



# ASPE AT A GLANCE

Section 3065 - Leases

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Effective Date  
Fiscal years beginning on or after January 1, 2011<sup>1</sup>

## DEFINITIONS

**Lease** - The conveyance, by a lessor to a lessee, of the right to use a tangible asset, usually for a specified period of time in return for rent.

**Operating Lease** - A lease in which the lessor does not transfer substantially all the benefits and risks incident to ownership of property.

**Capital Lease** - A lease that, from the point of view of the lessee, transfers substantially all the benefits and risks incident to ownership of property to the lessee.

## CLASSIFICATION

### ACCOUNTING TREATMENT

**Lessor**

- Continues to recognize leased asset on the balance sheet.
- Recognizes rental revenue as income on a straight line basis over the lease term.

**Lessee**

- Does not recognize leased asset or related obligation on the balance sheet.
- Recognizes lease rental expense in net income on a straight line basis over the lease term.

**Lessor**

- Classification as a sales-type or direct financing lease when ALL the following conditions are present:
  - Any one of the three conditions noted to the right for the lessee are met;
  - Credit risk associated with the lease is normal compared to the risk of collection of similar receivables; and
  - Amounts of any unreimbursable costs likely to be incurred by the lessor under the lease can be reasonably estimated.

**Lessee**

- Classification as a capital lease when one or more of the following conditions are present:
  - There is reasonable assurance the lessee will obtain ownership of the leased property by the end of the lease term (ownership transfer provisions or bargain purchase option are included in the lease).
  - The duration of the lease term is equal to a major portion (usually 75% or more) of the economic life of the leased property.
  - The lessor is assured of recovering the investment in the leased property and of earning a return on the investment as a result of the lease agreement. This occurs when the present value of the minimum lease payments, excluding any executory costs, is equal to substantially all (usually 90% or more) of the fair value of the leased property.

## ACCOUNTING TREATMENT

### Lessor

**Direct Financing Lease** - The fair value of the leased property is the same as its carrying amount to the lessor (usually not a manufacturer or dealer).

- A separate receivable equal to the net investment of the lease is recorded on the balance sheet, segregated between current and long-term portions.
- Unearned finance income is deferred and recognized in income over the lease term to produce a constant rate of return on the investment in the lease.
- The leased asset is derecognized.
- The discount rate is the interest rate implicit in the lease.
- Lease payments received are recorded as a reduction of the net investment in the lease.

### Lessee

**Sales-Type Lease** - The fair value of the leased property is not the same as its carrying amount to the lessor (usually a manufacturer or dealer).

- A separate receivable equal to the net investment of the lease is recorded on the balance sheet, segregated between current and long-term portions.
- A sale is recorded recognizing the initial manufacturer / dealer profit or loss on the sale at the time of the transaction.
- Unearned finance income is deferred and recognized in income over the lease term to produce a constant rate of return on the investment in the lease.
- The leased asset is removed from inventory and expensed as a cost of sale at the time of the transaction. Any other direct costs are also expensed at this time.
- The discount rate is the interest rate implicit in the lease.
- Lease payments received are recorded as a reduction of the net investment in the lease.

<sup>1</sup> Except as specified in paragraph 3065.82.

## ACCOUNTING TREATMENT (CONTINUED)

Lessee

- A leased asset is recognized separate from owned assets on the balance sheet at the present value of the minimum lease payments, excluding any executory costs. This amount cannot exceed the leased asset's fair value.
- The leased asset is amortized over the period of expected use on a basis consistent with the lessee's depreciation policy for similar fixed assets and depending on the terms of the lease.
- The related obligation under capital lease is recognized separately from other long-term obligations on the balance sheet at the present value of the minimum lease payments, excluding any executory costs. The current portion payable is presented separately in current liabilities.
- The discount rate is the lower of the lessee's rate for incremental borrowing and the interest rate implicit in the lease.
- Lease payments made are allocated as a reduction of the obligation, interest expense and any executory costs.

## SALE-LEASEBACK TRANSACTION

### Capital Lease / Direct Financing Lease

- Any profit or loss arising on sale is deferred and amortized in proportion to the amortization of the leased asset, unless it is a lease involving land only, in which case it is amortized on a straight-line basis over the lease term.
- However, if at the time of the transaction, the fair value of the property is less than its carrying value, the difference is immediately recognized as a loss.

### Operating Lease

- Any profit or loss arising on sale is deferred and amortized in proportion to rental payments over the lease term.
- However, if at the time of the transaction, the fair value of the property is less than its carrying value, the difference is immediately recognized as a loss.



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