

**ACCOUNTING STANDARD**

**AASB 117**  
July 2004

# Leases



**Australian Government**

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**Australian Accounting  
Standards Board**

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Australian Accounting Standard AASB 117 *Leases* is set out in paragraphs 1 – 66. All the paragraphs have equal authority. Terms defined in this Standard are in *italics* the first time they appear in the Standard. AASB 117 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation and Application of Standards*, which identifies the UIG Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

## **PREFACE**

### **Reasons for Issuing AASB 117**

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's policy of adopting the Standards of the International Accounting Standards Board (IASB) for application to reporting periods beginning on or after 1 January 2005. The AASB has decided it will continue to issue sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. Except for Standards that are specific to the not-for-profit or public sectors or that are of a purely domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, to broaden the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues.

The IASB defines International Financial Reporting Standards (IFRSs) as comprising:

- (a) International Financial Reporting Standards;
- (b) International Accounting Standards; and
- (c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

The Australian equivalents to IFRSs are:

- (a) Accounting Standards issued by the AASB that are equivalent to Standards issued by the IASB, being AASBs 1 – 99 corresponding to the IFRS series and AASBs 101 – 199 corresponding to the IAS series; and
- (b) UIG Interpretations issued by the AASB corresponding to the Interpretations adopted by the IASB, as listed in AASB 1048 *Interpretation and Application of Standards*.

## **Main Features of this Standard**

### **Application Date**

This Standard is applicable to annual reporting periods beginning on or after 1 January 2005. To promote comparability among the financial reports of Australian entities, early adoption of this Standard is not permitted.

### **First-time Application and Comparatives**

Application of this Standard will begin in the first annual reporting period beginning on or after 1 January 2005 in the context of adopting all Australian equivalents to IFRSs. The requirements of AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, the Australian equivalent of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, must be observed. AASB 1 requires prior period information, presented as comparative information, to be restated as if the requirements of this Standard had always applied. This differs from previous Australian requirements where changes in accounting policies did not require the restatement of the income statement and balance sheet of the preceding period.

### **Main Requirements**

The Standard requires:

- (a) a lessee and a lessor to each classify the lease as either a finance lease or an operating lease according to its economic substance;
- (b) a lessee under a finance lease to recognise a lease asset and a lease liability at the lower of the fair value of the leased asset or the present value of the minimum lease payments, and subsequently apportion lease payments between the finance charge and reduction of the liability;
- (c) a lessor under a finance lease to recognise a lease receivable of an amount equal to the net investment in the lease, and subsequently recognise finance income based on a pattern reflecting a constant periodic rate of return on that net investment;
- (d) a lessee under an operating lease to recognise lease payments as an expense on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern of the user's benefit;

- (e) a lessor under an operating lease to recognise lease income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the asset is diminished;
- (f) a lessee under a sale and leaseback transaction that is classified as a finance lease to defer and amortise any profit or loss arising from the transaction over the lease term;
- (g) a lessee of a sale and leaseback transaction that is classified as an operating lease:
  - (i) to recognise any profit or loss immediately where the sale price equals the fair value of the asset sold;
  - (ii) where the sale price is below fair value, to immediately recognise any profit or loss, except where the loss is compensated for by lower future rentals, in which case it is deferred and amortised over the period for which the asset is expected to be used;
  - (iii) where the sale price is above fair value, to defer and amortise the excess of sale price over fair value over the period for which the asset is expected to be used; and
- (h) a lessee and a lessor to disclose specific information in relation to finance leases and operating leases.

## **Differences between this Standard and AASB 1008**

There are no significant differences between this Standard and AASB 1008 *Leases*. A detailed description of the differences between this Standard and AASB 1008 accompanies this Standard under the heading “Differences between AASB 117 and AASB 1008”.

The requirements of the superseded AASB 1008 are essentially the same as AAS 17 *Leases*. Accordingly, there is no separate analysis of differences between AASB 117 and AAS 17.

## **COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS**

### **AASB 117 and IAS 17**

AASB 117 is equivalent to IAS 17 *Leases* issued by the IASB. Paragraphs that have been added to this Standard (and do not appear in the text of the equivalent IASB standard) are identified with the prefix “Aus”, followed by the number of the preceding IASB paragraph and decimal numbering.

### **Compliance with IAS 17**

Entities that comply with AASB 117 will simultaneously be in compliance with IAS 17.

### **AASB 117 and IPSAS 13**

International Public Sector Accounting Standards (IPSASs) are issued by the Public Sector Committee of the International Federation of Accountants.

IPSAS 13 *Leases* (December 2001), is drawn primarily from the 1997 version of IAS 17. The main differences between IPSAS 13 and AASB 117 are:

- (a) AASB 117 includes initial direct costs in the definition of the interest rate implicit in the lease, whereas IPSAS 13 does not;
- (b) AASB 117 includes commentary additional to that in IPSAS 13 on the classification and allocation of minimum lease payments for a lease of land and buildings; and
- (c) IPSAS 13 contains additional appendices which illustrate the classification of a lease, the treatment of a finance lease by a lessor, and the calculation of the interest rate implicit in a finance lease.

## ACCOUNTING STANDARD AASB 117

The Australian Accounting Standards Board makes Accounting Standard AASB 117 *Leases* under section 334 of the *Corporations Act 2001*.

Dated 15 July 2004

D.G. Boymal  
Chair – AASB

## ACCOUNTING STANDARD AASB 117

### *LEASES*

#### **Objective**

1. The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosure to apply in relation to leases.

#### **Application**

**Aus1.1 This Standard applies to:**

- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
- (b) general purpose financial reports of each other reporting entity; and
- (c) financial reports that are, or are held out to be, general purpose financial reports.

**Aus1.2 This Standard applies to annual reporting periods beginning on or after 1 January 2005.**

**Aus1.3 This Standard shall not be applied to annual reporting periods beginning before 1 January 2005.**

**Aus1.4 The requirements specified in this Standard apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.**

- Aus1.5** When applicable, this Standard supersedes:
- (a) Accounting Standard AASB 1008 *Leases* as notified in the *Commonwealth of Australia Gazette* No S 491, 6 October 1998; and
  - (b) AAS 17 *Leases* as issued in October 1998.
- Aus1.6 Both AASB 1008 and AAS 17 remain applicable until superseded by this Standard.
- Aus1.7 Notice of this Standard was published in the *Commonwealth of Australia Gazette* No S 294, 22 July 2004.

## Scope

2. This Standard shall be applied in accounting for all leases other than:
- (a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources; and
  - (b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.
- However, this Standard shall not be applied as the basis of measurement for:
- (a) property held by lessees that is accounted for as investment property (see AASB 140 *Investment Property*);
  - (b) investment property provided by lessors under operating leases (see AASB 140);
  - (c) biological assets held by lessees under finance leases (see AASB 141 *Agriculture*); or
  - (d) biological assets provided by lessors under operating leases (see AASB 141).
3. This Standard applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This Standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

## Definitions

4. The following terms are used in this Standard with the meanings specified.

**The commencement of the lease term** is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e. the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate).

**Contingent rent** is that portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (e.g. percentage of future sales, amount of future use, future price indices, future market rates of interest).

**Economic life** is either:

- (a) the period over which an asset is expected to be economically usable by one or more users; or
- (b) the number of production or similar units expected to be obtained from the asset by one or more users.

**Fair value** is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

**A finance lease** is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

**Gross investment in the lease** is the aggregate of:

- (a) the minimum lease payments receivable by the lessor under a finance lease; and
- (b) any unguaranteed residual value accruing to the lessor.

**Guaranteed residual value** is:

- (a) for a lessee, that part of the residual value that is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the

maximum amount that could, in any event, become payable); and

- (b) for a lessor, that part of the residual value that is guaranteed by the lessee or by a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

**The *inception of the lease* is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. At this date:**

- (a) a lease is classified as either an operating or a finance lease; and
- (b) in the case of a finance lease, the amounts to be recognised at the commencement of the lease are determined.

***Initial direct costs* are incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or dealer lessors.**

**The *interest rate implicit in the lease* is the discount rate that, at the inception of the lease, causes the aggregate present value of:**

- (a) the minimum lease payments; and
- (b) the unguaranteed residual value

**to be equal to the sum of:**

- (c) the fair value of the leased asset; and
- (d) any initial direct costs of the lessor.

**A *lease* is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.**

**The *lease term* is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.**

**The lessee's incremental borrowing rate of interest** is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

**Minimum lease payments** are the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

- (a) for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or
- (b) for a lessor, any residual value guaranteed to the lessor by:
  - (i) the lessee;
  - (ii) a party related to the lessee; or
  - (iii) a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.

**Net investment in the lease** is the gross investment in the lease discounted at the interest rate implicit in the lease.

**A non-cancellable lease** is a lease that is cancellable only:

- (a) upon the occurrence of some remote contingency;
- (b) with the permission of the lessor;
- (c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

- (d) **upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.**

**An *operating lease* is a lease other than a finance lease.**

***Unearned finance income* is the difference between:**

- (a) **the gross investment in the lease; and**
- (b) **the net investment in the lease.**

***Unguaranteed residual value* is that portion of the residual value of the leased asset, the realisation of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.**

***Useful life* is the estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits embodied in the asset are expected to be consumed by the entity.**

5. A lease agreement or commitment may include a provision to adjust the lease payments for changes in the construction or acquisition cost of the leased property or for changes in some other measure of cost or value, such as general price levels, or in the lessor's costs of financing the lease, during the period between the inception of the lease and the commencement of the lease term. If so, the effect of any such changes shall be deemed to have taken place at the inception of the lease for the purposes of this Standard.
6. The definition of a lease includes contracts for the hire of an asset that contain a provision giving the hirer an option to acquire title to the asset upon the fulfilment of agreed conditions. These contracts are sometimes known as hire purchase contracts.

## **Classification of Leases**

7. The classification of leases adopted in this Standard is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.

8. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.
9. Because the transaction between a lessor and a lessee is based on a lease agreement between them, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the lessor and lessee may result in the same lease being classified differently by them. For example, this may be the case if the lessor benefits from a residual value guarantee provided by a party unrelated to the lessee.
10. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract.<sup>1</sup> Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
  - (a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
  - (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
  - (c) the lease term is for the major part of the economic life of the asset even if title is not transferred;
  - (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
  - (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.
11. Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:
  - (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

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<sup>1</sup> See also UIG Interpretation 127 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*, as identified in AASB 1048 *Interpretation and Application of Standards*.

- (b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
  - (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
12. The examples and indicators in paragraphs 10 and 11 are not always conclusive. If it is clear from other features of the lease that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all such risks and rewards.
13. Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 6-12 if the changed terms had been in effect at the inception of the lease, the revised agreement is regarded as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.
14. Leases of land and of buildings are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the lessee by the end of the lease term, the lessee normally does not receive substantially all of the risks and rewards incidental to ownership in which case the lease of land will be an operating lease. A payment made on entering into or acquiring a leasehold that is accounted for as an operating lease represents prepaid lease payments that are amortised over the lease term in accordance with the pattern of benefits provided.
15. The land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification. If title to both elements is expected to pass to the lessee by the end of the lease term, both elements are classified as a finance lease, whether analysed as one lease or as two leases, unless it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership of one or both elements. When the land has an indefinite

economic life, the land element is normally classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term, in accordance with paragraph 14. The buildings element is classified as a finance or operating lease in accordance with paragraphs 7-13.

16. Whenever necessary in order to classify and account for a lease of land and buildings, the minimum lease payments (including any lump-sum upfront payments) are allocated between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception of the lease. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.
17. For a lease of land and buildings in which the amount that would initially be recognised for the land element, in accordance with paragraph 20, is immaterial, the land and buildings may be treated as a single unit for the purpose of lease classification and classified as a finance or operating lease in accordance with paragraphs 7-13. In such a case, the economic life of the buildings is regarded as the economic life of the entire leased asset.
18. Separate measurement of the land and buildings elements is not required when the lessee's interest in both land and buildings is classified as an investment property in accordance with AASB 140 and the fair value model is adopted. Detailed calculations are required for this assessment only if the classification of one or both elements is otherwise uncertain.
19. In accordance with AASB 140, it is possible for a lessee to classify a property interest held under an operating lease as an investment property. If it does, the property interest is accounted for as if it were a finance lease and, in addition, the fair value model is used for the asset recognised. The lessee shall continue to account for the lease as a finance lease, even if a subsequent event changes the nature of the lessee's property interest so that it is no longer classified as investment property. This will be the case if, for example, the lessee:
  - (a) occupies the property, which is then transferred to owner-occupied property at a deemed cost equal to its fair value at the date of change in use; or
  - (b) grants a sub-lease that transfers substantially all of the risks and rewards incidental to ownership of the interest to an unrelated third party. Such a sub-lease is accounted for by the lessee as a

finance lease to the third party, although it may be accounted for as an operating lease by the third party.

## **Leases in the Financial Statements of Lessees**

### **Finance Leases**

#### **Initial recognition**

- 20. At the commencement of the lease term, lessees shall recognise finance leases as assets and liabilities in their balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate shall be used. Any initial direct costs of the lessee are added to the amount recognised as an asset.**
21. Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with legal form. Although the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating, at the inception of the lease, the fair value of the asset and the related finance charge.
22. If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an entity are understated, thereby distorting financial ratios. Therefore, it is appropriate for a finance lease to be recognised in the lessee's balance sheet both as an asset and as an obligation to pay future lease payments. At the commencement of the lease term, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts except for any initial direct costs of the lessee that are added to the amount recognised as an asset.
23. It is not appropriate for the liabilities for leased assets to be presented in the financial statements as a deduction from the leased assets. If for the presentation of liabilities on the face of the balance sheet a distinction is made between current and non-current liabilities, the same distinction is made for lease liabilities.

24. Initial direct costs are often incurred in connection with specific leasing activities, such as negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are added to the amount recognised as an asset.

#### **Subsequent measurement**

25. **Minimum lease payments shall be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge shall be allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rents shall be charged as expenses in the periods in which they are incurred.**
26. In practice, in allocating the finance charge to periods during the lease term, a lessee may use some form of approximation to simplify the calculation.
27. **A finance lease gives rise to depreciation expense for depreciable assets as well as finance expense for each reporting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognised shall be calculated in accordance with AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.**
28. The depreciable amount of a leased asset is allocated to each reporting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the shorter of the lease term and its useful life.
29. The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is, therefore, inappropriate simply to recognise the lease payments payable as an expense. Accordingly, the asset and the related liability are unlikely to be equal in amount after the commencement of the lease term.
30. To determine whether a leased asset has become impaired, an entity applies AASB 136 *Impairment of Assets*.

31. Lessees shall, in addition to meeting the requirements of AASB 132 *Financial Instruments: Disclosure and Presentation*, make the following disclosures for finance leases:
- (a) for each class of asset, the net carrying amount at the reporting date;
  - (b) a reconciliation between the total of future minimum lease payments at the reporting date, and their present value. In addition, an entity shall disclose the total of future minimum lease payments at the reporting date, and their present value, for each of the following periods:
    - (i) not later than one year;
    - (ii) later than one year and not later than five years;
    - (iii) later than five years;
  - (c) contingent rents recognised as an expense in the period;
  - (d) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the reporting date; and
  - (e) a general description of the lessee's material leasing arrangements including, but not limited to, the following:
    - (i) the basis on which contingent rent payable is determined;
    - (ii) the existence and terms of renewal or purchase options and escalation clauses; and
    - (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.
32. In addition, the requirements for disclosure in accordance with AASB 116, AASB 136, AASB 138, AASB 140 and AASB 141 apply to lessees for assets leased under finance leases.

### **Operating Leases**

33. Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless another

**systematic basis is more representative of the time pattern of the user's benefit.<sup>2</sup>**

34. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.
35. **Lessees shall, in addition to meeting the requirements of AASB 132, make the following disclosures for operating leases:**
- (a) **the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:**
    - (i) **not later than one year;**
    - (ii) **later than one year and not later than five years;**
    - (iii) **later than five years;**
  - (b) **the total of future minimum sublease payments expected to be received under non-cancellable subleases at the reporting date;**
  - (c) **lease and sublease payments recognised as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments;**
  - (d) **a general description of the lessee's significant leasing arrangements including, but not limited to, the following:**
    - (i) **the basis on which contingent rent payable is determined;**
    - (ii) **the existence and terms of renewal or purchase options and escalation clauses; and**
    - (iii) **restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.**

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<sup>2</sup> See also UIG Interpretation 115 *Operating Leases – Incentives*, as identified in AASB 1048 *Interpretation and Application of Standards*.

## Leases in the Financial Statements of Lessors

### Finance Leases

#### Initial recognition

36. **Lessors shall recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease.**
37. Under a finance lease substantially all the risks and rewards incidental to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal and finance income to reimburse and reward the lessor for its investment and services.
38. Initial direct costs are often incurred by lessors and include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease. They exclude general overheads such as those incurred by a sales and marketing team. For finance leases other than those involving manufacturer or dealer lessors, initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the finance lease receivable; there is no need to add them separately. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease are excluded from the definition of initial direct costs. As a result, they are excluded from the net investment in the lease and are recognised as an expense when the selling profit is recognised, which for a finance lease is normally at the commencement of the lease term.

#### Subsequent measurement

39. **The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.**
40. A lessor aims to allocate finance income over the lease term on a systematic and rational basis. This income allocation is based on a pattern reflecting a constant periodic return on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

41. Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the income allocation over the lease term is revised and any reduction in respect of amounts accrued is recognised immediately.
- 41A. An asset under a finance lease that is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* shall be accounted for in accordance with that Standard.
- 42. Manufacturer or dealer lessors shall recognise selling profit or loss in the period, in accordance with the policy followed by the entity for outright sales. If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.**
43. Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:
- (a) profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and
  - (b) finance income over the lease term.
44. The sales revenue recognised at the commencement of the lease term by a manufacturer or dealer lessor is the fair value of the asset, or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the entity's policy for outright sales.
45. Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, selling profit is restricted to that which would apply if a market rate of interest were charged.

46. Costs incurred by a manufacturer or dealer lessor in connection with negotiating and arranging a finance lease are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or dealer's selling profit.
47. **Lessors shall, in addition to meeting the requirements in AASB 132, disclose the following for finance leases:**
- (a) **a reconciliation between the gross investment in the lease at the reporting date, and the present value of minimum lease payments receivable at the reporting date. In addition, an entity shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the reporting date, for each of the following periods:**
    - (i) **not later than one year;**
    - (ii) **later than one year and not later than five years;**
    - (iii) **later than five years;**
  - (b) **unearned finance income;**
  - (c) **the unguaranteed residual values accruing to the benefit of the lessor;**
  - (d) **the accumulated allowance for uncollectible minimum lease payments receivable;**
  - (e) **contingent rents recognised as income in the period; and**
  - (f) **a general description of the lessor's material leasing arrangements.**
48. As an indicator of growth it is often useful also to disclose the gross investment less unearned income in new business added during the period, after deducting the relevant amounts for cancelled leases.

### **Operating Leases**

49. **Lessors shall present assets subject to operating leases in their balance sheets according to the nature of the asset.**
50. **Lease income from operating leases shall be recognised in income on a straight-line basis over the lease term, unless another**

**systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.<sup>3</sup>**

51. Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised on a straight-line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.
52. **Initial direct costs incurred by lessors in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income.**
53. **The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets, and depreciation shall be calculated in accordance with AASB 116 and AASB 138.**
54. To determine whether a leased asset has become impaired an entity applies AASB 136.
55. A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.
56. **Lessors shall, in addition to meeting the requirements of AASB 132, disclose the following for operating leases:**
  - (a) **the future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:**
    - (i) **not later than one year;**
    - (ii) **later than one year and not later than five years;**
    - (iii) **later than five years;**
  - (b) **total contingent rents recognised as income in the period; and**

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<sup>3</sup> See also UIG Interpretation 115 *Operating Leases – Incentives*, as identified in AASB 1048 *Interpretation and Application of Standards*.

(c) a general description of the lessor's leasing arrangements.

57. In addition, the disclosure requirements in AASB 116, AASB 136, AASB 138, AASB 140 and AASB 141 apply to lessors for assets provided under operating leases.

## Sale and Leaseback Transactions

58. A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.
59. **If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount shall not be immediately recognised as income by a seller-lessee. Instead, it shall be deferred and amortised over the lease term.**
60. If the leaseback is a finance lease, the transaction is a means whereby the lessor provides finance to the lessee, with the asset as security. For this reason it is not appropriate to regard an excess of sales proceeds over the carrying amount as income. Such excess is deferred and amortised over the lease term.
61. **If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss shall be recognised immediately. If the sale price is below fair value, any profit or loss shall be recognised immediately except that, if the loss is compensated for by future lease payments at below market price, it shall be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value shall be deferred and amortised over the period for which the asset is expected to be used.**
62. If the leaseback is an operating lease, and the lease payments and the sale price are at fair value, there has in effect been a normal sale transaction and any profit or loss is recognised immediately.
63. **For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value shall be recognised immediately.**

64. For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with AASB 136.
65. Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of material leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.
66. Sale and leaseback transactions may trigger the separate disclosure criteria in AASB 101 *Presentation of Financial Statements*.

### **Transitional Provisions**

67. [Deleted by the AASB]
68. [Deleted by the AASB]

### **Effective Date**

69. [Deleted by the AASB]

### **Withdrawal of IAS 17 (revised 1997)**

70. [Deleted by the AASB]

## IMPLEMENTATION GUIDANCE

*This guidance accompanies, but is not part of, AASB 117.*

### Illustrative Examples of Sale and Leaseback Transactions that Result in Operating Leases

A sale and leaseback transaction that results in an operating lease may give rise to profit or a loss, the determination and treatment of which depends on the leased asset's carrying amount, fair value and selling price. The table below shows the requirements of the Standard in various circumstances.

Sale price at fair value (paragraph 61)	Carrying amount equal to fair value	Carrying amount less than fair value	Carrying amount above fair value
<b>Profit</b>	no profit	recognise profit immediately	not applicable
<b>Loss</b>	no loss	not applicable	recognise loss immediately

Sale price below fair value (paragraph 61)	Carrying amount equal to fair value	Carrying amount less than fair value	Carrying amount above fair value
<b>Profit</b>	no profit	recognise profit immediately	no profit (note 1)
<b>Loss <u>not</u> compensated for by future lease payments at below market price</b>	recognise loss immediately	recognise loss immediately	(note 1)
<b>Loss compensated for by future lease payments at below market price</b>	defer and amortise loss	defer and amortise loss	(note 1)

<b>Sale price above fair value</b> (paragraph 61)	<b>Carrying amount equal to fair value</b>	<b>Carrying amount less than fair value</b>	<b>Carrying amount above fair value</b>
<b>Profit</b>	defer and amortise profit	defer and amortise excess of sale price over fair value  recognise any excess of fair value over carrying amount immediately (note 3)	defer and amortise profit (note 2)
<b>Loss</b>	no loss	no loss	(note 1)

Note 1 These parts of the table represent circumstances dealt with in paragraph 63 of the Standard. Paragraph 63 requires the carrying amount of an asset to be written down to fair value where it is subject to a sale and leaseback.

Note 2 Profit is the difference between fair value and sale price because the carrying amount would have been written down to fair value in accordance with paragraph 63.

Note 3 The excess profit (the excess of sale price over fair value) is deferred and amortised over the period for which the asset is expected to be used. Any excess of fair value over the carrying amount is recognised immediately.

## **DIFFERENCES BETWEEN AASB 117 AND AASB 1008**

*This analysis of differences accompanies, but is not part of, AASB 117.*

This section identifies differences between AASB 117 *Leases* and AASB 1008 *Leases* under the following headings.

- A: Incompatibilities between AASB 117 and AASB 1008
- B: AASB 1008 is more detailed or restrictive
- C: AASB 117 is more detailed or restrictive

The analysis of differences should not be taken as providing an exhaustive list of differences.

### **Introduction**

Both AASB 1008 and AASB 117 look to the economic substance of the leasing arrangement when prescribing the appropriate accounting treatment. In both cases it is the transfer (or lack thereof) of substantially all the risks and benefits associated with the leased asset that determines the accounting treatment for both the lessor and lessee.

### **Scope**

AASB 117 differs in scope from AASB 1008 in the following ways:

- AASB 1008.2.1 excludes from its scope both operating and finance lease agreements to use self-generating and regenerating assets (SGARAs). In contrast, AASB 117.1 excludes from its scope the measurement by lessees of only some SGARAs (in particular, living animals and plants) held under finance leases, and the measurement by lessors of some SGARAs (in particular, living animals and plants) leased out under operating leases;
- unlike AASB 1008, the measurement by lessees of investment property held under finance leases and the measurement by lessors of investment property leased out under operating leases are excluded from the scope of AASB 117. Such properties fall within the scope of AASB 140 *Investment Property*.

## Differences

### A. Incompatibilities between AASB 117 and AASB 1008

#### A.1 Leases of non-human living assets other than biological assets

Non-human living assets, other than biological assets, held under a lease are subject to AASB 117, such that where:

- the item is subject to a finance lease, the lessee recognises a lease asset and lease liability, measured at the commencement of the lease term at the lower of the fair value of the leased property and the present value of the minimum lease payments (AASB 117.20); or
- the item is subject to an operating lease, it continues to be lessor-controlled property and the lessor applies the measurement requirements of AASB 116 *Property, Plant and Equipment*, together with the AASB 117 requirement that such assets be presented according to their nature.

Where exclusive rights to non-human living assets other than biological assets are obtained under a finance lease, AASB 1037 *Self-Generating and Regenerating Assets* paragraph 2.1(b) requires a lessee to recognise and measure the right at its net market value, as if that right is itself a non-human living asset other than a biological asset. Similarly, where such an asset is subject to an operating lease, the lessor applies AASB 1037.

#### A.2 Operating leases of biological assets

Under AASB 117.33 a lessee of a biological asset does not recognise an asset but instead recognises the operating lease payments as an expense. In contrast, where an operating lease gives the lessee an exclusive right over SGARAs, AASB 1037.2.1(b) requires the lessee to recognise and measure that right at its net market value, as if that right is itself a SGARA.

#### A.3 Interest rate implicit in the lease

AASB 117.4 defines the interest rate implicit in the lease as the discount rate that, at the inception of the lease, causes the aggregate present value of the minimum lease payments and any unguaranteed residual value to be equal to the sum of the fair value of the leased asset and any initial direct costs of the lessor. In contrast, AASB 1008.20.1 defines the interest rate implicit in the lease as the interest rate that, at the beginning of the lease term, equates the present value of the minimum lease payments and any unguaranteed residual value expected to accrue to the benefit of the lessor at the end of the lease term to the fair value of the leased asset at the inception of the lease.

Therefore, the interest rate implicit in the lease under AASB 117 will differ from the interest rate implicit in the lease under AASB 1008 whenever the inception of the lease (that is, the date of the lease agreement or, if earlier, the date of a commitment by the parties to the principal provisions of the lease) differs from the beginning of the lease term (that is, the date from which the lessee is entitled to exercise its right to use the leased asset). This difference in the interest rate implicit in the lease gives rise to the following incompatibilities between AASB 117 and AASB 1008 in relation to the accounting for finance leases:

- in the case of lessees, the amounts recognised as assets and liabilities arising from finance leases and as interest expense each period over the lease term under AASB 117 will differ from the amounts recognised under AASB 1008; and
- in the case of lessors, the amounts recognised as finance revenue each period over the lease term under AASB 117 will differ from the amounts recognised under AASB 1008;

whenever the inception of the lease differs from the beginning of the lease term.

#### **A.4 Relationship between fair value and present value of minimum lease payments**

Where a lease is classified as a finance lease, AASB 1008.6.1 and 6.2 require the lessee to recognise an asset and a liability equal in amount to the present value of the minimum lease payments, calculated using the interest rate implicit in the lease or, if that could not be determined practicably, the lessee's incremental borrowing rate. To calculate the rate implicit in the lease the fair value of the leased asset must be known. AASB 117.20 requires the lessee to recognise an asset and a liability at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments calculated using the interest rate implicit in the lease or, if that cannot be determined practicably, the lessee's incremental borrowing rate.

A difference may arise where the amount of unguaranteed residual is unknown. In this case, it is impossible to determine the implicit rate. Under AASB 117, the lessee would record a value equal to the fair value today or, if lower, the present value of the minimum lease payments discounted at the entity's incremental borrowing rate. In contrast, the default amount in AASB 1008 is the present value of the minimum lease payments discounted at the incremental borrowing rate. Thus, if the present value of the minimum lease payments discounted at the incremental borrowing rate exceeds the fair value (an unlikely scenario) the amounts recorded as assets and liabilities would differ under AASB 117.

#### **A.5 Lease term with cancellable period**

Where a lease includes a cancellable period, that period would have been included as part of the lease term under AASB 1008, whereas a cancellable period will only be included as part of the lease term under AASB 117 where, at the inception of the lease, there is reasonable certainty that the lessee will not cancel the lease during the cancellable period. In most cases AASB 117.4 and AASB 1008.20.1 will lead to the same lease term. Where the lease term under AASB 1008 includes a cancellable period which is not included as part of the lease term under AASB 117, the change has implications for the amounts capitalised as assets and liabilities (finance leases), sale and leaseback transactions, and the amortisation of initial direct costs under an operating lease.

#### **A.6 Contingent rentals under an operating lease**

AASB 117.33 requires a lessee to recognise operating lease payments as an expense on a straight-line basis over the lease term unless another systematic basis is representative of the time pattern of the user's benefit.

AASB 1008.8.1 requires a lessee to recognise that part of lease payments comprising contingent rentals as an expense in the reporting period in which the contingent rentals are incurred. Therefore, the basis on which contingent rentals under an operating lease are recognised as an expense by the lessee under AASB 117 will differ from the basis on which they are recognised as an expense under AASB 1008.

#### **A.7 Definition of sales-type lease**

AASB 1008.20.1 defines a sales-type lease as a finance lease in which the fair value of the asset at the inception of the lease differs from its carrying amount to the lessor. In contrast, AASB 117.42-46 refer to manufacturer or dealer lessors. Because AASB 1008 does not limit lessors in sales-type leases to manufacturers and dealers, there will be circumstances when an entity disposes of surplus property, plant and equipment through a finance lease, where a finance lease would be classified as a sales-type lease under AASB 1008 but is not under AASB 117. This difference in definition has the effect that for sales-type leases other than manufacturer or dealer finance leases:

- AASB 1008.12.4 requires the "selling" profit or loss to be recognised in the period of the lease transaction, whereas AASB 117 is silent on the issue; and
- initial direct costs for sales-type leases other than manufacturer or dealer lessors would be amortised over the lease term instead of being recognised as an expense in the period in which the transaction occurs.

## **A.8 Basis for recognition of operating lease revenue – lessor**

AASB 117.50 requires a lessor to recognise lease revenue (which presumably includes contingent rentals) under an operating lease “on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished”. AASB 1008.13.2 and 15.1 require a lessor to recognise lease revenue under an operating lease as follows:

- for that part of the revenue comprising minimum lease payments, by allocating the minimum lease payments on a basis representative of the pattern of service rendered through the provision of the leased asset; and
- for that part of the revenue comprising contingent rentals, in the reporting period in which the contingent rentals are earned.

Where the benefits from the leased asset are derived on a time basis AASB 1008 is consistent with AASB 117. However, because of the difference in treatment of contingent rentals, where the benefits from the leased asset are derived on some other basis (for example, on an output basis such as units of production, operating hours or distance travelled), the minimum lease payments would be recognised differently on adoption of AASB 117.

## **A.9 Definition of initial direct costs**

The definition of initial direct costs is consistent with AASB 1008, except that under AASB 1008 initial direct costs include costs incurred by a manufacturer or dealer lessor. Manufacturer and dealer lessors are specifically excluded from capitalising initial direct costs as part of the receivable and liability (finance lease) or carrying amount of the leased asset (operating lease) under AASB 117. Instead, AASB 117.42 requires costs incurred by a manufacturer or dealer lessor in connection with negotiating and arranging a lease to be immediately recognised as an expense when the selling profit is recognised.

## **B. AASB 1008 is more detailed or restrictive**

### **B.1 Leases of biological assets**

In respect of leases covering exclusive rights over SGARAs, AASB 1037.2.1(b), 5.2 and 5.3 require that:

- where a finance lease gives an exclusive right over a SGARA, the lessee recognise and measure that right as if that right is a SGARA; and

- where a lessor leases a SGARA under an operating lease, the lessor recognise and measure that right as if that right is a SGARA.

In respect of leases giving non-exclusive rights over SGARAs, there are no specific requirements in AASB 1037, and these leases are excluded from AASB 1008.2.1(a).

AASB 117.2 states that AASB 117 does not apply to:

- biological assets held by lessees under finance leases; and
- biological assets provided by lessors under operating leases.

It follows that, unlike AASB 117 and AASB 141 *Agriculture*, AASB 1037 contains “specific” requirements about leases of biological assets conveying exclusive rights. In some circumstances AASB 1008 and AASB 1037 and AASB 117 and AASB 141 would require a lessor to apply lease accounting in respect of operating leases conveying non-exclusive rights over biological assets controlled by the entity.

## **B.2 Recognition date**

When a lease is classified as a finance lease, AASB 1008.6.1 requires the lessee to recognise the resulting asset and liability as at the beginning of the lease term. In the case of the lessor, the lease receivable must also be recognised as at the beginning of the lease term (AASB 1008.12.1). For lessees, AASB 117.20 requires the finance lease asset and liability to be recognised in the financial statements at the commencement of the lease term. For lessors, however, AASB 117 is silent in relation to the point in time at which the lessor must recognise the lease receivable.

## **B.3 Executory costs**

AASB 1008.20.1 defined executory costs as the costs specifically related only to the operation and maintenance of the lease asset (including insurance, repairs and property taxes). Under AASB 1008.9.1 and 16.1:

- a lessee recognises any part of lease payments representing a reimbursement of executory costs incurred by the lessor as an expense in the reporting period in which those rentals are incurred; and
- a lessor recognises any part of lease payments representing a recovery of executory costs as revenues in the reporting period in which the related costs were incurred.

AASB 117 does not address these issues.

#### **B.4 Sale and leaseback losses**

Where a sale and leaseback transaction involves a leaseback which is classified as a finance lease by the lessee, both AASB 1008.10.1 and AASB 117.59 require any excess of the proceeds received over the carrying amount of the asset to be deferred and amortised by the lessee over the lease term. However, AASB 1008.10.1 also requires an excess of the carrying amount of the asset over the proceeds received to be deferred and amortised over the lease term. AASB 117 does not address this issue, meaning that where there is a loss to the lessee in a sale and leaseback transaction, that loss may be deferred or it may be recognised immediately under AASB 117.

#### **B.5 Sale and leaseback – amortisation of excess**

AASB 117 does not specify the amortisation method to be adopted. Therefore AASB 117 permits but does not require the AASB 1008 approach of amortising the excess in proportion to the rental payments.

### **C. AASB 117 is more detailed or restrictive**

#### **C.1 Allocation of minimum lease payments between land and buildings**

AASB 117 and AASB 1008 provide similar guidance on the allocation of minimum lease payments between land and buildings. AASB 117.16 specifically addresses the situation where the minimum lease payments cannot be allocated reliably between the land and buildings. Unless it is clear that both elements (land and buildings) are operating leases, the lease must be classified as a finance lease. AASB 1008 provides no such guidance.

#### **C.2 Balance sheet – Lessor**

AASB 117.49 requires a lessor to present leased assets subject to operating leases in its balance sheet according to the nature of the assets. Although AASB 1008 addresses the classification by lessors of leased assets subject to operating leases, AASB 1008 does not address the presentation of such assets in the lessor's balance sheet.