



HKFRS 16 “Leases”

Introduction

HKFRS 16 “Leases” sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective of HKFRS 16 is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents leasing transactions. HKFRS 16 supersedes the following Standards and Interpretations:

HKAS 17 “Leases”;

HK(IFRIC) - Int 4 “Determining whether an Arrangement contains a Lease”;

HK(SIC) - Int 15 “Operating Leases - Incentives”; and

HK(SIC) - Int 27 “Evaluating the Substance of Transactions Involving the Legal Form of a Lease”.

The accounting model for leases in HKAS 17 requires lessees and lessors to classify their leases as either finance leases or operating leases and account for the two types of leases differently. This model has been criticised for failing to provide a faithful representation of leasing transactions. In particular, it does not require lessees to recognise assets and liabilities arising from operating leases.

HKFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases (with limited exceptions). A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

HKFRS 16 substantially carries forward the lessor accounting requirements in HKAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and account for the two types of leases differently.

Effective Date and Transitional Provision

HKFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply HKFRS 15 “Revenue from Contracts with Customers” at or before the date of initial application. The date of initial application is the beginning of the annual reporting period in which an entity first applies HKFRS 16.

An entity is not required to reassess whether a contract contains a lease at the date of initial application. It is permitted to apply HKFRS 16 to contracts that were previously identified as leases applying the transition requirements in paragraphs C5 to C18 of HKFRS 16 and not to apply HKFRS 16 to contracts that were not previously identified as leases.



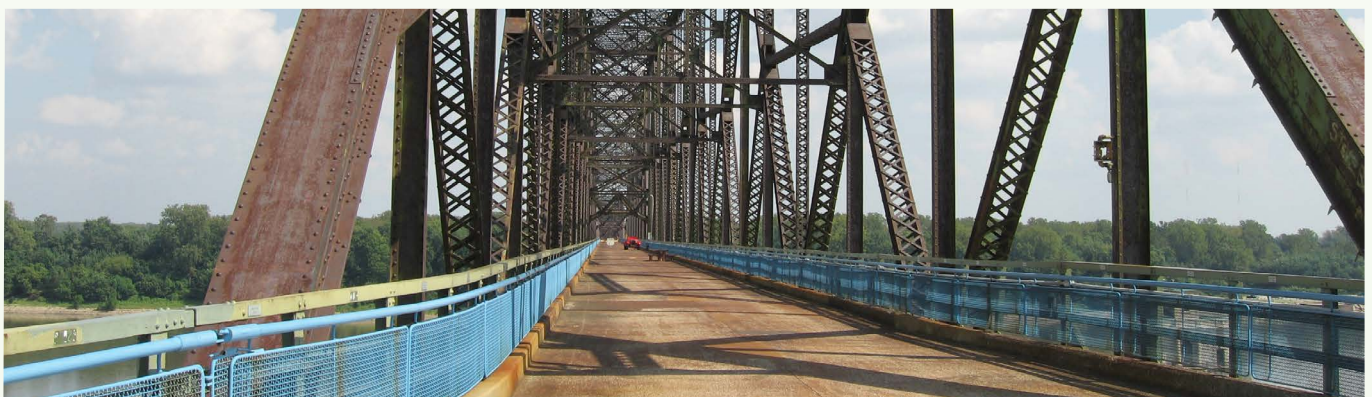
A lessee shall apply HKFRS 16 consistently to all of its leases either:

- ▶ retrospectively to each prior reporting period presented applying HKAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”; or
- ▶ retrospectively with the cumulative effect of initially applying HKFRS 16 recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application. Comparative information shall not be restated.

Scope

An entity shall apply HKFRS 16 to all leases, including leases of right-of-use assets in a sublease, except for:

- ▶ leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- ▶ leases of biological assets within the scope of HKAS 41 “Agriculture” held by a lessee;
- ▶ service concession arrangements within the scope of HK(IFRIC) - Int 12 “Service Concession Arrangements”;
- ▶ licences of intellectual property granted by a lessor within the scope of HKFRS 15; and
- ▶ rights held by a lessee under licensing agreements within the scope of HKAS 38 “Intangible Assets” for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights. A lessee may, but is not required to, apply HKFRS 16 to leases of other intangible assets.



Summary of Requirements of HKFRS 16

Portfolio application and combination of contracts

An entity may apply HKFRS 16 to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying HKFRS 16 to the portfolio would not differ materially from applying to the individual leases within that portfolio. An entity shall then use estimates and assumptions that reflect the size and composition of the portfolio.

An entity shall combine two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty), and account for the contracts as a single contract if one or more of the following criteria are met:

- ▶ the contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together.
- ▶ the amount of consideration to be paid in one contract depends on the price or performance of the other contract.
- ▶ the rights to use underlying assets conveyed in the contracts form a single lease component.



Identifying a lease

At inception of a contract, an entity shall assess whether the contract contains a lease. An entity shall reassess a contract only if the terms and conditions of the contract are changed.

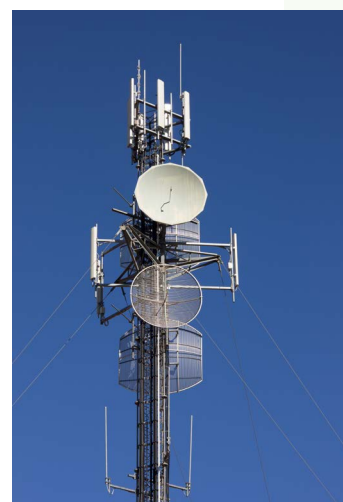
A contract contains a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration i.e. throughout the period of use, the customer has both of the following:

- ▶ the right to obtain substantially all of the economic benefits from use of the identified asset; and
- ▶ the right to direct the use of the identified asset.

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

- (a) the customer has the right to direct how and for what purpose the asset is used; or
- (b) the relevant decisions about how and for what purpose the asset is used are predetermined and:
 - i. the customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines), without the supplier having the right to change those operating instructions; or
 - ii. the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used.

A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).



Summary of Requirements of HKFRS 16

Separating components of a contract

An entity shall account for each lease component within a contract as a lease separately from non-lease components, unless the entity applies the practical expedient stated below. The right to use an underlying asset is a separate lease component if both:

- ▶ the lessee can benefit from use of the underlying asset either on its own or together with other resources readily available to the lessee; and
- ▶ the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components. The relative stand-alone price shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximising the use of observable information.

As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component except for embedded derivatives within the scope of HKFRS 9 “Financial Instruments”.

For a contract that contains a lease component and one or more additional lease or non-lease components, a lessor shall allocate the consideration in the contract applying paragraphs 73 to 90 of HKFRS 15 i.e. to allocate the transaction price to each performance obligation on a relative stand-alone selling price basis.



Lease term



The lease term is the non-cancellable period of a lease, together with both:

- ▶ periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- ▶ periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

In assessing whether a lessee is reasonably certain to exercise or not to exercise an option, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee. A lessee shall reassess whether it is reasonably certain to exercise or not to exercise an option upon the occurrence of either a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise or not to exercise an option.

Summary of Requirements of HKFRS 16

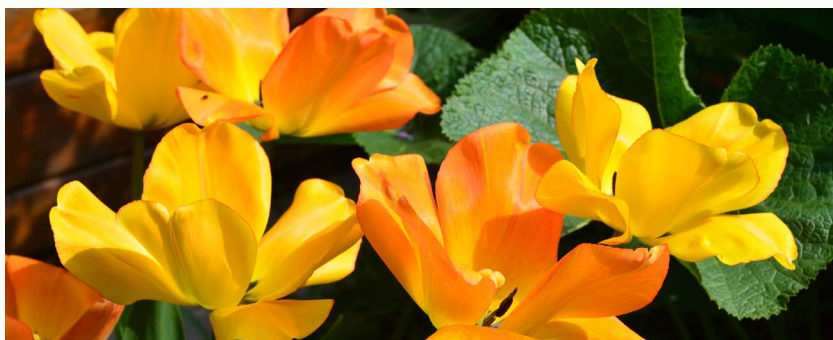
Lessee accounting

1 Right-of-use asset



At the commencement date, a lessee shall initially measure the right-of-use asset at cost comprising:

- ▶ the amount of the initial measurement of the lease liability;
- ▶ any lease payments made at or before the commencement date, less any lease incentives received;
- ▶ any initial direct costs incurred; and
- ▶ an estimate of costs to be incurred in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the lease.



A lessee shall subsequently measure the right-of-use asset applying the cost model unless the fair value/revaluation model is used. To apply the cost model, the right-of-use asset is measured at cost:

- ▶ less any accumulated depreciation and any accumulated impairment losses; and
- ▶ adjusted for any remeasurement of the lease liability.

If a lessee applies the fair value model in HKAS 40 “Investment Property” to its investment property, that fair value model shall also be applied to right-of-use assets that meet the definition of investment property in HKAS 40.

If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in HKAS 16 “Property, Plant and Equipment”, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.



Summary of Requirements of HKFRS 16

Lessee accounting

2 Lease liability

At the commencement date, a lessee shall initially measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, the lessee's incremental borrowing rate shall be used. The lease payments included in the measurement of the lease liability comprise the following payments:

- ▶ fixed payments (including in-substance fixed payments, i.e. payments that may, in form, contain variability but that, in substance, are unavoidable), less any lease incentives receivable;
- ▶ variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- ▶ amounts expected to be payable by the lessee under residual value guarantees;
- ▶ the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- ▶ payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.



A lessee shall subsequently measure the lease liability by:

- ▶ increasing the carrying amount to reflect interest on the lease liability;
- ▶ reducing the carrying amount to reflect the lease payments made; and
- ▶ remeasuring the carrying amount to reflect any reassessment or lease modifications, or to reflect revised in-substance fixed lease payments.

Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability.



Summary of Requirements of HKFRS 16

Lessee accounting

3 Reassessment of lease liability

A lessee shall remeasure the lease liability to reflect changes to the lease payments and recognise the remeasurement amount as an adjustment to the right-of-use asset. If the carrying amount of the right-of-use asset is zero, reduction in the measurement of the lease liability is recognised in profit or loss.

A lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate, for either:

- ▶ a change in the lease term; or
- ▶ a change in the assessment of an option to purchase the underlying asset.

The revised discount rate shall be the interest rate implicit in the lease for the remainder of the lease term. If that rate cannot be readily determined, the lessee's incremental borrowing rate at the date of reassessment shall be used.



A lessee shall remeasure the lease liability by discounting the revised lease payments using an unchanged discount rate, for either:

- ▶ a change in the amounts expected to be payable under a residual value guarantee; or
- ▶ a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review.

If the change in lease payments results from a change in floating interest rates, the lessee shall use a revised discount rate that reflects changes in the interest rate.



Summary of Requirements of HKFRS 16

Lessee accounting

4 Lease modifications



A lessee shall account for a lease modification as a separate lease if both:

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



For all other lease modifications, at the effective date of the lease modification a lessee shall:

- ▶ allocate the consideration in the modified contract on the basis of the relative stand-alone price of the components;
- ▶ determine the lease term of the modified lease; and
- ▶ remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate shall be the interest rate implicit in the lease for the remainder of the lease term. If that rate cannot be readily determined, the lessee's incremental borrowing rate at the effective date of the lease modification shall be used.



The lessee shall account for the remeasurement of the lease liability by:

- ▶ decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease that decrease the scope of the lease and recognise in profit or loss any resulting gain or loss; and
- ▶ making a corresponding adjustment to the right-of-use asset for all other cases.

Summary of Requirements of HKFRS 16

Lessee accounting

5 Recognition exemption

A lessee may elect not to apply the above lessee accounting requirements to:

- ▶ short-term leases; and
- ▶ leases for which the underlying asset is of low value.

A short term lease is a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

The assessment of whether an underlying asset is of low value is performed on an absolute basis and based on the value of the asset when it is new. The assessment is not affected by the size, nature or circumstances of the lessee. Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones. At the time of reaching decisions about the exemption, the IASB had in mind leases of underlying assets with a value, when new, in the order of magnitude of US\$5,000 or less.

An underlying asset can be of low value only if:

- ▶ the lessee can benefit from use of the underlying asset on its own or together with other resources readily available to the lessee; and
- ▶ the underlying asset is not highly dependent on, or highly interrelated with, other assets.

If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset.

When applying the recognition exemption, a lessee shall recognise the lease payments as an expense on either a straight-line basis over the lease term or another systematic basis. Another systematic basis is used if that basis is more representative of the pattern of the lessee's benefit. For short-term leases, the lessee shall consider the lease to be a new lease if:

- ▶ there is a lease modification; or
- ▶ there is any change in the lease term.

The election for short-term leases shall be made by class of underlying asset to which the right of use relates. The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.



Summary of Requirements of HKFRS 16

Lessee accounting

6 Presentation

A lessee shall either present in the statement of financial position, or disclose in the notes:

(a) right-of-use assets separately from other assets or:

- i. include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and
- ii. disclose which line items in the statement of financial position include those right-of-use assets.

(b) lease liabilities separately from other liabilities or disclose which line items in the statement of financial position include those liabilities.

Right-of-use assets that meet the definition of investment property shall be presented in the statement of financial position as investment property.

In the statement of profit or loss and other comprehensive income, a lessee shall present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset.

In the statement of cash flows, a lessee shall classify:

- ▶ cash payments for the principal portion of the lease liability within financing activities;
- ▶ cash payments for the interest portion of the lease liability applying the requirements in HKAS 7 “Statement of Cash Flows” for interest paid; and
- ▶ short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

7 Disclosure Requirements

For details of the disclosure requirements for lessees, please refer to paragraphs 51 to 60 of HKFRS 16.

Summary of Requirements of HKFRS 16

Lessor accounting

1 Lease classification

A lessor shall classify each lease as either an operating lease or a finance lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise, it is classified as an operating lease.

Lease classification is made at the inception date and is reassessed only if there is a lease modification.



Finance leases

At the commencement date, a lessor shall recognise assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the net investment in the lease. The lessor shall use the interest rate implicit in the lease to measure the net investment in the lease.

The lease payments included in the measurement of the net investment in the lease comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:

- ▶ fixed payments (including in-substance fixed payments), less any lease incentives payable;
- ▶ variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- ▶ any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;
- ▶ the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- ▶ payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

A lessor shall recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.

A lessor shall account for a modification to a finance lease as a separate lease if both:

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



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Summary of Requirements of HKFRS 16

Lessor accounting

For other modifications to a finance lease, a lessor shall account for the modification as follows:

- (a) if the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:
 - i. account for the lease modification as a new lease from the effective date of the modification; and
 - ii. measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
- (b) otherwise, the lessor shall apply the requirements of HKFRS 9.

3 Operating leases

A lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. Another systematic basis is used if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.

A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.



4 Disclosure Requirements

For details of the disclosure requirements for lessors, please refer to paragraphs 89 to 97 of HKFRS 16.



Summary of Requirements of HKFRS 16

Sale and leaseback transactions

If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:

- ▶ any below-market terms shall be accounted for as a prepayment of lease payments; and
- ▶ any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

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