DIGITAL CFO SOLUTIONS • IFRS SERIES

ACTIVE STANDARD

INTERNATIONAL FINANCIAL REPORTING STANDARDS

IFRS 16 — Leases

Nearly every lease comes onto the lessee's balance sheet — how the right-of-use asset and lease liability are built, carried, and eventually released

BD

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PART I — OBJECTIVE, SCOPE & IDENTIFYING A LEASE

One Balance Sheet, Almost Every Lease

IFRS 16 requires lessees to bring nearly all leases onto the balance sheet — a right-of-use asset paired with a lease liability.

Objective

To ensure that lessees and lessors provide relevant information that faithfully represents lease transactions — giving users a basis to assess the effect of leases on financial position, financial performance, and cash flows.

Scope & Exclusions

IFRS 16 applies to all leases, including leases of right-of-use assets in a sublease — except for the following, which are scoped out:

Exploration Rights

Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources

Biological Assets

Leases of biological assets held by a lessee, within the scope of IAS 41 Agriculture

Service Concessions

Service concession arrangements within the scope of IFRIC 12

IP Licences

Licences of intellectual property granted by a lessor, and rights held under licensing agreements within IAS 38 — e.g. films, manuscripts, patents, copyrights

Identifying a Lease

A contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

This assessment is made at inception of the contract — for both the customer and the supplier — and revisited only if the terms and conditions of the contract are changed.

Recognition Exemptions

1

Short-Term Leases

Lease term of 12 months or less at the commencement date, and containing no purchase option

2

Low-Value Assets

The underlying asset is of low value when new — commonly illustrated with items such as tablets, small office furniture, and telephones (the IASB's basis for conclusions references roughly US$5,000 or less as new)

If exempted, the lessee recognises the lease payments as an expense — either on a straight-line basis over the lease term, or another systematic basis if more representative.

PART II — LESSEE ACCOUNTING: INITIAL MEASUREMENT

Building the Right-of-Use Asset & Liability

At commencement, the lessee recognises a right-of-use asset and a matching lease liability — each built from a defined set of components.

Lessee Accounting — Overview

Right-of-Use Asset

1. Initial measurement: at cost
2. Subsequent: cost model (less depreciation & impairment), or revaluation model if elected for that PP&E class
3. Presented separately from other assets

Lease Liability

1. Initial measurement: at present value of future lease payments
2. Subsequent: carrying amount + interest − payments made, remeasured for reassessments
3. Presented separately from other liabilities

Statement of Profit or Loss presents interest expense on the lease liability separately from the depreciation charge on the right-of-use asset.

Right-of-Use Asset

The cost of the right-of-use asset comprises four components:

1

Initial Lease Liability

The amount of the initial measurement of the lease liability

2

Upfront Payments

Lease payments made at or before commencement, less any lease incentives received

3

Initial Direct Costs

Incremental costs of obtaining the lease that would not have been incurred otherwise

4

Dismantling & Restoration

Estimated costs of dismantling, removing, or restoring the asset or site, per the lease terms

Lease Liability & the Discount Rate

Measured at the present value of lease payments not yet paid, discounted using the interest rate implicit in the lease — or, if that cannot be readily determined, the lessee's incremental borrowing rate.

1. Fixed payments (including in-substance fixed payments), less lease incentives receivable
2. Variable payments linked to an index or rate, measured using its value at commencement
3. Amounts expected under residual value guarantees
4. The exercise price of a purchase option, if reasonably certain to be exercised
5. Penalties for terminating the lease, if the lease term reflects that option being exercised

Illustration — Initial Measurement

SCENARIO

Meridian Retail Ltd leases a warehouse for 5 years, $50,000 payable annually in arrears, incremental borrowing rate 6%. Initial direct costs $5,000; estimated dismantling costs (PV) $8,000. No purchase option or incentives.

Lease Liability	$
PV of 5 yrs × $50,000 @ 6%	210,618
Lease liability at commencement	**210,618**

Right-of-Use Asset	$
Initial lease liability	210,618
Initial direct costs	5,000
Dismantling & restoration costs	8,000
Total cost of ROU asset	**223,618**

Straight-line depreciation (no ownership transfer/purchase option) = $223,618 ÷ 5 years = $44,724 per year.

PART III — LESSEE ACCOUNTING: SUBSEQUENT MEASUREMENT

Carrying the Balances Forward

After commencement, the right-of-use asset depreciates while the lease liability unwinds at a constant rate of interest — and both respond to reassessments and modifications.

Right-of-Use Asset

1

Cost Model (Default)

Cost, less accumulated depreciation and impairment losses, adjusted for any lease liability remeasurement

2

Depreciation Period

To the end of the underlying asset's useful life if ownership transfers or a purchase option is expected to be exercised; otherwise to the earlier of the ROU asset's useful life or the end of the lease term

3

Impairment & Revaluation

IAS 36 applies for impairment testing. If the lessee applies the IAS 16 revaluation model to that class of PP&E, it may elect to apply it to related right-of-use assets too

Lease Liability

How the Balance Moves

1. Increase for interest on the lease liability
2. Decrease for lease payments made
3. Remeasure for reassessments, modifications, or revised in-substance fixed payments

Interest & P&L Treatment

1. Interest is charged at a constant periodic rate on the remaining balance — the discount rate used at initial (or revised) measurement
2. Interest expense and any variable payments not in the liability are both recognised in profit or loss as they arise

Illustration — Lease Liability Amortisation

Meridian Retail Ltd — 5-year warehouse lease, $50,000 p.a. in arrears, 6% discount rate

Year	Opening Liability	Interest @ 6%	Payment	Closing Liability
1	210,618	12,637	(50,000)	**173,255**
2	173,255	10,395	(50,000)	**133,650**
3	133,650	8,019	(50,000)	**91,669**
4	91,669	5,500	(50,000)	**47,169**
5	47,169	2,831	(50,000)	**0**

Total interest over the term ($39,382) plus total liability reduction ($210,618) equals total cash paid ($250,000). Depreciation is separately charged at $44,724 p.a. on the right-of-use asset — the two are never blended in the P&L.

Reassessment & Lease Modifications

Reassessment

1. Triggered by a change in the lease term, a revised assessment of a purchase option, or a change in expected residual value guarantee amounts
2. Also triggered by changes in index/rate-linked payments
3. Remeasure the liability and adjust the right-of-use asset by the same amount (or through profit or loss if the asset is already reduced to zero)

Modification

1. A change in scope or consideration not part of the original terms
2. If it increases scope at a price commensurate with the stand-alone price — account for as a separate new lease
3. Otherwise, remeasure the liability using a revised discount rate; decreases in scope also trigger a gain/loss on the proportionate ROU asset reduction

PART IV — LESSEE PRESENTATION & DISCLOSURE

Making the Balances Visible

Where the right-of-use asset and lease liability sit in the financial statements, and what a lessee must disclose about them.

Presentation

Statement of Financial Position

Right-of-use assets presented separately from other assets; lease liabilities separately from other liabilities (or, if not, disclosed within the relevant line items in the notes). ROU assets meeting the definition of investment property are presented as investment property instead.

Statement of Profit or Loss

Interest expense on the lease liability is presented separately from the depreciation charge on the right-of-use asset — interest expense forms part of finance costs.

Statement of Cash Flows

Principal repayments within financing activities; interest paid within financing (or operating, per the entity's IAS 7 policy); short-term, low-value and unincluded variable lease payments within operating activities.

Disclosure Requirements — Lessee

1. Depreciation charge for right-of-use assets, by class of underlying asset
2. Interest expense on lease liabilities
3. Expense relating to short-term leases (excluding leases of one month or less)
4. Expense relating to leases of low-value assets
5. Expense relating to variable lease payments not included in the lease liability
6. Income from subleasing right-of-use assets
7. Total cash outflow for leases, and additions to right-of-use assets
8. Gains or losses from sale and leaseback transactions, and carrying amount of ROU assets by class at period end

PART V — LESSOR ACCOUNTING

The Other Side of the Lease

A lessor first classifies each lease as finance or operating — and that single judgement determines everything that follows.

Classification of Leases — Finance vs Operating

A lease is classified as a finance lease if it transfers substantially all the risks and rewards of ownership; otherwise it is an operating lease. Indicators that would normally lead to a finance lease classification include:

1. Ownership of the asset transfers to the lessee by the end of the lease term
2. The lessee has a purchase option at a price expected to be sufficiently lower than fair value, and is reasonably certain to exercise it
3. The lease term is for the major part of the asset's economic life, even if title doesn't transfer
4. At inception, the present value of lease payments amounts to substantially all of the asset's fair value
5. The underlying asset is so specialised that only the lessee can use it without major modification
6. If the lessee can cancel the lease, the lessor's losses on cancellation are borne by the lessee
7. Gains or losses from residual value fluctuations accrue to the lessee
8. The lessee can extend the lease for a secondary period at a rent substantially lower than market rent

Lessor Accounting — Overview

Finance Lease

1. Recognise a receivable at the net investment in the lease
2. Recognise finance income over the term at a constant periodic rate of return
3. Manufacturer/dealer lessors also recognise selling profit or loss at commencement

Operating Lease

1. Continue to present the underlying asset in the balance sheet, per its nature
2. Recognise lease income on a straight-line basis, or another systematic basis if more representative
3. Depreciate the underlying asset consistently with similar owned assets

Recognition & Initial Measurement

A lessor recognises assets held under a finance lease as a receivable, at an amount equal to the net investment in the lease.

The net investment comprises the lease payments not yet received, being:

1. Fixed payments, less lease incentives payable
2. Variable payments linked to an index or rate
3. Residual value guarantees from the lessee or a financially capable third party
4. The exercise price of a purchase option reasonably certain to be exercised
5. Penalties for terminating the lease, where relevant

Manufacturer or Dealer Lessors

1

Revenue

The fair value of the underlying asset, or if lower, the present value of the lease payments accruing to the lessor, discounted at a market rate of interest

2

Cost of Sale

The cost (or carrying amount, if different) of the underlying asset, less the present value of the unguaranteed residual value

3

Selling Profit or Loss

Revenue less cost of sale, recognised at the commencement date — following the entity's policy for outright sales under IFRS 15

Subsequent Measurement

%

A lessor recognises 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.

Recognition, Measurement & Presentation

1 Recognition & Measurement

Lease payments are recognised as income on a straight-line basis, unless another systematic basis better represents the pattern in which benefit from the underlying asset is diminished.

2 Presentation

The lessor presents the underlying asset subject to the operating lease in its balance sheet according to the asset's nature — e.g. within property, plant & equipment.

Disclosure Requirements — Lessor

For Finance Leases

1. Selling profit or loss
2. Finance income on the net investment in the lease
3. Income relating to variable lease payments not included in the net investment

For Operating Leases

1. Lease income for the period
2. Separately disclosing income from variable lease payments that do not depend on an index or rate

PART VI — SALE & LEASEBACK

Selling an Asset You Still Use

When a seller-lessee sells an asset and immediately leases it back, the accounting hinges on a single question: does the transfer qualify as a sale?

Is the Transfer a Sale?

Both the seller-lessee and buyer-lessor account for the transfer and the leaseback by first applying IFRS 15 to determine whether the transfer of the asset satisfies the requirements to be accounted for as a sale.

1 **If Consideration Is Off-Market**

Any below-market terms are accounted for as a prepayment of lease payments; any above-market terms are accounted for as additional financing from the buyer-lessor to the seller-lessee.

2 **Sale Proceeds Are Adjusted to Fair Value**

This ensures the accounting reflects the economics of the transaction, not just the contractually stated price — a common feature of sale and leaseback arrangements.

Accounting Treatment — Sale vs Not a Sale

If the Transfer IS a Sale

1. Seller-lessee measures the right-of-use asset as the proportion of the previous carrying amount relating to the right of use retained
2. Only the gain or loss relating to the rights transferred to the buyer-lessor is recognised
3. Buyer-lessor accounts for the purchase applying the relevant Standards, and the lease as a lessor under IFRS 16

If the Transfer Is NOT a Sale

1. Seller-lessee continues to recognise the transferred asset, and recognises a financial liability equal to the transfer proceeds, accounted for under IFRS 9
2. Buyer-lessor does not recognise the transferred asset, and instead recognises a financial asset equal to the transfer proceeds under IFRS 9

THANK YOU

IFRS 16 — Leases

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A Career Built on Making IFRS Understandable

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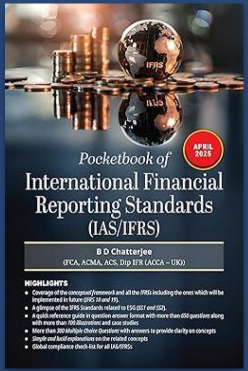

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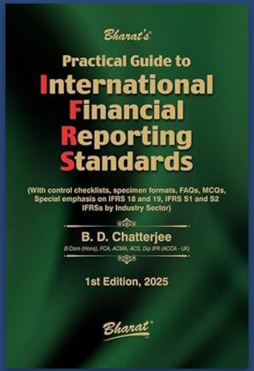

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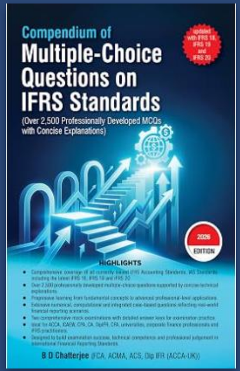

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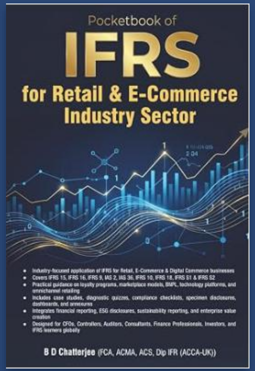

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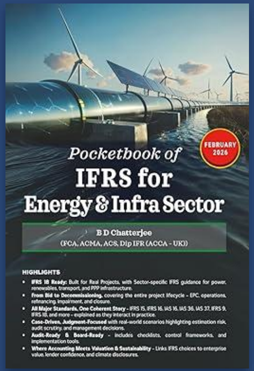

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