

HKFRS 16 – Leases

Newsletter – Issue No. 01/2016

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.

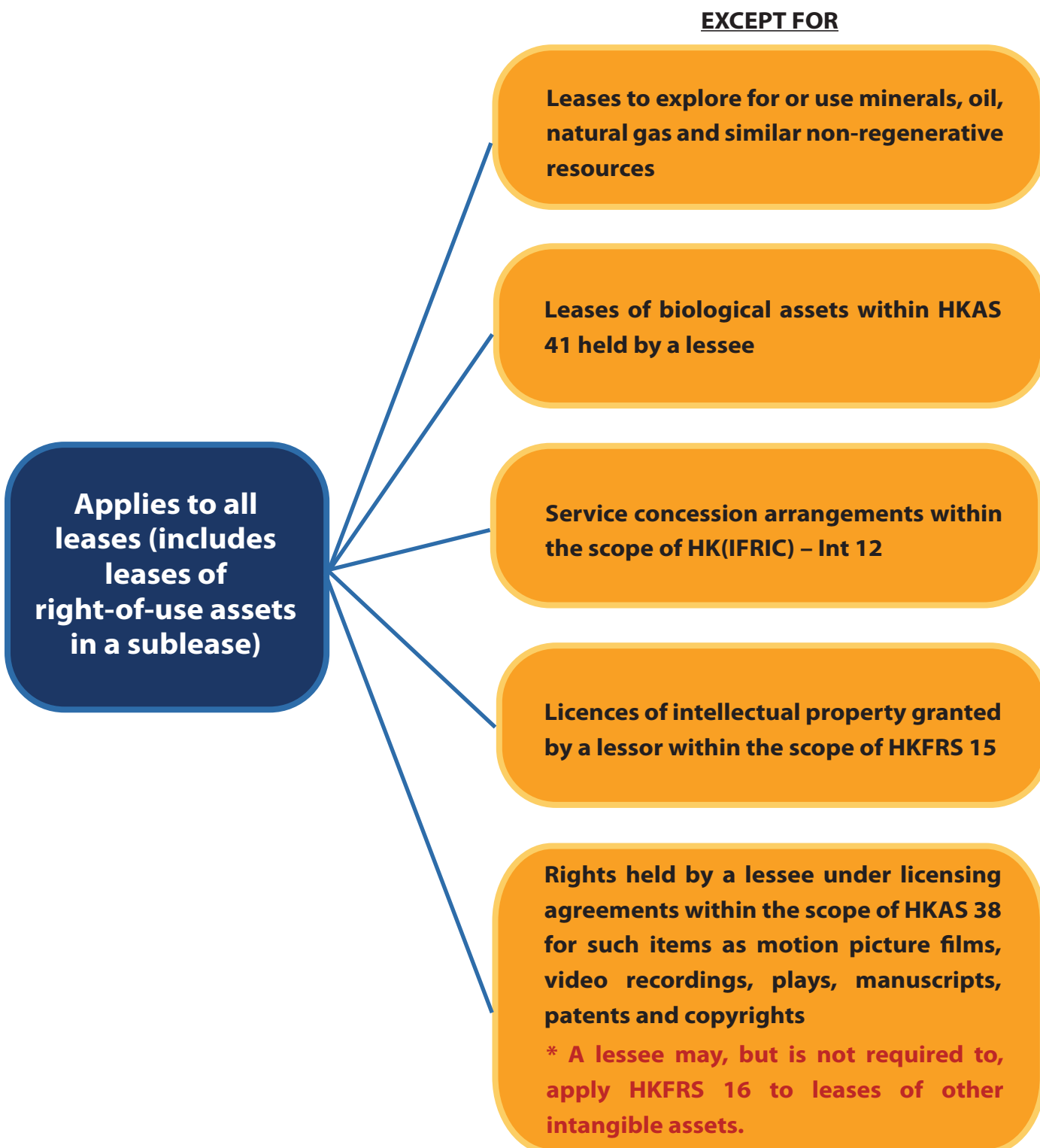
Background

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.

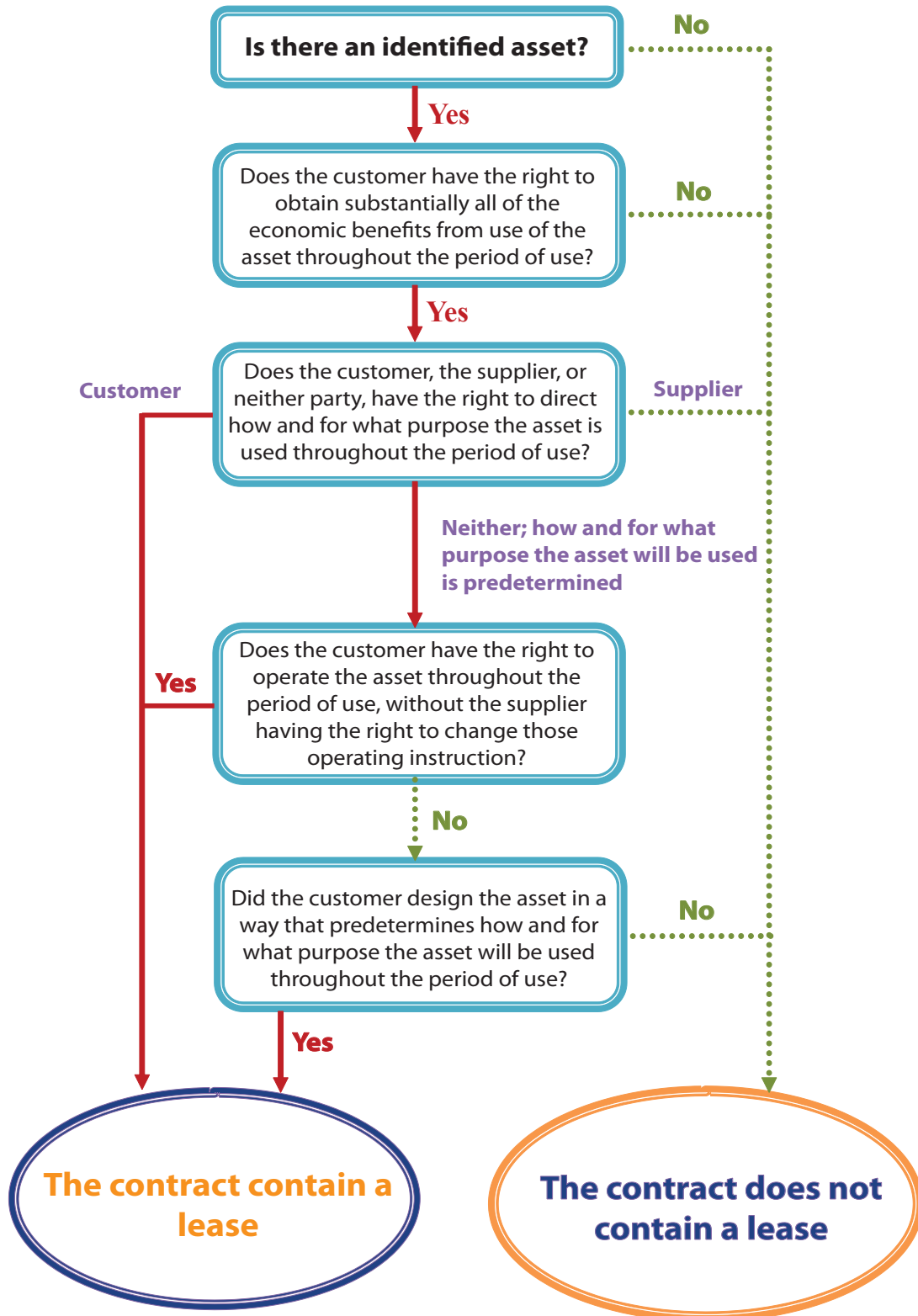
Content of HKFRS 16

(A) Scope



(B) Determination of whether a contract contain a lease

At the inception of a contract¹, an entity shall assess whether the contract is, or contains, a lease.



¹ 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**.

	Lessee accounting
Initial recognition	
■ Right-of-use asset²	<ul style="list-style-type: none">● at cost, in which it shall comprise:<ul style="list-style-type: none">(a) the amount of the initial measurement of the lease liability;(b) any lease payments made at or before the commencement date, less any lease incentives received;(c) any initial direct costs incurred by the lessee; and(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.
■ Lease liability	<ul style="list-style-type: none">● at the present value of the lease payments that are not paid at the commencement date, which comprises:<ul style="list-style-type: none">(a) fixed payments less any lease incentives receivables;(b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;(c) amounts expected to be payable by the lessee under residual value guarantees;(d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and(e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

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

Lessee accounting

Subsequent measurement	
■ Right-of-use asset	<ul style="list-style-type: none">● 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● Apply HKAS 36 for determination of impairment on right-of-use asset and to account for any impairment loss identified● 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● 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
■ Lease liability	<ul style="list-style-type: none">● 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 payments³
■ Effect on profit or loss	<ul style="list-style-type: none">● Recognise depreciation or impairment loss (if any) for the right-of use asset● Recognise interest arising on the lease liability● 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

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.

³ 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:

	Items
Statement of financial position or in the notes	<ul style="list-style-type: none">• Present right-of-use assets separately from other assets• 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• 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• Present lease liabilities separately from other liabilities• 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
Statement of profit or loss and other comprehensive income	<ul style="list-style-type: none">• Present interest expense on the lease liability separately from the depreciation charges for the right-of-use asset• Interest expense on the lease liability is a component of finance cost

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

This publication intended to provide general information and guidance on the subject concerned. No one should act upon such information without consulting a qualified professional adviser. SHINEWING (HK) CPA Limited takes no responsibility for any errors or omission in, or for the loss incurred by individuals and companies due to the use of, the information of this publication.

No claims, action or legal proceedings in connection with this publication brought by any individuals or companies having reference to the information of this publication will be entertained by SHINEWING (HK) CPA Limited.