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IFRS 16 : Lease accounting

Effective for accounting periods beginning on or after 1 January 2019

December 2017

IFRS 16: Lease accounting

The IASB published the new IFRS 16 lease standard, in order to avoid 'off-balance sheet' financing. IFRS 16 requires lessees to recognise most leases on the balance sheet. The new standard is a significant change in approach from current IFRS standard.

- IFRS 16 is effective for accounting periods beginning on or after 1 January 2019.
- Lessees will have a single accounting model for all leases.
- IFRS 16 will introduce additional disclosures requirements.

Scope IFRS 16

IFRS 16 applies to all leases, including leases of right-of-use assets in a sublease and rental agreements, except the following:

- leases to explore for, or use, minerals, oil, natural gas, similar non-regenerative resources;
- leases of biological assets within the scope of IAS 41;
- service concession arrangements within the cope of IFRIC 12;
- licences of intellectual property granted by a lessor within the scope of IFRS 15;
- rights held by lessee under licensing agreements within the scope of IAS 38

IFRS 16 requires lessees to recognise a liability to make lease payments and assets representing the right to use the underlying asset during the lease term for al leases, except for **short-term leases** (lease term of 12 months or less) and leases of **low-value assets** (value of a US$5,000 or less) if they choose to apply such exemptions. However, a lessee that makes such elections must make certain quantitative and qualitative disclosures about short-term leases and leases of low-value assets.

Definition of a Lease

IFRS 16 changes the definition of a lease and provides new guidance on applying the definition.

Under IFRS 16 a lease is defined as: 'a contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for a consideration'.

A contract can be (or contain) a lease only if the underlying asset is 'identified' and convey the right to control the use of an identified asset. The right to control the use of an identified asset contains two requirements:

- obtain all of the economic benefits from use of the identified asset; and
- direct the use of the identified asset

In order to direct the use of the identified asset, the lessee has the right to control the operational activities of the identified asset without any restrictions from the lessor. If there are con-tractual restrictions for the operational activities, the lessee can not direct the use of the asset.

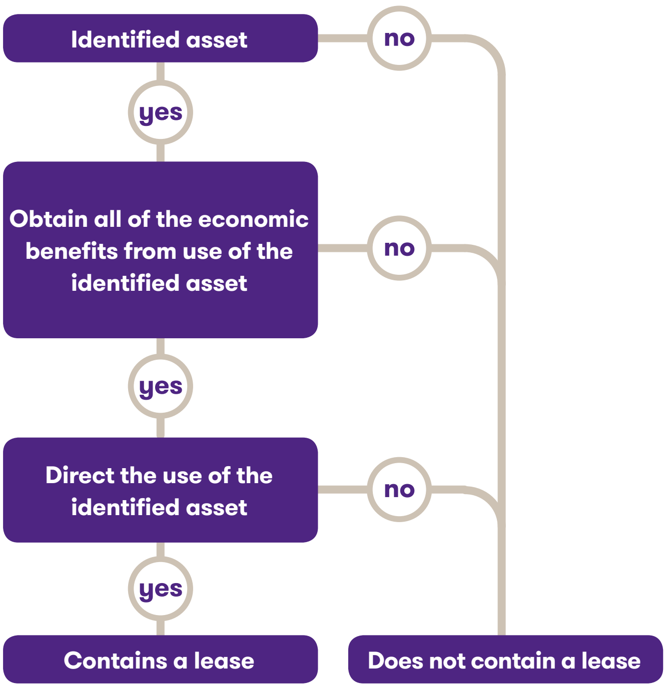
Exhibit A | Example

Lee BV is a manufacturing company with more than 1000 employees. Within the coming year some employees have to travel in order to attract suppliers for the purchase of raw materials. Lee BV wants to facilitate these employees with a car. They approached Leaseplan BV. Lee BV will lease 20 car's form Leaseplan BV with the following contractual agreements:

1. **Leaseplan BV is owner of the 20 car's;**
2. **Leaseplan BV is responsible fort he maintenance of the car's;**
3. **It is forbidden to use the car outside the Netherlands.**
4. **The contract term of this agreement is 5 years**
5. **Each car has a value of €25.000**

Based on these contractual terms the lessee does not direct the use of the identified asset during the contract term. There is a contractual restriction regarding the use if the identified asset. It is forbidden to use the car outside the Netherlands. Based on this example, the agreement would not be classified as a lease.

If the contract contains an underlying 'identified' asset and conveys the right to control and use the identified asset, the contract will contain a lease in the scope of IFRS 16.



The definitions of a finance lease and operating leas is not affected by IFRS 16. Finance lease: ' A lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset'. Operating lease: 'A lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset'.

Lease accounting short-tem lease

Under IFRS 16 leases with a lease term of 12 months or less and which do not include an option to purchase the underlying asset are an optional exemption. The lessee that makes this accounting policy election does not recognise a lease liability or right-to-use assets on its balance sheet. The lessee recognises the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or other systematic basis that is more representative of the pattern of the lessee's benefit. However, a lessee that makes this election must make certain quantitative and qualitative disclosures about the short-term leases.

Lease accounting 'low-value' assets

IFRS 16 provides an optional exemption for leases of 'low-value' assets. The assessment of value is based on the value of the underlying asset **when new**, regardless of it's actual age. The exemption is available whether or not these leases are material of the reporting entity. Assets with a value when new of US$5,000 or less are classified as low-value assets. Accordingly, leases of assets such as low value IT equipment, office equipment and furniture would typically qualify, but vehicle leases would not. The lessee that makes this accounting policy election does not recognise a lease liability or right-to-use assets on its balance sheet.

Exhibit B

Office equipment, such as computers, are based on IFRS 16 'low-value assets'. IFRS 16 provides an optional exemption for leases of 'low-value' assets. The lessee that makes this accounting policy election does not recognise a lease liability of right-to-use assets on its balance sheet. However vehicle leases are not within the scope of this exemption. Vehicles can be classified as a short-term lease if the contract fits the requirements.

Exhibit C

Rental contracts of buildings with a term of 5 till 10 years are classified as a lease under the scope of IFRS 16. The lessee has to revise the contract in order to determine the contractual rights. There are two criteria that should be met in order to determine if the lessee has the right to control the use:

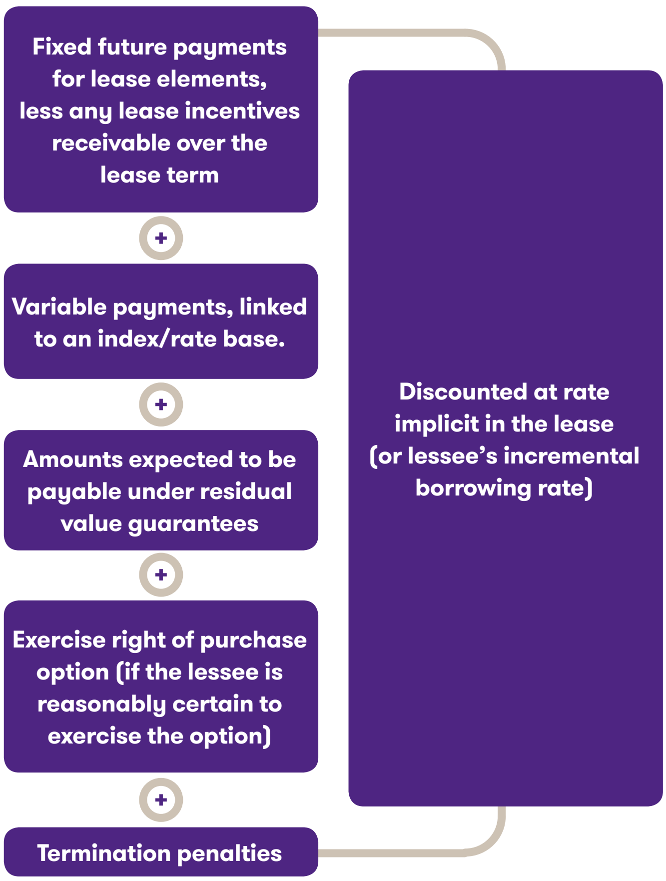
- **obtain all of the economic benefits from use of the identified asset; and**
- **direct the use of the identified asset**

If the lessee can obtain substantially all the economic benefits of the use of the identified asset and can direct the use of the identified asset the lessee has to recognise a lease liability on its balance sheet.

Accounting Approach

At the commencement date the lessee recognises a lease liability and a right-to-use assets. The labiality is initially measured at the present value of future lease payments. The lease payments include fixed, non-cancellable payments for lease elements, amount due under residual value guarantees, certain types of contingent payments and amounts due during optional periods that are 'reasonably certain.' Termination penalties are included if the lease term reflects the exercise of a termination option.
The lease liability does not include:

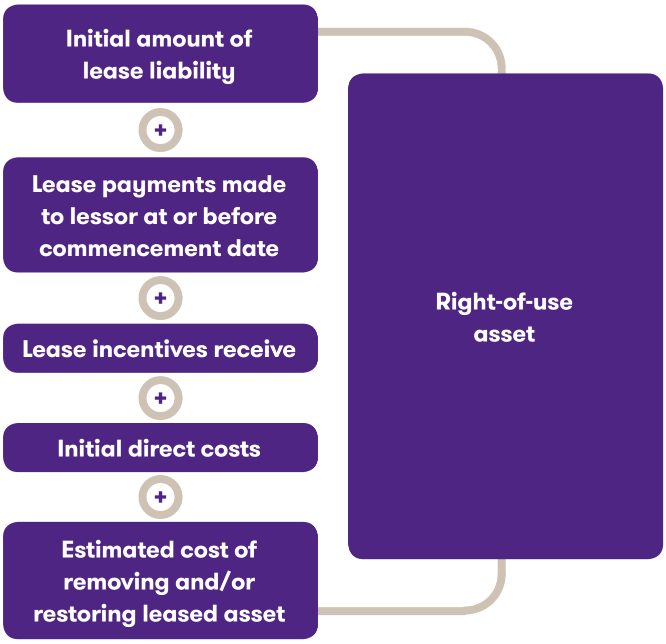
- payments for non-lease elements (unless the practical expedient permitting non-separation of non-lease elements is applied – see below)
- payments in optional extension periods unless extension is 'reasonably certain'
- future changes in variable payments that depend on an index or rate
- variable payments linked to the lessee's future sales or usage of the underlying asset



The initial measurement of the right-of-use asset is based on the lease liability. Adjustments are made for any:

- prepaid lease payments
- lease incentives received
- initial direct costs incurred
- an estimate of costs the lessee is obliged to incur to dismantle, remove or restore the underlying asset and/or site.

The right-to-use asset can be determined by:



Changes in lease accounting for lessor

IFRS 16's requirements for lessor accounting are similar to IAS 17's. In particular:

- The distinction between finance and operating leases is retained
- the definitions of each type of lease, and the supporting indicators of a finance lease, are substantially the same as IAS 17's
- the basic accounting mechanics are also similar, but with some different or more explicit guidance in a few areas.

New definition lease

As mentioned above the definition of a lease changed under IFRS 16. Under IFRS 16 a lease is defined as: 'a contract, or part a contract, that conveys the right to use an asset for a period of time in exchange for a consideration'. A contract can be (or contain) a lease only if the underlying asset is 'identified' and convey the right to control the use of an identified asset.

Subleases

A sublease involves the re-leasing by a lessee of the underlying asset to a third party, while the 'head lease' between the original lessor and lessee remains in effect. Under IFRS 16 subleases are accounted for by the sub-lessor in the same way as other leases. Under IFRS 16 the head lease and a sublease are separate contracts that are accounted for under the lessee and lessor models. The sublease is classified by reference to the right-of-use asset. IAS 17 has limited guidance but in practice subleases are often classified by the intermediate lessor by reference to the underlying asset.

Lease modifications

IFRS 16 has new guidance on lease modifications for the two lease types:

Modification to a finance lease

A modification to a finance lease is accounted for as a separate lease if:

- the modification increases the scope of the lease by adding the right to use of one or more underlying assets; and
- the consideration increases by an amount commensurate with the stand-alone price for the increased scope and any appropriate adjustments to reflect the circumstances.

If these conditions are not met, the accounting depends on whether the lease would have been an operating lease if the new terms were in effect at inception. If so, the lessor accounts for the modified lease as a new operating lease from the modification date (measuring the underlying asset equal to the net investment in the original lease immediately before the modification). If not, the guidance in IFRS 9 on modified financial assets applies.

Modification to an operating lease

A modification to an operating lease is accounted for as a new lease from the modification date.

Variable payments

Under IAS 17 contingent rents are not part of 'minimum lease payments' and generally excluded from finance lease liabilities and assets

Lessor disclosures

The objective of the disclosures is for lessors to disclose information that gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor. IFRS 16 requires a lessor to disclose quantitative and qualitative information about its leases, the significant judgements made in applying IFRS 16 and the amounts recognised in the financial statements related to the leases. Lessors may need to exercise judgement to determine the appropriate level at which to aggregate, or disaggregate, disclosures so that meaningful information is not obscured by insignificant details or by grouping items with different characteristics.

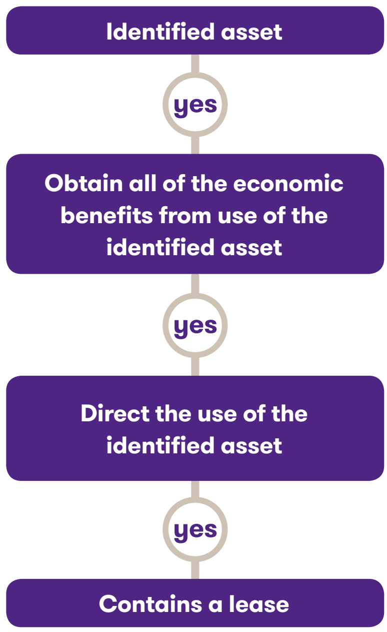
Exhibit D

IFRS 16 will effect the lessor, but these changed are mainly a consequence of changes to lessee accounting. The main changes from IAS 17:

- **new lease detention**
- **subleases**
- **lease modifications**
- **variable payments**
- **lessor disclosures**

Real estate

For most real estate contracts, the landlord does not have a substantive substitution right. Further, the tenant generally has exclusive use of the leased property and, therefore, has the right to substantially all of the economic benefits from its use. The tenant also generally has the right to direct the use of the underlying property because the tenant decides how and for what purpose the property will be used. Property leases often contain clauses requiring the tenant to maintain the property and allow the landlord to inspect the conditions of the property. From the perspective of the Lessee with the mentioned circumstances the contracts will contain an underlying 'identified' asset and conveys the right to control and use the identified asset, the contract will contain a lease in the scope of IFRS 16.



While IFRS 16 provides new criteria for determining whether an arrangement meets the definition of a lease, we expect real estate entities to generally reach conclusions that are similar to those they reach today about whether arrangements are, or include, leases of real estate properties.

Separating non-lease components

Some contracts contain a lease coupled with an agreement to purchase or sell other goods or services (non-lease components). These non-lease components are identified and accounted for separately from the lease component. Under IFRS 16 there is a practical expedient that permits tenants to make an accounting policy election, by class of underlying asset, to account for each separate lease component of a contract and any associated non-lease components as a single lease component.

Tenants that do not make an accounting policy election to use this practical expedient are required to allocate the consideration in the contract to the lease and non-lease components on a relative stand-alone price basis. If observable stand-alone prices are not readily available, tenants estimate stand-alone prices, maximising the use of observable information.

Exhibit E | Example

Van Dam vastgoed is a real estate firm specialized in office rentals in Amsterdam. Lee BV wants to rent a new office in Amsterdam. They approached Van Dam vastgoed in order to facilitate them with a new head office. Van Dam vastgoed found the perfect location in Amsterdam for Lee BV. Lee BV will lease the 500 m2 office in Amsterdam with the following contractual agreements:

1. **Van Dam vastgoed is owner of the 500 m2 office;**
2. **The monthly payment will be €25.000 a month;**
3. **The contract term of this agreement is 10 years**
4. **Van Dam vastgoed is responsible for the maintenance of the office**

Based on these contractual terms this agreement contains a non-lease component. Van Dam vastgoed is responsible for the maintenance of the office. Lee BV can specify this agreement within a lease component (the rent of the office) and a non-lease component (maintenance of the office). Lessees are required to allocate the consideration in the contract to the lease and non-lease components on a relative standalone price basis. Lessors are required to apply IFRS 15 to allocate the consideration in the contract.
Lessee's can also make an accounting policy election to account for both components as a single lease component.

Lessors are required to apply IFRS 15 to allocate the consideration in a contract between the lease and non-lease components generally on a relative stand-alone selling price basis.

Consideration landlord

Payments for maintenance activities, including common area maintenance and other goods or services that are transferred to the tenant are considered as non-lease components under IFRS 16.

Exhibit F

IFRS 16 requires that landlords account for consideration related solely to services provided using the requirements of IFRS 15. If the variable consideration allocation exception criteria in IFRS 15 are met, the resulting pattern of revenue recognition for many arrangements may be consistent with how entities recognise such operating lease and lease-related revenue today.

If a tenant reimburse (or make certain payments of behalf of) the landlord that relate to the leased asset for activities and costs that do not transfer a good or service to the tenant (e.g. taxes), then under IFRS 16, such costs are not separate components of the contract, but are considered to be part of the total consideration that is allocated to the separately identified components of the contract (i.e., the lease and non-lease components). For such payments that are allocated to the lease component, landlords will need to evaluate whether they are fixed (or in-substance fixed) lease payments or variable lease payments.

Landlord accounting

IFRS 16 requires landlord to account for operating lease using an approach that is unchanged from IAS 17. Under IFRS 16, landlord are requires to account for finance lease also using an approach that is unchanged from IAS 17.

If a leased property meets the definition of investment property, the sublease is classified as an operating lease and the intermediate landlord elects the fair value model in IAS 40 Investment Property as an accounting policy, IFRS 16 requires the intermediate landlord to measure right-of-use assets arising from leased property in accordance with IAS 40. This represents a change from the current scope of IAS 40.

Tenant accounting

A tenant recognises a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset (e.g., a real estate property) during the lease term (i.e., the right-of-use asset). The accounting approach is the same as the accounting approach discussed earlier. The same exception for short-tem lease is possible for tenant accounting.

For this ‘right-of-use’ asset the normal impairment approach (IAS 36) is applicable. For these ‘right-of-use’ assets the recoverable amount will be the value-in-use, and not the higher of its fair value less costs to sell and its value in use.

More information?

If you want to know more about IFRS 16, please contact your personal advisor, or else Hanneke Knoop, Head Department Professional Practice Audit.

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