

## DEFINITIONS

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

**Operating Lease** - A lease other than a finance lease.

**Finance Lease** - A lease that transfers substantially all the risks and rewards incidental to ownership. Title may or may not eventually be transferred.

### ACCOUNTING TREATMENT

#### LESSOR

- Retains leased asset on the Statement of Financial Position
- Recognises lease income on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefits derived from the leased asset is diminished.
- Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the leased asset and expensed over the lease term on the same basis as the lease revenue.

#### LESSEE

- Does not recognise leased asset on the Statement of Financial Position
- Recognises lease expense on a straight line basis over the lease term, unless another systematic basis is representative of the time pattern of the user's benefits.

### CLASSIFICATION

#### FINANCE LEASE (individually or combination)

- 1) The lease transfers ownership of the asset to the lessee by the end of the lease term.
- 2) The lessee has a bargain purchase option and it is certain at the date of inception that the option will be exercised.
- 3) The lease term is for the major part of the economic life of the asset even if title is not transferred.
- 4) At the inception of the lease the present value of the minimum lease payments amounts to substantially all of the fair value of the leased asset; and
- 5) The leased assets are of such a specialised nature that only the lessee can use them without major modifications.
- 6) Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee; and
- 7) The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
- 8) If the lease can cancel the lease, the lessor's associated losses are borne by the lessee.

### ACCOUNTING TREATMENT

#### LESSOR

- Leased asset is not recognised on the Statement of Financial Position.
- Derecognises the tangible asset (and recognises resultant gain/loss).
- Lessor recognises a receivable equal to the net investment of the lease.
- Recognises finance income based on a pattern reflecting a constant periodic rate of return on the lease.

#### LESSEE

- Recognises a leased asset on the Statement of Financial Position at the lower of the fair value of the leased asset and present value of lease payments.
- Present value (PV) discount rate is the implicit rate in the lease.
- Liability recognised.
- Lease payments made are apportioned between finance charges and reduction of liability.
- The finance charge allocation is allocated to a period to produce a constant rate of interest over the period.

### ISSUES

- A lessee may classify a property interest held under an operating lease as an investment property in accordance with PBE IPSAS 16 - *Investment Property*. If this is done, then that interest is accounted for as if it were a finance lease.
- Lessors and lessees recognise incentives granted to a lessee under an operating lease as a reduction in lease rental income or expense over the lease term.
- A lease of land generally will be classified as an operating lease unless title transfers to the lessee.
- A lease of land and building should be treated as two separate leases, a lease of the land and a lease of the building, and the two leases may be classified differently.
- A series of linked transactions in the legal form of a lease should be accounted for based on the substance of the arrangement; the substance may be that the series of transactions is not a lease.
- Special requirements apply to manufacturer or dealer lessors granting finance leases.

### SALE AND LEASEBACK TRANSACTIONS

#### FINANCE LEASE

Any excess of sale proceeds over carrying amount is recognised by the lessor over the lease term and not immediately.

#### OPERATING LEASE

- If the sale price is at fair value, any excess of sale proceeds over carrying amount is recognised by the lessor immediately.
- If the sale is below fair value, any gain or loss should be recognised immediately unless the loss is in respect of future lease payments below market value in which case it is deferred and amortised over the period for which the asset is expected to be used.
- If the sale price is above market value, the excess of fair value is deferred and amortised over the lease period.

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