

LEASES

MFRS 117

What is Lease?

An agreement whereby the lessor (owner of a particular asset) conveys to the lessee (the user) in return for a payment or series of payments the right to use an asset for an agreed period of time

Scope

MFRS 117 covers:

- Lease accounting in the books of the lessee and the lessor
- Accounting for finance lease
- Sales and leaseback transactions

Classifications

The main criteria - extent to which risks and rewards incident to ownership of the leased asset, lie with the lessor or the lessee

Finance Lease

- Lessee that transfers substantially all the risks and rewards incident to ownership of an asset
- Reflects the consolidation of substance over form
- Non-cancellable

Examples

- A lease contract to be taken at the end of the term
- A contract to purchase the asset at the end of the term
- A contract to purchase the asset at a price that is significantly below the fair value of the asset at the end of the term
- A contract to purchase the asset at a price that is significantly below the fair value of the asset at the end of the term

Operating Lease

- A lease that does not transfer substantially all the risks and rewards incident to ownership of an asset
- A lease that is cancellable
- A lease that is for a short period of time
- A lease that is for a long period of time

Definitions

- 1) **Lease payment** - a certain amount that need to be paid by lessee to lessor for the use of the asset
- 2) **Lease term** - non-cancellable period for which the lessee has contracted to lease the asset
- 3) **Commencement of lease term** - the date from which the lessee is entitled to exercise its right to use the leased asset
- 4) **Inception of lease** - the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease
- 5) **Minimum lease payment** - the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes.

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Finance Lease

- Lease that transfers substantially all the risks and rewards incidental to ownership of an asset
- Relies on the consideration of substance over form
- Non-cancellable

Examples

- 1) Transfer ownership to lessee at the end of the lease term
- 2) Lessee has option to purchase at price sufficiently lower than FV
- 3) Lease term is major part of the economic life
- 4) Present value of the minimum lease payments amount to at least substantially all of the FV
- 5) Leased asset are specialised nature that can be used without major modification