Australian Accounting Standard **AAS 17**
October 1998

Leases

Prepared by the
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Defined words appear in *italics* the first time they appear in a section. The definitions are in Section 20. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

The Standard requires:

(a) a lessee and a lessor of a lease, which is not excluded from the scope of the Standard, to classify the lease as either an operating lease or a finance lease according to its economic substance. Leases relating to natural resources or licensing rights on items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are excluded from the scope of the Standard. A lessor of what is commonly described as a leveraged leasing transaction is required to account for the transaction in accordance with the requirements of the Standard

(b) a lessee of a finance lease to recognise a lease asset and a lease liability equal to the present value of the minimum lease payments at the beginning of the lease term

(c) a lessee of a finance lease to capitalise initial direct costs incurred as part of the lease asset. Accordingly, where such costs are incurred, the lease asset comprises the present value of the minimum lease payments and the amount of initial direct costs incurred

(d) a lessee of a finance lease to discount the minimum lease payments by the interest rate implicit in the lease. However, where it is not practicable to determine the interest rate implicit in the lease, the lessee's incremental borrowing rate is used

(e) a lessor of a finance lease to recognise a lease receivable of an amount equal to the aggregate of the present value of the minimum lease payments and the present value of any unguaranteed residual value

(f) a lessor of a finance lease to discount the minimum lease payments and the unguaranteed residual value by the interest rate implicit in the lease

(g) a lessee of 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

(h) 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) to write down the asset sold to its fair value where the sale price is not established at fair value and where the carrying amount exceeds the fair value of the asset

(iii) where the sale price is above fair value, to defer and amortise over the lease term the excess of sale price over fair value

(iv) where the sale price is below fair value, to immediately recognise any profit or loss, calculated as the difference between the sale price and the carrying amount (adjusted to fair value where applicable), except where the loss is compensated by lower future rentals

(i) a lessee and a lessor to disclose specific information in relation to a finance lease and an operating lease.

AUSTRALIAN ACCOUNTING STANDARD

AAS 17 “LEASES”

1 Application

1.1 This Standard applies to:

(a) *general purpose financial reports* of each *reporting entity* to which Accounting Standards operative under the Corporations Law do not apply; or

(b) financial reports that are held out to be general purpose financial reports by an *entity* which is not a reporting entity, and to which Accounting Standards operative under the Corporations Law do not apply.

1.1.1 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.

2 Scope

2.1 This Standard applies to accounting for *leases* other than:

(a) lease agreements to explore for or use natural resources, such as *self-generating and regenerating assets*, oil, gas and metals; and

(b) licensing agreements for items such as mineral rights, motion picture films, video recordings, plays, manuscripts, patents and copyrights.

2.1.1 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 their operation or maintenance. 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.

2.1.2 The term "lease" as defined in paragraph 20.1 includes hire purchase agreements and other agreements under which an *entity* has an option to acquire title to the asset upon fulfilment of agreed conditions.

2.1.3 The standards specified in this Standard apply to the financial report where information resulting from their application is material, in accordance with Australian Accounting Standard AAS 5 "Materiality".

3 Operative Date

3.1 This Standard applies to reporting periods ending on or after 31 December 1999.

3.2 This Standard may be applied to reporting periods ending before 31 December 1999.

3.2.1 Australian Accounting Standard AAS 17 "Accounting for Leases", as issued in June 1987, continues to apply to reporting periods that end before 31 December 1999. However, where an *entity* elects to apply this Standard early in accordance with paragraph 3.2, it will not also be obliged to comply with AAS 17, as issued in June 1987, for the reporting periods to which the election applies.

3.3 When operative, this Standard supersedes Australian Accounting Standard AAS 17 "Accounting for Leases", as issued in June 1987.

4 Purpose of Standard

4.1 The purpose of this Standard is to:

(a) prescribe the accounting treatment for leasing transactions

(b) require specific disclosures to be made about leasing transactions.

5 Classification of Leases at Inception of the Lease

5.1 A *lease* must be classified either as an *operating lease* or as a *finance lease* at the *inception of the lease.*

5.2 A lessor must sub-classify a finance lease as either a *sales-type lease* or a *direct financing lease* as at the inception of the lease.

5.3 A lease resulting from a *sale and leaseback transaction* must be classified by the lessor either as a direct financing lease or an operating lease as at the inception of the lease and must not be classified as a sales-type lease.

5.3.1 The classification of a lease depends upon its economic substance. Where substantially all of the risks and benefits incident to ownership of the leased *asset* effectively remain with the lessor, the lease is an operating lease. Where substantially all of these risks and benefits effectively pass to the lessee, the lease is a finance lease.

5.3.2 The risks of asset ownership include those associated with unsatisfactory performance, obsolescence, idle capacity, losses in realisable value, uninsured damage and condemnation of the asset; the benefits include those obtainable from the use of the asset and gains in realisable value.

5.3.3 The following criteria are presented as guidelines to assist lessees and lessors in classifying leases. However, their application is not a substitute for applying the definitions of "finance lease" and "operating lease" in paragraph 20.1.

5.3.4 The effective passing of substantially all of the risks and benefits incident to ownership from a lessor to a lessee is normally presumed where both of the following criteria are satisfied:

(a) the lease is a *non-cancellable lease*

(b) either one or both of the following tests is met:

(i) the *lease term* is for 75 per cent or more of the remaining *economic life* of the leased asset

(ii) the present value at the *beginning of the lease term* of the *minimum lease payments* equals or exceeds 90 per cent of the *fair value* of the leased asset at the inception of the lease.

5.3.5 In order to discount the minimum lease payments to their present value at the beginning of the lease term, the lessee ascertains the *interest rate implicit in the lease*. Where the lessee knows the fair value of the leased asset at the inception of the lease and is able to make a reliable estimate of the *residual value*, the implicit interest rate can be readily computed. However, in some circumstances the lessee may not be able to determine the fair value of the leased asset at the inception of the lease or may not be able to estimate reliably the residual value. In these circumstances, the lessee uses the lessee's *incremental borrowing rate.*

5.3.6 Where a lease contains a *bargain purchase option*, the amount payable on exercise of that option forms part of the minimum lease payments. In these circumstances, the criterion set down in paragraph 5.3.4(b)(ii) is met since the present value of the minimum lease payments equals the fair value of the leased asset at the inception of the lease.

5.3.7 Similarly where the lessee, or a party related to the lessee, is committed to guaranteeing the full residual value of the leased asset, the criterion set down in paragraph 5.3.4(b)(ii) is met since the present value of the minimum lease payments equals the fair value of the leased asset at the inception of the lease.

5.3.8 When determining the economic substance of a lease for classification purposes, it is necessary to consider any implied terms or arrangements. For example, although a lease or a sale and leaseback may formally be for a minor portion of an asset's economic life, the asset may be so specialised that the lessee could not operate effectively without it, while the lessor would be unlikely to be able to re-lease it or sell it to another party. In these circumstances, it would be implied either that the lease will be renewed or that the lessee will gain ownership of the asset, thus leading to classification of the lease as a finance lease.

5.3.9 The application of the guidelines in paragraph 5.3.4 results in a particular lease being identically classified by the lessee and the lessor involved except where the residual value is guaranteed by a party that is unrelated to the lessee. In this case, it could result in the lease being classified as an operating lease by the lessee but as a finance lease by the lessor.

5.3.10 A lessee and a lessor may agree to change the provisions of a lease, other than by renewing the lease or extending its term, in a manner that would have resulted in a different classification of the lease had the changed terms been in effect at the inception of the lease. In such a case, the revised agreement is considered as a new agreement over the remaining term of the original lease.

Land and Buildings

5.3.11 Leases of land and buildings are classified as operating or finance leases in the same way as other leases. However, a characteristic of land is that it normally has an infinite economic life. Where title to land possessing this characteristic is not expected to pass to the lessee at the end of the lease term, the lessee does not receive substantially all of the risks and rewards incident to ownership and accordingly, the lease of land is classified as an operating lease.

5.3.12 Where a lease involving both land and buildings does not provide for ultimate transfer of ownership to the lessee, and does not provide for a bargain purchase option, and the fair value of the land at the inception of the lease is immaterial in relation to the fair value of the total property, the property may be treated as a unit for the purpose of lease classification. Otherwise, the land and buildings are considered separately for the purposes of lease classification. In the latter case, minimum lease payments as at the beginning of the lease term are apportioned between the land and the buildings in proportion to their relative fair values at the inception of the lease.

5.3.13 For a lease involving land with an immaterial fair value at the inception of the lease and one or more buildings, the remaining economic life of the building(s) is taken as the remaining economic life of the lease asset. Where the lease is for more than one building, the economic life is the average of their economic lives.

5.3.14 Where a premium forms part of a lump-sum payable for a long-term lease of land and buildings, the premium payable in respect of each of the land and the buildings is calculated by apportioning the total lump sum between land and buildings in proportion to their fair values at the inception of the lease. The premium is included in minimum lease payments. Where it relates to an operating lease, it is treated as a prepayment and is amortised over the lease term on a basis which reflects the pattern in which the economic benefits from the asset are consumed by the lessee.

Sub-leases

5.3.15 A sub-lease is classified in the normal manner as either an operating lease or a finance lease at the inception of the sub-lease.

6 Accounting for Finance Leases by Lessees

Initial Determination of Lease Asset and Lease Liability

6.1 Where a *lease* is classified by the lessee as a *finance lease,* the lessee must *recognise* as at the *beginning of the lease term* an *asset* and a *liability* equal in amount to the present value of the *minimum lease payments.*

6.2 The discount rate to be used by the lessee in determining the present value of the minimum lease payments for a finance lease as at the beginning of the lease term must be the *interest rate implicit in the lease,* except that, where it is impracticable to determine the interest rate implicit in the lease, the lessee's *incremental borrowing rate* must be used.

6.2.1 Recognition of lease assets under finance leases in the lessee's statement of financial position is justified by a consideration of substance over form. Although the usual legal form of a lease agreement is such that the lessee does not acquire legal title to the leased asset, in the case of finance leases the substance is that the lessee acquires the right to most of the economic benefits from the use of the leased asset. In return for that right, the lessee enters into an obligation to make periodic payments which in total approximate the *fair value* of the leased asset and the related finance charge.

6.2.2 If transactions involving finance leases are not recognised in the lessee's statement of financial position, the economic resources and the level of obligations of the lessee are understated. Accordingly, a lessee in a finance lease recognises the right to use the leased asset as an asset, and the obligation for minimum lease payments as a liability.

6.2.3 Where the full *residual value* is not guaranteed by the lessee, or by a party related to the lessee, the amount determined in accordance with paragraph 6.1 equals the fair value of the asset as at the *inception of the lease* minus the present value of the *unguaranteed residual value* expected to accrue to the benefit of the lessor at the end of the *lease term*.

6.3 A lessee must capitalise its *initial direct costs* which relate to a finance lease as part of the lease asset.

Depreciation of Lease Asset

6.4 The asset recognised under a finance lease must be depreciated by the lessee in accordance with Australian Accounting Standard AAS 4 "Depreciation".

6.4.1 In accordance with AAS 4, an asset recognised under a finance lease is depreciated by the lessee over the *useful life* of the asset. Where there is reasonable assurance at the inception of the lease that the lessee will obtain ownership of the asset at the end of the lease term, the useful life of the asset is the estimated remaining period, from the beginning 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*.

6.4.2 *Non-current* lease assets are subject to the requirements of Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets", including the requirements relating to an asset not being stated at an amount in excess of its *recoverable amount*.

Reduction of Lease Liability

6.5 Minimum lease payments must be allocated by the lessee between interest *expense* and reduction of the lease liability. The interest expense must be determined by applying the discount rate specified in paragraph 6.2 to the outstanding lease liability at the beginning of each lease payment period.

6.5.1 The difference between the lessee's minimum lease payments as at the beginning of the lease term and the initial liability recorded by the lessee represents the interest cost of the lease. The interest cost is recognised in the reporting periods covered by the lease term.

6.5.2 The interest rate which discounts minimum lease payments as at the beginning of the lease term to the initial liability recognised by the lessee will also yield the interest component of each minimum lease payment when applied to the outstanding lease liability at the beginning of each lease payment period. The remainder of the periodic payment is treated as a repayment of the principal of the lease liability.

7 Accounting for Operating Leases by Lessees

7.1 Where a *lease* is classified by the lessee as an *operating lease*, the *minimum lease payments* must be *recognised* as an *expense* on a basis which reflects the pattern in which economic benefits from the leased *asset* are consumed by the lessee.

8 Accounting for Contingent Rentals by Lessees

8.1 *Contingent rentals* must be *recognised* as an *expense* by the lessee in the reporting period in which they are incurred.

8.1.1 Some *leases* may provide for contingent rentals which could cause variations between actual future payments and the amounts of *minimum lease payments* determined at the *inception of the lease*.

8.1.2 Lease payments can be based upon factors other than the expiration of time, for example, the sales volume in a leased facility, a specified interest rate such as the maximum overdraft rate, or an index such as the Consumer Price Index.

8.1.3 Lease payments which depend on factors that exist and can be measured reliably at the inception of the lease are included in minimum lease payments. Increases or decreases in lease payments that result from subsequent changes in those factors are contingent rentals and are excluded from minimum lease payments.

9 Accounting for Executory Costs by Lessees

9.1 Any part of lease payments representing a reimbursement of *executory costs* incurred by the lessor must be *recognised* as an *expense* by the lessee in the reporting period in which those rentals are incurred.

10 Accounting for Sale and Leaseback Transactions by Lessees

Finance Leases

10.1 Where a *sale and leaseback transaction* involves a leaseback which is classified as a *finance lease* by the lessee, the transaction

must not be accounted for as a sale. The difference between the proceeds received by the lessee and the *carrying amount* of the *asset* must be deferred and amortised by the lessee over the *lease term*.

10.1.1 A leaseback that involves a finance lease results in the lessor providing finance to the lessee with the asset as security. Accordingly, it is not appropriate to *recognise* either an excess of sales proceeds over the carrying amount of the asset, or an excess of carrying amount over sales proceeds, in the profit and loss or other operating statement in the period of the "sale". An excess of sales proceeds over the carrying amount or an excess of carrying amount over sales proceeds is considered to be an adjustment to lease payments and is deferred and amortised over the lease term.

Operating Leases

Sale Price Equals Fair Value

10.2 Where a sale and leaseback transaction:

(a) involves a leaseback which is classified as an *operating lease* by the lessee; and

(b) the sale price is established at *fair value*

any profit or loss on the sale must be recognised immediately by the lessee.

10.2.1 A leaseback is classified as an operating lease where substantially all of the risks and benefits incident to ownership of the asset effectively pass to the lessor. If the sale price for the asset is established at fair value as at the date of sale, the transaction is treated as a normal sale and any profit or loss is recognised immediately in the profit and loss or other operating statement.

Sale Price Does Not Equal Fair Value

10.3 Where a sale and leaseback transaction:

(a) involves a leaseback which is classified as an operating lease by the lessee; and

(b) the sale price is not established at fair value*;* and

(c) the carrying amount of the asset exceeds its fair value

the asset must be written down immediately to its fair value by the lessee before applying paragraphs 10.4 and 10.5.

10.4 Where a sale and leaseback transaction:

(a) involves a leaseback which is classified as an operating lease by the lessee; and

(b) the sale price is below fair value

any profit or loss must be recognised immediately by the lessee except that, to the extent the loss is compensated by future rentals at below market price, it must be deferred and amortised in proportion to the rental payments over the lease term.

10.4.1 Where the sale price is below fair value and a loss occurs (because the sale price is also less than the carrying amount), lower future rentals may compensate for that loss. When this interdependence occurs, it is reflected by deferring and amortising the loss over the lease term.

10.4.2 Where the sale price is below fair value and the asset is written down to its fair value in accordance with paragraph 10.3, the loss is the difference between the fair value and the sale price.

10.5 Where a sale and leaseback transaction:

(a) involves a leaseback which is classified as an operating lease by the lessee; and

(b) the sale price is above fair value

the excess of sale price over fair value must be deferred and amortised by the lessee in proportion to the rental payments over the lease term.

10.5.1 Where the sale price is more than fair value, financial interdependence between the sale and leaseback can be presumed.

10.5.2 Where the sale price is above fair value, any excess of fair value over the carrying amount of the asset is recognised immediately as *revenue* in the profit and loss or other operating statement.

Disclosure

10.5.3 The disclosure requirements for lessees and lessors, as set out in paragraphs 11.1 to 11.2 and paragraphs 17.1 to 17.2 respectively, apply equally to sale and leaseback transactions. The required description of leasing arrangements includes disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transaction.

11 Disclosures by Lessees

Finance Leases

11.1 The following information must be disclosed separately by a lessee in respect of *finance leases*:

(a) the *carrying amount* of each class of lease *asset* as at *reporting date*

(b) *contingent rentals recognised* as an *expense* in the reporting period

(c) for each of the following time bands, according to the time which is expected to elapse from the reporting date to the expected date of payment, a reconciliation of *lease commitments* to the carrying amount of the lease *liabilities*:

(i) not later than one year

(ii) later than one year and not later than five years

(iii) later than five years

(d) for non-cancellable sub-leases, the total of future *minimum lease payments* expected to be received as at the reporting date

(e) a general description of the lessee's leasing arrangements including but not limited to the following:

(i) the basis on which contingent rental payments are determined

(ii) **the existence and terms of renewal or purchase options and escalation clauses**

(iii) **restrictions imposed by lease arrangements such as those concerning dividends, additional debt, and further leasing.**

11.1.1 The requirements of Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments" apply to finance leases.

11.1.2 Lease liabilities are not presented in the statement of financial position as a deduction from lease assets unless the lessee has a right to set off in accordance with Australian Accounting Standard AAS 23 "Set-off and Extinguishment of Debt".

Operating Leases

11.2 The following information must be disclosed separately by a lessee in respect of *operating leases*:

(a) **the total amount of rental expense recognised in the reporting period, with separate amounts for minimum lease payments, contingent rentals, and rental expense arising from sub-leases**

(b) **for non-cancellable sub-leases, the total of future minimum lease payments expected to be received as at the reporting date**

(c) **for non-cancellable operating leases, the minimum lease payments and, where different from the minimum lease payments, the lease commitments in the following time bands, according to the time which is expected to elapse from the reporting date to the expected date of payment:**

(i) **not later than one year**

(ii) **later than one year and not later than five years**

(iii) **later than five years**

(d) **a general description of the lessee's leasing arrangements including, but not limited to the following:**

(i) **the basis on which contingent rental payments are determined**

(ii) **the existence and terms of renewal or purchase options and escalation clauses**

(iii) **restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.**

12 Accounting for Finance Leases by Lessors

Direct Financing Leases

12.1 Where a *lease* is classified by the lessor as a *direct financing lease*, the lessor must *recognise*, as at the *beginning of the lease term*, an *asset* (lease receivable) at an amount equal to the aggregate of the present value of the *minimum lease payments* and the present value of any *unguaranteed residual value* expected to accrue to the benefit of the lessor at the end of the *lease term*.

12.1.1 The amount recognised by the lessor as a lease receivable equates to the *fair value* of the leased asset as at the *inception of the lease*.

12.2 The discount rate to be used by the lessor in determining the present value of the minimum lease payments and the unguaranteed residual value for a direct financing lease as at the beginning of the lease term must be the *interest rate implicit in the lease*.

12.3 *Lease finance revenue* must be recognised progressively by the lessor over the lease term to achieve a constant periodic rate of return on the *carrying amount* of the lease receivable at the beginning of each lease payment period.

12.3.1 The lessor apportions the minimum lease payments received over the lease term between reduction in the lease receivable and lease finance revenue.

12.3.2 The difference between:

(a) the sum of the total minimum lease payments receivable over the lease term and the amount of any unguaranteed residual value expected to accrue to the benefit of the lessor; and

(b) the fair value of the leased asset at the inception of the lease

represents the lease finance revenue to be recognised progressively by the lessor over the lease term. The interest component of each lease payment received is determined by applying the interest rate implicit in the lease to the balance of the lease receivable at the beginning of the period covered by the payment.

12.3.3 The unguaranteed residual value of a leased asset is regularly reassessed to confirm that it continues to represent a realistic estimate of the realisable value at the end of the lease term. If there has been a reduction in the unguaranteed residual value, the lease finance revenue is correspondingly reduced. The *revenue* allocation over the lease term is revised and any reduction in respect of the lease finance revenue already accrued is recognised immediately as an *expense.*

Sales-type Leases

12.4 Where a lease is classified by the lessor as a *sales-type lease*, the difference between the fair value of the leased asset at the inception of the lease and its carrying amount must be recognised by the lessor as a revenue or an expense of the reporting period in which the transaction takes place.

12.5 A sales-type lease must be accounted for by the lessor in accordance with paragraphs 12.1 to 12.3.

12.5.1 The difference between the total amount receivable under a sales-type lease and the carrying amount of the leased asset at the inception of the lease consists of two elements: gross profit, representing a manufacturer's or merchant's usual margin, and lease finance revenue.

13 Accounting for Operating Leases by Lessors

13.1 Where a *lease* is classified by the lessor as an *operating lease*, the leased *asset* must be classified as a *non-current* asset.

13.1.1 Non-current depreciable leased assets must be depreciated in accordance with Australian Accounting Standard AAS 4

"Depreciation". They are also subject to the provisions of Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets", including the requirements relating to an asset not being stated at an amount in excess of its *recoverable amount*.

13.2 Rental *revenue* under an operating lease must be *recognised* by the lessor in the profit and loss or other operating statement by allocating *minimum lease payments* on a basis representative of the pattern of service rendered through the provision of the leased asset.

14 Accounting for Initial Direct Costs by Lessors

14.1 *Initial direct costs* incurred by a lessor which relate to a *direct financing lease* must be included as part of the lease receivable.

14.1.1 Under a direct financing lease, the initial direct costs incurred by a lessor are included as part of the lease receivable. This approach reduces the unearned revenue remaining to be recognised in future reporting periods, and is equivalent to amortising the costs over the entire lease term. It is necessary to recalculate the interest rate in order to apportion properly the unearned revenue over the term of the *lease*.

14.2 Initial direct costs incurred by a lessor which relate to a *sales-type lease* must be accounted for by the lessor as a cost of sales in the reporting period in which the lease transaction occurs.

14.3 Initial direct costs incurred by a lessor which relate to an *operating lease* must be deferred by the lessor and amortised over the *lease term* in proportion to the rental *revenue recognised* in each reporting period.

15 Accounting for Contingent Rentals by Lessors

15.1 *Contingent rentals* must be *recognised* by a lessor as *revenues* in the reporting period in which they are earned.

16 Accounting for Executory Costs by Lessors

16.1 Lease payments representing a recovery of *executory costs* must

be *recognised* as *revenues* by a lessor in the reporting period in which the related costs are incurred.

17 Disclosures by Lessors

Finance Leases

17.1 The following information must be disclosed by a lessor in respect of *finance leases*:

(a) a reconciliation of the aggregate of the *minimum lease payments* and any *unguaranteed residual value* from the standpoint of the lessor, to the lease receivable in the following time bands, according to the time which is expected to elapse from the *reporting date* to the expected date of receipt:

(i) not later than one year

(ii) later than one year and not later than five years

(iii) later than five years

disclosing separately *lease finance revenue* not yet *recognised* as *revenues* and the unguaranteed residual values

(b) *lease commitments* receivable as at the reporting date

(c) the accumulated allowance for uncollectable minimum lease payments receivable

(d) *contingent rentals* recognised as revenues in the reporting period

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

17.1.1 The requirements of Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments" apply to finance leases.

Operating Leases

17.2 The following information must be disclosed by a lessor in respect of *operating leases*:

(a) for each class of *asset*:

(i) the gross amount of leased assets as at the reporting date

(ii) accumulated depreciation as at the reporting date

(iii) accumulated write-downs to *recoverable amount* as at the reporting date

(iv) depreciation recognised as an *expense* in the reporting period

(v) write-downs recognised as an expense in the reporting period

(vi) reversals of write-downs recognised as revenues in the reporting period

(b) lease commitments receivable as at the reporting date

(c) for operating leases that are *non-cancellable leases*, the future minimum lease payments in the following time bands, according to the time which is expected to elapse from the reporting date to the expected date of receipt:

(i) not later than one year

(ii) later than one year and not later than five years

(iii) later than five years

(d) contingent rentals recognised as revenues in the reporting period

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

18 Comparative Information

18.1 The *entity* must disclose information for the preceding corresponding reporting period which corresponds to the disclosures required by this Standard for the current reporting period, except where this Standard is being applied for the first time and:

(a) the superseded Standard applied to the entity in the preceding corresponding reporting period but did not require corresponding information; or

(b) the superseded Standard or this Standard did not apply to the entity in the preceding corresponding reporting period.

18.1.1 In relation to the preparation of a consolidated financial report of an *economic entity*, comparative information is not required for the first reporting period after an entity becomes a *parent entity*.

18.1.2 Disclosure of comparative information is encouraged where, in accordance with paragraph 18.1, disclosure of comparative information is not required.

19 Transitional Provisions

19.1 Subject to paragraph 19.2, the accounting policies required by this Standard must be applied as at the beginning of the reporting period to which this Standard is first applied. Where this gives rise to initial adjustments which would otherwise be *recognised* in the profit and loss or other operating statement, the net amount of those adjustments, including any adjustments to deferred income tax balances, must, in accordance with Australian Accounting Standard AAS 1 "Profit and Loss or other Operating Statements", be adjusted against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.

19.2 The requirements of this Standard need not be applied to those *finance leases* where the *beginning of the lease term* occurs prior to the operative date of this Standard and where:

(a) the *lease* involves at least three parties, being a lessee, a lessor, and a credit provider that contributes a substantial proportion of the finance to acquire the *asset* to be leased in return for repayment of principal and interest; and

(b) the credit provider's recourse to the lessor in the event of the lessee's default is restricted to the proceeds from disposal of the leased asset and any unremitted rentals relating to the leased asset.

20 Definitions

20.1 In this Standard:

assets **means future economic benefits controlled by the *entity* as a result of past transactions or other past events**

bargain purchase option **means a provision of a *lease*, express or otherwise, which allows the lessee to purchase the leased *asset* for a price which, in relation to the likely *fair value* of the asset at the date the option becomes exercisable, is low enough to make the exercise of the option appear, at the *inception of the lease*, to be reasonably assured**

beginning of the lease term **means the commencement date of the period during which the risks and benefits incident to ownership of the leased asset are transferred from the lessor to the lessee**

carrying amount **means, in relation to an asset or a *liability*, the amount at which the asset or liability is recorded in the accounting records as at a particular date**

contingent rentals **means the increases or decreases in lease payments that result from changes occurring subsequent to the inception of the lease in the factors (other than the expiration of time) on which lease payments are based**

current **means in the ordinary course of business, would be consumed or converted into cash, or would be due and payable, within twelve months after the end of the reporting period**

direct financing lease* means a *finance lease* other than a *sales-type lease

economic entity* means a group of entities comprising the *parent entity* and each of its *subsidiaries

***entity* means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives**

***equity* means the residual interest in the assets of the entity after deduction of its liabilities**

***economic life* means either:**

(a) the period over which an asset is expected to be economically useable 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

***executory costs* means the costs specifically related only to the operation and maintenance of the leased asset (including insurance, repairs and property taxes)**

***expenses* means consumptions or losses of future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in *equity* during the reporting period**

***fair rental* means the market price for rental of an equivalent asset under similar terms and conditions**

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

***finance lease* means a lease under which the lessor effectively transfers to the lessee substantially all the risks and benefits incident to ownership of the leased asset and where legal ownership may or may not eventually be transferred**

***general purpose financial report* means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports**

tailored so as to satisfy, specifically, all of their information needs

guaranteed residual value **means:**

(a) **in the case of the lessee, that part of the *residual value* which is guaranteed by the lessee or by a third party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable)**

(b) **in the case of the lessor, that part of the residual value which is guaranteed by the lessee or by a third party unrelated to the lessor who is financially capable of discharging the obligations under the guarantee**

inception of the lease **means the date of the lease or, if earlier, the date of a commitment by the parties to the principal provisions of the lease**

incremental borrowing rate **means 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**

initial direct costs **means those costs that are directly associated with negotiating and executing a lease agreement (including commissions, legal fees and costs of preparing and processing documentation for new leases)**

interest rate implicit in the lease **means the interest rate that equates the present value, at the *beginning of the lease term*, of:**

(a) **the *minimum lease payments*; and**

(b) **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

lease **means an agreement conveying the right from a lessor to a lessee to use an asset for a stated period of time in return for payment by the lessee to the lessor**

lease commitmentsmeans the aggregate amount, at a specific date, of payments due under a lease over the remainder of the lease term by way of:

(a) minimum lease payments

(b) any rentals relating to the reimbursement of *executory costs* to be met by the lessor

(c) those *contingent rentals* which, at that specific date, are known to be payable over the remainder of the lease term

***lease finance revenue* means the difference between:**

(a) the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor; and

(b) the present value of (a) above, determined using the *interest rate implicit in the lease*

***lease term* means the sum of:**

(a) the period of the lease

(b) any period of renewal of the lease flowing from an option, express or implied, which allows the lessee to renew the lease for a rental which, in relation to the expected *fair rental* of the asset at the date the option becomes exercisable, is low enough to make renewal of the lease appear, at the inception of the lease, to be reasonably assured

***liabilities* means future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events**

***minimum lease payments* means the rental payments over the remainder of the lease term as at a specific date, including the amount of any *bargain purchase option*, premium and *guaranteed residual value*, but excluding any rental relating to a reimbursement of executory costs to be met by the lessor and any contingent rentals**

***non-cancellable lease* means a lease which:**

(a) can be cancelled only with the permission of the lessor or upon the occurrence of some remote contingency; or

(b) the lessee, upon cancellation, is committed to enter into a further lease for the same or equivalent asset with the same lessor or a third party related to the lessor; or

(c) provides that the lessee, upon cancellation, incurs a penalty of a magnitude that is expected to discourage cancellation in normal circumstances

non-current* means other than *current

***operating lease* means a lease under which the lessor effectively retains substantially all the risks and benefits incident to ownership of the leased asset**

***parent entity* means an entity which controls another entity**

***recognised* means reported on, or incorporated in amounts reported on, the face of the profit and loss or other operating statement or the statement of financial position (whether or not further disclosure of the item is included in the notes)**

***recoverable amount* means, in relation to an asset, the net amount that is expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal**

***reporting date* means the end of the reporting period to which the financial report relates**

***reporting entity* means an entity (including an *economic entity*) in respect of which it is reasonable to expect the existence of users dependent on *general purpose financial report*s for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources**

***residual value* means the estimated fair value of the leased asset at the end of the lease term, based on price levels and market conditions existing at the inception of the lease**

***revenues* means the inflows or other enhancements, or savings in outflows, of future economic benefits in the form of**

increases in assets or reductions in liabilities of the entity, other than those relating to *contributions by owners*, that result in an increase in equity during the reporting period

***sale and leaseback transaction* means a transaction which involves the sale of an asset, with all or part of that asset being leased back to the seller/lessee by the purchaser/lessor**

***sales-type lease* means 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**

***self-generating and regenerating asset* means a non-human living asset**

***subsidiary* means an entity which is controlled by a parent entity**

***unguaranteed residual value* means that part (if any) of the residual value which is unguaranteed, or guaranteed solely by a third party related to the lessor**

***useful life* means:**

(a) the estimated period of time over which the future economic benefits embodied in a depreciable asset are expected to be consumed by the entity; or

(b) the estimated total service, expressed in terms of production or similar units, that is expected to be obtained from the asset by the entity.

Economic Life and Useful Life of the Lease Asset

20.1.1 The definition of *economic life* refers to the whole life of an asset. The definition of *useful life* refers to the life of an asset from the perspective of its current lessee, which may be a shorter period than its economic life.

Minimum Lease Payments, Lease Commitments and Contingent Rentals

20.1.2 Minimum lease payments include all future rental payments where the amounts can be determined reliably at the inception of the lease. For example, where a lease stipulates that the rental payments are subject to a fixed percentage increase every five years, the amounts to be included as minimum lease payments are the base amount plus the incremental amount. Increases or decreases in rental payments due to the tagging to some index, for example, the Consumer Price Index, or other factors such as sales turnover, are not included as part of minimum lease payments where these increments or decrements cannot be determined reliably at the inception of the lease. Such changes in the rental payments are contingent rentals.

20.1.3 Where the rental payments are tagged to an index and the increment or decrement in the payment can be determined reliably subsequent to the inception of the lease, the change from the base amount forms part of the *lease commitments*. For example, where the lease agreement provides that rental payments are indexed to the Consumer Price Index, the amounts by which the rental payments have increased and will now be payable in the future are included as part of lease commitments.

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CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

Where a lease is classified by a lessee as a finance lease, International Accounting Standard IAS 17 "Leases" requires the lessee to recognise an asset and a liability at the inception of the lease. Although this Standard requires the lessee to recognise the asset and liability as at the beginning of the lease term, the Boards are of the view that the treatment required by this Standard conforms with the treatment intended under IAS 17.

Accordingly, as at the date of issue of this Standard, compliance with this Standard will ensure conformity with International Accounting Standard IAS 17 "Leases".

Conformity with New Zealand Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with Statement of Standard Accounting Practice SSAP 18 "Accounting for Leases and Hire Purchase Contracts" except that SSAP 18 requires lessees to disclose finance lease liabilities and commitments under non-cancellable operating leases in four time bands rather than the three time bands required in this Standard.

APPENDIX

SALE AND LEASEBACK TRANSACTIONS THAT RESULT IN OPERATING LEASES

This Appendix forms part of the commentary. The purpose of the Appendix is to explain the sale and leaseback requirements of the Standard.

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

Sale price established at fair value (paragraph 10.2)	**Carrying amount equal to fair value**	**Carrying amount less than fair value**	**Carrying amount above fair value**
Profit	no profit	recognise profit immediately	not applicable
Loss	no loss	not applicable	recognise loss immediately

Sale price below fair value (paragraphs 10.3 & 10.4)	**Carrying amount equal to fair value**	**Carrying amount less than fair value**	**Carrying amount above fair value**
Profit	no profit	recognise profit immediately	no profit see Note 1 below
Loss not compensated by future rentals at below market price	recognise loss immediately	recognise loss immediately	recognise loss immediately see Note 1 below
Loss compensated by future rentals at below market price	defer and amortise loss	defer and amortise loss	defer and amortise loss see Note 1 below

Sale price above fair value (paragraphs 10.3 & 10.5)	**Carrying amount equal to fair value**	**Carrying amount less than fair value**	**Carrying amount above fair value**
Profit	defer and amortise profit	defer and amortise excess of sale price over fair value recognise any excess of fair value over carrying amount immediately	defer and amortise profit see Note 2 below
Loss	no loss	no loss	no loss see Note 2 below

Note 1 The asset is written down to fair value in accordance with paragraphs 10.3. The loss is the difference between the fair value and the sale price.

Note 2 The profit is the difference between the fair value and the sale price as the asset is written down to its fair value in accordance with paragraph 10.3.

BACKGROUND TO REVISION

This section does not form part of the Standard. It is a summary of the reasons for the current revision to the Standard.

1 The reissue of the Standard is part of a program being undertaken by the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation and the Australian Accounting Standards Board (the Boards) to achieve greater harmony between Australian accounting standards and those of the International Accounting Standards Committee.

2 The issue of the Standard follows consideration of the responses received on Exposure Draft ED 82 "Leases", which was prepared by the Boards and released in July 1997. ED 82 contained proposals aimed at harmonising Australian Accounting Standard AAS 17 and Accounting Standard AASB 1008 "Accounting for Leases" with International Accounting Standard IAS 17 "Leases".

Principal Changes from the Previous Standard

3 Consistent with the proposals in ED 82, the Standard:

(a) applies to lessors in relation to leveraged leases

(b) requires that when it is impracticable for lessees to determine the interest rate implicit in the lease, the lessee's incremental borrowing rate is to be used as an alternative

(c) removes the quantitative guidelines for determining whether land should be treated separately where title to the land is not expected to pass to the lessee at the end of the lease term

(d) requires a lessee of a sale and leaseback transaction that is classified as an operating lease:

(i) to write down the asset sold to its fair value where the sale price is not established at fair value and where the carrying amount exceeds the fair value of the asset

(ii) where the sale price is above fair value, to defer and amortise over the lease term the excess of sale price over fair value

(iii) where the sale price is below fair value, to immediately recognise any profit or loss, calculated as the difference between the sale price and the carrying amount (adjusted to fair value where applicable), except where the loss is compensated by lower future rentals

(e) requires disclosure of specified commitments and present values in the following three bands:

(i) not later than one year

(ii) later than one year and not later than five years

(iii) later than five years.

Noteworthy Differences from ED 82

4 ED 82 proposed that where the fair value of a leased asset in a sale and leaseback transaction that involves a finance lease is lower than its carrying amount, the lessee must write down the asset to its fair value. This proposal is not included in the Standard as the Boards' Impairment of Assets project will deal with this issue.

5 ED 82 proposed transitional provisions that would have required lessors of what are commonly described as leveraged leasing transactions to apply the requirements of the Standard retrospectively to such transactions. Leveraged leasing transactions are finance leases that:

(a) involve at least three parties, being a lessee, a lessor, and a credit provider that contributes a substantial proportion of the finance to acquire the asset to be leased in return for repayment of principal and interest; and

(b) restrict the credit provider's recourse to the lessor in the event of the lessee's default to the proceeds from disposal of the leased asset and any unremitted rentals relating to the leased asset.

The transitional provisions included in the Standard provide that the requirements of the Standard need not be applied to such finance leases where the beginning of the lease term occurs prior to the operative date of the Standard.

6 Other than the differences outlined above, the Standard retains the basic structure and content of the proposals in ED 82.