initial direct costs

+

Prepaid lease payments

+

Estimated costs to dismantle, remove or restore, measured in accordance with IAS 37

−

Lease incentives received

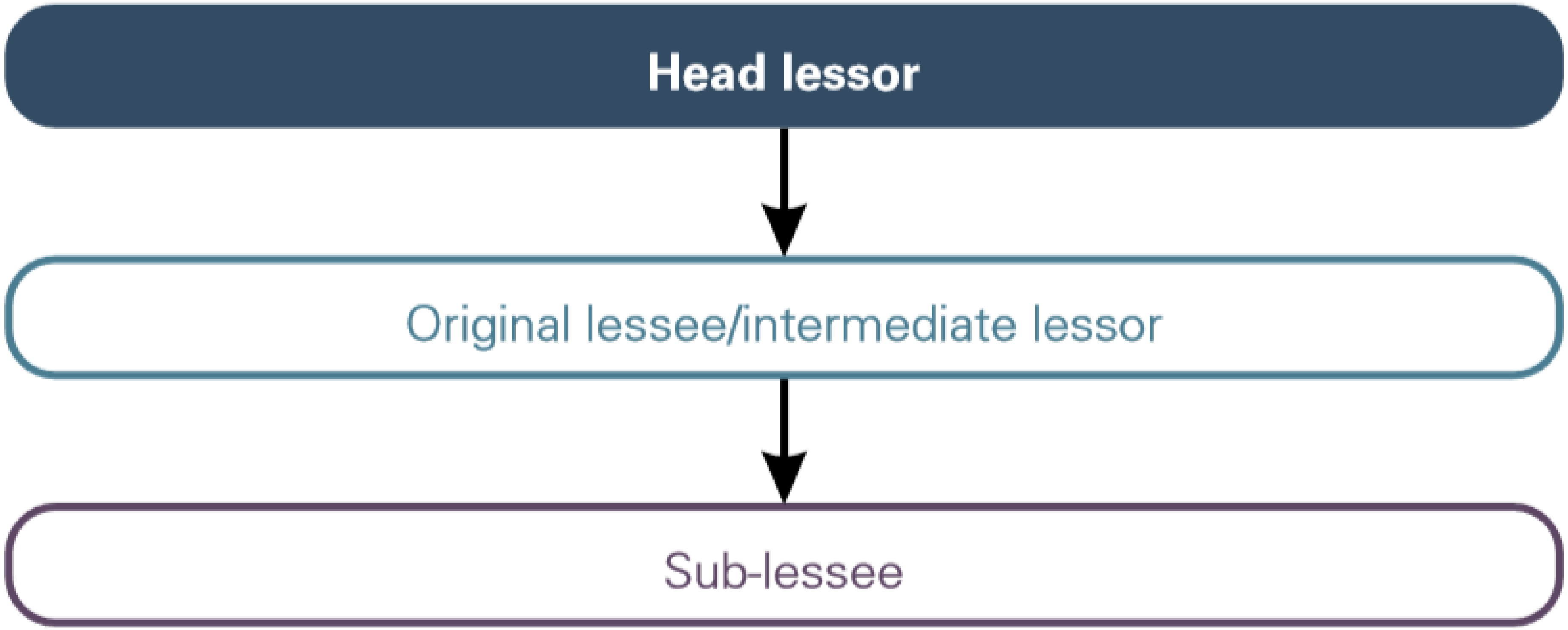
=

Right-of-use asset

Directly attributable cost

Typical initial direct costs of a lessee	
Include ✔	**Exclude** ✘
– Commissions – Legal fees* – Costs of negotiating lease terms and conditions* – Costs of arranging collateral – Payments made to existing tenants to obtain the lease * If they are contingent on origination of the lease	– General overheads – Costs to obtain offers for potential leases

Sub Lease


Head lessor
Original lessee/intermediate lessor
Sub-lessee

Example

Head lease: Intermediate lessor L enters into a five-year lease for 5,000m^2 of office space (the head lease) with Company M (the head lessor).

Sub-lease: At the beginning of Year 3, L sub-leases the 5,000m^2 of office space for the remaining three years of the head lease to Sub-lessee N.

L classifies the sub-lease with reference to the right-of-use asset arising from the head lease. Because the sub-lease is for the whole of the remaining term of the head lease – i.e. the sub-lease is for the major part of the useful life of the right-of-use asset – L classifies it as a finance lease.

Disclosure

Statement of Financial Position

	Right-of-Use: Land	Right-of-Use: Buildings	Right-of-Use: IT equipment	Right-of-Use: Telecommuni-cations network and equipment	Right-of-Use: Motor vehicles	Right-of-Use: Other	Right-of-Use: Total
Cost							
As at January 1, 2017	132,530	1,174,013	82,525	74,056	25,767	718	1,489,609
Additions	39,143	217,493	-	5,980	-	27	262,643
Asset retirement obligation	-	10,145	-	-	-	-	10,145
Transfers and reclassifications	(7,513)	7,513	(17,236)	-	7,483	-	(9,753)
Disposals	(706)	(39,701)	(2,289)	(7,041)	(6,155)	-	(55,892)
As at December 31, 2017	**163,454**	**1,369,463**	**63,000**	**72,995**	**27,095**	**745**	**1,696,752**
Accumulated depreciation							
As at January 1, 2017	44,524	572,474	58,716	54,518	13,203	665	744,100
Charge	10,816	103,270	14,337	9,553	7,437	13	145,426
Charge from asset retirement obligation	-	2,602	-	-	-	-	2,602
Transfers and reclassifications	(377)	377	(17,345)	-	-	-	(17,345)
Disposals	(134)	(20,608)	(2,276)	(4,756)	(6,124)	-	(33,898)
As at December 31, 2017	**54,829**	**658,115**	**53,432**	**59,315**	**14,516**	**678**	**840,885**
Net book value as at December 31, 2017	**108,625**	**711,348**	**9,568**	**13,680**	**12,579**	**67**	**855,867**