Get ready for FRS 116: Leases

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Overview of main changes

- Replaces FRS 17 'Leases', INT FRS 104 'Determining whether an Arrangement contains a Lease', INT FRS 15 'Operating Leases-Incentives', and INT FRS 27 'Evaluating the Substance of Transactions Involving the Legal For of a Lease'
- New lease definition
- Lessee accounting significantly impacted – most leases recognised on the balance sheet
- Lessor accounting – largely unchanged
- Sale and leaseback transactions – accounting based on whether the transfer is a sale (i.e., a performance obligation under FRS 115)
- New disclosure requirements

Scope

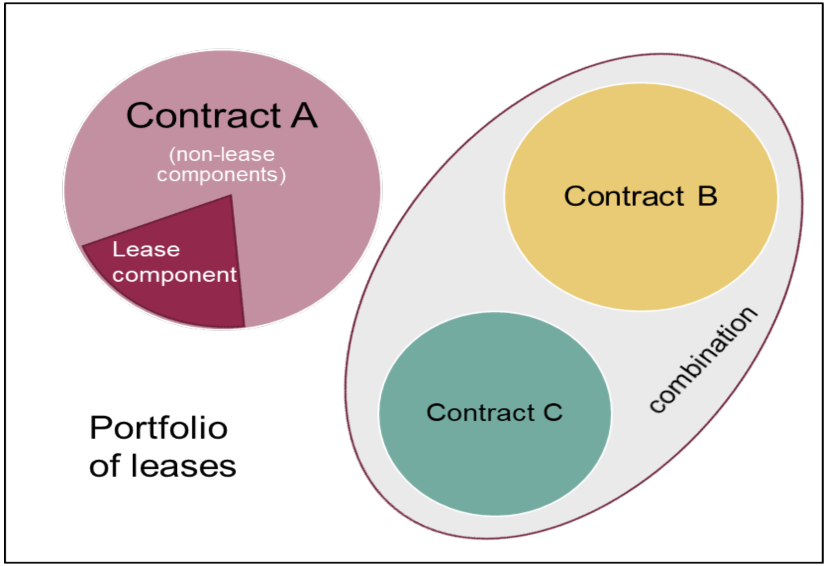
- all leases for both lessees and lessors, (except the below)
- scope exclusions
  - leases to explore for or use minerals, oil, natural gas & similar non-regenerative resources
  - leases of biological assets
  - service concession arrangements
  - licences of intellectual property granted by a lessor
  - rights held by a lessee under certain licencing agreements
    (e.g., films, video recordings)
- recognition exemptions (short-term leases / low-value assets)

Practical Insight

- FRS 116 makes consequential amendments to FRS 40, including expanding its scope to include all investment property held under leases (including leases that would be classified as operating under FRS 17).
- As a result, an investor-lessee recognises a lease liability and a right-of-use asset. The 'right-of-use' asset is accounted for at cost less depreciation and impairment in accordance with FRS 16.

What is the contract? — A unit of account question

- Some contracts contain both lease and non-lease (service) components. For example, a contract for a building may combine a lease with maintenance services.
- Non-lease components are identified and accounted for separately from the lease component in accordance with other FRS.
- In addition, many contracts contain two or more lease components. For example, a single contract may include leases of land, buildings and equipment.



Portfolio of leases

- Standard specifies the accounting for an individual leases
- However as a practical expedient (it's discretionary), can be applied to portfolio of leases
- May be applied to a portfolio of leases if:
  - Leases have similar characteristics
  - Impact on F/S is materially the same as result obtained by applying to leases individually
- Use estimates and assumptions that reflect the size and composition of the portfolio

- Falling within the scope of this practical expedient are circumstances when an entity enters into a single contract to lease a number of identical assets.
- Take, for example, a contract to lease 20 printers (assumed for the purposes of this example ones that do not qualify as low-value assets).
- The practical expedient helps to reduce that complexity by permitting the entity to account for the leases as one portfolio, rather than recognising and accounting for 20 leases separately.

Definition of a lease - FRS 116

- "A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration"

Control

Is there an identified asset?

No → **Contract is not (does not contain) a lease**

Yes

Does the customer have the right to obtain substantially all of the economic benefits from the use of the identified asset throughout the period of use?

No → **Contract is not (does not contain) a lease**

Yes

Does the customer have the right to direct the use of the identified asset throughout the period of use?

No → **Contract is not (does not contain) a lease**

Yes

Contract is (contains) a lease

Assessment performed at lease inception

Identified assets

- 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.
- An asset would **not be considered as identified asset** if the lessor has a **substantive right to substitute the asset** for an alternative asset during the lease term.
  - has the practical ability to substitute the asset; and
  - would benefit economically from exercising its right to substitute the asset.
- Examples of identified assets:
  - Specific cars / truck / ship / aircraft to transport the goods as mentioned in the contract.
  - Specific retail unit identified in the contract.

Identified assets

Example : 1

Customer A enters into a five-year contract with Supplier B for the use of a container specifically designed for Customer A to transport materials used in Customer A's production process. This container cannot be used by any other customers without significant modification.

Details of the container is not explicitly specified in the contract, but Supplier B owns only one container that is suitable for Customer A's use. If the container does not operate properly, the contract requires Supplier B to repair or replace the container. Assume that Supplier B does not have a substantive substitution right.

Determine whether this container is specified asset?

Analysis : The container is an identified asset. While the container is not explicitly specified in the contract (e.g., by serial number), it is implicitly specified because Supplier B must use it to fulfil the contract.

Identified assets

Example : 2

Company X provide centralised accounting and billing services in an outsourcing model along with data management and storage facility on its servers.

Company X maintains many identical servers in their office which they use for their clients. Each client is given a separate server for their data storage.

Supplier determines at inception of the contract that it is permitted to and can easily substitute another server without the customer's consent throughout the period of use.

Further, the supplier would benefit economically from substituting an alternative asset.

Determine Whether asset is specified asset or not?

Analysis : The customer does not have the right to use an identified asset because, at the inception of the contract, the supplier has the practical ability to substitute the server and would benefit economically from such a substitution.

Right to economic benefit

To control the use of an identified asset, a customer must have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use. e.g. by having exclusive use of the asset throughout that period.

Economic benefit	Can be obtained by the customer in many ways e.g. by using, holding or sub-leasing the asset. Include the asset's primary outputs and any by-products, including potential cash flows derived from these items Include benefits from using the asset that could be realised from a commercial transaction with a third party (e.g. subleasing the asset).

Protective rights does not prevent the customer from obtaining substantially all of the economic benefits from use of the asset.

Right to economic benefit

Example : 1

Lessor A enters into a contract for the lease of a store in a shopping centre for 5 years.

The rental terms include payments equal to 10% of the gross sales revenue generated from the store.

The retailer has the right to determine which products are to be sold, the interior design of the store, etc.

Determine whether customer has the right to obtain substantially all of the economic benefits?

Analysis :

- Retailer control and use of the property which generates all of the sales revenue.
- Retailer substantially obtains benefits arising from use of the store
- The fact that a portion of the cash flows generated from use of the property are passed to the lessor is not relevant

Right to direct the use

A customer has the right to direct the use of an identified asset throughout the period of use only if either:

customer has the right to direct **how** and for **what purpose** the asset is used throughout the period of use

Examples:
- the type of output produced
- when the output is produced
- where the output is produced whether the output is produced, and the quantity of that output

Or

relevant decisions about how and for what purpose the asset is used are predetermined and following conditions are met:

has the right to operate the asset throughout the period of use, without the supplier having the right to change those operating instructions;
Example: use of property on lease only for purpose stated in the contract

Or

Customer designed the asset in a way that predetermines how and for what purpose the asset will be used throughout the period of use.
Example: a contract with a power company to purchase all of the electricity produced by a new solar farm for 20 years.

Example 1

- a multi-national business (the customer) enters into a five-year contract with an aviation company for the exclusive use of a particular executive jet
- the contract details the interior and exterior specifications for the jet
- the aviation company is permitted to use an alternative aircraft but this would be uneconomic due to various factors such as the cost of customising the aircraft to meet the contractual specifications
- subject to certain restrictions, the customer decides where the executive jet will fly and which passengers will use it. The aviation company operates the aircraft using its own crew.

Does this arrangement for printer fall under definition of Lease?

- the contract contains a lease
- the contract specifies an executive jet. The aviation company's right to substitute another aircraft is not substantive because it would be uneconomic to exercise this right. The customer decides how and for what purpose the jet is used which provides it with the right to control the use of the jet.

Example 2

- a car manufacturer enters into a contract with a shipping company to transport cars from Adelaide to Singapore
- the contract specifies a particular ship and the cars to be transported, which will require the full capacity of the ship
- the shipping company operates and maintains the ship and is responsible for the safe passage of the cars to Singapore
- the car manufacturer is not able to make changes (eg to the destination or nature of the cargo) once the contract has been signed.

Analysis

- the contract does **not** contain a lease
- after signing the contract the car manufacturer is not able to direct how and for what purpose the ship is used and does not therefore control the use of the asset
- the contract pre-determines how and for what purpose the ship will be used and the car manufacturer neither operates nor designed the ship.

Definition of a lease - Separating components

Lease and non-lease components are accounted for separately

- each lease component – apply FRS 116
- each non-lease component – apply other standards

Practical expedient:

- lessees can make a policy election (by underlying asset class) to account for lease and non-lease components as lease components
- if the practical expedient is adopted, entity is not permitted to account for the combined lease and non-lease component as a service

Allocate consideration to lease and non-lease components:

- lessees – on a relative standalone price basis (unless the practical expedient is elected)
- lessors – using FRS 115

Example - Separating components

Example – A lessee enter in a lease of truck with it maintenance services

Assumptions:

- Lessor will provide the lease services
- Lease term is 4 years
- Annual lease payments are fixed at S$19,000 per year.

Determine how lessee allocate the contract consideration to lease and non-lease components?

Example - Separating components

Analysis

This lease arrangement contain one lease and one non-lease components, i.e. Truck and Maintenance service respectively.

Both truck and maintenance services are separately identifiable from other promises in the contract and Lessee can benefit either alone or with other readily available resources.

Lessee identified the standalone selling price of the truck and maintenance service which are as follows

Lease	15,000
Maintenance services	5,000
Total	**20,000**

The lessee allocates the consideration in the contract (S$ 19,000), as follows

Lease	14,250 (19,000 * 15,000/20,000)
Maintenance service	4,750 (19,000 * 5,000/20,000)
Total	**19,000**

Lease term

Total Lease term

=

Non-cancellable period

+

Rent free periods

+

Optional renewable periods (where lessee is reasonably certain to extend the lease)

+

Periods after an optional termination date (where lessee is reasonably certain not to terminate early)

Facts and circumstances to consider

Contractual/ market

Asset-specific

Example - Lease term

Entity A enters into a lease agreement with entity B for building.

As per lease agreement, lease term includes a non-cancellable term of five years

Also agreement includes a two- one year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception.

Case 1: - There are no termination penalties or other factors indicating that Entity A is reasonably certain to exercise the renewal option.

Case 2: - Building is designed as per the requirement of lessee and there are significant penalties on cancelation of lease at the end initial non cancellable lease period.

Determine the lease term in both the cases?

Case 1: 5 years because there is no penalty on termination after end of non-cancellable period

Case 2: 7 years because on cancellation of lease there is significant amount of penalty even after the end of non cancellable period.

Lessee accounting

Lessee accounting - Overview

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 and Loss	**Lease expense = Depreciation + Interest**

Optional accounting simplifications

- Election made by class of underlying asset
- Determination of ‘short-term’ depends on lease term
- Lease that contains purchase option cannot be considered short-term lease
- Treat any lease modifications or changes in lease term as new lease
- Disclose short-term lease expense

Short-term leases

- Election available on lease-by-lease basis
- No explicit definition of 'low-value' assets
- Assessment based on the value of asset when new, regardless of age of leased asset
- Highly dependent / interrelated assets do not qualify
- Head leases do not qualify

Low-value asset leases

Impact: Recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term

Lessee accounting - Impact

Comparison with Old Standard

	Lease classification test	ON Balance sheet	Off Balance sheet
New standard	✗	**All Leases**	**Services arrangements**
Old standard	✓	**Only Finance lease**	**Operating lease**

FRS 17 deal with dual accounting approach i.e. both on balance sheet and off balance sheet accounting model. While FRS116 covers only balance sheet accounting model.

Initial measurement

Lease liability

=

NPV

+ Fixed payments less lease incentives receivable over the lease term
+ Variable payments (based on rate/index)
+ Expected payment under residual value guarantee
+ Purchase options
+ Termination costs

ROU asset

=

+ Initial amount of lease liability
+ Prepaid lease payments
− Lease incentives received
+ Initial direct costs
+ Estimated costs to dismantle, remove, or restore, measured in accordance with FRS 37

Initial measurement of the right-of-use asset

Typical initial direct costs included in ROU of a lease

- ✓ Commissions
- ✓ Legal fees*
- ✓ Costs of negotiating lease terms and conditions*
- ✓ Costs of arranging collateral
- ✓ Payments made to existing tenants to obtain the lease

- ✕ General overheads
- ✕ Costs to obtain offers for potential leases

*If they are contingent on origination of the lease

Initial measurement – Lease liability

Example

- A Company takes an office building on rent
- The lease term is five years and the initial annual rental payment is 2.5 million.
- Payments are made at the end of each year.
- The rent will be reviewed every year and increased by the change in the CPI.
- The discount rate is 5%

Initial measurement of the lease liability

Year	Lease Payment	Discounting factor	Present value
1	2,500,000	0.952380952	2,380,952
2	2,500,000	0.907029478	2,267,574
3	2,500,000	0.863837599	2,159,594
4	2,500,000	0.822702475	2,056,756
5	2,500,000	0.783526166	1,958,815
	Lease liability at inception of lease		10,823,692

Initial recognition	Debit	Credit
ROU	10,823,692	
Lease liability		10,823,692

Subsequent measurement

Lease liability		ROU asset
=		=
Initial value		1. Cost model FRS 16
+ Interest accrued	+/–	Remeasurement
– Lease payments		2. Revaluation model FRS 16
+/– Remeasurements	–	Depreciation
		3. Fair value model FRS 40
	–	Impairment

Subsequent measurement

After initial recognition, the lease liability will be measured at amortised cost using the effective interest method.

For Example

Lessee X has entered into a contract with Lessor L to lease a building for 7 years.

The annual lease payments are 900, payable at the end of each year.

X's incremental borrowing rate is 5.04%.

Calculate the value of lease liability ?

IFRS 16 example

Response

- The calculated initial recognition of the obligation to make lease payments is 5,200.
- The carrying amount of the liability at the start of Year 2 is 4,562 (5,200-638).

Subsequent measurement

Copmputation of ROU and depreciation

Date	Period	Yearly Rent	PV	Depreciation Expense	Closing Balance of ROU
01/Apr/19	0				
31/Mar/20	1	900	857	743	4,457
31/Mar/21	2	900	816	743	3,714
31/Mar/22	3	900	777	743	2,972
31/Mar/23	4	900	739	743	2,229
31/Mar/24	5	900	704	743	1,486
31/Mar/25	6	900	670	743	743
31/Mar/26	7	900	638	743	-0
		6,300	5,200	5,200	

Copmputation of Lease liability and interest

Date	Period	Yearly Rent	Opening balance	Payment	Interest	Closing Balance
01/Apr/19	0	-5,200	5,200			5,200
31/Mar/20	1	900	5,200	900	262	4,562
31/Mar/21	2	900	4,562	900	230	3,892
31/Mar/22	3	900	3,892	900	196	3,188
31/Mar/23	4	900	3,188	900	161	2,449
31/Mar/24	5	900	2,449	900	123	1,672
31/Mar/25	6	900	1,672	900	84	857
31/Mar/26	7	900	857	900	43	0
		1,100			1,100	

Variable payments

Type of payment	Initial Accounting	Subsequent Accounting
Variable lease payments that depend on an index or a rate	Include in lease liability and asset based on level of index/rate at the commencement date	Adjust lease liability and asset when revised index/rate changes the lease payments (using original discount rate)
Other variable lease payments (e.g payments linked to sale or usage)	Exclude from lease liability and asset	Recognise an expense in the period that the event or condition that triggers the payments occurs
In-substance fixed lease payments	Treat as fixed lease payments	Treat as fixed lease payments

Variable payments

Example

An entity has a mine that is starting commercial production. The entity enters into a contract to lease substantially all of its critical mining and milling equipment.

The lease has a term of 20 years, which is the estimated life of the mine.

Lease payments are determined based on realized mineral extraction at a rate of S$100 per unit of mineral product. There is no minimum payment.

Based on the entity's mine plan, it expects that realized mineral extraction will be at least 100,000 units per annum.

Determine how entity recognise the above transaction?

There is genuine variability to the lease payments and the variability will remain throughout the lease term. As a result, the entity will recognize lease payments as an expense in profit or loss when it realizes mineral extraction.

Variable payments

1) Company ABC leases a production line. The lease payments depend on the number of operating hours of the production line - i.e. ABC has to pay 1,000 per hour of use. However, the annual minimum payment is 1,000,000. The expected usage per year is 1,500 hours.

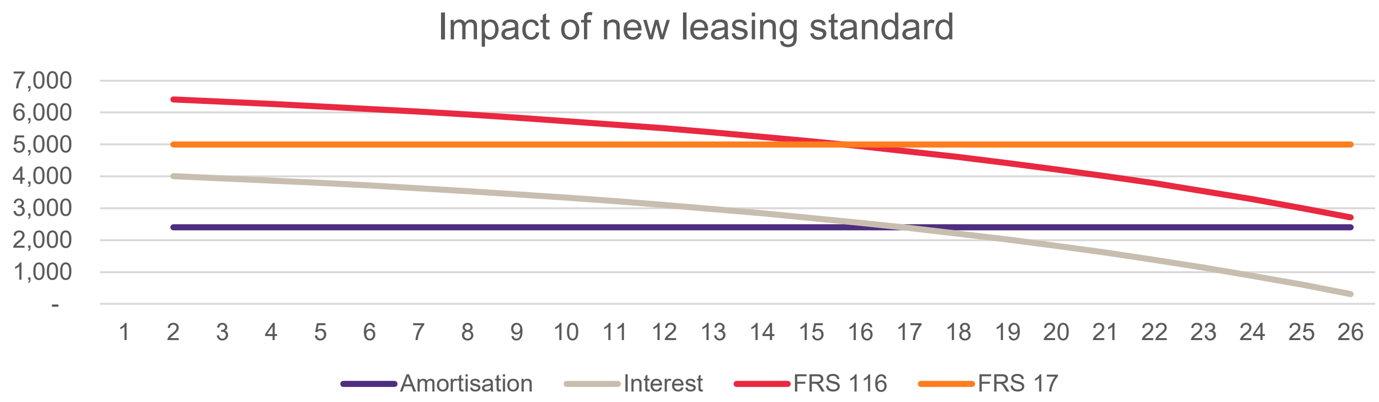
- Payments of 1,000,000 is in-substance fixed payment and hence will be considered as **a part of lease payments.**
- Additional 500,000 that ABC expect to pay are variable payment that do not depend upon index or rate (not part of lease payments). Since the payment is not dependent on any index, **hence not to be included in the lease liability and will be charged to P&L.**

2) A has entered into a lease with X to lease a truck. The lease term is 10 years.

A also agrees on a residual value guarantee – if the fair value of the truck at the end of the lease term is below 100,000, then A will pay to X an amount equal to the difference between 100,000 and the fair value of the truck. At inception, A expects that the fair value of the truck at the end of the lease term will be 60,000.

- 40,000 will be included in lease payments when calculating lease liability.

Lessee accounting model impact

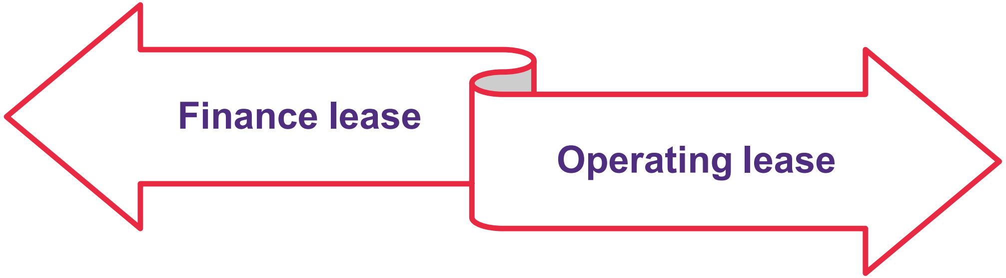


Metric	Measure	Calculation	Impact
Leverage	Solvency	Liability / Equity	Negative
EBIT	Profitability	Net Income/Net sales	Positive

Lessor accounting

Lessor accounting

- Lessor accounting requirements are similar to FRS 17's:
  - 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
  - the basic accounting mechanics are also similar, but with some different/more explicit guidance in a few areas such as sub-leases



Indicators of finance lease

Following indicators individually or in combination would normally lead to a lease being classified as finance lease, else it would be an operating lease:

- **Ownership transfers at end of lease**
- **Purchase option**
- **Lease for majority of economic life**
- **Minimum lease payments**
- **Specialised nature**

Finance Lease

Additional indicators for Finance lease:-

1. Lessor's cancellation losses borne by lessee.
2. Gains or losses from the fluctuation in the fair value of the residual fall to the lessee
3. Lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

Example

Entity A (the lessor) leases a truck to entity B (the lessee) for a period of three years. Lease rentals are set by the lessor, assuming a residual value for the truck of C4,000 at the end of the lease term.

Market data suggests that the likely range of residual values at the end of three years is S$4,000 to S$5,000.

The lessee will guarantee any fall in the truck's residual value below S$4,000 down to S$2,500. The lessor will bear the cost of any fall in the residual value below S$2,500.

How should this lease be classified?

- The lease should be classified as a finance lease.
- The sharing of the residual value risk is not even, because it is unlikely that the truck's residual value will fall below S$2,500.
- The risk retained by entity A is remote and should therefore be ignored. The residual value risk is, in substance, borne by entity B.

Accounting Treatment - General

Particulars	Finance lease	Operating Lease
Statement of financial position	▪ Derecognise the underlying asset ▪ Recognise a finance lease receivable at an amount equal to the net investment in the lease. ▪ The net investment present value of sum of (1) lease payments receivable by the lessor, and (2) any unguaranteed residual value accruing to the lessor discounted at the interest rate implicit in lease.	▪ Continue to present the underlying asset. ▪ Add any initial direct costs incurred in connection with obtaining the lease to the carrying amount of the underlying asset
Statement of profit or loss	▪ Recognise finance income on the receivable based on the effective interest method.	▪ Recognise lease income over the lease term, typically on a straight-line basis. ▪ Depreciation expense to be recognised related to the underlying asset

Accounting Treatment – manufacturer/dealer lessor

At the commencement date, a manufacturer or dealer lessor should recognise the following for each of its finance leases:

1. revenue, which is the fair value of the underlying asset, or, if lower, the present value of the lease payments accruing to the lessor, discounted using a market rate of interest;

2. the cost of sale, which is the cost (or carrying amount if different) of the underlying asset less the present value of the unguaranteed residual value; and

3. selling profit or loss (which is the difference between revenue and the cost of sale) in accordance with its policy for outright sales to which FRS 115 Revenue from Contracts with Customers applies.

Example- manufacturer/dealer lessor

- Entity A manufactures trucks. It offers customers a choice of either buying the trucks outright or of leasing them under a finance lease.
- Trucks cost S$25,000 to manufacture. If the trucks are purchased outright, they are sold for S$ 31,000.
- If a customer chooses to lease the trucks, they are leased for a period of 20 years at an annual rental of S$ 2,500 payable annually in advance.
- Entity A believes that the truck's residual value at the end of the 20-year lease term will be S$2,000.
- A market rate of interest on leases of this type is 8%.
- The present value of the minimum lease payments is S$26,509 and the present value of the residual is S$ 429.

Determine the accounting treatment lessor?

Example

Solution

Therefore, entity A will record sales revenue equal to the lower of the fair value of the asset (S$31,000) and the present value of the minimum lease payments (S$26,509). The cost of sales will be equal to the truck's carrying value (S$25,000) less the present value of the residual (S$429).

Therefore, on entering into the lease, entity A will make the following accounting entries:

Particulars	Amount
Lease receivable	26,509
Revenue	(26,509)
Cost of sales	24,570
Lease receivable	429
Inventory	(25,000)

Lessor accounting – Sub leases

A sub-lease is a transaction in which a lessee (or ‘intermediate lessor’) grants a right to use the underlying asset to a third party, and the lease (or ‘head lease’) between the original lessor and lessee remains in effect.

Head lessor → **Original lessee or intermediate lessor** → **Sub - lessee**

- An intermediate lessor classifies the sub-lease as a finance lease or as an operating lease with reference to the right-of-use asset arising from the head lease.
- However, if the head lease is a short term lease then intermediate lessor shall classify the sub lease as operating lease.

Case study

Head lease : Intermediate lessor B enters into a 5 year lease for 5,000 Sq. M. of office space (the head lease) with Company A (the head lessor).

Sub-lease : At the beginning of Year 3, B sub-leases the 5,000 Sq. M of office space for the remaining 3 years of the head lease to Sub-lessee C.

How would B account for such sub-lease?

Response:

- B 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 - B classifies it as a finance lease (assuming other conditions of finance lease are satisfied).

Sale and lease back

In a sale-and-leaseback transaction, two transactions are involved :

- **Sale of an asset -** An entity shall apply the requirements for determining when a performance obligation is satisfied in FRS 115 to determine whether the transfer of an asset is accounted for as a sale of that asset and
- **Leaseback of the same asset to the seller.**

Particulars	Lessee (seller)	Lessor (buyer)
Transfer is a sale	• Derecognise the underlying asset • Apply the lessee accounting model to the leaseback asset. • Measure the ROU asset at the retained portion of the previous carrying amount (i.e. at cost). • Recognise a gain or loss related to the rights transferred to the lessor	• Recognise the underlying asset • Apply the lessor accounting model to the leaseback asset.
Transfer is a not sale	• Continue to recognise the underlying asset • Recognise a financial liability under FRS 109 for any amount received from the buyer-lessor.	• Do not recognise the underlying asset. • Recognise a financial asset under FRS 109 for any amount paid to the seller lessee.

Sale and leaseback accounting

Example

- SellCo sells a building to BuyCo for cash of S$1,800,000, which is its fair value at that date the previous carrying value of the building is S$1,000,000
- At the same time, SellCo enters into a lease with BuyCo conveying back the right to use the building for 18 years
- Annual payments are S$120,000 payable at the end of each year, which is at market rate   the transfer qualifies as a sale based on the guidance on satisfying a performance obligation in FRS 115.
- the rate implicit in the lease is 4.5%

Sale and leaseback accounting

Analysis

(a) SellCo

present value of the annual payments

= S$1,459,200 (18 payments of S$120,000, discounted at 4.5%).

right-of-use asset retained through the leaseback

= S$1,000,000 x [S$1,459,200/S$1,800,000] = S$810,667

total gain on sale of building

= S$1,800,000 – S$1,000,000 = S$800,000

total gain on sale is split into:

the portion relating to the rights to use the building retained by SellCo

= S$800,000 x [S$1,459,200/S$1,800,000] = S$648,533

the portion relating to the rights retained in the underlying asset at the end of the leaseback by BuyCo

= S$800,000 x [(S$1,800,000 – S$1,459,200)/S$1,800,000] = S$151,467

Solution

Analysis (cont.)

At the commencement date, SellCo's accounting entries are:

	Dr. CU	Cr. CU
Cash	1,800,000	
Right-of-use asset	810,667	
Buildings		1,000,000
Gain on sale		151,467
Lease liability		1,459,200

(b) BuyCo

At the commencement date, BuyCo's accounting entries are:

	Dr. CU	Cr. CU
Building	1,800,000	
Cash		1,800,000

BuyCo classifies the lease as an operating lease taking into account, among other things, that the present value of the lease payments is 19% less than the fair value of the building. BuyCo accounts for the lease accordingly.

Transition impact

Mandatory date

1 Jan 2018

FRS 115

1 Jan 2019

FRS 116

Early adoption permitted if FRS 115 is applied before or on the same date

Transition overview

1. Identify population of contracts for transition (1)

- Decide whether to reassess the definition of a lease
- Decide whether to apply recognition exemptions

2. Decide transition method

Cumulative catch-up approach **OR** Full retrospective (FRS 8)

3. Identify population of contracts for transition (2)

- Decide whether to apply short-term transition practical expedient

4. Measure lease liability

Decide whether to apply PEs for:

- Portfolio discount rate
- Use of hindsight

5. Measure ROU asset

Decide whether to apply PEs for:

- ROU asset = lease liability
- Onerous leases
- Initial direct costs

Presentation

Presentation

Lessees are required to:

Balance sheet

- either present right-of-use assets separately from other assets on the balance sheet or disclose separately in the notes
- either present lease liabilities separately from other liabilities on the balance sheet or disclose separately in the notes

Income statement

- show interest expense on the lease liability separately from the depreciation charge for the right-of-use asset

Statement of cash flows

- present cash payments for the principal portion of the lease liability within financing activities
- present cash payments for the interest portion either within operating or financing activities in accordance with FRS 7

Presentation

For Lessors:

- largely the same as FRS 17's requirements
- in summary:
  - for finance leases the net investment is presented as a receivable in the balance sheet
  - assets subject to operating leases are presented according to the nature of the underlying asset

Tax treatment

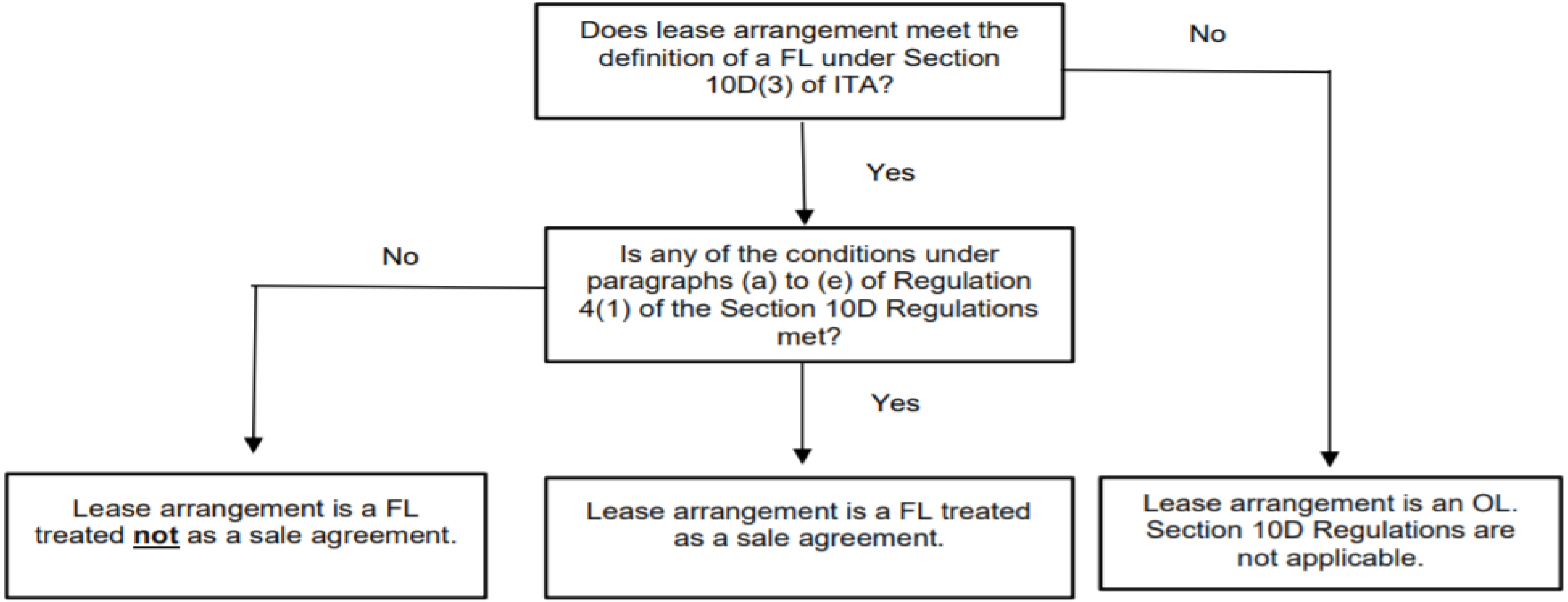
FRS 116 and tax treatment

- FRS 116
  - Concept of Finance Lease (FL) and Operating Lease (OL) not relevant
  - Based on the concept of the Right of Use (ROU)
- Tax treatment
  - Section 10D, Section 10D regulation and IRAS circular dated 8 October 2018
  - Lessor
    - Like the accounting standard treatment, largely no change
  - Lessee
    - To determine if lease arrangement giving rise to the ROU asset is a FL
    - If it is not a FL, it will be considered an OL
    - If FL, need to evaluate if it is a sale agreement or not

Tax treatment for Lessor

<table>
<tr><th colspan="2">Classification in accordance with the tax rules</th><th>Tax treatment</th></tr>
<tr><td colspan="2">Operating Lease</td><td>Taxable when lease income accrues
CA given if item qualifies for CA claims</td></tr>
<tr><td rowspan="2">Finance Lease treated as a sale agreement</td><td>No</td><td>Same as OL except
CA can be offsetted against income from FL only
Can offset against other income and/or transfer out only upon cessation of finance leasing activities</td></tr>
<tr><td>Yes</td><td>Taxable on interest income on an accrual basis
CA not allowed</td></tr>
</table>

Tax treatment for Lessee - classification of a lease arrangement under the Singapore tax rules



Tax treatment for Lessee – Section 10D(3)

“finance lease” means “a lease of plant or machinery which has the effect of **transferring substantially** the obsolescence, risks or rewards incidental to **ownership** of such plant or machinery to the lessee”

Tax treatment for Lessee – Regulation 4(1) of section 10D

Lease to treated as a sale if

- Lessee has the option to purchase the lease upon the expiry of the lease agreement; or
- Plant or machinery is a limited use asset; or
- Plant or machinery in a sale and lease back arrangement has been previously used by the lessee or any other person; or
- Additional conditions for related party transactions; or
- Lease is a leveraged asset.

Tax treatment for Lessee

Classification in accordance with the tax rules		Tax treatment
Operating Lease (one that is not a Finance Lease)		Contractual lease payment tax deductible No CA allowed
Finance Lease treated as a Sale	Yes	Claim interest and CA (if qualifying assets)
	No	Claim contractual lease payment Interest and depreciation charged to P/L to be added back No CA allowed

Withholding tax obligations

- Determined based on the legal characterisation of the payments (regardless of the accounting entries)
- Unless exempted, interest payment and rental of equipment payment made to non-resident person is subject to withholding tax
- Where the FL is treated as a sale under the tax regulations, the interest portion of the amount is subject to WHT
  - Where the interest payable is implicit from the lease agreement
  - Where the interest payable is NOT implicit from the lease agreement, to use incremental borrowing cost to compute PV of the lease payment and interest recognised in the book – that value will be subject to WHT
- Where the payment is an OL or a FL not treated as a sale, the entire amount is subject to WHT (unless exempted under domestic rules or DTA)
- Exemption of WHT for charter of ship only applies to OL
  - Does not cover FL not treated as a sales for any leasing of ship arrangement

Others

- Total Asset method to attribute interest expense
  - Not affected
  - As long as the asset is used wholly and exclusively in the production of income
- Transitional Tax adjustments
  - None as they are not required

Others

- Documentations to support tax deductions
  - Need to retain but no need to submit
  - Lessee will need to provide in its tax computation a reconciliation of the contractual lease payments and the expenses reflected in the profit and loss account
- GST treatment remains unchanged
  - Supply of goods if the possession of the goods is transferred under an agreement which expressly contemplates that the ownership will pass some time in the future
  - Supply of services if only possession of the goods is transferred without any provision for possible future ownership transfer

Thank you for your attention
Any questions?