

SCOPE	CLASSIFICATION OF LEASES & ACCOUNTING TREATMENT (based on the substance of transaction rather than form of contract)				
<p>Lease – agreement whereby lessor conveys to the lessee, in return for payment/series of payments, the right to use an asset for an agreed period of time.</p> <p>Apply for ALL leases OTHER THAN:</p> <ul style="list-style-type: none"> Leases to explore for/use non-regenerative resources (e.g., oil, natural gas and minerals). Licensing agreements (e.g., plays, patents, copyrights, manuscript, etc.) <p>Not applied as basis of measurement for:</p> <ul style="list-style-type: none"> Investment property (IAS 40) or Biological assets (IAS 41) held by lessee under <i>finance lease</i>/provided by lessor under <i>operating lease</i>. 	<p>Lease classification is made at the inception of the lease (i.e., the earlier of date of agreement/commitment to principal provisions of lease).</p> <ul style="list-style-type: none"> If change to provisions of lease (other than renewal) would have resulted in different classification at <i>inception</i> → regarded as new agreement over its term. 				
	<p style="text-align: center;">OPERATING LEASE = lease other than <i>finance lease</i>.</p>		<p style="text-align: center;">FINANCE LEASE = transfers substantially all risks & rewards incidental to ownership. Title may/may not eventually transfer.</p>		
	LESSOR	LESSEE	FINANCE LEASE INDICATORS	LESSOR	LESSEE
	<ul style="list-style-type: none"> Apply IAS 16/IAS 36/ IAS 38 to leased asset retained on statement of financial position. Recognize lease income on a straight-line basis over the lease term unless another systematic basis is more representative of time pattern in which benefit derived is diminished. Initial direct costs added to carrying amount of leased asset and amortized on same basis as lease income. Recognize aggregate cost of incentives as reduction of income on straight-line basis. <u>Manufacturer/dealer</u>: no selling profit recognized. 	<ul style="list-style-type: none"> Do not recognize leased item as an asset. Recognize lease expense on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of user's benefit. Recognize aggregate benefit of incentives as reduction of expense on straight-line basis. 	<p>Situations that individually/in combination normally indicate finance lease classification:</p> <ul style="list-style-type: none"> Ownership transfer to lessee by end of term. Lessee has option to purchase asset at price expected to be sufficiently < FV @ option exercise date. Term = major part of economic life even if title not transferred. @ inception of lease, PV of <i>MLP</i> = at least substantially all of FV of leased asset. Leased assets are of specialized nature – only lessee can use without major modifications. <p>Other situations that individually/in combination could indicate:</p> <ul style="list-style-type: none"> If lessee can cancel – lessor's cancellation losses are borne by lessee. Gains/losses from fluctuation in FV of residual accrue to lessee. Lessee has ability to continue lease for a secondary period @ substantially < market rent. 	<p>Initial recognition:</p> <ul style="list-style-type: none"> Recognize receivable equal to <i>net investment</i> in lease. Leased asset not recognized on statement of financial position. Initial direct costs included in initial measurement of receivable (e.g., legal cost and commission) and reduces income recognized over the term. Interest rate implicit in lease is defined so that no need to add direct costs separately. <p>Subsequent measurement:</p> <ul style="list-style-type: none"> Recognize finance income on pattern reflecting constant periodic rate of return on <i>net investment</i> in lease. Lease payments applied against <i>gross investment</i> to reduce both principal and unearned finance income. Revise income allocation for reduction in unguaranteed residual value. <u>Manufacturer/dealer</u>: costs incurred to negotiate and arrange lease are NOT included in receivable. Instead, expensed when selling profit recognized in accordance with entity policy (if artificially low interest rate – restrict profit as if market rates charged). 	<p>Initial recognition:</p> <ul style="list-style-type: none"> Recognize leased asset and liability at the LOWER of: leased asset FV & PV of <i>MLP</i> (at <i>inception</i>). Discount rate for PV of <i>MLP</i> = interest rate implicit in lease/lessee's incremental borrowing rate. Initial direct costs are added to asset amount recognized. <p>Subsequent measurement:</p> <ul style="list-style-type: none"> Apportion <i>MLP</i> between finance charges & reduction of liability. Allocate finance charge to each period to produce a constant periodic rate of interest on remaining liability. Contingent rent charged as expense in period incurred. Apply IAS 16 and IAS 38 to calculate depreciation. No reasonable certainty that ownership will be obtained → depreciate over SHORTER of: useful life or lease term. Apply IAS 36 to determine impairment.
KEY DEFINITIONS					
<p>Minimum lease payments (MLP) = payments over lease term that lessee is/can be required to make (EXCLUDES contingent rent, costs for services or taxes paid by and reimbursed to lessor) PLUS guaranteed amounts by lessee/ guaranteed residual value to lessor.</p>					
<p>Gross investment in the lease = <i>MLP</i> under finance lease PLUS any unguaranteed residual value accruing to lessor.</p>					
<p>Net investment in the lease = <i>gross investment</i> discounted @ interest rate implicit in the lease.</p>					
<p>FV = measured in accordance with IAS 17, not IFRS 13.</p>					

SALE AND LEASEBACK		OTHER POINTS	
Accounting treatment depends on type of lease involved: ↕			
OPERATING LEASE	FINANCE LEASE		
<ul style="list-style-type: none"> Sales price = fair value → profit/ loss recognized immediately. Sales price < fair value → any profit/loss recognized immediately EXCEPT if loss compensated by future lease payments below market value, then deferred and amortized in proportion to lease payments over period of expected use. Sale price > fair value → excess deferred & amortized over period of expected use. FV < carrying amount → immediately recognize difference. 	<ul style="list-style-type: none"> Means whereby lessor provides <i>finance</i> to lessee with asset as security. Sales proceeds > carrying value → excess is deferred and amortized over lease term (NOT recognized immediately). Apply IAS 36 if FV < carrying amount. 	<ul style="list-style-type: none"> Classification of land (normally indefinite economic life) & building elements of a lease are assessed separately. Allocate <i>MLP</i> in proportion to relative FVs of leasehold interest in respective elements at <i>inception</i> of lease. See IAS 17.16-18 for more detail. Separate measurement of land and buildings is not required if both land & buildings classified as investment property and FV model is adopted. Lessee may classify property interest held under operating lease as investment property → then interest is accounted for as if it were a <i>finance lease</i> and FV model is used (even if subsequent event changes the nature of the lessee's property interest so that no longer investment property). Also see IFRIC 4 <i>Determining Whether an Arrangement Contains a Lease</i>. 	

This communication contains a general overview of the topic and is current as of March 31, 2017. The application of the principles addressed will depend upon the particular facts and circumstances of each individual case. Accordingly, this publication is not a substitute for professional advice and we recommend that any decisions you take about the application or not of any of the information presented be made in consultation with a qualified professional, who can address any variance that may be required to reflect your circumstances. Please contact your local MNP representative for customized assistance with the application of this material. MNP LLP accepts no responsibility or liability for any loss related to any person's use of or reliance upon this material. © MNP LLP 2017. All rights reserved.