6. Leases

|  |  |
| --- | --- |
| **OVERVIEW** | * A lease should be classified as either a finance lease or an operating lease. * Lease classification depends on whether substantially all of the risks and rewards incidental to ownership of a leased asset have been transferred from the Lessor to the Lessee. * Under a finance lease, the Lessor recognizes a finance lease receivable and the Lessee recognizes the leased asset and a liability for future lease payments. * Under an operating lease, the asset remains on the balance sheet of the Lessor and the Lessee recognizes an expense for the lease payments over the lease term. * Leases of a land are normally considered operating leases. * Sales proceeds generated through “back to back lease” arrangements should be deferred and amortized over the lease term. |

6.1 Purpose and scope

This policy provides guidance and rules on accounting for Leases for the purpose of preparing the financial statements of the Group according to International Financial Reporting Standards.

6.2 Definition

A lease is an agreement, sometimes also described as a rental contract, 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. Legal ownership remains with the lessor and may or may not eventually be transferred.

Samsonite classifies leased assets as finance leases or operating leases and acts primarily as the lessee.

A lease is considered to be a finance lease when substantially all of the risks and rewards incidental to ownership of the leased asset are transferred from the Lessor to the Lessee by the agreement. Typical indicators assessed to determine whether substantially all of the risks and rewards are transferred include the minimum lease payments that the lessee is required to make in contrast with the value of the asset at the inception of the lease, the duration of the lease in contrast with the useful life of the asset, and whether the lessee will obtain ownership of the lease.

Risks include the possibilities of losses from idle capacity or technological obsolescence; rewards include the profitable operation over the asset’s economic life and the gain from the increase in value of the asset or realization of the residual value at the end of the lease.

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

The accounting treatment for a lease does not depend on which party has legal ownership of the leased asset, but rather on which party bears the risks and rewards incidental to ownership of the leased asset. The classification of a lease is determined at the inception of the lease and is not revised unless the lease agreement is modified.

Lease accounting can apply to arrangements that explicitly convey the right to use specifically identifiable assets, but not in the contractual form of a lease. An arrangement is a lease if:

* The purchaser can direct the operation of the asset and controls more than an insignificant amount of its output
* The purchaser can control physical access to the asset and controls more than an insignificant amount of its output
* It is remote that a party other than the purchaser will take more than an insignificant amount of the asset’s output, and the price that the purchaser will pay is neither fixed per unit of output nor equal the market price at delivery date

6.3 Distinction between finance lease and operating lease

6.3.1 Classification criteria

Those ***primary lease classification indicators*** should be considered individually or in combination in determining the classification of a lease:



Those *supplementary indicators* also should be considered individually or in combination in determining the classification of a lease:



6.3.2 Primary lease classification criteria

a) *Transfer of ownership*

If legal ownership of the asset ultimately transfers to the lessee, either during or at the end of the lease term, the agreement usually will be classified as a finance lease.

b) *Bargain purchase option*

A purchase option that is expected at inception of the lease, to be exercised means that title to the asset is expected to transfer. Therefore, a lease with such an option normally should be classified as a finance lease. For example, if the lessee has the option to purchase the leased asset at a price that is expected to be sufficiently lower than the expected fair value of the leased asset at the date the option become exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, then the agreement should be classified as a finance lease.

c) *Major part of economic life*

If the lease term is for the major part of the economic life of the leased asset, the agreement normally should be classified as a finance lease.

In practice, a lease term equivalent to 75 percent or more of the economic life of an asset may be considered to be the major part of the asset’s economic life.

However, this US GAAP threshold should be used as a preliminary indicator rather than as an absolute conclusive criterion.

d) *Present value of minimum lease payments*

Minimum lease payments are those payments which the lessee is or may be required, to pay to the lessor over the lease term. The lease term used to determine the minimum lease payments should include the periods for which the lessee has an option to extend the lease where its extension is regarded as sufficiently certain. Those payments should not include contingent rent amounts, costs for services and taxes to be paid by and reimbursed to the lessor.

If there is a purchase option that is reasonably certain to be exercised, the purchase option payment (exercise price) should be included in the minimum lease payments.

If at the inception of the lease the present value of the minimum lease payments amounts to substantially all of the fair value of the leased asset, then the agreement normally should be classified as a finance lease.

In practice, if the present value of minimum lease payments is 90 percent or more of the fair value of the leased asset at inception of the lease, then the lease may be classified as finance lease.

However, this US GAAP “bright‑line” threshold should be used as a preliminary indicator rather than as an absolute conclusive criterion.

The interest rate applicable is the interest rate implicit in the lease contract. The interest rate implicit in the lease contract is the discount rate that, at the inception of the lease, causes the aggregate present value of the minimum lease payments and the unguaranteed residual value to be equal to the sum of the fair value of the leased asset and any initial direct costs of the lessor. When there is no sufficient information to determine the interest rate implicit in the lease, Samsonite’s incremental borrowing rate could be used as the discount rate to be applied in the determination of the present value of minimum lease payments.

The residual value of a leased asset is the expected value of the asset at the end of the lease term. ***For a lessee***, amounts guaranteed by the *lessee or a party related to the lessee* are included in the lessee’s calculation of minimum lease payments. ***For a Lessor***, amounts guaranteed by *any party* (lessee, party related to lessee or third party such as a residual insurer) is included in the Lessor’s calculation of minimum lease payments.

In determining the interest rate implicit in the lease, please consider the following discounting formulas:

* Payments made at the beginning of each period:



* Payments made at the end of each period



FV: Fair value of the asset

SP: Special payment at inception of the lease

MR: Non‑cancelable lease payments

R: Implicit interest rate

N: Number of payment periods

RV: Residual value (guaranteed and un-guaranteed) or purchase option (if any)

DC: Initial direct costs of the lessor

FP: First payment made at the beginning of the first period

In order to determine the implicit interest rate you may also use the Excel function “Rate” as illustrated below:



* **Nper**: number of payment periods.
* **Pmt**: payment made at each period (negative sign).
* **Pv**: Present value of the unit less any upfront payments made at the inception of the lease.
* **Fv**: Purchase option (negative sign) and unguaranteed residual value.

**Type**: payment at the beginning of the period = 1; payment at the end of the period = 0.

e) *Specialized nature of the asset*

If a leased asset is so specialized that only the lessee can use it without major modification, then the agreement normally should be classified as a finance lease.

6.3.3 Supplementary indicators of a finance lease

There are several additional indicators that a contract may be a finance lease. These are:

* If the lessee can cancel the lease, the lessor’s losses associated with the cancellation are borne by the lessee (the calculation of the minimum lease payments should be based on the smaller of the non‑cancellable lease payments plus the penalty or the total minimum lease payment);
* Gains or losses from the fluctuation in the fair value of the residual fall to the lessee (e.g., in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); or
* The lessee can extend the lease at a rent substantially lower than the market rent.

6.3.4 Leases of land

Because land has an indefinite useful life, a lease of land will normally be classified as an operating lease to the extent that title does not pass to the Group by the end of the lease. This does not apply to leases for long term land lease rights, which are classified as Property, Plant and Equipment.

6.4 Accounting for leases

6.4.1 Accounting for operating leases

6.4.1.1 The Group as lessor

Lease income from an operating lease is recognized in income on a straight-line basis over the lease term. Future contractual rental payments from the lessee are recognized as receivables over the lease term as the payments become receivable.

Incentives granted to customers in negotiating a new or renewed operating lease are recognized as an integral part of the net consideration agreed for the use of the asset. They are recognized as a reduction of rental income over the lease term using the same recognition basis as for the lease income (i.e., on a straight-line basis). If, for example, a rent-free period of one year is agreed in a lease agreement covering 10 years at an annual amount of $1,000 for years 2 to 10, the Group would recognize the net consideration of $9,000 systematically over the 10‑year term.

6.4.1.2 The Group as lessee

Operating lease agreements, for which the Group has a financial commitment but does not bear all of the risks and rewards of ownership, are not reflected in the consolidated balance sheet, nor are liabilities for rentals in respect of future periods recognized.

Rent expense is recognized on a straight line basis over the lease term (i.e., between the commencement date and the end of the lease term). Generally, this will result in the recognition of prepaid rent or accrued liabilities for rental payments.

6.4.2 Accounting for finance leases

The Group has classified some rental fleet leases as finance leases. The classification of a majority of these leases is primarily driven by bargain purchase options included in the terms of the lease agreements. As mentioned above, bargain purchase options are considered to be an indicator of a finance lease. The Group evaluates if the lessee has the option to purchase the fleet vehicle at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable.

6.4.3 Back to back lease transactions

6.4.3.1 Classification and measurement

From time to time, the Group may enter into back to back lease transactions. These situations are not frequent and in such case, the Group enters at the same time into a sale and lease back arrangement. Both the Group and the client have an option to purchase the leased asset by the end of the lease term. The two contracts usually have the same duration.

Back to back leases may be presented as follows:



The back to back arrangement has two separate components:

1. A finance lease between the Group and the client

2. A sale and leaseback contract between the financing institution and the Group

The finance lease between the Group and the client should be accounted for pursuant to the Group’s finance lease accounting policy.

The sale and leaseback transaction between the Group and the financing institution consists of two elements:

i) Sale of the rental unit to the financing institution

ii) Leaseback of the rental unit from the financing institution

Due to the bargain purchase option included in the rental unit lease arrangements the sale and leaseback transaction meets the criteria for finance lease classification. The finance lease element in the sale and leaseback transaction is accounted for pursuant to the Group’s finance lease accounting policy.

Any excess of sales proceeds over the carrying amount in the sale of the rental unit to the financing institution should not be immediately recognized as income instead any gain recognized should be deferred and amortized over the lease term. If the transaction results in a loss, no loss is recognized unless there has been an impairment in the value of the rental unit. In which case, the carrying amount of the unit should be reduced to the recoverable amount in accordance with the Group’s impairment policy (see *Impairment*).

Corporate Finance should be informed before entering into any new back‑to back lease agreement.

6.5 Disclosure

Footnote

**Operating Leases: Company as lessee**

Samsonite is obligated under non‑cancellable operating leases for certain equipment, vehicles and parcels of land. The rentals for these operating leases are payable as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **December 31,** | | | | | |
|  | **20X1** | |  | **20XX** | |
| Less than one year |  |  |  |  |  |
| Between one and five years |  |  |  |  |  |
| More than five years |  |  |  |  |  |
|  | $ | ‑ |  | $ | ‑ |

During the year ended December 31, 20X1 US$\_\_\_\_\_\_\_\_ was recognized as an expense in the income statement in respect of operating leases (20XX: US$\_\_\_\_\_\_).

**Finance leases: The Group as lessee**

The Group is obligated under non‑cancellable finance leases for certain property, equipment and vehicles.

The total minimum future lease payments under these finance leases are as follows:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **December 31, 20X1** | | | | |  | **December 31, 20XX** | | | | |
|  | **Future minimum** |  |  |  | **Present value of minimum lease** |  | **Future minimum** |  |  |  | **Present value of minimum lease** |
|  | **lease payments** |  | **Interest** |  | **payments** |  | **lease payments** |  | **Interest** |  | **payments** |
| Less than one year |  |  |  |  |  |  |  |  |  |  |  |
| Between one and five years |  |  |  |  |  |  |  |  |  |  |  |
| More than five years |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

6.6 Examples

6.6.1 Operating lease illustrative example:

On January 1, 2008 the Group signed a 5 year lease agreement for rental equipment under the following terms:

|  |  |
| --- | --- |
| Lease term | 5 years |
| Cost of the equipment | $30,000 |
| Total lease payments | $20,000 (4,000/year) |
| Residual value | $12,000 |
| Useful life of the equipment | 10 years |

* As **a lessee**

The journal entries are:

* **As at December 31, 2008**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| I/S | Rental expense | |  | Dr |  | 4,000 |  |
| B/S |  | Cash or Accrued lease rental payable | | Cr |  | 4,000 |  |

* **As a lessee**
* **As at January 1, 2008**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| I/S | Rental equipment | |  | Dr |  | 30,000 |  |
| B/S |  | Cash or creditor | | Cr |  | 30,000 |  |

* **As at December 31, 2008**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| I/S | Depreciation expense | |  | Dr |  | 1,800 |  |
| B/S |  | Rental equipment | | Cr |  | 1,800 |  |
|  |  | (30,000 – 12,000)/10 | |  |  |  |  |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| B/S | Cash or accrued lease rental | |  | Dr |  | 4,000 |  |
| I/S |  | Lease rental income | | Cr |  | 4,000 |  |

6.6.2 The Group as lessee

Illustrative example

This illustrative example aims at providing a step‑by‑step IFRS guidance on accounting for finance lease as a lessee.

With effect from 1 January 2008, the Group leases office furniture **from** a third party for 3 years including the following terms:

Inception of the lease: 1 January 2008

Lease term: 36 months

Monthly rent: $10,000

Special payment at inception of the lease: $25,000

Payment mode: End of period

Fair value of the asset: $345,000

Economic useful life: 4 years

Guaranteed residual value after 36 months: $15,000

Unguaranteed residual value after 36 months: $5,000

Imputed residual value after 36 months: $20,000

Initial acquisition cost of the asset (acquired in  
December 2007) $280,000

Purchase option: The guaranteed residual value

At commencement of the finance lease, the leased asset and the lease liability are recorded at the lower of:

* the fair value of the leased asset at the inception date; and

the present value of the minimum lease payments at the inception date.

The discount rate to be used in determining the present value of the minimum lease payments is the interest rate implicit in the lease. The minimum lease payments include the exercise price of options expected, at inception of the lease, to be exercised and predetermined increases in the lease payments. The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of the minimum lease payments and the unguaranteed residual value to be equal to the fair value of the leased asset plus any initial direct costs of the lessor. If the rate implicit in the lease cannot be determined, then the lessee’s incremental borrowing rate is used. Initial direct costs incurred are capitalized as an addition to the cost of the asset.

The periodic lease payments should be split into two components: the interest charge for the period and the reduction of the lease liability. The interest charge should be determined so that a constant periodic rate of interest is recognized on the outstanding balance of the liability. Interest and reduction of the liability are determined on an effective interest rate basis, whereby the interest amount generally decreases over the lease term and the redemption amount generally increases each period.

Subsequent accounting for the asset under a finance lease should be similar to other owned assets (See *Property, plant and equipment*).

The asset under a finance lease should be depreciated in accordance with the depreciation policy used for comparable owned assets, over the shorter of the period of the asset’s useful life and the lease term. However if at inception of the lease it is reasonably certain that the lessee will obtain ownership of the asset by the end of the lease term, then the asset should be depreciated over the expected useful life of the asset.

Leased assets should be reviewed regularly for the existence of impairment losses in accordance with the principles applicable to comparable assets.

Determination of minimum lease payments

The gross investment in the lease of the office furniture corresponds to both the minimum lease payments (including the guaranteed residual value) and the unguaranteed residual value:

|  |  |  |  |
| --- | --- | --- | --- |
| * Non‑cancellable lease payments: | $385,000 |  | [(36 x 10,000) + 25,000] |
| * Guaranteed residual value: | 15,000 |  |  |
| ***Minimum lease payments*** | ***400,000*** |  |  |

Interest rate implicit in the lease

The interest rate implicit in the lease is the discount rate that, at inception of the lease, causes the present value of the gross investment in the lease to be equal to the fair value of the office furniture.

The interest rate implicit in the lease should be determined by using the effective interest rate method as illustrated below:

* *Determination of the monthly interest rate implicit in the lease:*



*345,000 = 25,000 + [10,000 x (1 – (1 + R) ‑36/R] + 20,000 (1 + R) ‑36*

***R = 0.91407%***

Following the calculation of the implicit interest rate, the second step is to calculate the present value of the gross investment in the lease.

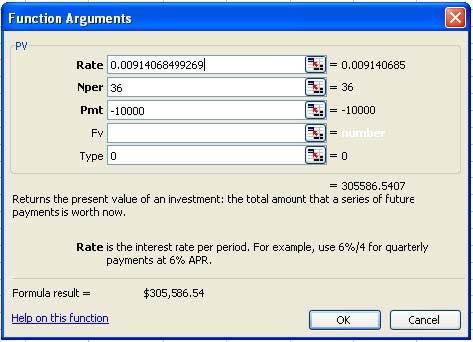
* *Determination of the present value of the gross investment in the lease (= Net investment in the lease):*

Since $15,000 of the residual value is guaranteed by the lessee, this should be included in the minimum lease payments, while the remaining unguaranteed residual value of $5,000 does not represent a component of the minimum lease payments.

|  |  |  |
| --- | --- | --- |
|  | Present value of the special payment (equals to nominal amount, since made at the inception of the lease) | $25,000.00 |
| + | Present value of the monthly lease payments PV = *10,000 x [1 – (1 + 0.91407%)‑36)/0.91407%]* | 305,586.54 |
| + | Present value of the guaranteed residual value *PV = 15,000 x (1 + 0.91407%)‑36* | 10,810.10 |
| = | **Present value of minimum lease payments** | **341,396.64** |

The present value of the minimum lease payments on the basis of the implicit interest rate amounts to 99% of the fair value of the rental equipment (345,000). Accordingly, the lease should be classified as a finance lease as it is also assumed that the purchase option will be exercised.

In order to determine the present value you may also use the Excel function “PV” as illustrated below:



The net investment in the lease is therefore calculated as follows:

|  |  |  |
| --- | --- | --- |
| Present value of minimum lease payments (see above) | | 341,396.64 |
| + | Present value of unguaranteed residual value of 5,000 *PV = 5,000 x (1 + 0.91407%)‑36* | 3,603.36 |
| = | PRESENT VALUE OF THE GROSS INVESTMENT IN THE LEASE | **345,000.00** |

The present value of the minimum lease payments is calculated as follows:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  | **Carrying** |
|  |  | **Carrying** |  |  |  |  |  | **Repayment** |  | **amount of** |
| **Date** |  | **amount** |  | **Payment** |  | **Interest** |  | **of principal** |  | **receivables**  **341,396.64** |
|  |  |  |  |  |  |  |  |  |  |  |
| Jan‑08 |  | 341,396.64 |  | 35,000.00 |  | 2,892.08 |  | 32,107.92 |  | 309,288.72 |
| Feb‑08 |  | 309,288.72 |  | 10,000.00 |  | 2,827.11 |  | 7,172.89 |  | 302,115.83 |
| Mar‑08 |  | 302,115.83 |  | 10,000.00 |  | 2,761.55 |  | 7,238.45 |  | 294,877.38 |
| Apr‑08 |  | 294,877.38 |  | 10,000.00 |  | 2,695.38 |  | 7,304.62 |  | 287,572.76 |
| May‑08 |  | 287,572.76 |  | 10,000.00 |  | 2,628.61 |  | 7,371.39 |  | 280,201.37 |
| Jun‑08 |  | 280,201.37 |  | 10,000.00 |  | 2,561.23 |  | 7,438.77 |  | 272,762.60 |
| Jul‑08 |  | 272,762.60 |  | 10,000.00 |  | 2,493.24 |  | 7,506.76 |  | 265,255.84 |
| Aug‑08 |  | 265,255.84 |  | 10,000.00 |  | 2,424.62 |  | 7,575.38 |  | 257,680.46 |
| Sep‑08 |  | 257,680.46 |  | 10,000.00 |  | 2,355.38 |  | 7,644.62 |  | 250,035.84 |
| Oct‑08 |  | 250,035.84 |  | 10,000.00 |  | 2,285.50 |  | 7,714.50 |  | 242,321.33 |
| Nov‑08 |  | 242,321.33 |  | 10,000.00 |  | 2,214.98 |  | 7,785.02 |  | 234,536.32 |
| Dec‑08 |  | 234,536.32 |  | 10,000.00 |  | 2,143.82 |  | 7,856.18 |  | 226,680.14 |
|  |  |  |  | **145,000.00** |  | **30,283.50** |  | **114,716.50** |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Jan‑09 |  | 226,680.14 |  | 10,000.00 |  | 2,072.01 |  | 7,927.99 |  | 218,752.15 |
| Feb‑09 |  | 218,752.15 |  | 10,000.00 |  | 1,999.54 |  | 8,000.46 |  | 210,751.70 |
| Mar‑09 |  | 210,751.70 |  | 10,000.00 |  | 1,926.41 |  | 8,073.59 |  | 202,678.11 |
| Apr‑09 |  | 202,678.11 |  | 10,000.00 |  | 1,852.62 |  | 8,147.38 |  | 194,530.73 |
| May‑09 |  | 194,530.73 |  | 10,000.00 |  | 1,778.14 |  | 8,221.86 |  | 186,308.87 |
| Jun‑09 |  | 186,308.87 |  | 10,000.00 |  | 1,702.99 |  | 8,297.01 |  | 178,011.86 |
| Jul‑09 |  | 178,011.86 |  | 10,000.00 |  | 1,627.15 |  | 8,372.85 |  | 169,639.01 |
| Aug‑09 |  | 169,639.01 |  | 10,000.00 |  | 1,550.62 |  | 8,449.38 |  | 161,189.63 |
| Sep‑09 |  | 161,189.63 |  | 10,000.00 |  | 1,473.38 |  | 8,526.62 |  | 152,663.01 |
| Oct‑09 |  | 152,663.01 |  | 10,000.00 |  | 1,395.44 |  | 8,604.56 |  | 144,058.46 |
| Nov‑09 |  | 144,058.46 |  | 10,000.00 |  | 1,316.79 |  | 8,683.21 |  | 135,375.25 |
| Dec‑09 |  | 135,375.25 |  | 10,000.00 |  | 1,237.42 |  | 8,762.58 |  | 126,612.67 |
|  |  |  |  | **120,000.00** |  | **19,932.53** |  | **100,067.47** |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Jan‑10 |  | 126,612.67 |  | 10,000.00 |  | 1,157.33 |  | 8,842.67 |  | 117,770.00 |
| Feb‑10 |  | 117,770.00 |  | 10,000.00 |  | 1,076.50 |  | 8,923.50 |  | 108,846.50 |
| Mar‑10 |  | 108,846.50 |  | 10,000.00 |  | 994.93 |  | 9,005.07 |  | 99,841.43 |
| Apr‑10 |  | 99,841.43 |  | 10,000.00 |  | 912.62 |  | 9,087.38 |  | 90,754.05 |
| May‑10 |  | 90,754.05 |  | 10,000.00 |  | 829.55 |  | 9,170.45 |  | 81,583.60 |
| Jun‑10 |  | 81,583.60 |  | 10,000.00 |  | 745.73 |  | 9,254.27 |  | 72,329.33 |
| Jul‑10 |  | 72,329.33 |  | 10,000.00 |  | 661.14 |  | 9,338.86 |  | 62,990.47  **Guaranteed residual value** |
| Aug‑10 |  | 62,990.47 |  | 10,000.00 |  | 575.78 |  | 9,424.22 |  | 53,566.25 |
| Sep‑10 |  | 53,566.25 |  | 10,000.00 |  | 489.63 |  | 9,510.37 |  | 44,055.88 |
| Oct‑10 |  | 44,055.88 |  | 10,000.00 |  | 402.7 |  | 9,597.30 |  | 34,458.58 |
| Nov‑10 |  | 34,458.58 |  | 10,000.00 |  | 314.98 |  | 9,685.02 |  | 24,773.56 |
| Dec‑10 |  | 24,773.56 |  | 10,000.00 |  | 226.45 |  | 9,773.55 |  | 15,000.00 |
|  |  |  |  |  |  |  |  |  |  |  |
| **Total** |  | **‑** |  | **385,000.00** |  | **58,603.37** |  | **326,396.63** |  | **‑** |

The following are the accounting entries that Samsonite should record as lessee in respect of the finance lease:

* **At 1 January 2008 (at the inception of the lease)**

|  |  |  |  |
| --- | --- | --- | --- |
| Office Furniture 1 | Dr | 341,396.64 | |
| Finance lease debt >1 year |  | Cr | 226,680.14 |
| Finance lease debt <1 year |  | Cr | 114,716.50 |

1 Lower of fair value and present value of the minimum lease payments: 341,396.64 (PVMLP) < 345,000 (FV)

* **At 31 December 2008**

|  |  |  |  |
| --- | --- | --- | --- |
| Interest on financial leases | Dr | 30,283.50 | |
| Finance lease debt <1 year | Dr | 114,716.50 |  |
| Lease rental payable |  | Cr | 145,000.00 |

|  |  |  |  |
| --- | --- | --- | --- |
| Depreciation and amortization expense 2 | Dr | 113,798.88 | |
| Accumulated depreciation |  | Cr | 113,798.88 |

2 Depreciation over the lease term (36 months): 113,798.88 = 341,396.63/3.

6.6.3 Sale and leaseback illustrative example

The Group owns a building which is carried in the balance sheet at $2 million and is sold to a financing institution in a sale and leaseback transaction. The examples below illustrate how the gain or loss should be accounted resulting from the sale of the rental unit to the financing institution.

Example 1

The Group sells the building to a financing institution for $1.8 million and leases it back for 10 years at a rent of $0.25 million per year with a bargain purchase option at the end of the lease.

In this situation, the building should be impaired by $0.2 million prior to the sale. The carrying amount of the building should be adjusted to reflect the lower of the present value of the future minimum lease payments and its fair value (i.e., the price). Assuming that this lease is a finance lease and that the fair value is lower than the minimum lease payments, an asset should be recognized for $1.8 million. Accordingly, no gain or loss is recognized on the transaction.

Example 2

The Group sells the building for $2.2 million and leases them back for 10 years at a rent of $0.25 million per year.

Assuming that this lease is a finance lease and that the fair value is lower than the minimum lease payments, an asset should be recognized for $2.2 million and the gain on the sale of $0.2 million should be treated as a deferred profit and recognized over the lease term, i.e. 10 years.