

**RECOGNITION OF LEASE INCOME AND EXPENSE ON A BASIS  
OTHER THAN THE STRAIGHT LINE BASIS UNDER IFRS 16 - LEASES**

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# **RECOGNITION OF LEASE INCOME AND EXPENSE ON A BASIS OTHER THAN THE STRAIGHT LINE BASIS UNDER IFRS 16 - LEASES**

Circular 2/2020

## **Introduction**

- .01 The South African Institute of Chartered Accountants' Accounting Practices Committee (APC) wishes to explain the requirements of IFRS 16 – *Leases*, in respect of the recognition of lease income/expense, on a basis other than the straight-line basis, over the lease term.
- .02 Circular 5/2018 – *Recognition of Lease Income and Expense on a Basis Other Than the Straight Line Basis Under IFRS 16 - Leases* was an update to Circular 12/2006 – *Operating Leases* as a result of the implementation of IFRS 16. This circular, Circular 2/2020 – *Recognition of Lease Income and Expense on a Basis Other Than the Straight Line Basis Under IFRS 16 - Leases*, is an update to Circular 5/2018 for editorial changes that remove historical information which is no longer relevant for the purposes of this circular post the complete phasing out of IAS 17 – *Leases*.
- .03 The process of using International Financial Reporting Standards (IFRS) implies not only the use of such standards, but also uniformity in the way in which the standards are applied. Increased global usage of international standards focuses attention on the way in which standards should be applied and highlights the importance of consistency within the South African market.

## **Scope**

- .04 This circular addresses the recognition of lease income/expense, on a basis other than the straight-line basis, over the lease term. IFRS 16 requires recognition of lease income/expense on a straight-line basis or another systematic basis for (i) Lessors where the appropriate lease classification is an operating lease; (ii) Lessees where the lessee has elected not to apply the lease model in IFRS 16 paragraphs 22-49 – this is relevant where the underlying asset value is low or for short-term leases.

## **Accounting references**

- .05 Paragraph 81 of IFRS 16 states “*A lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.*”
- .06 Paragraph 6 of IFRS 16 states “*If a lessee elects not to apply the requirements in paragraphs 22–49 to either short-term leases or leases for which the underlying asset is of low value, the lessee shall recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee’s benefit.*”

## **Conclusion**

- .07 The APC concluded that the use of ‘another systematic basis’ other than straight-line recognition is expected to be rare. When applying another systematic basis, the pattern of the user's benefit is only affected by factors which impact the physical usage of the underlying asset. Straight-line recognition means that the payments over the lease term are to be aggregated and divided by the lease term in months in order to arrive at the monthly income or expense. The cumulative difference between the amounts

recognised in the income statement and the cash flows, is recognised on the statement of financial position. The effect on deferred tax should be determined with reference to IAS 12 – *Income Taxes*.

**Responsibility**

- .08 SAICA members should determine the necessary action required in the context of their responsibilities as preparers, auditors or users.

## **Basis for Conclusions**

- .01 APC decided that Circular 12/2006 needed reconsideration given that IFRS 16 is in issue.
- .02 The first matter considered was whether or not all of the items noted in Circular 12/2006 required clarification in the updated Circular. These items were (i) the recognition of leases income or expense other than on a straight-line lease basis; and (ii) clarification of contingent receipts/payments. The APC concluded that there is sufficient guidance in IFRS 16 dealing with those lease receipts/payments which are contingent and those which are not, and the consequential accounting treatment. As a result it was not necessary to reconsider this aspect.
- .03 With regard to a suitable basis other than straight-line lease income or expense recognition, the APC noted that the wording in IFRS 16 in particular paragraphs 6 and 81 were not worded in precisely the same manner as that of IAS 17. In particular it was noted that the 'another systematic basis' dealt with in these paragraphs of IFRS 16 omitted the words 'time-pattern' of use or benefit, which had previously been included in the requirements of IAS 17. The key issue is whether or not this was intended to be a change to lease accounting under IFRS 16 or not; and whether or not this exception to straight-line recognition can be more broadly applied.
- .04 IFRS 16 paragraph BC 65 notes that lessor accounting has been substantially carried forward with the exception of the definition of a lease and the requirements for subleases and modifications. Further IFRS 16 paragraph BC 66 notes that the IASB decided to carry forward substantially all the wording in IAS 17 with respect to lessor accounting, on the basis that changes in wording could have unintended consequences and could imply that there were changes where none were intended. There is no further discussion in the basis of conclusions that a change in the meaning of the requirements was intended by the IASB.

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