

ASSURANCE AND ACCOUNTING

ASPE - IFRS: A Comparison

Leases

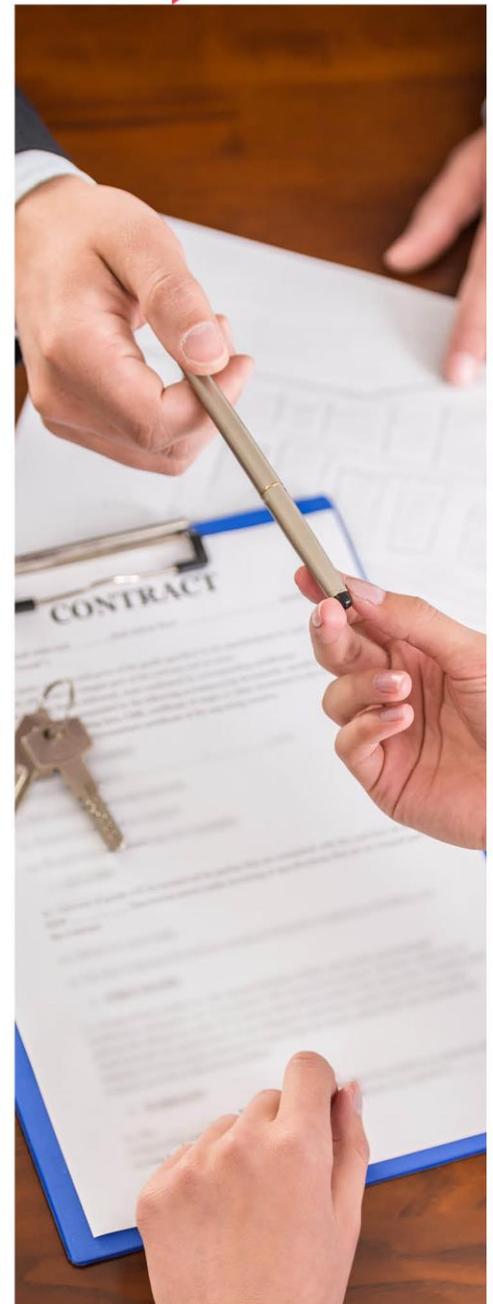
In this publication we will examine the key differences between International Financial Reporting Standards (IFRS) and Accounting Standards for Private Enterprises (ASPE) relating to leases.

This publication will focus on:

- Definition of a lease and lease term;
- Classification of leases;
- Initial measurement (lessees);
- Subsequent measurement (lessees);
- Sale-and-leaseback transactions; and
- Lessor accounting.

References

ASPE	IFRS 16
<ul style="list-style-type: none"> • Section 3061 - <i>Property, Plant and Equipment</i> • Section 3065 - <i>Leases</i> 	<ul style="list-style-type: none"> • IFRS 16 - <i>Leases</i> • IAS 16 - <i>Property, Plant and Equipment</i> • IAS 40 - <i>Investment Property</i>



ASPE-IFRS differential rating scale



Overview of Major Differences

Under ASPE from the perspective of the lessee, leases are classified as either operating or capital. Operating leases are “off-balance sheet” and lease payments are recognized as an expense over the term of the lease. Capital or finance leases are those that transfer substantially all the risks and rewards incidental to ownership of the asset to the lessee, and are recognized “on balance sheet” with a corresponding asset and financial liability.

From the perspective of lessors, under ASPE operating lease income is recognized over the term of the lease and the underlying asset is not derecognized. Capital or finance type leases result in the derecognition of the underlying asset and the recognition of a net investment in the lease, representing the amounts receivable from the lessee over the term of the contract.

IFRS 16 is significantly different than these requirements for lessees. With limited exceptions, all leases are “on balance sheet” and result in the recognition of an asset and a liability.

Scope

The scope of the standards are consistent in that they provide guidance on accounting for contracts that meet the definition of a lease, however, that definition differs between each standard.

Definition of a Lease and Lease Term

There are differences in applying the definition of a lease between ASPE and IFRS. In general terms, most contracts that meet the definition of a lease in one standard would also meet the definition in another. However, there are subtle differences that may lead to some contracts being in scope under one standard and out of scope in another. The definition of a lease term also differs under ASPE and IFRS primarily due to the requirement under IFRS to consider the intention of the lessee and whether it is reasonably certain they will renew the lease when determining the lease term.

Differences in the definition of a lease, applying the definition of a lease and the definition of a lease term include:

ASPE	IFRS 16
A lease is 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.	A lease is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.
ASPE does not contain further elaboration on applying the definition of a lease.	IFRS 16 contains significant explanatory guidance on the characteristics a contract must contain to meet the definition of a lease. These include: <ul style="list-style-type: none"> • The contract conveys the right to control the use of an identified asset; • The lessee obtains the substantially all of the economic benefits from its use; and • The lessee has the right to direct the use of the asset over the lease term.

<p>Lease term is the fixed non-cancellable period of the lease plus:</p> <ul style="list-style-type: none"> • all periods covered by bargain renewal options; • all periods for which failure to renew would impose on the lessee a penalty sufficiently large that renewal appears, at the inception of the lease, reasonably assured; • all periods covered by ordinary renewal options during which the lessee has undertaken to guarantee the lessor's debt related to the leased property; • all periods covered by ordinary renewal options preceding the date on which a bargain purchase option is exercisable; and • all periods representing renewals or extensions of the lease at the lessor's option; <p>provided that the lease term does not extend beyond the date a bargain purchase option becomes exercisable.</p>	<p>The non-cancellable period for which a lessee has the right to use an underlying asset, together with both:</p> <ul style="list-style-type: none"> • periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and <p>periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.</p>
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Classification of Leases

Once an arrangement meets the definition of a lease, it is then classified as either operating or capital under ASPE, and this affects its subsequent measurement and accounting treatment.

From a lessee's perspective, under IFRS 16, once an arrangement meets the definition of a lease, they are all recognized in the same manner, except for practical exceptions for leases with a short term and low-value leases, as described below. However, the distinction between operating and finance leases remains in IFRS 16 from the perspective of lessors.

Differences in the classification of leases include:

ASPE	IFRS 16
<p>Leases are classified based on whether or not substantially all the risks and rewards incidental to ownership are transferred, as follows:</p> <ul style="list-style-type: none"> • From the point of view of the lessee: as either capital or operating leases; and • From the point of view of the lessor: as either sales-type, direct financing or operating leases. 	<p>No distinction is made between finance and operating leases from the perspective of lessees. The classification between operating and finance remains for lessors.</p>

<p>One or more of the following conditions is required to be present for a lessee to classify a lease as a capital lease:</p> <ul style="list-style-type: none"> • Ownership will be transferred to the lessee by the end of the lease term or the lease provides for a bargain purchase option; • The lessee will receive substantially all of the economic benefits to be derived from the leased property when the lease term is equal to a major portion (usually 75 percent or more) of the economic life of the leased property; or • The present value, at the beginning of the lease term, of the minimum lease payments, excluding any portion thereof relating to executory costs, is equal to substantially all (usually 90 percent or more) of the fair value of the leased property, at the inception of the lease. <p>ASPE is not strictly a quantitative threshold but generally in practice these have been interpreted as bright lines and used in this way.</p>	<p>No distinction is made between finance and operating leases from the perspective of lessees. The classification between operating and finance remains for lessors.</p>
<p>A lessee requires one or more of the conditions above to be present for a lease to be classified as capital, whereas all of the conditions below for a lessor usually need to be met in order to classify the lease as a direct financing or sales-type lease. These conditions are:</p> <ul style="list-style-type: none"> • Any one of the conditions above for lessees; • The credit risk associated with the lease is normal when compared to the risk of collection of similar receivables; and <p>The amounts of any unreimbursable costs that are likely to be incurred by the lessor under the lease can be reasonably estimated.</p>	
<p>The length of the term of the lease only impacts the classification in that the length of the lease term relative to the useful life of the asset is a factor in determining whether a lessee obtains substantially all of the benefits and risks incidental to ownership, and therefore classified the lease as capital/finance.</p>	<p>IFRS 16 provides an option to lessees with short-term leases to account for them as operating leases (i.e. “off-balance sheet”). Short-term leases are those that as of the commencement date, have a term of 12 months or less, after considering reasonably certain lease options for extensions and terminations. This election must be applied consistently by class of underlying asset.</p>
<p>The value of the underlying asset only impacts the classification of the lease if the present value, at the beginning of the lease term, of the minimum lease payments, excluding any portion relating to executory costs, is equal to substantially all (>90% guidance provided in ASPE) of the fair value of the property at the inception of the lease; then it is a capital/finance lease.</p>	<p>IFRS 16 provides an option to lessees with leases where the underlying asset is of “low value” to account for them as operating leases (i.e. “off-balance sheet”). Examples of low-value assets include tablets and personal computers, small items of office furniture and telephones. The definition is not to be applied based on the relative value of the asset to the entity (e.g. a lease of an office building may be “low value” to a large entity, but is not low value in absolute terms, therefore this option is not available). This election can be applied on a lease-by-lease basis.</p>

Classification of Leases involving Land and Building

While requirements for leases involving land and building are not as much of a matter of concern here in Canada as they may be in other countries (where property rights are obtained under long-term leases and the substance of those leases differs little from buying a property), ASPE contains similar guidance on how to account for the leases. However, there are some differences in how these leases should be accounted for. IFRS 16 does not contain specific guidance on land and building leases since there is no classification of leases between operating or finance type, as a result there is no criteria to assess.

Differences relating to the classification of leases involving land and building are as follows:

ASPE	IFRS 16
<p>When a lease involving land and building does not contain terms that allow ownership to pass or provide for a bargain purchase option, and the fair value of land at the inception of the lease is minor in relation to the total fair value of the leased property, the land and the building are considered a single unit for the purposes of classification of the lease.</p> <p>When this is not the case, land and building are treated as two separate leases and the minimum lease payments are allocated between the land and building in proportion to their fair values.</p>	<p>The rationale for separating land and building leases under ASPE is so they can be analyzed separately as to whether they are finance/capital or operating type leases. IFRS 16 does not contain this distinction from the perspective of lessees, so no specific guidance is provided in IFRS 16.</p>
<p>Leasehold interests in land are normally classified as operating leases unless there is reasonable assurance that ownership will pass to the lessee by the end of the lease term.</p>	

Finance Leases in the Financial Statements of Lessees

ASPE requires recognition of an asset (by way of acquisition) and an assumption of an obligation (to pay future lease payments) based on the lesser of either the present value of the minimum lease payments or the fair value of the leased asset. Subsequent to initial recognition, the asset is amortized over the period of expected use/useful life on a basis that is consistent with the lessee's depreciation policy for other similar assets. Lease payments are apportioned between a finance charge and a reduction of the outstanding liability. However, there are some differences in the requirements, which are set out in the table below.

IFRS 16 contains substantially different guidance as capital/finance leases do not exist from the perspective of lessees. All leases (with limited exception) are recorded "on balance sheet", similar to finance/capital lease treatment under ASPE. The assets arising from leases under IFRS 16 are known as "right-of-use" assets.

ASPE	IFRS 16
<p>The discount rate used by the lessee in determining the present value of minimum lease payments is the lower of:</p> <ul style="list-style-type: none"> • The lessee's rate for incremental borrowing; and • The interest rate implicit in the lease, if practicable to determine. <p>Minimum lease payments, from the point of view of the lessee, include:</p> <ul style="list-style-type: none"> • Minimum rental payments over the lease term; • Partial or full guarantees of the residual value of the leased property at the end of the lease term; and • Any penalties required to be paid by the lessee for failure to renew or extend the lease at the end of the lease term. 	<p>A lessee shall discount the lease payments using the interest rate implicit in the lease, unless it is not readily determinable, in which case the lessee shall use the incremental rate of borrowing.</p> <p>Lease payments included in the determination of the asset and liability are not the minimum lease payments, but all fixed payments, certain variable payments (see below) and reasonable certain termination and/or extension payments. When extension or purchase options exist, the lessee shall include reasonably certain options in the determination of the initial asset and liability.</p>
<p>Lease payments that depend on factors measurable at the inception of the lease, such as consumer price index or the prime interest rate, are not, in substance, contingent rentals in their entirety, and are included in the minimum lease payments, based on the index or rate existing at the inception of the lease.</p>	<p>Variable payments that depend on an index or rate (e.g. CPI, inflation, etc.) are included in the initial measurement of the lease using the index or rate as at the commencement date.</p> <p>Variable payments do not include contingent rentals. Contingent rentals are charged to profit or loss as incurred.</p>
<p>Any initial direct costs of the lessee (e.g. for negotiating and securing leasing arrangements) are added to the amount recognized as an asset.</p>	<p>Any initial direct costs of the lessee (e.g. for negotiating and securing leasing arrangements) are added to the amount recognized as an asset.</p>
<p>The asset is amortized in a similar manner to other property, plant and equipment.</p> <p>If the lease does not contain terms that allow ownership to pass to the lessee or a bargain purchase option, the property is amortized over the lease term, rather than over the period of expected use.</p>	<p>Right-of-use assets arising from leases following either the cost or revaluation model under IAS 16 - <i>Property, Plant and Equipment</i>. The method chosen must be consistent within major classes of assets. For example, if an entity wishes to revalue one particular piece of equipment, all equipment in the similar asset class must be revalued, including both assets owned outright and those under a finance lease. If an entity follows the fair value model in IAS 40 <i>Investment Property</i>, the same classification must also be applied to right-of-use assets that meet the definition of investment property.</p> <p>When assessing the lease term, if it is not reasonably certain that the asset will pass to the lessee at the end of the lease, then the asset is depreciated over the shorter of the lease term and its useful life.</p>
<p>A renewal, an extension or a change in the provisions of an existing lease would be considered a new lease, and would be classified based on the 'new' lease conditions and accounted for prospectively over the remaining term of the lease.</p>	<p>Changes in the original assessment of the lease term due to a change in the assessment of purchase, extension or termination options result in the right-of-use asset and lease liability being remeasured using revised assumptions and a revised discount rate. The rate used is the rate implicit in the revised lease, unless it is not readily determinable, then the incremental rate of borrowing is used.</p> <p>Changes in the estimated residual guarantee or the index or rate (e.g. CPI, inflation, etc.) affecting payments results in the lease being remeasured using revised assumptions, but no change in the discount rate.</p> <p>A modification to the underlying agreement is accounted for as a separate new lease if the modification increases the scope of</p>

	<p>the lease by adding the right to use one or more assets and the consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope.</p> <p>If the modification is a decrease in scope, the lease liability is remeasured with a revised discount rate, the right-of-use asset is remeasured based on its relative scope decrease and the difference between these two items is recognized in profit or loss.</p>
	<p>All other modifications result in the remeasurement of the lease liability with a revised discount rate, with the resulting adjustment being recorded to the right-of-use asset, with no profit or loss impact.</p>
<p>An entity applies Section 3063 - <i>Impairment of Long-Lived Assets</i> in determining whether assets under capital lease are impaired.</p>	<p>An entity applies IAS 36 - <i>Impairment of Assets</i> in determining whether assets under finance lease or right-of-use assets are impaired.</p>

Operating Leases in the Financial Statements of Lessees

ASPE requires lease rentals or payments made under an operating lease to be recognized as an expense on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern of the user's benefit. Therefore, incentives received under an operating lease (such as rent-free periods or contributions by the lessor to the lessee's relocation costs) are recognized as a reduction in rental payments over the lease term, with each party using a single amortization method applied to the net consideration.

IFRS 16 differs very significantly from ASPE. All leases (with limited exception - see Classification section) are recorded "on balance sheet", similar to finance/capital lease treatment under ASPE. Lessees would follow the guidance contained in the section earlier comparing finance/capital leases to IFRS 16 (see Finance Leases in the Financial Statements of Lessees section).

Sale-and-Leaseback Transactions

There are significant differences in accounting for sale-leaseback transactions between ASPE and IFRS. ASPE make distinctions based on the classification of the resulting lease, while IFRS 16 is consistent in its view that all leases result in similar underlying economic results, and the treatment is guided more so by whether the sale transaction meets the definition of a sale under IFRS 15 - *Revenue from Contracts with Customers*.

This section addresses differences from both the lessee and lessor's perspective. Differences relating to sale-and-leaseback transactions include:

ASPE	IFRS 16
<p>A lease in a sale-leaseback transaction is accounted for as a capital, direct financing or operating lease, as appropriate, by the seller-lessee and by the purchaser-lessor.</p>	<p>To determine whether the transaction is accounted for as the sale of an asset and a corresponding lease, the lessee and lessor analyze the terms of the arrangement to determine whether it meets the requirements of IFRS 15 - <i>Revenue from Contracts with Customers</i> to be accounted for as a sale.</p>

<p>Any profit or loss arising in a sale-leaseback transaction that results in a capital lease is deferred and amortized in proportion to the amortization of the leases asset except:</p> <ul style="list-style-type: none"> • A loss is immediately recognized when, at the time of the sale-leaseback transaction, the fair value of the property is less than its carrying value; and • For leases involving land only, the profit or loss is amortized over the lease term on a straight-line basis. 	<p>The subsequent accounting treatment for a sale-and-leaseback transaction under IFRS 16 is unaffected by any classification of the subsequent lease. There is no such classification for lessees, and it is not taken into consideration for lessors.</p> <p>When a transfer to buyer-lessor qualifies as a sale, the lessee derecognizes the asset and applies the general leasing requirements of IFRS 16 to the related lease. The right-of-use asset is measured as the retained portion of the previous carrying value. The gain/loss recognized is limited to the rights transferred to the lessor.</p> <p>The lessor applies the general requirements of IFRS 16 relating to the lease and classifies it as operating or finance as appropriate.</p>
<p>Any profit or loss arising in a sale and leaseback transaction that results in an operating lease is deferred and amortized in proportion to the rental payments over the lease term except, a loss is immediately recognized when the fair value of the property at the time of the sale-leaseback transaction is less than its carrying value.</p>	<p>When a transfer to buyer-lessor does not qualify as a sale, the lessee continues to recognize the asset. Amounts received from the buyer-lessor are recognized as a financial liability and subsequently accounted for in accordance with IFRS 9 - <i>Financial Instruments</i>. The lessor does not recognize the asset. Instead, amounts paid are recognized as a financial asset and subsequently accounted for in accordance with IFRS 9 - <i>Financial Instruments</i>.</p>
<p>ASPE permits immediate recognition of a gain when the seller leases back only a minor portion of the property sold.</p> <p>When the seller leases back more than a minor portion but less than substantially all of the property sold, the gain deferred and amortized is the amount allocable to the portion of the property covered by the leaseback agreement.</p>	

Lessor Accounting

Lessor accounting is very similar between ASPE and both versions of IFRS. Leases are classified as either operating or finance/capital, which drives the subsequent accounting.

IFRS 16 provides additional guidance in certain areas where ASPE does not provide specific guidance.

The differences in lessor accounting are explained in the sub-categories below.

Operating Leases of Lessors Other than Manufacturers and Dealers

Both ASPE and IFRS require lease receipts under an operating lease to be recognized as revenue on a straight-line basis over the lease term, unless another systematic and rational basis is more representative of the time pattern in which the benefit from the leased property is utilized (e.g. a units of production or use allocation method). Incentives granted under an operating lease are, therefore, recognized as a reduction in rental income over the lease term. However, there are differences between ASPE and IFRS in relation to the treatment of executory costs and initial direct costs.

ASPE	IFRS 16
Lease receipts recognized under an operating lease exclude all executory costs.	Lease receipts recognized under an operating lease exclude only receipts for services provided, such as insurance and maintenance costs.
Initial direct costs incurred by lessors are recognized as an asset.	Initial direct costs incurred by lessors are required to be added to the carrying amount of the leased asset.

Finance Leases of Lessors Other than Manufacturers and Dealers

ASPE and IFRS have similar requirements in relation to recognition of a capital/finance lease by a lessor. However, there are some differences, which are set out in the table below:

ASPE	IFRS 16
<p>Direct financing leases give rise to income in the form of finance income. This income is the difference between:</p> <ul style="list-style-type: none"> • The total minimum lease payments, net of any executory costs and related profit included therein, plus any unguaranteed residual value of the leased property accruing to the lessor; and • The cost or carrying amount, if different, of the leased property. 	<p>At the inception of the lease, lessors should recognize assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease, which is defined as the gross investment in the lease discounted at the interest rate implicit in the lease.</p> <p>The lease payment is treated by the lessor as repayment of principal and finance income to reimburse and reward the lessor for its investment and services.</p> <p>Finance income is the difference between the gross investment in the lease and the net investment in the lease (i.e. the discounted amount).</p>
<p>Finance income should be deferred and taken into income over the lease term to produce a constant rate of return on the investment in the lease.</p>	<p>The standard specifies that the recognition of finance income is based on a systematic and rational basis reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.</p> <p>Any lease payments made relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.</p>

<p>Initial direct costs should be expensed as incurred and a portion of unearned income equal to the initial direct costs should be recognized in income in the same period.</p>	<p>Other than manufacturer or dealer finance leases, lessors' initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of income recognized over the lease term.</p> <p>IFRS provides specific examples of initial direct costs that are often incurred by lessors. These include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease.</p> <p>IFRS specifically excludes general overheads, such as those incurred by sales and marketing teams, from being included in the initial direct costs.</p> <p>The interest rate implicit in the lease is defined as the discount rate that, at the inception of the lease, causes the aggregate present value of:</p> <ul style="list-style-type: none"> • The minimum lease payments; and • The unguaranteed residual value to be equal to the sum of: <ul style="list-style-type: none"> ○ The fair value of the leased asset; and ○ Any initial direct costs of the lessor. <p>Effectively, this definition automatically includes the initial direct costs in the finance lease receivable, therefore there is no requirement or need to add these costs separately to the finance lease receivable.</p>
<p>The estimated residual value would be reviewed annually to determine whether a decline in its value has occurred.</p> <p>If the decline in value is other than temporary, the accounting for the lease transaction would be revised using the changed estimate. The resulting reduction in the net investment in the lease would be charged to income. An upward adjustment of the residual value would not be made.</p>	<p>Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly, rather than specifically required to be on an annual basis.</p> <p>The income allocation over the lease term is revised and any reduction in respect of amounts accrued is recognized immediately where there has been a reduction in the estimated unguaranteed residual value. There is no mention of the reduction being other than temporary.</p>

Leases of Lessors - Manufacturers and Dealers

ASPE and IFRS have a similar concept for recognition of manufacturer and dealer leases: recognize an initial profit or loss on the sale of the product at the inception of the lease and finance income over the lease term. However, there are differences in how this recognized amount is determined.

ASPE	IFRS 16
<p>A sales type (finance) lease by a lessor gives rise to two types of income:</p> <ul style="list-style-type: none"> • The initial profit or loss on the sale of the product at the inception of the lease; and • Finance income over the lease term. 	<p>A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:</p> <ul style="list-style-type: none"> • Profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and • Finance income over the lease term.

<p>When a lease is a sales-type lease, a sale should be recorded with the manufacturer's or dealer's profit or loss being recognized at the time of the transaction.</p>	<p>Manufacturer or dealer lessors should recognize selling profit or loss in the period of the transaction, in accordance with the policy followed by the entity for outright sales.</p>
<p>The sales revenue recorded at the inception of a sales-type lease is the present value of the minimum lease payments net of any executory costs and related profit included therein, computed at the interest rate implicit in the lease.</p> <p>The discount rate for determining the present values would be the interest rate implicit in the lease.</p>	<p>The sales revenue recognized at the commencement of the lease term by a manufacturer or dealer lessor is the fair value of the asset (usually the cash price), or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest.</p> <p>Therefore, if artificially low rates of interest are quoted, selling profit is restricted to that which would apply if a market rate of interest were charged.</p>
<p>Initial direct costs are considered to be incurred in order to produce the sale; therefore, they would be recognized as an expense at the inception of the lease, and unearned finance income should be deferred and taken into income over the lease term to produce a constant rate of return on the investment in the lease.</p>	<p>Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease are excluded from the definition of initial direct costs.</p> <p>These costs are, therefore, excluded from the net investment in the lease and are recognized as an expense when the selling profit is recognized, which, for a finance lease, is normally at the commencement of the lease term. Note that this treatment is different than when a lessor arranges a finance lease; in that situation, the indirect costs are added to the finance receivable amount.</p>

Conclusion

IFRS 16 contains significantly different guidance for lessees, therefore significantly more analysis would likely be required for an entity moving to it from ASPE. If you require further guidance on accounting for leases under ASPE or IFRS, please contact your local BDO Canada LLP office. If you are considering the adoption of a new standard, learn how our [BDO Accounting Advisory Services Team](#) can help you with the transition.

To learn more about the differences between standards, view our [ASPE-IFRS: A Comparison Series](#).

The information in this publication is current as of July 31, 2020.

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