Hong Kong Institute of
Certified Public Accountants
香港會計師公會

HKFRS 16 *Leases*

HKICPA Standard Setting Department Staff Summary (May 2016)

Introduction

1. HKFRS 16 is the equivalent of IFRS 16 *Leases* issued by the International Accounting Standards Board (IASB).

2. HKFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives 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 entity.

3. HKFRS 16 is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted provided HKFRS 15 *Revenue from Contracts with Customers* is also applied.

4. At its effective date, HKFRS 16 supersedes:

   (a) HKAS 17 *Leases*;

   (b) HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*;

   (c) HK(SIC)-Int 15 *Operating Leases—Incentives*; and

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

Reasons for issuing HKFRS 16

5. HKICPA supports the reasons for the IASB issuing IFRS 16 and therefore issued HKFRS 16 to maintain convergence of HKFRS with International Financial Reporting Standards.

6. Leasing is an important activity for many entities. It is a means of gaining access to assets, of obtaining finance and of reducing an entity's exposure to the risks of asset

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ownership. The prevalence of leasing means that it is important that users of financial statements have a complete and understandable picture of an entity's leasing activities.

7. The accounting for leases under HKAS 17 requires a lease to be classified as either finance lease or operating lease. Finance leases are recognized on the balance sheet whereas operating leases are not recognized on the balance sheet. Users of financial statements have criticized the dual-model lease accounting because it did not always provide a faithful representation of leasing transactions.

8. Accordingly, the IASB and the US national standard-setter, the Financial Accounting Standards Board (FASB), initiated a joint project to develop a new approach to lease accounting that requires a lessee to recognise assets and liabilities for the rights and obligations created by leases. This approach will result in a more faithful representation of a lessee's assets and liabilities and, together with enhanced disclosures, will provide greater transparency of a lessee's financial leverage and capital employed.

9. Both Boards decided that a lessee should be required to recognise assets and liabilities for all leases (with limited exceptions), and both Boards have defined leases in the same way. The Boards reached similar decisions regarding the measurement of lease liabilities, and how to account for leases that were formerly classified as finance leases. In addition, both Boards decided not to substantially change lessor accounting.

10. However, the Boards reached different decisions for leases that were formerly classified as operating leases with respect to the recognition of lease expenses and the reporting of lease-related cash flows. The IASB decided to adopt a single lessee accounting model whereby a lessee accounts for all leases in the same way. The FASB decided to adopt a dual lessee accounting model, classifying leases in a similar manner to the previous requirements in US Generally Accepted Accounting Principles (US GAAP) for distinguishing between operating leases and capital leases, and to account for those two types of leases differently.

11. IFRS 16 completes the IASB's project to improve the financial reporting of leases.

Main features of HKFRS 16

Lessee accounting

12. HKFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. 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.

13. A lessee measures right-of-use assets similarly to other non-financial assets (such as property, plant and equipment) and lease liabilities similarly to other financial liabilities. As a consequence, a lessee recognises depreciation of the right-of-use asset and interest on the lease liability, and also classifies cash repayments of the lease liability into a principal portion and an interest portion and presents them in the statement of cash flows applying HKAS 7 *Statement of Cash Flows*.

14. Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease.

15. HKFRS 16 contains disclosure requirements for lessees. Lessees will need to apply judgement 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.

Lessor accounting

16. 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 to account for those two types of leases differently.

17. HKFRS 16 also requires enhanced disclosures to be provided by lessors that will improve information disclosed about a lessor's risk exposure, particularly to residual value risk.

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