

# HKFRS 16 – Leases

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## MAIN FEATURES

- Hong Kong Financial Report Standard (“HKFRS”) 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer (“lessee”) and the supplier (“lessor”).
- For lessee accounting, HKFRS 16 introduces a single accounting model and requires lessee to recognise assets and liabilities for all leases, unless the lease term is within 12 months or for which the underlying asset is of low value.
- For lessor accounting, the accounting requirements are substantially the same as those in HKAS 17.
- HKFRS 16 supersedes Hong Kong Accounting Standard (“HKAS”) 17 and related Interpretations.
- Effective for annual periods beginning on or after 1 January 2019, with earlier application permitted provided that HKFRS 15 *Revenue from Contracts with Customers* has been applied.

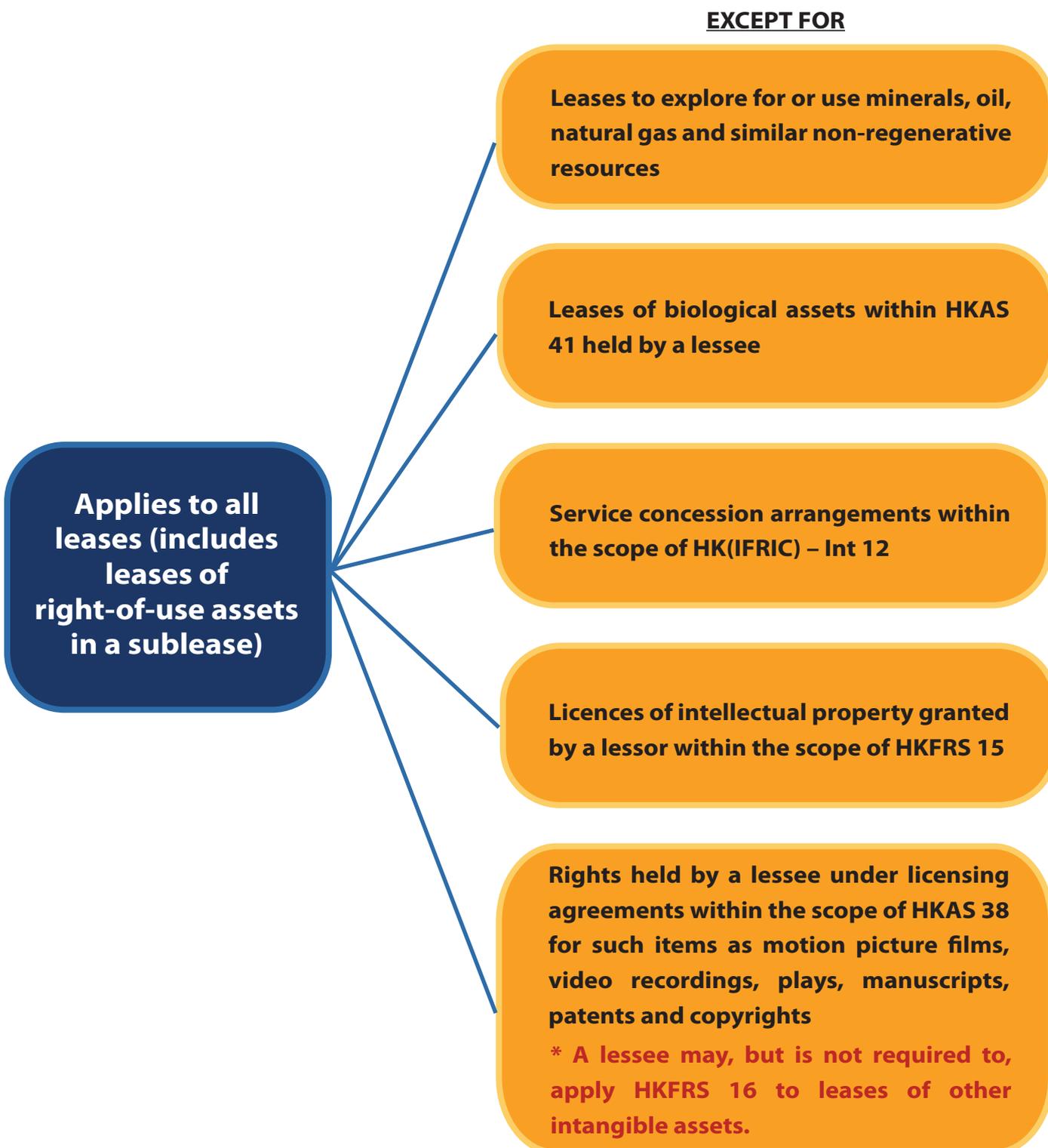
## Background

In January 2016, The International Accounting Standards Board has issued International Financial Reporting Standard 17 *Leases* in order to address the public concern on current accounting standards for leases, especially those relating to the lack of transparency of information about lease obligations.

Subsequently in May 2016, the Hong Kong Institute of Certified Public Accountants also issued the same standard, HKFRS 16 *Leases*, so as to maintain the convergence with International Financial Reporting Standards.

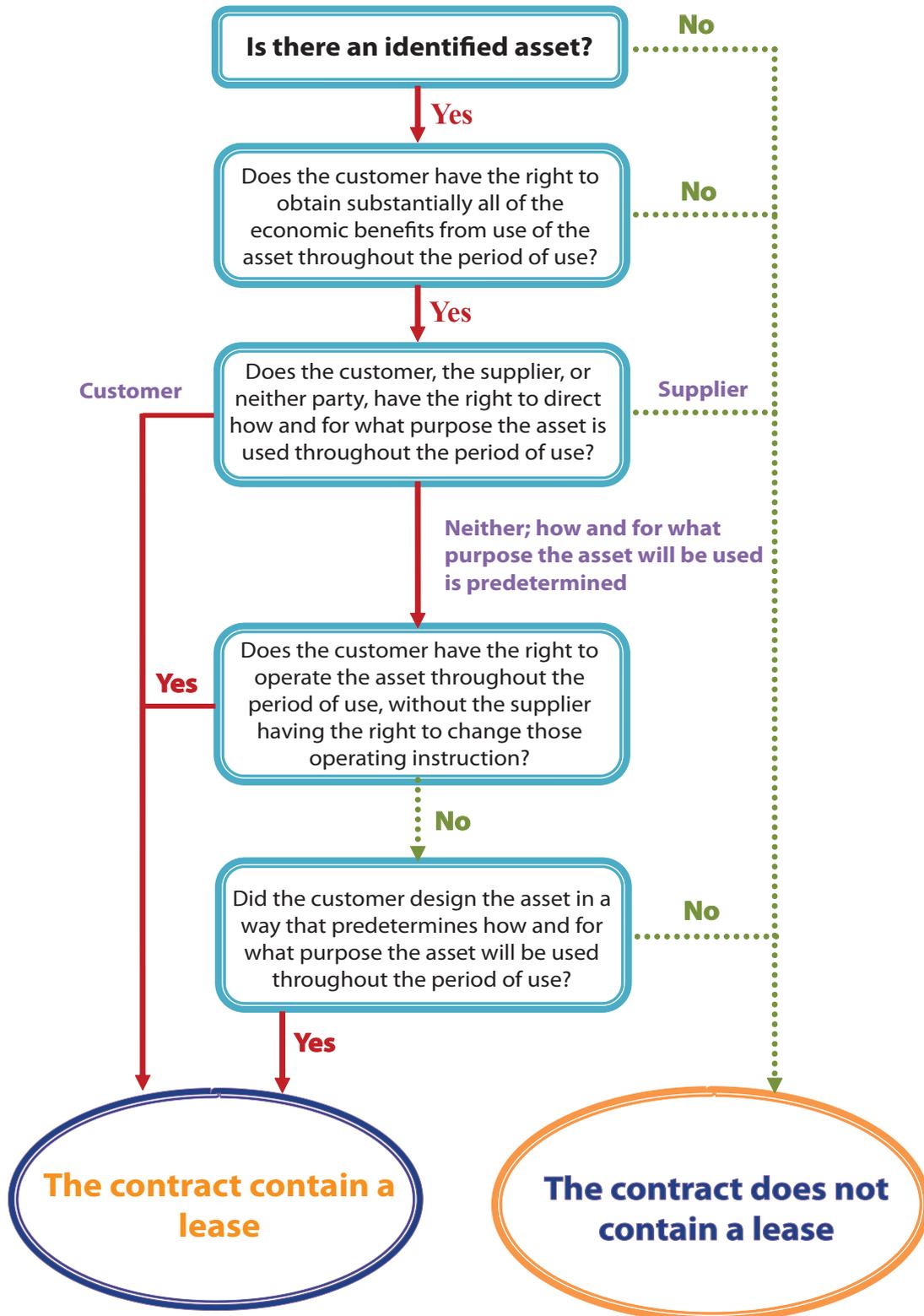
## Content of HKFRS 16

### (A) Scope



**(B) Determination of whether a contract contain a lease**

At the inception of a contract<sup>1</sup>, an entity shall assess whether the contract is, or contains, a lease.



<sup>1</sup> A contract is, or 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.

## (C) Recognition and Measurement

HKFRS 16 introduces a single accounting method for lessee accounting while it substantially carries forward the accounting requirements of HKAS 17 for **lessor accounting**, i.e. the entity has to determine whether the lease is a finance lease or operating lease for **lessor accounting**.

The following summarised the initial recognition and measurement for **lessee accounting**.

	<b>Lessee accounting</b>
<b>Initial recognition</b>	
<b>■ Right-of-use asset<sup>2</sup></b>	<ul style="list-style-type: none"><li>● at cost, in which it shall comprise:<ul style="list-style-type: none"><li>(a) the amount of the initial measurement of the lease liability;</li><li>(b) any lease payments made at or before the commencement date, less any lease incentives received;</li><li>(c) any initial direct costs incurred by the lessee; and</li><li>(d) an estimate of costs to be incurred by the lessee 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 terms and conditions of the lease, unless those costs are incurred to produce inventories.</li></ul></li></ul>
<b>■ Lease liability</b>	<ul style="list-style-type: none"><li>● at the present value of the lease payments that are not paid at the commencement date, which comprises:<ul style="list-style-type: none"><li>(a) fixed payments less any lease incentives receivables;</li><li>(b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;</li><li>(c) amounts expected to be payable by the lessee under residual value guarantees;</li><li>(d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and</li><li>(e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.</li></ul></li></ul>

<sup>2</sup> Right-of-use asset is an asset that represents a lessee's right to use an underlying asset for the lease term.

## Lessee accounting

<b>Subsequent measurement</b>	
<b>■ Right-of-use asset</b>	<ul style="list-style-type: none"><li>● Measure the right-of-use asset at cost less any accumulated depreciation and any impairment loss and adjusted for any remeasurement of the lease liability</li><li>● Apply HKAS 36 for determination of impairment on right-of-use asset and to account for any impairment loss identified</li><li>● If a lessee applies fair value model in HKAS 40 to its investment property, the lessee should also apply that fair value model to right-of-use assets that meet the definition of investment property in HKAS 40</li><li>● If the right-of-use assets relate to a class of property, plant and equipment to which the lessee applies revaluation model in HKAS 16, 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</li></ul>
<b>■ Lease liability</b>	<ul style="list-style-type: none"><li>● 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 modification or to reflect revised in-substance fixed lease payments<sup>3</sup></li></ul>
<b>■ Effect on profit or loss</b>	<ul style="list-style-type: none"><li>● Recognise depreciation or impairment loss (if any) for the right-of use asset</li><li>● Recognise interest arising on the lease liability</li><li>● Recognise variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs</li></ul>

Besides, HKFRS 16 provides recognition exemption to either short-term leases or leases for which the underlying asset is of low value. In such cases, the lessees should recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis.

<sup>3</sup>

In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable.

### Reassessment of lease liability

For **lessee accounting**, a lessee should remeasure the lease liability when there is a change in:

- the lease term;
- the assessment of an option to purchase the underlying asset;
- the amounts expected to be payable under a residual value guarantee; or
- future lease payments resulting from a change in an index or a rate used to determine those payments.

In such cases, a lessee should recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. If the carrying amount of the right-of-use asset is reduced to zero and there is a further deduction in the measurement of the lease liability, a lessee should recognise any remaining amount of the remeasurement in profit or loss.

### **(D) Presentation**

The presentation for **lessor accounting** is similar to those in HKAS 17. The presentation requirements for **lessee accounting** is summarised as below:

	<b>Items</b>
<b>Statement of financial position or in the notes</b>	<ul style="list-style-type: none"><li>• Present right-of-use assets separately from other assets</li><li>• If right-of-use assets are not separately presented in statement of financial position, the lessee should 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 disclose which line items in the statement of financial position include those right-of-use assets</li><li>• If the right-of-use assets meet the definition of investment property, that right-of-use assets should be presented as “investment property” in the statement of financial position</li><li>• Present lease liabilities separately from other liabilities</li><li>• If lease liabilities are not separately presented in the statement of financial position, the lessee should disclose which line items in the statement of financial position include those liabilities</li></ul>
<b>Statement of profit or loss and other comprehensive income</b>	<ul style="list-style-type: none"><li>• Present interest expense on the lease liability separately from the depreciation charges for the right-of-use asset</li><li>• Interest expense on the lease liability is a component of finance cost</li></ul>

### Statement of cash flows

- Classify cash payments for principal portion of the lease liability within financing activities
- Classify cash payments for the interest portion of the lease liability applying the requirements in HKAS 7 for interest paid
- Classify 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



## (E) Disclosure

For **lessee accounting**, lessees are required to apply judgment in deciding upon the information to disclose to meet the objective of providing 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 lessee.

**For lessee accounting, a lessee shall include but not limited to the following disclosures in the financial statements for the reporting period:**

- Depreciation charges for right-of-use assets by class of underlying asset\*;
- Interest expense on lease liabilities\*;
- The expense relating to short-term leases that are accounted for under recognition exemption, excluding the expense relating to leases within a lease term of one month or less\*;
- The expense relating to leases of low-value assets that are accounted for under recognition exemption, excluding the expense relating to short-term leases of low-value assets that are accounted for under recognition exemption\*;
- The expense relating to variable lease payments not included in the measurement of lease liabilities\*;
- Income from subleasing of right-of-use assets\*;
- Total cash outflow for leases\*;
- Additions to right-of-use assets\*;
- Gains or losses arising from sale and leaseback transactions\*;
- The carrying amount of right-of-use assets at the end of the report period by class of underlying asset\*; and
- A maturity analysis of lease liabilities in accordance with HKFRS 7 separately from the maturity analysis of other financial liabilities.

For **lessor accounting**, lessors are required to provide enhanced disclosures that would improve the information disclosed about a lessor's risk exposure, particularly to residual value risk.

**For lessor accounting, a lessor shall include but not limited to the following disclosures in the financial statements for the reporting period:**

**Finance leases:**

- **Selling profit or loss\***;
- **Finance income on the net investment in the lease\***; and
- **Income relating to variable lease payments not included in the measurement of the net investment in the lease\***.

**Operating leases:**

- **Lease income\***, separately disclosing income relating to variable lease payments that do not depend on an index or a rate.

\* That information should be presented in tabular form.

## **Accounting standards superseded by HKFRS 16**

Once HKFRS 16 becomes effective, the following accounting standards and interpretations (“Int”) will be superseded:

- 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*.

## **Effective Date**

HKFRS 16 becomes effective for annual 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 of HKFRS 16. If an entity applies HKFRS 16 for an earlier period, it shall disclose that fact.

# Contact us

## HONG KONG

43/F., Lee Garden One,  
33 Hysan Avenue,  
Causeway Bay, Hong Kong  
Tel: (852) 3583 3800  
Fax: (852) 3583 8001  
Email: info@shinewing.hk  
Website: www.shinewing.hk

## CHENGDU

8/F, Block B, Avic Int Financial Centre,  
No.88, High-tech district, Chengdu, Sichuan,  
PRC (Postal Code: 610051)  
Tel: (86) 28 6299 1888  
Fax: (86) 28 6292 2666

## TIANJIN

21/F, Xinda Plaza, No.188, Jiefang Road,  
Heping District, Tianjin, PRC  
(Postal Code: 300042)  
Tel: (86) 22 5829 6288  
Fax: (86) 22 5829 6299

## CHANGCHUN

7/F, Building 7, Wanhao International Business  
Plaza, No.9399, People Street, Changchun,  
Jilin, PRC (Postal Code: 130022)  
Tel: (86) 431 8133 2000  
Fax: (86) 431 8133 2111

## DALIAN

15/F, Block B, Karen International Mansion,  
No.1-1 Section A Wucai Town,  
Dalian Development Area, Liaoning,  
PRC (Postal Code: 116600)  
Tel: (86) 0411 8762 6818  
Fax: (86) 0411 8762 6307

## FUZHOU

13/F, Block A, Hongli Mansion, No.168,  
Hudong Road, Fuzhou, 350003,  
PRC (Postal Code: 350003)  
Tel: (86) 0591 2830 9955  
Fax: (86) 0591 2830 9000

## WUHAN

Room 2701-2709, 27/F, Block 4, Xingguang  
Wuxian Building (Guanggu Yinzu), No.727  
Luoyu Road, Donghu New Technology  
Development Zone, Wuhan, Hubei, PRC  
(Postal Code: 430071)  
Tel: (86) 027 5975 9900  
Fax: (86) 027 5975 9922

## CHONGQING

26/F, Qibo Building, No.99 Jinyu Avenue,  
Northern New District, Chongqing, PRC  
(Postal Code: 401122)  
Tel: (86) 23 8911 2588  
Fax: (86) 23 8911 2599

## MELBOURNE

Level 10, 530 Collins Street, Melbourne,  
Victoria 3000, Australia  
Tel: (61) 3 8635 1800  
Fax: (61) 3 8102 3400

## BEIJING

9/F, Block A, Fu Hua Mansion  
No.8 Chaoyang Men Beidajie,  
Dongcheng District, Beijing,  
PRC (Postal Code: 100027)  
Tel: (86) 10 6554 2288  
Fax: (86) 10 6554 7190

## SHANGHAI

32/F, China Development Bank Tower,  
No.500, Pudong South Road, Pudong New Area,  
Shanghai, PRC (Postal Code: 200120)  
Tel: (86) 21 6164 3939  
Fax: (86) 21 6164 3900

## QINGDAO

27/F, HuaYin Mansion, No.5,  
Donghai Road(west), Shinan District, Qingdao,  
PRC (Postal Code: 266071)  
Tel: (86) 532 8089 5858  
Fax: (86) 532 8089 5959

## YINCHUAN

11/F, Investment Plaza, No.65,  
Hubin Street(west), Xingqing District,  
Yinchuan, Nixia, PRC (Postal Code: 750001)  
Tel: (86) 951 671 8800  
Fax: (86) 951 672 1553

## KUNMING

9-10/F, Ruyi Plaza, No.36, Middle People Road,  
Kunming, Yunnan, PRC  
(Postal Code: 650021)  
Tel: (86) 871 6815 9955  
Fax: (86) 871 6364 6916

## NANJING

7/F, Hetai International Mansions, No. 128,  
Shanxi Road, Nanjing, Jiangsu, PRC  
(Postal Code: 210009)  
Tel: (86) 025 5280 8866  
Fax: (86) 025 8371 6000

## HANGZHOU

Room 702, Wangjiang Internatioal Center,  
Shangcheng District, Hangzhou, Zhejiang, PRC  
(Postal Code: 310008)  
Tel: (86) 0571 2689 7676  
Fax: (86) 0571 2689 7636

## NANNING

17/F, Tian Jian Business Building, No.8 Zhong  
Tai Road, Nanning, Guangxi, PRC  
(Postal Code: 530029)  
Tel: (86) 771 5086 363  
Fax: (86) 771 5086 880

## SYDNEY

Level 8, 167 Macquarie Street,  
Sydney, NSW 2000, Australia  
Tel: (61) 2 8059 6800  
Fax: (61) 2 8059 6899

## SHENZHEN

10/F, Block A, United Plaza, Binhe Road,  
Futian District, Shenzhen,  
PRC (Postal Code: 518033)  
Tel: (86) 755 8290 0800  
Fax: (86) 755 8290 0815

## XI'AN

16/F, Block C, Fortune Center, No.180,  
Western section of the second ring road,  
Xi'an, PRC (Postal Code: 710075)  
Tel: (86) 29 6335 8888  
Fax: (86) 29 6335 8899

## CHANGSHA

26/F, Block C1, Kai Fu Wanda Plaza, No.598,  
Zhongshan Road, Changsha, Hunan, PRC  
(Postal Code: 410005)  
Tel: (86) 731 8828 5566  
Fax: (86) 731 8828 5567

## JINAN

6/F Huate Plaza, No.17703 Jingshi Road, Lixia  
District, Jinan, PRC (Postal Code: 250012)  
Tel: (86) 531 8925 9000  
Fax: (86) 531 8925 9099

## GUANGZHOU

Floor 39, Guangzhou International Trade Center  
Building, No.1 Lin He Road (west), Tianhe  
District, Guangzhou, PRC (Postal Code: 510620)  
Tel: (86) 020 2830 9500  
Fax: (86) 020 2830 9530

## URUMQI

13/F, Hongshan New Century Building, No. 8, Xin  
Hua North Road, Urumuqi, Xinjiang, PRC  
(Postal Code: 830002)  
Tel: (86) 0991 6516 688  
Fax: (86) 0991 6787 779

## TAIYUAN

Room 1103/1105, Fortune Building, No.98  
Southern Inner Ring Street, Taiyuan, Shanxi, PRC  
(Postal Code: 030012)  
Tel: (86) 0351 7899 187  
Fax: (86) 0351 7899 023

## HEFEI

12/F, Block B, AHCOF Dong Yi Financial Plaza,  
No.169 Funan Road, Luyang District, Hefei,  
Anhui, PRC (Postal Code: 230001)  
Tel: (86) 551 6492 1166  
Fax: (86) 551 6492 1111

## BRISBANE

Riverside Centre, Suite 1853, Level 18, 123  
Eagle Street, Brisbane, QLD 4000, Australia  
Tel: (61) 7 3085 0888

**LAHORE**

HM House, 7 Bank Square, Off The  
Mall, Lahore  
Tel: (92) 42 3723 5084 87  
Fax: (92) 42 3723 5083

**KARACHI**

5th Floor, Karachi Chambers, Hasrat Mohani  
Road, Karachi  
Tel: (92) 21 32411474, 32412754  
Fax: (92) 21 32424835

**EGYPT**

21 Mahmoud Bassiouny, Talaat Harb  
Square, Cairo, Egypt  
Tel: (202) 2578 2775  
Fax: (202) 2578 2776

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