

Regulation of the Ministry of Finance on the
“Establishment of the Guidelines of the Accounting Standards Board”
Note 9
In force from: 01.01.2019
Applicable to the accounting periods, starting on 01.01.2018 or later.

ASBG 9 ACCOUNTING FOR LEASES

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OBJECTIVE AND BASIS FOR PREPARATION

1. The objective of this Accounting Standards Board's guideline ASBG 9 "*Accounting for Leases*" is to prescribe criteria for accounting for and recognition of lease agreements in the financial statements of both lessees as well as lessors that have been prepared in accordance with the Estonian financial reporting standard (hereinafter also *the financial statement*). Estonian financial reporting standard is a body of financial reporting requirements directed at the public and based on the internationally accepted accounting and reporting principles, which principal requirements are established by the Accounting Act and which is specified by a regulation of the minister responsible for the area established on the basis of subsection 34 (4) of the Accounting Act (hereinafter *guideline of the Standards Board* or for short *ASBG*).

2. ASBG 9 is based on IFRS for SMEs section 20 "*Leases*" and on concepts defined in section 2 "*Concepts and Pervasive Principles*" and "*Glossary of Terms*", except for clauses of ASBG 9, which are based on the principles of the International Financial Reporting Standard IFRS 16 "*Leases*". The guideline contains references to the specific paragraphs of IFRS for SMEs that the requirements of the guideline are based on. The comparison of ASBG 9 with IFRS for SMEs is presented in clauses 48-49. In areas where ASBG 9 does not specify a particular accounting policy, but it is covered by IFRS for SMEs, it is recommended to abide by the accounting policy described in IFRS for SMEs (except for application of the accounting policy of IFRS 16, described in sub-section 31 (b), where the instructions described in IFRS 16 should be followed).

SCOPE

3. ***ASBG 9 "Accounting for Leases" shall be used for recognition of all lease agreements (or other conceptually similar agreements) in the financial statements.***

4. This guideline shall apply to such agreements that transfer the right to use assets from one party to the other, even if the lessor is required to provide ongoing maintenance for these assets (e.g. different forms of operating agreements). This guideline shall not apply to arrangements of rendering services that do not transfer the right to use assets from one party to another. (IFRS for SMEs 20.2).

DEFINITIONS

5. ***The following terms are used in this guideline with the meanings specified:***

A lease is an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for a payment or series of payments. (IFRS for SMEs Glossary of Terms)

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee. Title may or may not eventually be transferred to the lessee. (IFRS for SMEs 20.4)

An operating lease is a lease other than a finance lease. (IFRS for SMEs 20.4)

The inception of the lease is the earlier of either:

- (a) *the date of the lease agreement, or*
- (b) *the date of commitment by the parties to the principal terms of the lease.*

At the inception of the lease, the lease agreement shall be classified as an operating or finance lease and for finance lease, also the amounts initially recorded in the balance sheet, shall be calculated.

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 agreement in the financial statements of both parties.*

The lease term *is the non-cancellable period for which a lessee has contracted to lease an 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. Lease term does not contain a period, within which termination of the lease agreement by the lessee and the lessor is economically justified.*

The non-cancellable period *is the period during which the lease agreement can be cancelled 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 agreement for the same or an equivalent asset with the same lessor; or*
- (d) *upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.*

Minimum lease payments *are the lease payments over the lease term that the lessee is, or can be required, to make (except for 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 him; or*
- (b) *for a lessor, any residual value guaranteed to the lessor by:*
 - (i) *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.*

If the lessee has an option on an agreed date to redeem the leased assets at price notably lower than its estimated fair value and it is reasonably certain that the lessee will exercise the option, the minimum amount of lease payments consists of the minimum lease payments of the lease term and the payments made when exercising the option.

Fair value *is the amount for which an asset could be exchanged or a liability settled in a transaction between knowledgeable, willing and independent parties in an arm's length transaction. (IFRS for SMEs 2.34 (b))*

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 other similar units expected to be obtained from the asset by one or more users.

Useful life is the period over which it is economical to use the asset, irrespective of the end of the lease term. (IFRS for SMEs Glossary of Terms)

Guaranteed residual value on:

(a) for a lessee, the part of the residual value that is guaranteed by the lessee or by a related party of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become repayable); and

(b) for a lessor, the 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 liabilities under the guarantee.

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

Gross investment in the lease is the aggregate of the minimum lease payments receivable by the lessor under a finance lease and any unguaranteed residual value of the leased asset accruing to the lessor. (IFRS for SMEs 20.17)

Unearned finance income is the difference between the gross investment in the lease and the net investment in the lease.

Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease. (IFRS for SMEs 20.17)

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 the fair value of the leased asset and any initial direct costs. (IFRS for SMEs Glossary of Terms)

The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or to borrow funds necessary for the purchase of a similar asset. (IFRS for SMEs Glossary of Terms)

Initial direct costs are the incremental costs related to the lease agreement, except for the costs made by manufacturers and dealers as lessors. (IFRS for SMEs 20.18)

Contingent rent is that portion of the lease payments that is not fixed in amount and is not determined on the basis of the passage of time but some other factors (e.g. percentage of sales, degree of use, price indices, market rates of interest).

CLASSIFICATION OF LEASES INTO FINANCE AND OPERATING LEASES

6. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership to the lessee; otherwise a lease agreement is classified as an operating lease. (IFRS for SMEs 20.4).

7. According to this guideline, recognition of lease agreements generally depends on whether it is an operating or finance lease. An exception is recognition in the statements of such lessee, who follows the accounting policy of IFRS 16 described in sub-clause 31 (a) of this guideline – in this case, all lease agreements are accounted for pursuant to method described in clauses 34-38 (irrespective of whether or they correspond to the definition of operating or finance lease) (an exception is short-term lease agreements or lease agreements of low value assets, which may be accounted for pursuant to the method described in clauses 39-40). The determining factor for the classification of leases is the extent to which the risk and rewards of ownership of a leased asset lie with the lessor or the lessee.

8. Risks relating to a leased asset include among others, the possible losses from idle capacity or obsolescence and risks arising from the economic environment impacting the use of an asset. Rewards relating to a leased asset include expected earning of income over the asset's economic life, appreciation of an asset's value or a profit from the sale of an asset.

9. Because the transaction between the lessor and the lessee is based on a lease agreement between them, which is binding on both parties, then both parties generally classify lease agreements similarly. At the same time, since both parties use different estimates for the classification of lease agreements, under certain circumstances the lessor and the lessee may classify the same lease agreement differently.

10. The classification of a lease agreement into finance or operating lease depends on the substance of the transaction rather than the legal form of the agreement. Lease agreements that under this guideline meet the criteria for a finance lease, shall be recognised for accounting purposes and in the financial statements as finance lease agreements, despite the fact that legally or formally they may be classified as operating lease agreements. (IFRS for SMEs 20.5).

11. The following criteria generally refer to situations, where the main risks and rewards incidental to ownership of the asset are transferred to the lessee, which is why a lease agreement is classified as a finance lease (IFRS for SMEs 20.5):

(a) ownership of the asset is transferred to the lessee by the end of the lease term;

(b) the lessee has an option to purchase the leased asset at a price that is expected to be sufficiently lower than its fair value at the date of realising the option and there is sufficient certainty at the inception of the lease that the lessee uses this option;

(c) the lease term covers a major part (e.g. over 75%) of the economic life of the leased asset, even if the title is not transferred;

(d) at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially (over 90%) all of the fair value of the leased asset;

(e) the leased asset is of such specialised nature that only the lessee can use it without major modifications as a result of which the lease agreement is likely to be renewed so that it covers a major part of the asset's economic life.

12. The following examples are of situations that individually or in combination could lead to a lease being classified as a finance lease (IFRS for SMEs 20.6):

- (a) if upon the termination of the lease by the lessee, the lessor's losses associated with the termination are borne by the lessee;
- (b) gains or losses from the fluctuations in the fair value of the residual accrue to the lessee (for example, lease payments are lowered by the proceeds received from the sale of an asset at the end of the lease term);
- (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than the market rent.

13. In general, the presence of at least one situation listed in clauses 11-12 refers to the fact that substantially all the risks and rewards incidental to ownership have been transferred to the lessee, and hence this is a case of a finance lease. However, all the risks and rewards arising from a lease agreement should be taken into consideration when classifying leases and in some cases the risks and rewards incidental to ownership may not be transferred to the lessee although some conditions listed in clauses 11-12 are met. For example, in a situation where the lease term covers most of the economic life of the leased asset but most of the lease payments are conditional (e.g. depending on the turnover related to the leased asset), the lessor continues to have substantially all the risks and rewards incidental to ownership, as a result of which the lease agreement is classified as an operating lease. (IFRS for SMEs 20.7).

14. Lease classification is made at the inception of the lease. If the lessor and the lessee agree at a later date to change the terms of the lease (other than renewing the lease), in a manner that would have resulted in a different classification of the lease at its initial inception, the revised agreement is regarded as a new agreement. Changes in estimates (e.g. of the economic life or the residual value of the leased asset) and circumstances (e.g. default by the lessee) do not give rise to a new classification of a lease for accounting purposes. (IFRS for SMEs 20.8).

15. Similarly to the leases of other assets, the leases of land and buildings are also classified as finance or operating leases. In case the lease agreement is both for land and a building, the minimum lease payments are allocated between the land and the buildings elements (except for the cases listed in clause 16), in proportion to the relative fair values of these elements. In general, land has an indefinite useful life as a result of which the lease payments for the land element are classified as an operating lease, except when the title is passed to the lessee under the lease agreement. Classification of facility is based on criteria provided in clauses 11-12.

16. The minimum lease payments need not be allocated between the land and the buildings elements in the following cases:

- (a) lease payments cannot be allocated reliably between the land and the building elements (in such a case, the entire lease is recognised as a finance lease, unless it is clear that both elements meet the criteria for an operating lease);
- (b) the land element is immaterial (in such a case the entire lease is recognised based on the classification of building element in accordance with clauses 11-12);

(c) for an investment property leased under a finance lease that the lessee recognises under the fair value model (the entire property is recognised as single unit in accordance with the ASBG 6 “Investment Properties”).

RECOGNITION OF LEASES IN THE FINANCIAL STATEMENTS OF LESSORS

Finance Leases

17. *The lessor shall recognise assets leased out under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the finance lease. (IFRS for SMEs 20.17).*

18. Under a finance lease, the lessor transfers substantially all the risks and rewards incidental to ownership to the lessee, thus the lessor removes the leased asset from its balance sheet and replaces it with a finance lease receivable (or “the net investment in the finance lease”). The finance lease receivable (“net investment in the finance lease”) is equal to the sum of the present value of lease payments receivable and the probable residual value of the leased asset (or “unguaranteed residual value”) at the end of the lease term.

19. The lease payments receivable from the lessee are divided into principal payments of the finance lease receivable and financial income (or interest payments). Financial income is allocated over the lease term so as to produce a constant periodic rate of interest on the remaining balance of the net investment in the finance lease. (IFRS for SMEs 20.19).

20. The estimates used with regard to unguaranteed residual values for determining the lessor’s gross investment shall be periodically reviewed. In the case the unguaranteed residual value decreases, the allocation of income over the lease term shall be reviewed and the potential decrease of the amounts already recognised as income shall be immediately recognised as an expense. (IFRS for SMEs 20.19).

21. Initial direct costs incurred by the lessor for concluding lease agreements (e.g. commissions and notary fees) are used to account for the effective interest rate of the lease and the finance lease receivable, and are recognised as a reduction of income over the lease term. (IFRS for SMEs 20.18) Exceptions are manufacturer and dealer lessors who recognise initial direct costs related to the signing of the lease agreement immediately as an expense. (IFRS for SMEs 20.22) If the amount of the above-mentioned direct costs is immaterial, then other lessors may also recognise it as an immediate expense under the materiality principle.

22. *When selling their products under the finance lease, manufacturer or dealer lessors recognise two types of income (IFRS for SMEs 20.20):*

- (a) *sales revenue to be recognised at the inception of a lease agreement; and***
- (b) *financial income to be recognised over the lease term.***

23. Manufacturer or dealer lessors recognise as revenue upon the sale of goods through finance lease transactions at the inception of the lease term the fair value of the sold asset

or, if lower, the present value of minimum lease payments accruing to the lessor discounted at the market rate of interest. The cost of goods sold recognised at the inception of the lease term is the carrying amount of the leased asset, less the present value of any unguaranteed residual value. (IFRS for SMEs 20.21).

24. Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such rates would result in an excessive portion of the total income from the transaction being recognised at the time of the sale. If artificially low rates of interest are quoted, only that portion is recognised as sales revenue that would have been recognised had the market rates of interest been used. (IFRS for SMEs 20.22).

25. Direct costs incurred in connection with the lease agreement entered into by manufacturer or dealer lessors are recognised as an expense at the inception of the lease because they are mainly related to earning profit on sales of the manufacturer or the dealer. (IFRS for SMEs 20.22).

Operating Leases

26. *Lessors shall present assets leased out under an operating lease in their balance sheet according to the nature of the asset, similarly to other assets presented in the balance sheet. (IFRS for SMEs 20.24).*

27. *Operating lease payments shall be recognised in income on a straight-line basis over the lease term, unless another systematic method reflects more objectively the time pattern of the user's benefits from the assets. (IFRS for SMEs 20.25).*

28. The payments received over the lease term shall be recognised as revenue evenly over the lease term regardless of the timing and the actual size of the payments.

29. Initial direct costs incurred for concluding operating lease agreements shall be recognised as an asset (in the same item with the leased asset) and depreciated into an expense over the lease term in proportion to the recognition of the rental income. (IFRS for SMEs 20.27) If the amount of the above-mentioned costs is immaterial it may be immediately expensed based on the materiality principle.

30. The leased out asset shall be depreciated in accordance with regular depreciation methods used for depreciating the entity's assets of the same category. If there is doubt regarding the impairment of the leased out asset below its carrying amount, an impairment test shall be performed in accordance with ASBG 5 "Property, Plant and Equipment and Intangible Assets". (IFRS for SMEs 20.26, 20.28).

ACCOUNTING FOR LEASES IN THE FINANCIAL STATEMENTS OF LESSEES

Selecting between Accounting Policies

31. The lessee shall recognise all lease agreements consistently following one of the below described accounting policies:

- (a) lease agreements, corresponding to finance lease definition, are accounted for pursuant to method described in clauses 34-38 and lease agreements, corresponding to operating lease definition, are accounted for pursuant to method described in clauses 39-40 (IFRS for SMEs accounting policy); or*
- (b) all lease agreements are accounted for pursuant to method described in clauses 34-38 (irrespective of whether or they correspond to the definition of operating or finance lease), except for the short-term lease agreements or lease agreements of low value assets, which may be accounted for pursuant to the method described in clauses 39-40) (IFRS 16 accounting policy).*

32. The accounting policy described in sub-clause 31 (a) is consistent with the principles described in section 20 of IFRS for SMEs. The accounting policy described in sub-clause 31 (a) is consistent with the principles described in section 16 “Leases” of IFRS. If an entity applies the accounting policy of IFRS 16 in accounting for lease agreements, it is recommended to examine all instructions described in IFRS 16 applicable to accounting for leases in the statements of lessees. An entity shall choose one of the accounting policies provided in clause 31 and use it consistently for all lease agreements. Change in the accounting policy is possible only in the cases and pursuant to manner described in clauses 69-73 of ASBG 1.

33. A lease agreement, whose length of lease term is less than 12 months and with no option to redeem the asset, are deemed short-term lease agreements. A low-value asset is an asset, the value of which is low and which can be used independently (e.g. PC-s, phones, office furniture). An indication of which value should be considered low, can be obtained from the minimum cost level of non-current assets established by the entity.

Finance Leases

34. At the inception of the lease, the lessee shall recognise a finance lease as an asset and a liability in its balance sheet at amounts equal to the fair value of the leased property or at the present value of the minimum lease payments, if lower. The discount rate used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease or if it is not easily calculated, the lessee’s incremental borrowing rate of interest shall be used. (IFRS for SMEs 20.9, 20.10).

35. Although in accordance with the legal form of the lease agreement, the legal title of the leased asset may not be transferred to the lessee, in the case of a finance lease the lessee essentially acquires the major part of the economic benefits derived from use of the leased asset during its economic life in return for assuming an obligation to pay for that right an amount approximating the fair value of the asset and the related finance charges. If such a lease transaction were not reflected in the lessee’s balance sheet, the level of assets and liabilities would be smaller than otherwise. At the inception of the lease, the asset and the lease payment liabilities are equal in the lessee’s balance sheet.

36. Initial direct costs incurred by the lessee in connection with concluding a finance lease agreement are added to the cost of the leased asset. (IFRS for SMEs 20.9).

37. Lease payments are allocated to the finance charge and the reduction of the residual value of the liability. The costs of finance are allocated over the lease term (or until the next revaluation of interest if it is a floating interest rate lease agreement) so as to produce a constant periodic rate of interest on the remaining balance of the liability. (IFRS for SMEs 20.11).

38. Each accounting period involves the depreciation cost and cost of finance of assets depreciated under finance lease. Assets leased under finance lease are depreciated based on regular depreciation policies applied by the entity to assets of the same category. If there is no reasonable certainty that the lessee will obtain ownership of the asset by the end of the lease term, then the asset is depreciated over the shorter of the lease term and its useful life. If there is doubt regarding the impairment of the leased out asset below its carrying amount, an impairment test shall be performed in accordance with ASBG 5 “Property, Plant and Equipment and Intangible Assets”. (IFRS for SMEs 20.12).

Operating Leases

39. *Operating lease payments shall be recognised in expenses on a straight-line basis over the lease term, unless another systematic method reflects more objectively the time pattern of the user’s benefits from the assets. (IFRS for SMEs 20.15).*

40. The lease payments made over the lease term shall evenly be recognised as an expense over the lease term, irrespective of when the payments are actually made.

Example 1 – Accounting of lessee for time-based lease payments

An entity leases office premises for five years under operating lease. According to the terms of the lease, the first year’s rent is for free, but in the following four years, annual payments of 25 000 euros have to be made.

a) Recognition based on the accounting method in IFRS for SMEs (clause 31 (a))

Lease is classified as operating lease. The total lease expense is 100 000 euros. The entity recognises 20 000 euros as the annual lease expense, irrespective of when the lease payments are actually made.

b) Recognition based on the accounting method in IFRS 16 (clause 31 (b))

The entity calculates the present value of lease payments by using as the discount rate the interest rate implicit in the lease (if it can be easily calculated) or the incremental borrowing rate of interest of the lessee. Assuming that the interest rate implicit in the lease could be easily calculated and the incremental borrowing rate of interest of the lessee is 5%, the present value of lease payments is 84,427 euros.

The entity reports in its balance sheet the leased asset and the lease liability in amount of 84,427 euros. The leased asset is depreciated into an expense over the lease term (5 years) (each year 16,885 euros). Interest on lease liability is calculated based on the alternative interest rate of the lessee ($5\% \times 84,427 = 4,221$ euros in year 1 and $5\% \times 88,649 = 4,432$

euros in year 2) and the imputed rate of interest increases the carrying amount of the lease liability (i.e. at the end of year 1, the lease liability increases to $84,427 + 4,221 = 88,649$ euros and at the end of year 2, before settlement of the lease payment to $88,649 + 4,432 = 93,081$ euros. Lease payments reduce the carrying amount of the lease liability (after payment of 25,000 euros at the end of year 2, the lease liability will decrease to 68,081 euros). By the end of the lease term (5 years), the leased asset as well as the lease liability have reduced to zero.

Example 2 – Accounting of lessee in case of lease agreement without a term

The lessee and the lessor enter into a lease agreement for an unspecified term, which the lessee may cancel after 3 years and the lessor after 5 years. Total lease payments amount to 1,000 euros per month.

a) Recognition based on the accounting method in IFRS for SMEs (clause 31 (a))

Lease is classified as operating lease. The lessee accounts monthly for lease expense of 1,000 euros (i.e. 12,000 euros a year) until cancellation of the lease agreement either by the lessee or the lessor.

b) Recognition based on the accounting method in IFRS 16 (clause 31 (b))

The entity calculates the present value of minimum amount of lease payments made during the lease period, by using as the discount rate the incremental borrowing rate of interest of lease (if it can be easily calculated) or the alternative loan interest rate of the lessee. The lease term is the non-cancellable period (i.e. a period, within which the lessee cannot exit the lease agreement only at its own discretion – in this case 3 years), plus an additional period, when the lessee has the option to continue to lease the asset, provided that it is reasonably certain in continuing and the lessor cannot unilaterally cancel the agreement (in this cases a period of 3-5 years, as after 5 years, the continued lease is independent of the lessee's decision).

If at the moment of entering into a lease agreement, the lessee is not reasonably certain that it will continue the lease after 3 years, the lease term is deemed to be 3 years. The lessee reports in its balance sheet the leased asset and the lease liability in the amount of present value, which for a 5% discount rate and 3-year lease term is 33,365 euros.

If the lessee is reasonably certain that it wishes to stay in the agreement for at least 4 years, the lease term is deemed to be 4 years and the lessee reports in its balance sheet the leased asset and the lease liability in amount of 43,423 euros. If the lessee wants to stay in the lease agreement for more than 5 years, the length of the lease term is deemed to be 5 years (as after that the lessee may also unilaterally cancel the agreement) and the present value of the lease payments would be 52,991 euros.

The leased asset is depreciated over the lease term and interest on the lease liability is calculated similarly to previous example. Lease payments reduce the carrying amount of the lease liability and by the end of the lease term, the leased asset as well as the lease liability have reduced to zero.

SALE AND LEASEBACK TRANSACTIONS

41. A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset to the seller. The lease payments and the sale price are usually interdependent because they are negotiated as a package. The recognition of a sale and leaseback transaction depends on whether the leaseback is an operating or a finance lease and in the case of an operating lease, whether the transaction occurred at the market price or not. (IFRS for SMEs 20.32).

42. *If a sale and leaseback transaction results in a finance lease, the transaction shall be recognised as a financing transaction and not as a purchase and sales transaction, i.e. the “sold” asset shall stay on the balance sheet of the seller and the finance lease liability shall be recognised in the amount of the payment received (“sale price”). The difference between the “sale price” and the minimum lease payments is recognised as an interest expense over the lease term similarly to regular finance lease agreements.*

Example 2 – Recognition of sale-leaseback transaction

An entity enters into a sale and leaseback transaction for a building with the bank under the following terms:

Carrying amount of the building in the entity’s balance sheet 1.5 million euros

“Sale price” of the building 2 million euros

(of which 1.5 million the entity repays to the bank via lease payments over 10 years; a repurchase option for 0.5 million euros at the end of the lease term; additionally, 7% interest is paid on the balance of liability)

Market value of the building 2.5 million euros

Lease term 10 years

Remaining useful life of the building 40 years

A purchase option considerably more favourable than the market price at the end of the lease term gives reason to believe that the entity will use it to repurchase the asset, hence the leaseback takes place under the finance lease terms.

Based on the substance over form principle, this is a case of property being used as collateral for the loan and it shall be recognised in the entity’s balance sheet accordingly:

D Cash 2,000,000

C Finance lease liability 2,000,000

Lease payments are allocated to principal payments of the liability and interest expense.

43. *If the leaseback in the sale-leaseback transaction is under operating lease terms, the transaction shall be recognised as a purchase-sale transaction, whereas any profit or loss shall be recognised immediately, except in cases when (IFRS for SMEs 20.34):*

(a) the sale price is below the fair value of the asset and the low price is compensated for by low interest rates in the future (see clause 43); or

(b) the sale price is above the fair value of the asset (see clause 44).

44. If the leaseback transaction is an operating lease and the lease payments and the sale price are at fair value, then there has been a normal sales transaction and any profit or loss is recognised immediately. (IFRS for SMEs 20.34).

45. If the sale price is below fair value, the profit or loss shall be recognised immediately, except if the loss is compensated for by future lease payments at below the market price. In this case, the difference between the sale price and fair value shall be recognised as deferred expense on the balance sheet and amortised into the expense in proportion to the lease payments over the period for which the asset is expected to be used. (IFRS for SMEs 20.34).

46. If the sale price is above fair value, the excess over fair value shall be recognised as deferred income on the balance sheet and amortised into the income over the period for which the asset is expected to be used. (IFRS for SMEs 20.34).

47. For operating leases, if fair value at the time of a sale and leaseback transaction is less than the carrying amount of an asset, a loss equal to the amount of the difference between the fair value and carrying amount shall be recognised immediately.

COMPARISON WITH IFRS FOR SMES

48. In connection with entry into force of IFRS from 01.01.2019 (early application is permitted), the lessee's accounting for leases will be different in IFRS from accounting for leases in IFRS for SMEs. Clause 31 of this guideline allows to choose between both accounting methods. The accounting policy described in sub-clause 31 (a) is consistent with IFRS for SMEs and the accounting policy described in sub-clause 31 (b) is consistent with IFRS. This guideline enables to choose a method that is in conformity with IFRS (not in conformity with IFRS for SMEs), as it allows to avoid double-counting for entities belonging to a larger group, whose consolidated financial statements are prepared based on IFRS.

49. A difference from IFRS for SMEs exists also in recognising the sale and leaseback transactions from the viewpoint of the seller of the sale leaseback transaction. Under section 20.33 of IFRS for SMEs, the difference between the sale price and the carrying amount of the "sold" asset is amortised into the income over the lease term; under ASBG 9 the transaction is recognised as a loan with the asset used as collateral and the income (and also higher amortisation expense) shall not be recognised.

TRANSITIONAL PROVISIONS

50. If an entity decides during the accounting period, from beginning in a period from 01.01.2017 to 31.12.2019 to change its previous accounting policy and start accounting for its lease agreements as a lessor based on the accounting policy of IFRS 16 (as described in sub-clause 31 (b)), a recalculation of all lease agreement, valid at the beginning date of this accounting period shall be made based on the accounting policy of IFRS 16. As a result of recalculation, the leased assets and lease liabilities are recognised in the entity's balance sheet as at the starting date of this accounting period as if the entity had consistently followed the policies of IFRS 16 (impact on the equity arising from recalculation is recorded in retained earnings as at the starting date of the accounting period). The comparative data of the period preceding the period when accounting policy was changed may, but do not need to be recalculated base on the accounting policy of IFRS 16.