

# *IFRS 16: Leases*

# Overview

*This standard sets out the principles for the recognition, measurement, presentation and disclosure of leases*

*Lessee recognises right-of-use asset and lease liability for almost all lease contracts*

*Lessor accounting stays substantially the same as under previous guidance*

*Cash payments for principal portion: cash flow from financing activities; cash payments for interest portion: depending on entity's policy for interest payments*

*Lessor accounting stays almost the same as under current guidance*

*Exemptions for short term leases and leases of low value assets*

*Enhanced disclosure requirements*

*Effective date 1 January 2019*

*Earlier application permitted (together with IFRS 15)*

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## ***Agenda (1/2)***

### **Identifying a lease**

- Scope of IFRS 16
- Definition of a lease
- Separating components of a contract
- Lease term
- Recognition and measurement exemptions

### **Lessee accounting**

- Overview
- Initial measurement
- Subsequent measurement
- Modification of a lease
- Presentation/Disclosures

### **Lessor accounting**

- Overview
- Modification of a lease

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## ***Agenda (2/2)***



**Appendix**

- IFRS 16 Disclosures
- Practical challenges

# Agenda

## Identifying a lease

- Scope of IFRS 16
- Definition of a lease
- Separating components of a contract
- Lease term
- Recognition and measurement exemptions

## Lessee accounting

- Overview
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## Definition of a lease

**1**

There is an **identified asset**



No identified asset if supplier has *substantive right to substitute* asset

**and**

**2**

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

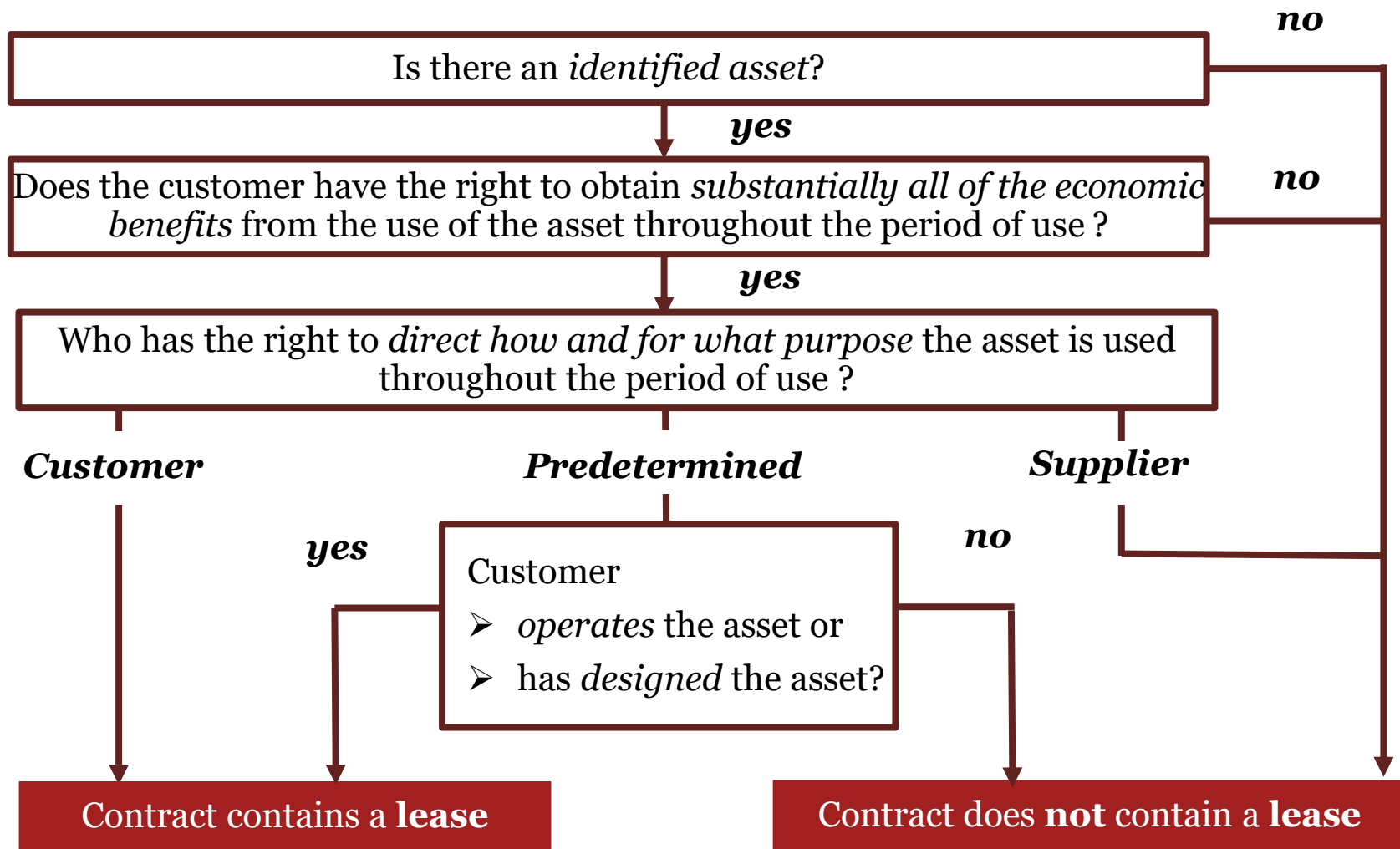


Right to obtain **substantially all of the economic benefits** from use of the identified asset throughout the period of use **and**



**Right to direct the use** of the identified asset throughout the period of use

# Definition of a lease - process



## *Separating components of a contract (1/2)*

*Entity shall identify and account for each separate component*

*Separate lease  
component*

*Separate lease  
component*

*non-lease  
component*

### **Criteria:**

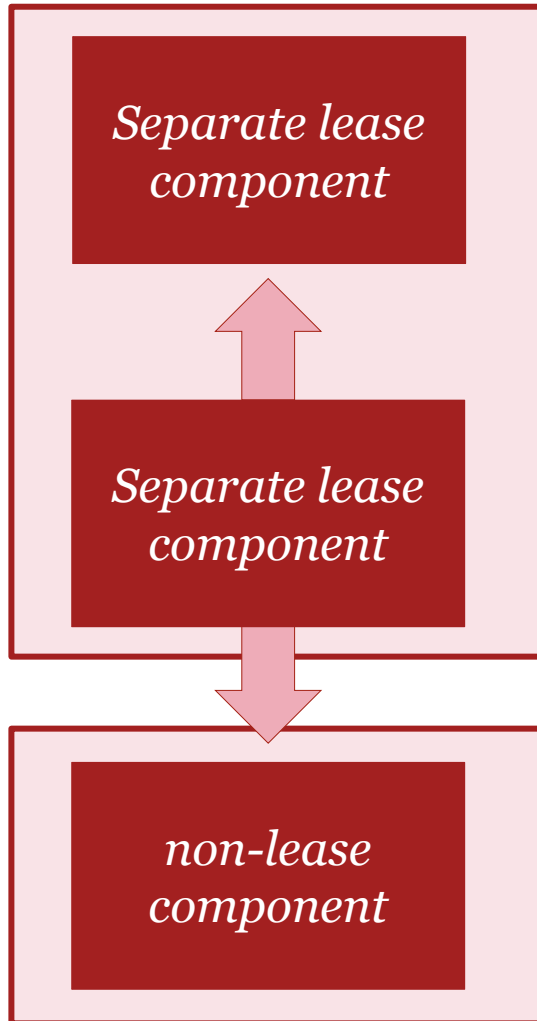
Lessee can benefit from the component on its own or with other readily available resources

***and***

Components are neither dependent nor highly interrelated



## Separating components of a contract (2/2)



### Allocation of consideration

#### **Apply IFRS 16**

#### **Lessee:**

Based on relative *stand-alone prices*

#### **Lessor:**

Based on relative *stand-alone selling prices* in accordance with *IFRS 15.73-90*

#### **Apply other applicable standards**

## Lease term (1/2)

*Non-cancellable period of lease*

+

Periods covered by  
*option to extend*

+

Periods covered by *option to terminate*

if lessee is **reasonably certain** to exercise option


if lessee is **reasonably certain** not to exercise option

Assessing “**reasonably certain**” – consider all facts/circumstances creating economic incentive to exercise, e.g.:

- contractual terms/conditions for optional periods compared with market rates
- significant leasehold improvements undertaken (or expected to be undertaken)
- costs relating to termination of lease/signing of new replacement lease
- importance of underlying asset to lessee’s operations
- conditionality associated with exercising the option

## *Lease term (2/2)*

### *Reassessment of the lease term when*



**Modification** of contract  
not accounted for as  
separate lease (lessee)



Exercise of **option** becomes or ceases to  
be reasonably certain

*Because:*

- Event occurs that obliges lessee to exercise [prohibits from exercising] option *or*
- Lessee does not exercise [exercises] option previously included [not included] in lease term *or*
- Significant event or significant change in circumstances within control of lessee occurs and affects reasonably certainty of exercising option

# *Recognition and measurement exemptions*

## *(1/2)*

### **Short-term leases**

- Lease term of 12 months or less; lease that contains a purchase option is not a short-term lease
- **Accounting policy choice** (by class of underlying assets)
- Only applicable for **lessee**
- Subsequent periods:



Lease modification



Change in lease term



Consider lease to  
be new lease

## *Recognition and measurement exemptions (2/2)*

### **Exemption for leases for which the underlying asset is of low value**

- Assets with a value, when new, of \$5,000 or less
- **Accounting policy choice** (lease-by-lease basis)
- Only applicable for **lessee**

## *Knowledge Check*

1. Does the following contract contain a lease?

A coffee company enters a contract with an airport operator to use space to sell goods for a three-year period. The contract states the exact amount of space and that the space must be located at any one of several boarding areas within the airport. The airport operator can change location at any time; there are minimal costs to the airport operator associated with doing so.

- Yes
- No

## *Knowledge Check*

Answer: No

The contract does not contain a lease. As the airport operator can change location at any time with minimal costs, it has a substantive substitution right. There is therefore no identified asset.

- Identified asset? No - **Substantive substitution right!**
- Substantially all of the economic benefits? No
- Right to direct the use? No

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# *Exercises!*





# Definition of a lease

## Use of ship



- Oil company enters into contract with shipowner for exclusive charter of particular oil tanker for five year period.
- Oil company decides whether, when and to which ports oil tanker sails, and what oil to be transported, throughout five year period.
- Shipowner's crew operate and maintain tanker

### Does the contract contain a lease?

Identified asset?



Substantially all of the economic benefits?



Right to direct the use?



The contract contains a lease.

# Definition of a lease

## Use of aircraft



- Contract conveys **exclusive use of explicitly specified aircraft**
- Customer determines **where and when aircraft will fly, and which passengers and cargo will be transported.** Supplier is responsible for operating aircraft, using its own crew.
- Supplier is **permitted to substitute aircraft;** substitute aircraft must meet original specifications in contract; **significant costs involved in outfitting aircraft in Supplier's fleet to meet specifications**

### Does the contract contain a lease?

Identified asset?	<b>Substitution right is not substantive!</b>	✓
Substantially all of the economic benefits?		✓
Right to direct the use?		✓

The contract contains a **lease**.

# Definition of a lease

## Fibre-optic cable



- Contract conveys right to exclusive use of three specified, physically distinct dark fibres within larger cable
- Customer makes all decisions about use of fibres by connecting each end to its electronic equipment (ie Customer 'lights' fibres).
- Supplier owns extra fibres; can only substitute Customer's fibres for reasons of repairs, maintenance or malfunction

### Does the contract contain a lease?

Identified asset?



Substantially all of the economic benefits?



Right to direct the use?



The contract contains a **lease**.

# Agenda

## Identifying a lease

- Scope of IFRS 16
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- Lease term
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## Lessee accounting

- Overview
- Initial measurement
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## Lessor accounting

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## *Lessee accounting – overview*

Balance sheet

**Right-of-use asset/  
Lease liability**

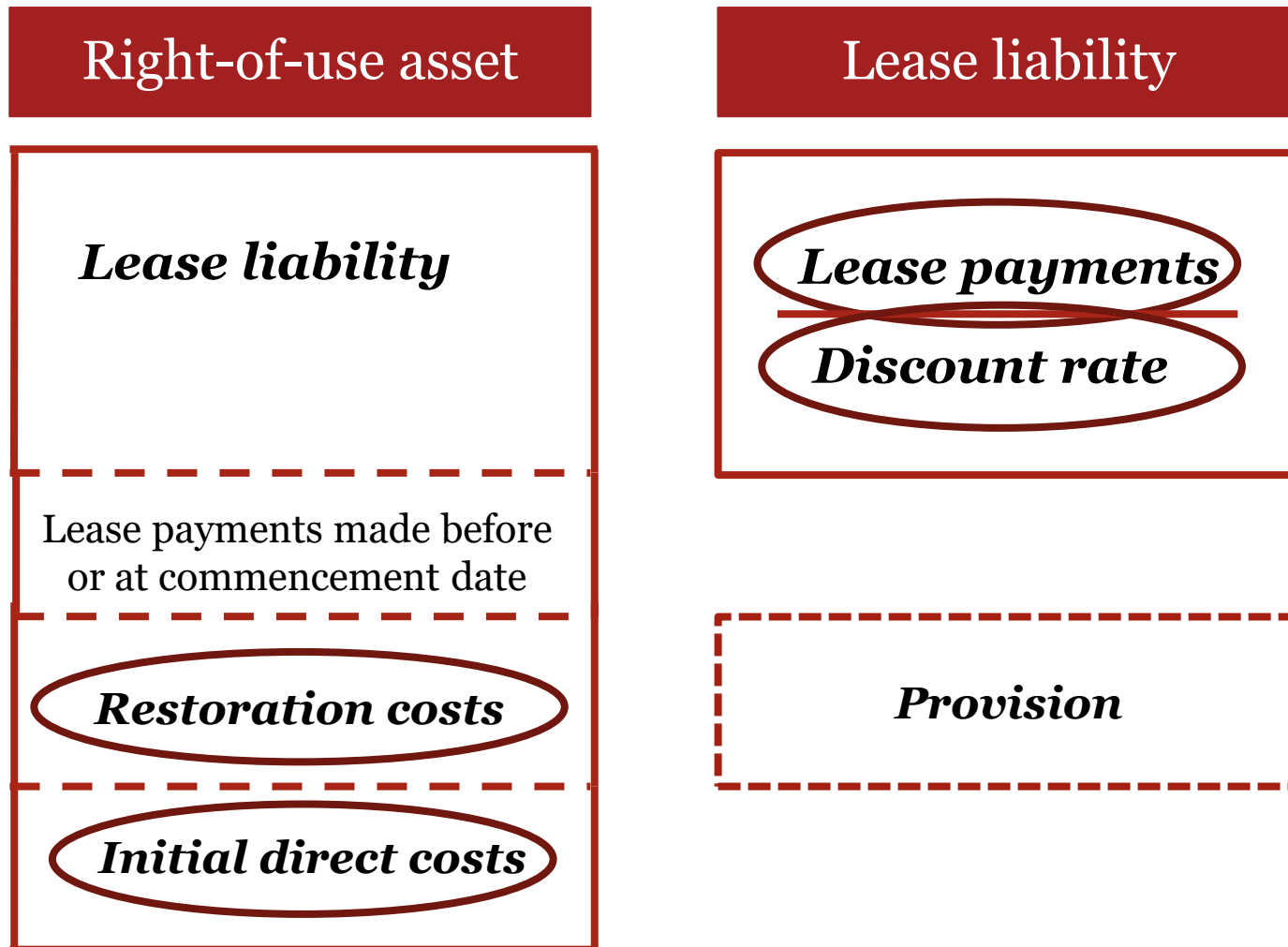
Income  
statement

Depreciation/Impairment  
(Right-of-use asset)

Interest expense  
(Lease liability)

Variable lease payments not included in lease liability

# Lessee accounting initial measurement (1/5)



## Lessee accounting – initial measurement (2/5)

### Lease payments

Fixed payments

+

Variable lease payments

+

Residual value guarantees

+

Exercise price of a  
purchase option

+

Penalties for terminating

- Including *in-substance fixed payments*
- Only if they depend on index/rate
- Measured using index/rate as at commencement date
- *Expected payments lessee has to make under guarantee*
- if the lessee is **reasonably certain** to exercise the option
- if the **lease term** reflects the termination by the lessee

## *Lessee accounting – initial measurement (3/5)*

### Variable lease payments

dependent on ....

rate/index

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



**Part** of lease  
liability

other variable

*e.g. sales in a retail store*



**Not part** of lease  
liability

### In-substance fixed payments

*e.g. payments made only if  
asset is proven capable of  
operating*



**Part** of lease liability



## ***Lessee accounting – initial measurement (4/5)***

### ***Discount rate***

**Interest rate implicit in the lease**

*if rate cannot be readily  
determined*

**Incremental borrowing rate at commencement date**

### ***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

## *Lessee accounting – initial measurement (5/5)*

### *Restoration costs*

- Costs to
  - 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 (IAS 37)

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## ***Exercise!***



### *Instructions:*

- Read **scenario** in the next slide
- **Prepare journal entries:**
  - Year 1: **IFRS 16**
  - Year 2: **IFRS 16**
- You have **20 minutes**

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## ***Exercise!***

Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are FJD50,000 per year during the initial term and FJD55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of FJD20,000, of which FJD15,000 relates to a payment to a former tenant occupying that floor of the building and FJD5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of FJD5,000 and Lessee's leasehold improvements of FJD7,000.

At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines that the lease term is 10 years.

The interest rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

## ***Exercise!***

Initial term: **9 years**

Initial rate: **5%**

PV formula:  **$PV = P \cdot (1 - (1 + r)^{-n}) / r$**

**Present value table**

<b>Years</b>	<b>Payments</b>	<b>Discount Factor</b>	<b>Present Value</b>
0	65,000.00	1	65,000.00
1	50,000.00	0.952380952	47,619.05
2	50,000.00	0.907029478	45,351.47
3	50,000.00	0.863837599	43,191.88
4	50,000.00	0.822702475	41,135.12
5	50,000.00	0.783526166	39,176.31
6	50,000.00	0.746215397	37,310.77
7	50,000.00	0.71068133	35,534.07
8	50,000.00	0.676839362	33,841.97
9	50,000.00	0.644608916	32,230.45

## *Exercise!*

<b>Lease liability</b>				
Year	Beginning	Lease Payment	Interest	Ending
0	420,391.08	(65,000.00)		355,391.08
1	355,391.08	(50,000.00)	17,769.55	323,160.64
2	323,160.64	(50,000.00)	16,158.03	289,318.67
3	289,318.67	(50,000.00)	14,465.93	253,784.60
4	253,784.60	(50,000.00)	12,689.23	216,473.83
5	216,473.83	(50,000.00)	10,823.69	177,297.53
6	177,297.53	(50,000.00)	8,864.88	136,162.40
7	136,162.40	(50,000.00)	6,808.12	92,970.52
8	92,970.52	(50,000.00)	4,648.53	47,619.05
9	47,619.05	(50,000.00)	2,380.95	0.00

## Exercise Debrief

Lease liability = PV =  $50,000 / (1+5\%)^9 = 355,391$

Right-of-use asset = Lease liability + C1 + Direct Cost – Incentive  
=  $355,391 + 50,000 + 20,000 - 5,000 = 420,391$

Year 0

IFRS 16

Dr. Right-of-use asset	420,391	
Cr. Lease liability		355,391
Cr. Cash		65,000

Year 1

IFRS 16

Dr. Depreciation	42,039	
Cr. Right-to-use asset		42,039
Dr. Lease liability	32,320	
Dr. Interest expense	17,770	
Cr. Cash		50,000

## ***Lessee accounting – subsequent measurement (1/4)***

### ***Right-of-use asset***

- Depreciation (in general on straight-line basis)
- Impairment test based on guidance in IAS 36
- Adjustments for remeasurement of lease liability

### ***Lease liability***

- Measured using effective interest rate method
- Remeasured to reflect reassessment, modifications or revised in-substance fixed payments

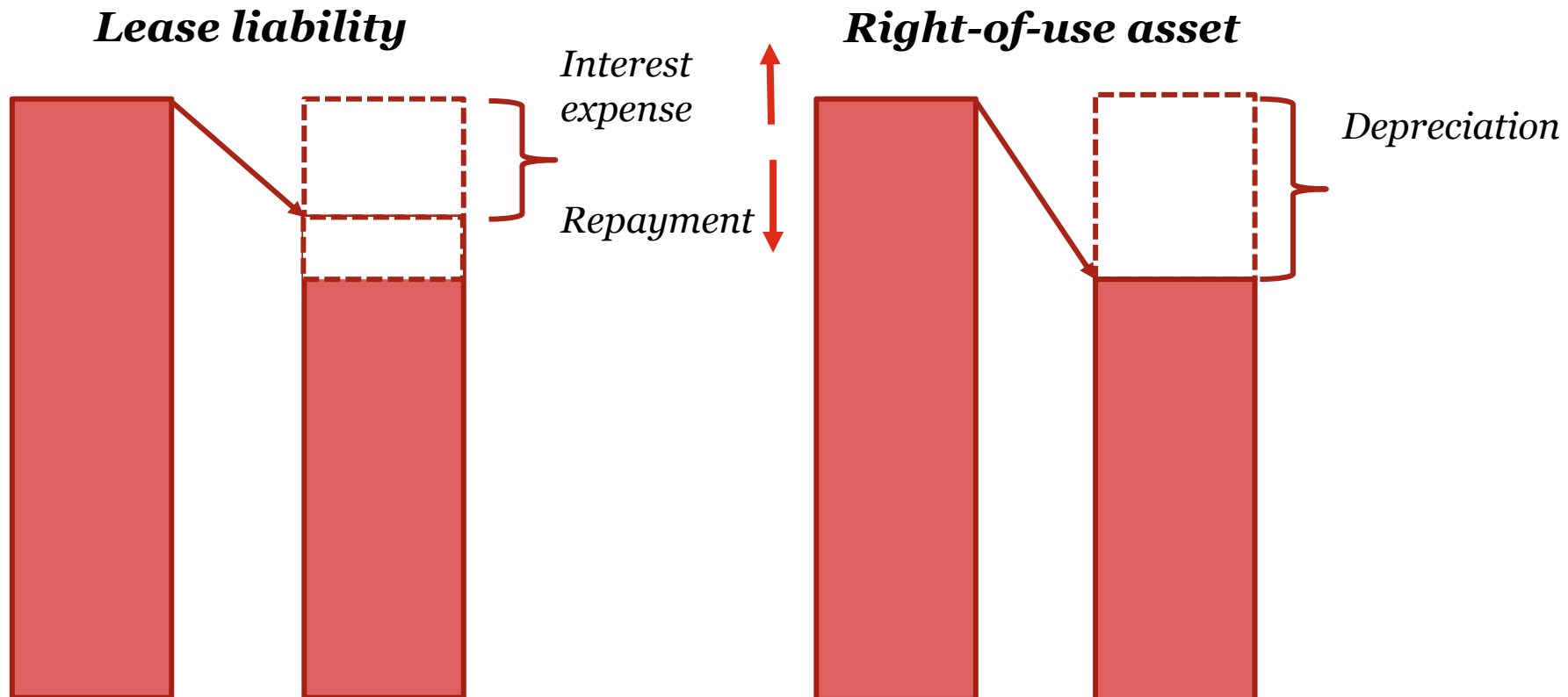
### ***Variable lease payments (not dependent on rate/index)***

- Recognised in profit/loss in period in which incurred



# Lessee accounting – subsequent measurement (2/4)

## Comparison



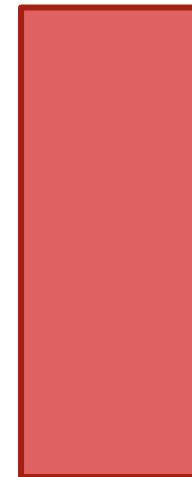
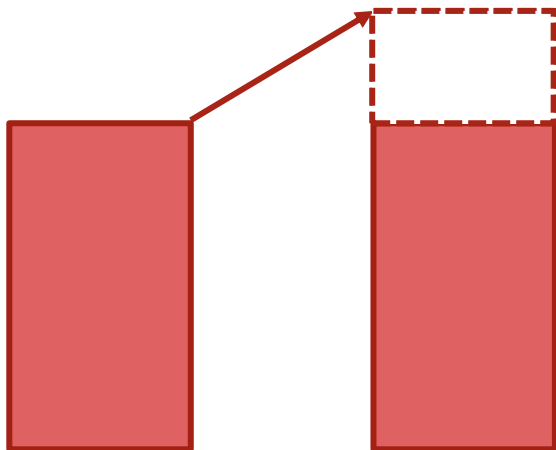
## *Lessee accounting – subsequent measurement (3/4)*

### *Reassessment due to changes in the restoration obligation*

*Corresponding adjustment of the right-of-use asset*

*Restoration obligation*

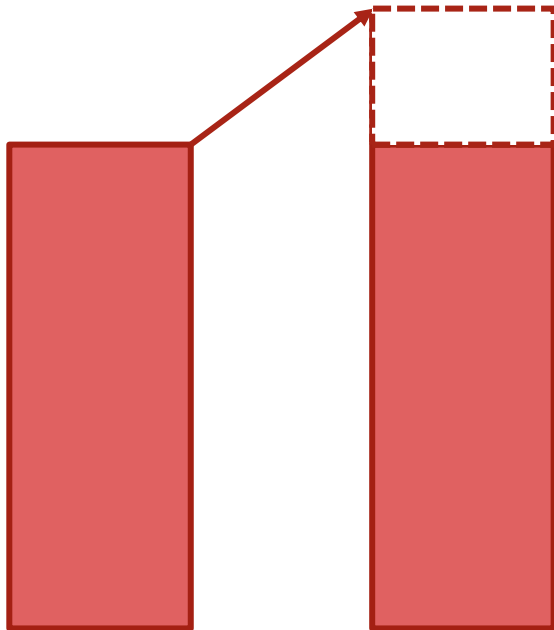
*Right-of-use asset*



# Lessee accounting – subsequent measurement (4/4)

## Reassessment of lease liability

### Lease liability



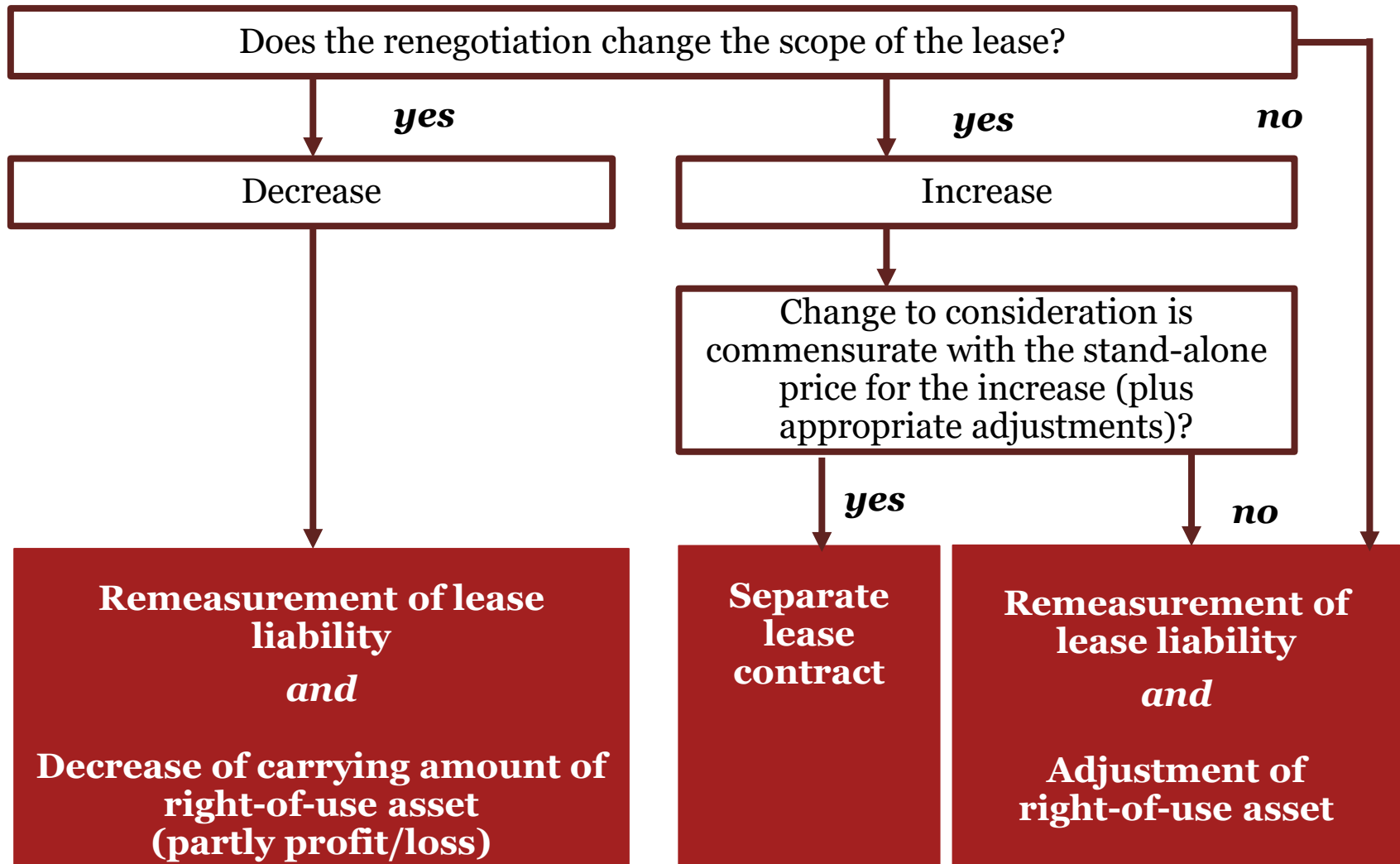
### Reassessment occurs when

- Change in *lease term*\*
- Exercise of purchase option becomes or ceases to be reasonably certain (given certain additional criteria are met)\*
- Change regarding expected payments under *residual value guarantees*\*\*
- Change in *index/rate* used to calculate variable lease payments\*\*

\* Adjustment is based on revised discount rate.

\*\* Adjustment in general is based on the unchanged discount rate.

# Lessee accounting – modification of a lease



## *Other measurement models for right-of-use asset*

### *Property, plant and equipment*

Lessee **may** elect to apply revaluation model in IAS 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 class

### *Investment property*

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

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

# Lessee accounting – presentation

## Balance sheet

Right-of-use asset	Lease liability
Property, plant and equipment <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 10px auto;">Right-of-use asset*</div>	Financial liabilities <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 10px auto;">Lease liability*</div>

\* Additional disclosures required

## Income statement

Revenue

(...)

Depreciation and amortisation

*Depreciation expense  
on the right-of-use asset*

Finance cost

*Interest expense on the  
lease liability*

# *Lessee accounting – presentation*

## *Statement of cash flows*

Cash flows from operating activities

*Short-term lease payments*

*Payments for leases of low value assets*

*Variable lease payments not included in lease liability*

*Cash payments for the interest portion of the liability*

Depending on  
entities' policy for  
interest payments

Cash flows from financing activities

*Cash payments for the principal portion of the liability*

*Cash payments for the interest portion of the liability*

# *Examples of lease modifications*



## *Modifications*

- Extend or shorten the term of an existing contract (with or without changing the other contractual terms)
- To change the underlying asset
- The lessor might agree to reduce lease payments as a concession to support a restructuring



## ***Exercise!***



### ***Lease modification***

A lessee enters into a lease for 5,000 square metres of office space for 10 years. The lease payments are fixed at \$50,000 per annum. After five years, the parties amend the contract to reduce the office space by 2,500 square metres. From year 6 onwards, the annual lease payments will be \$30,000. Incremental borrowing rate is 6% at the start of the lease.

At the beginning of year 6, the lessee's incremental borrowing rate is 5% (assume that the rate implicit in the lease at that date is not readily determinable).

#### **Instructions:**

- Calculate the balances at Y5
- Calculate the modification entry at beginning of Y6

You have 20mins.

## Exercise Debrief

**Carrying amount – Lease liability and ROU – Y5**

Right of use	\$184,004
Lease liability	\$210,618

**Gain in profit or loss:  
Lease liability reduced  
by 50%**

Dr. Lease liability	105,309	
Cr. Right-to-use asset		92,001
Cr. Gain – P&L		13,308
\$30,000 at 5yrs, PV: \$129,884		
Dr. Right of use	24,575	
Cr. Lease liability		24,575

## ***Exercise Debrief***

### **Balances before modification – End of Y5**

Right of use	\$184,004
Lease liability	\$210,618

### **Balances post modification – Beginning of Y6**

Right of use	\$116,577
Lease liability	\$129,884

# Agenda

## Identifying a lease

- Scope of IFRS 16
- Definition of a lease
- Separating components of a contract
- Combination of contracts
- Lease term
- Recognition and measurement exemptions

## Lessee accounting

- Overview
- Initial measurement
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- Presentation/Disclosures

## Lessor accounting

- Overview
- Modification of a lease

## *Lessor accounting – overview (1/2)*

Classification

Distinction based on  
**risk and rewards**

Finance lease

**Lease receivable**  
(net investment in lease)

Operating  
lease

**Underlying asset**



**No significant change compared to  
current guidance**

## ***Lessor accounting – overview (2/2)***

### **Classification indicators**

#### **Finance lease, if transfer of substantially all risks and rewards of ownership**

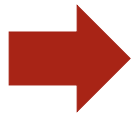
##### **Indicators:**

- Transfer of ownership of underlying asset
- Option to purchase that is reasonably certain
- Lease term for major part of economic life of underlying asset
- Present value of lease payments at least substantially all of underlying asset's fair value
- Underlying asset is of specialized nature
- Lessee bears lessor's losses if it cancels lease
- Gains/losses from fluctuation of residual value accrue to lessee
- Lessee's option to continue lease at rent substantially lower than market rate

#### **Otherwise: operating lease**

## ***Lessor accounting – modification of a lease***

### ***Modification to an operating lease***



- ✓ Account for as a new lease
- ✓ Prepaid/accrued lease payments = payments for new lease

### ***Modification to a finance lease***



- Distinction on whether modification results in
- ✓ *a separate lease* or
  - ✓ *adjustment of an existing lease*

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# *Agenda*



## **Appendix**

- IFRS 16 Disclosures
- Practical challenges



# ***IFRS 16 Disclosures***

<b><i>Item</i></b>	<b><i>IFRS 16</i></b>
<b>Lessee accounting</b>	
Balance sheet	<u>Right-of-use asset</u> and <u>lease liability</u> for all leases
Variable lease payments	Part of the lease liability if they depend on index/rate
Income statement	<ul style="list-style-type: none"><li>• <u>Right-of-use asset</u>: depreciation</li><li>• <u>Lease liability</u>: effective interest rate method</li><li>• <u>Variable lease payments</u> not included in lease liability</li></ul>

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# ***IFRS 16 Disclosures***

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## ***Item***

## ***IFRS 16***

### **Lessee accounting**

#### Cash flow statement

- Part of lease payment that represents principal portion: Cash flow resulting from financing activities
  - Part of lease payment that represents interest portion: operating cash flow or cash flow resulting from financing activities (depending on entity's policy)
  - Payments for short-term leases, for lease of low-value assets and variable lease payments not included in lease liability: operating cash flow
-

# IFRS 16 Disclosures

<i>Item</i>	<i>IFRS 16</i>
<b>Lessor accounting</b>	
Balance sheet	<ul style="list-style-type: none"><li>• <u>Operating lease</u>: Assets subject to lease</li><li>• <u>Finance lease</u>: Receivable at amount equal to the investment in the lease</li></ul>
Income statement	<ul style="list-style-type: none"><li>• <u>Operating lease</u>: lease payments on straight-line basis</li><li>• <u>Finance lease</u>: interest on receivable measured using the effective interest method</li></ul>
<b>Modifications</b>	<ul style="list-style-type: none"><li>• Adjustment of existing lease, or</li><li>• accounted for as a separate lease, depending on kind of modification</li></ul>
<b>Subleases</b>	Classification of sublease refers to right-of-use asset

# Disclosures

## 8(b) Leases

This note provides information for leases where the group is a lessee. For leases where the group is a lessor, see [note 8\(c\)](#).

### (i) Amounts recognised in the balance sheet

IFRS16(54) The balance sheet shows the following amounts relating to leases:

		Notes	2022 CU'000	2021 CU'000
IFRS16(47)(a)	<b>Right-of-use assets</b> <sup>6,7</sup>			
IFRS16(53)(j)	Buildings		3,846	2,994
IFRS16(53)(j)	Equipment		4,678	5,264
IFRS16(53)(j)	Vehicles		1,232	1,250
IFRS16(53)(j)	Others		-	-
			<u>9,756</u>	<u>9,508</u>
IFRS16(47)(b)	<b>Lease liabilities</b>			
	Current		3,008	2,777
	Non-current		8,493	8,514
			<u>11,501</u>	<u>11,291</u>

IFRS16(53)(h) Additions to the right-of-use assets during the 2022 financial year were CU2,152,000 (2021 – CU3,000,000). <sup>6</sup>

# Disclosures

*(ii) Amounts recognised in the statement of profit or loss*

IFRS16(54)	The statement of profit or loss shows the following amounts relating to leases:	Notes	2022 CU'000	2021 CU'000
IFRS16(53)(a)	<b>Depreciation charge of right-of-use assets</b>			
	Buildings		(348)	(366)
	Equipment		(1,236)	(681)
	Vehicles		(320)	(153)
		5(c)	<u>(1,904)</u>	<u>(1,200)</u>
IFRS16(53)(b)	Interest expense (included in finance cost)	5(d)	(527)	(505)
IFRS16(53)(c)	Expense relating to short-term leases (included in cost of goods sold and administrative expenses)	5(c)	(120)	(98)
IFRS16(53)(d)	Expense relating to leases of low-value assets that are not shown above as short-term leases (included in administrative expenses)	5(c)	(85)	(69)
IFRS16(53)(e)	Expense relating to variable lease payments not included in lease liabilities (included in administrative expenses)	5(c)	(941)	(750)
IFRS16(53)(g)	The total cash outflow for leases in 2022 was CU3,615,000 (2021 – CU2,760,000).			

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## ***Practical challenges – In Fiji***

### **Discount rates / implicit rates**

- In the absence of discount rates/interest rates in the lease contract, there is allowance to use the incremental borrowing rate
- The discount rate changes at the time of a new agreement and a new rate needs to be assessed. And if there is a change in scope
- Expertise required to determine the rates.

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## ***Practical challenges – In Fiji***

### **Variable lease payments**

- Variable lease payments based on an index or a rate include for example payments linked to a consumer price index, a benchmark interest rate or a market rental rate.
- Variable lease payments not based on an index or a rate are not part of the lease liability. Such payments are recognised in profit or loss in the period in which the obligation for the payment occurs, that is, when the contingent event takes place.

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## ***Practical challenges – In Fiji***

### **Lease term**

- It is not uncommon for leases to contain break clauses. A break clause gives the lessee the right to terminate a lease after a certain period. The lease term should disregard a termination option if it is **reasonably certain** that the termination option will not be exercised by the lessee.
- **Reasonably certain:**
- Lease payments are lower than the market rates
- Business plans and budgets
- Importance of underlying assets
- Asset is of specialized nature



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## ***Key consideration***

- *What is a lease?*
- *Payments taken up in the lease calculation ?*
- *Discount rate?*
- *Disclosures - Financial statement disclosures ?*

### ***Other areas***

- *Accounting for rent concessions (outside scope of this presentation). Remeasurements during COVID 19*
- *ROU impairments*

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## ***Key consideration***

- There are applications available for setting up IFRS 16 and working out entries.

### **Benefits**

- i. IFRS 16 Reporting
- ii. Get rid of excels
- iii. Cost savings
- iv. Central repository and reminders on lease due dates
- v. Document storage

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## ***Knowledge Check***

1. Under IFRS 16, lessees must recognize a lease liability for every lease contract.

- True
- False

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## *Knowledge Check*

1. Under IFRS 16, lessees must recognize a lease liability for every lease contract.

- True
- False

Answer:

False

Lessees must recognize a lease liability for nearly every lease contract, but there are exemptions for short-term leases and leases of low-value assets.

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## *Knowledge Check*

2. Under IFRS 16, lessor accounting stays substantially the same.

- True
- False

---

## *Knowledge Check*

2. Under IFRS 16, lessor accounting stays substantially the same.

- True
- False

Answer:

True

The accounting for lessors stays almost the same.

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## ***Knowledge Check***

3. Where are cash flows from interest payments on the lease liability presented in the cash flow statement?
- A. Operating activities
  - B. Financing activities
  - C. Policy choice

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## ***Knowledge Check***

3. Where are cash flows from interest payments on the lease liability presented in the cash flow statement?

- A. Operating activities
- B. Financing activities
- C. Policy choice

Answer

C. Policy choice

The part of the lease payments that reflects interest on the lease liability will be presented in accordance with the requirements for interest paid in IAS 7, 'Statement of cash flows'. They are presented as either operating cash flow or within financing activities depending on the entity's general accounting policy (i.e. the presentation has to be consistent with the presentation of other interest payments).



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# *Questions?*



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# *Thank you*

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