

MPSAS 13: Leases

Accrual Accounting Manual Training



Jabatan Perbendaharaan Negeri Sarawak

Agenda



Day 1

Introduction

Accounting Principles

First Time Adoption of
MPSAS

Presentation of Financial
Statements

Day 2

Property, Plant and
Equipment

Intangible Assets

Day 3

Inventories

Agriculture

Investment Properties

Prepayments

Impairment of Asset

Day 4

Financial Instrument

Day 5

Investments

Grants, Provisions and
Contingencies

Commitments

Day 6

Revenue

Construction Contract

Employee Benefits

Borrowing Cost

Day 7

Public Private Partnership

Lease Accounting

Day 8

Policies, Estimates &
Errors

Events After Reporting

Related Party Disclosures

General Government
Sector

Trust Accounts and Trust
Fund



Components & elements of financial statements

COMPONENTS		MPSAS	
1	Statement of Financial Position		MPSAS 1
2	Statement of Financial Performance		MPSAS 1
3	Statement of Changes in Net Assets/Equity		MPSAS 1
4	Cash Flow Statement		MPSAS 2
5	Statement of Budget Performance		MPSAS 24
6	Notes to the Financial Statements		Various MPSAS

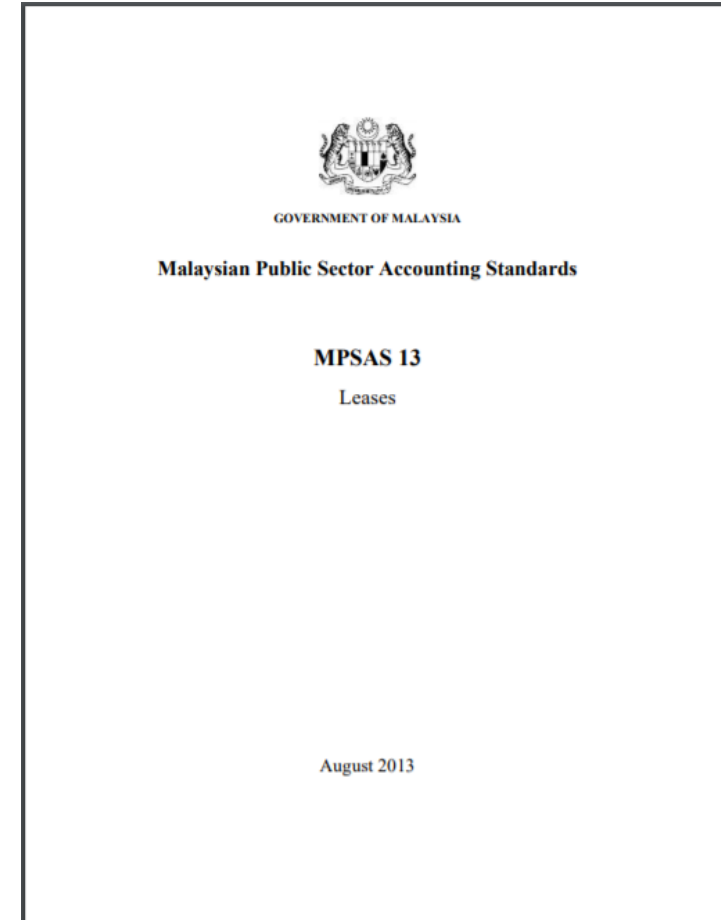
- Financial statement is to be prepared in accordance with the accounting principles



MPSAS 13

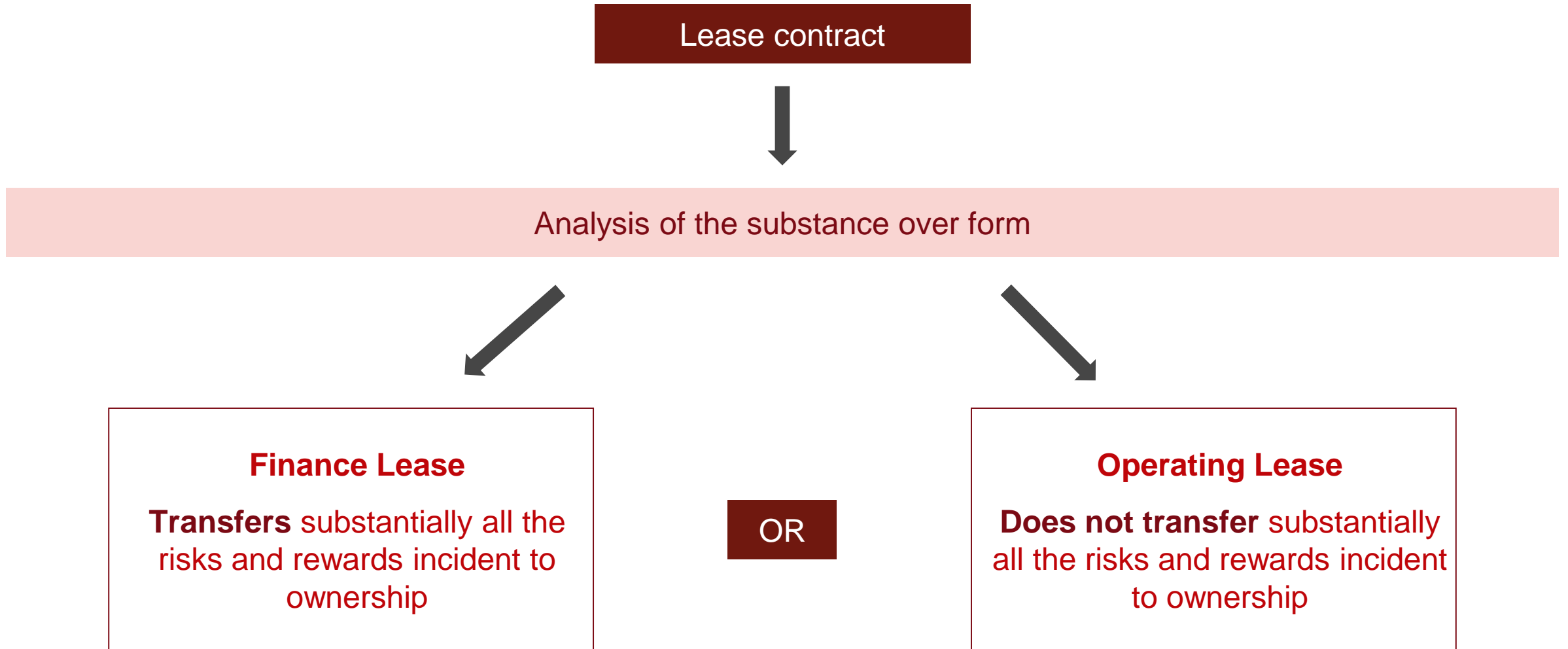
Leases

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment of series of payments the **right to use an asset** for an agreed period of time



Effective Date: 1 January 2017

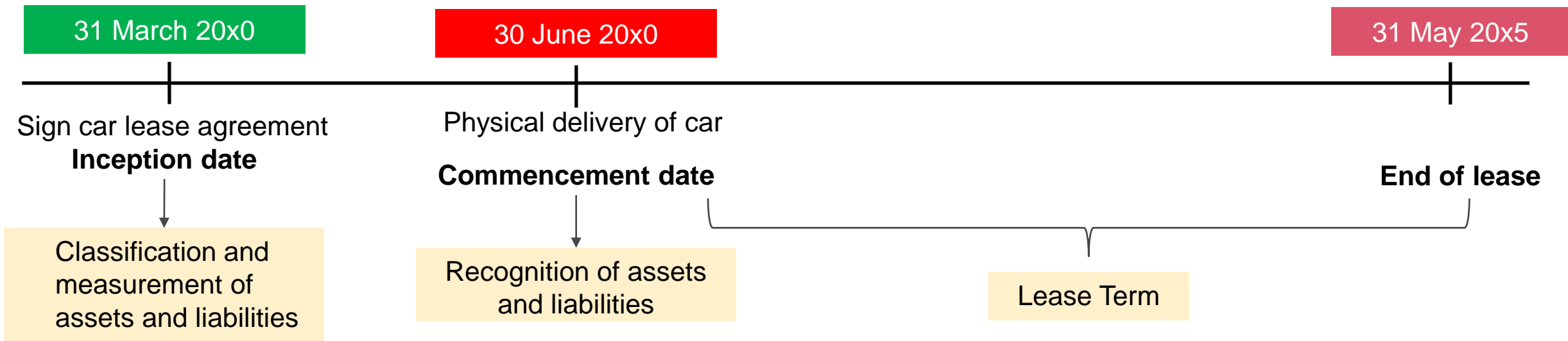
Lease classification





When to classify and recognise leases?

Inception, commencement and lease term



Non-cancellable period for which the lessee has contracted to lease the asset

Lease that is only cancellable by:

- *Occurrence of remote situation*
- *Permission of lessor*



Key lease indicators

Finance lease	Operating lease
Transfer of substantially all risks and rewards of ownership	No transfer of substantially all risks and rewards of ownership
Option to purchase the asset at a price expected to be exercised (lower than fair value)	No option to purchase the asset, or option to purchase not expected to be exercised
Lease term is for the major part of the economic life of the asset	Lease term is for the minor part of the economic life of the asset
Leased asset's nature is very specialised and only suitable for lessee	Leased asset is generic in nature; usable by others without major modification
Present value of minimum lease payments (MLPs) equals to substantially all of the fair value (FV) of the asset at inception	Present value of MLPs differs substantially from the FV of the asset
The leased assets cannot easily be replaced by another asset	The leased assets can easily be replaced by another asset



Other lease indicators

Finance lease	Operating lease
Lessee can cancel the lease and bears the loss of cancellation	Lessee has no right to cancel the lease
Lessee bears the risk of residual value of the lease asset	Lessor bears the risk of residual value of the lease asset
Lessee has the right to extend the lease term at a rent that is substantially lower than market rent	Lessee has the right to extend the lease term at a rent that is equivalent to market rent
Leased assets cannot easily be replaced by another asset	Leased asset can easily be replaced by another asset



Recognition of lease in financial statements



Lease type	Book of	Statement of financial position	Statement of financial performance
Finance lease	Lessee	<ul style="list-style-type: none"> • Asset and accumulated depreciation • Lease liability (<i>obligation to pay future rentals</i>) • Reduction in lease liability 	<ul style="list-style-type: none"> • Depreciation expenses • Finance charge
	Lessor	<ul style="list-style-type: none"> • Lease receivable • Reduction in receivable 	<ul style="list-style-type: none"> • Finance income • Profit / loss on sale
Operating lease	Lessee	Off balance sheet (not accounted)	<ul style="list-style-type: none"> • Lease expense
	Lessor	<ul style="list-style-type: none"> • Asset and accumulated depreciation 	<ul style="list-style-type: none"> • Depreciation expense • Lease income



Measurement for finance lease

Lessee's books

	Asset	Liability
Initial measurement	<ul style="list-style-type: none">• Recognised at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at inception of lease.• In calculating the present value of the minimum lease payments, the discount factor is the interest rate implicit in the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset.	
Subsequent measurement	<p>For depreciable asset, account in accordance with</p> <ul style="list-style-type: none">- MPSAS 17 (PPE) or MPSAS 31 (IA) <p>Asset has to be depreciated over the shorter of:</p> <ul style="list-style-type: none">- the period of the lease and- the useful life of the asset	<ul style="list-style-type: none">• MLPs shall be apportioned between finance charged and the reduction in the outstanding liability• Finance charge allocated to each period during the lease term so as to produce a constant periodic rate of interest



Finance lease agreement as lessee

Illustrative Example (Scenario 1)

- Lessor lease equipment to lessee – 1 January 20x5
- Lease term is 5 years, non-cancellable with equal payments of RM23,982/year (annuity due basis)
- Fair value at inception of lease – RM100,000 and estimated economic useful life – 5 years with no residual value
- No renewal options and equipment reverts to Lessor at termination of the lease
- Depreciation on straight-line basis
- Lessor sets 10% as the rate of return on the lease investment; and lessee is aware

Is this finance or operating lease?

Finance

- Lease term of 5 years = Estimated useful life of 5 years
- Present value of the minimum lease payments equals the fair value of the property (RM100,000).



Finance lease agreement as lessee

Illustrative Example (Scenario 1)

1) To record the recognition of finance lease on January 1, 20X5

The asset value and the amount of the obligation are recorded at the beginning of the lease term at the present value of the lease payments. The minimum lease payments are RM119,910 (RM23,982 x 5) and the amount capitalized as lease assets is RM100,000, the present value of the minimum lease payments is determined as:

$$\begin{aligned}\text{Capitalised amount} &= \text{RM}23,982 \times \text{present value of an annuity due of RM1 for 5 periods at 10\%} \\ &= \text{RM}23,982 \times 4.16986 \\ &= \text{RM}100,000\end{aligned}$$

The lessor's implicit interest rate of 10% is used instead of the lessee's incremental borrowing rate of 11% because (1) it is lower, and (2) the lessee has knowledge of it.



Finance lease agreement as lessee

Illustrative Example (Scenario 1)

2) To record the first lease payment on 1 January, 20X5

The first lease payment of RM23,982 represents a reduction of the principal of the lease obligation.

There is no interest paid out at this point. Each rental payment of RM23,982 consists of two elements:

- (1) a reduction in the principal of the lease obligation and
- (2) a financing cost (interest expense).

The total financing cost or interest expense over the term of the lease of RM19,910 is the difference between the present value of the lease payments (RM100,000) and the actual cash disbursed for lease payments which amounts to RM119,910.



Finance lease agreement as lessee

Illustrative Example (Scenario 1)

2) To record the first lease payment on 1 January, 20X5

Lease amortisation schedule – Annuity due basis (RM)				
Date	Annual lease payment	Interest (10%) on unpaid obligation	Reduction of lease obligation	Balance of lease obligation
	(a)	(b)	(c)	(d)
1 January 20X5	23,982			100,000
1 January 20X5	23,982		23,982	76,018
1 January 20X6	23,982	7,602	16,830	59,639
1 January 20X7	23,982	5,964	18,018	41,621
1 January 20X8	23,982	4,162	19,820	21,801
1 January 20X9	23,982	2,180	21,801	-
Total	119,910	19,910	100,000	

a) Lease payment as required by lessor

b) 10% of the preceding balance of (d) except for 1 January, 20X5; since this is an annuity due, no time has elapsed at the date of the first payment and no interest has accrued.

c) (a) minus (b)

d) Preceding balance minus (c)



Finance lease agreement as lessee

Illustrative Example (Scenario 1)

2) To record the first lease payment on 1 January, 20X5

DR/CR	Account description	Amount (RM)
DR	Lease liability – equipment	23,982
CR	Cash	23,982

Note: In the journal entry 2 above no portion of the RM23,982 relates to interest expense. Please refer to journal entry 4 for payments that relate to principal reduction and interest expense incurred.



Finance lease agreement as lessee

Illustrative Example (Scenario 1)

3) To record the depreciation expense for the year

The entity should record depreciation expense and accumulated depreciation as per the entity's normal depreciation policy (e.g. straight line method). $RM100,000/5 \text{ years} = RM20,000/\text{year}$.

DR/CR	Account description	Amount (RM)
DR	Depreciation expense – equipment (leased)	20,000
CR	Accumulated depreciation – equipment (leased)	20,000



Finance lease agreement as lessee

Illustrative Example (Scenario 1)

4) To record the first lease payment on 1 January, 20X6

The recording of the lease payment results in a reduction of the lease obligation and the interest expense incurred. The interest in suspense are reversed and recorded as an interest expense when the lease payment is made.

DR/CR	Account description	Amount (RM)
DR	Lease liability - equipment	23,982
DR	Interest expense	7,602
CR	Cash	23,982
CR	Interest in suspense	7,602



Recognition of lease in financial statements

Lease type	Book of	Statement of financial position	Statement of financial performance	Illustrative example
Finance lease	Lessee	<ul style="list-style-type: none"> • Asset and accumulated depreciation • Lease liability (<i>obligation to pay future rentals</i>) • Reduction in lease liability 	<ul style="list-style-type: none"> • Depreciation expenses • Finance charge 	<ul style="list-style-type: none"> • Scenario 1
	Lessor	<ul style="list-style-type: none"> • Lease receivable • Reduction in receivable 	<ul style="list-style-type: none"> • Finance income • Profit / loss on sale 	<ul style="list-style-type: none"> • Scenario 2
Operating lease	Lessee	Off balance sheet (not accounted)	<ul style="list-style-type: none"> • Lease expense 	<ul style="list-style-type: none"> • Scenario 3
	Lessor	<ul style="list-style-type: none"> • Asset and accumulated depreciation 	<ul style="list-style-type: none"> • Depreciation expense • Lease income 	<ul style="list-style-type: none"> • Scenario 4



Finance lease agreement as lessor

Illustrative Example (Scenario 2)

- The State leases out land to a member of the public for 99 years at a value of RM1.5 million being the minimum lease payment paid at the inception of the lease.
- At the end of the lease term, the ownership of land will revert back to the State.
- The carrying value of the land to the State was RM1.2 million.
- For the purpose of this scenario, the unguaranteed residual value is estimated at RM600,000 with a present value of RM400,000.
- Fair value of the land at inception of lease is RM1.6 million.
- As present value of minimum lease payment amounts to substantially the land value, this transfer is treated as a finance lease.



Finance lease agreement as lessor

Illustrative Example (Scenario 2)

1) To record the sale of leasehold land

The State will need to ascertain the value of the unguaranteed residual value of this land. Hence, the minimum lease payment of RM1.5 million and the unguaranteed residual value will equal the gross investment.

The total gross investment will reflect the fair value of the leasehold land that will also need to be brought back to its current present value. This will provide a net discounted gross investment

DR/CR	Account description	Amount (RM)
DR	Cash	1,500,000
DR	Finance lease receivable	400,000
CR	Property, plant and equipment - land	1,200,000
CR	Gain on disposal	700,000

Finance lease receivable reflects the unguaranteed residual value.



Finance lease agreement as lessor

Illustrative Example (Scenario 2)

2) To record periodic accretion of gain over the lease period

Total gain at the end of the lease period amounts to RM200,000 (RM600,000 – RM400,000).

DR/CR	Account description	Amount (RM)
DR	Finance lease receivable	200,000
CR	Gain on finance lease	200,000



Finance lease agreement as lessor

Illustrative Example (Scenario 2)

3) To record the return of leasehold land to the State

At the expiry of the lease term, the land is returned to the State.

DR/CR	Account description	Amount (RM)
DR	Property, plant and equipment - land	600,000
CR	Finance lease receivable	600,000

Recognition of lease in financial statements



Lease type	Book of	Statement of financial position	Statement of financial performance	Illustrative example
Finance lease	Lessee	<ul style="list-style-type: none"> • Asset and accumulated depreciation • Lease liability (<i>obligation to pay future rentals</i>) • Reduction in lease liability 	<ul style="list-style-type: none"> • Depreciation expenses • Finance charge 	<ul style="list-style-type: none"> • Scenario 1
	Lessor	<ul style="list-style-type: none"> • Lease receivable • Reduction in receivable 	<ul style="list-style-type: none"> • Finance income • Profit / loss on sale 	<ul style="list-style-type: none"> • Scenario 2
Operating lease	Lessee	Off balance sheet (not accounted)	<ul style="list-style-type: none"> • Lease expense 	<ul style="list-style-type: none"> • Scenario 3
	Lessor	<ul style="list-style-type: none"> • Asset and accumulated depreciation 	<ul style="list-style-type: none"> • Depreciation expense • Lease revenue 	<ul style="list-style-type: none"> • Scenario 4



Operating lease agreement as lessee

Illustrative Example (Scenario 3)

- An entity leases a building from an external party for 6 months as their temporary control centre in a commercial area is heavily affected by flood.
- The monthly rental is RM10,000 and the contracted lease term is 6 months.



Operating lease agreement as lessee

Illustrative Example (Scenario 3)

1) To record the recognition monthly lease expense

Lease expense is debited once the actual payment has been made to the lessor, cash is credited to reflect the cash outflow for the settlement of the liability.

DR/CR	Account description	Amount (RM)
DR	Lease expense	10,000
CR	Cash	10,000



Recognition of lease in financial statements

Lease type	Book of	Statement of financial position	Statement of financial performance	Illustrative example
Finance lease	Lessee	<ul style="list-style-type: none"> • Asset and accumulated depreciation • Lease liability (<i>obligation to pay future rentals</i>) • Reduction in lease liability 	<ul style="list-style-type: none"> • Depreciation expenses • Finance charge 	<ul style="list-style-type: none"> • Scenario 1
	Lessor	<ul style="list-style-type: none"> • Lease receivable • Reduction in receivable 	<ul style="list-style-type: none"> • Finance income • Profit / loss on sale 	<ul style="list-style-type: none"> • Scenario 2
Operating lease	Lessee	Off balance sheet (not accounted)	<ul style="list-style-type: none"> • Lease expense 	<ul style="list-style-type: none"> • Scenario 3
	Lessor	<ul style="list-style-type: none"> • Asset and accumulated depreciation 	<ul style="list-style-type: none"> • Depreciation expense • Lease revenue 	<ul style="list-style-type: none"> • Scenario 4



Operating lease agreement as lessor

Illustrative Example (Scenario 4)

- An entity leases a building to an external party for 6 months as their temporary office.
- The monthly rental is RM10,000 and the contracted lease term is 6 months.



Operating lease agreement as lessor

Illustrative Example (Scenario 4)

1) To record the recognition monthly lease expense

The revenue account is credited once the actual payment has been made by the lessee, cash balance is debited to reflect the cash inflow for the settlement of the liability.

DR/CR	Account description	Amount (RM)
DR	Cash	10,000
CR	Lease revenue	10,000



Accounting for sale and leaseback

- A sale and leaseback transaction arises when an owner sells an asset and immediately re-acquires the use of the asset by entering into a lease with the buyer.

Finance leaseback

- Finance leaseback is essentially a financing operation where seller/lessee never disposes of the risks and rewards of ownership of the asset and so it should not recognise a gain or loss on the sale. Any apparent profit should be deferred and amortised over the lease term.

Operating leaseback

- Where the seller enters into a sale and operating leaseback, it effectively disposes of substantially all the risks and rewards of owning the asset in the sale transaction; and may re-acquire some of the risks and rewards of ownership in the leaseback, but does not re-acquire substantially all of them.
- The transaction should be treated as a disposal and any gain or loss on the transaction should be recognised immediately in the statement of financial performance.



Finance leases

Disclosures for lessee

Assets

Note 11: Property, plant and equipment (continued)						
20X1	Freehold land (RM'000)	Leasehold land (RM'000)	Buildings (RM'000)	Office equipment, furniture and fittings (RM'000)	[Specify] (RM'000)	Total (RM'000)
Cost						
As at 1 January		XX				
Additions		XX				

Net carrying amount at reporting date

(b) Assets held under finance lease arrangement

The carrying amount of lands and buildings held under finance lease arrangement (Note 17) amounted to RM[] as at 31 December 20X2 (20X1: RM[]).

Liabilities

Note 17: Borrowings		20X2 RM'000	20X1 RM'000
Current			
Finance leases			
Loans from Federal Government			
[Specify]			
Non-current			
Finance leases			

(a) Finance leases

These obligations are secured by a charge over the leased assets (Note 11). The average discount rate implicit in the leases is []% (20X1: []%) per annum. These obligations are denominated in Malaysian Ringgit.

Finance leases

Disclosures for lessee



General description of leasing arrangement

(c) Finance lease commitments (as lessee)

The State has finance leases items of property, plant and equipment (land and buildings). These leases do not have terms of renewal, but some of the contracts have purchase options at nominal values at the end of the lease term.

Future minimum rentals payable under finance leases together with the present value of the net minimum lease payments at the reporting date are as follows:

Reconciliation between the total of future MLP and PV

A reconciliation between the total of future MLP by 1 year, 1 – 5 year, more than 5 year

	20X2 RM'000	20X1 RM'000
Minimum lease payments		
Not later than 1 year	xx	xx
Later than 1 year but not later than 5 years	xx	xx
Later than 5 years	xx	xx
Total minimum lease payments	xx	xx
Less: Finance charges	(xx)	(xx)
Present value of minimum lease payments	xx	xx
Present value of minimum lease payments		
Not later than 1 year	xx	xx
Later than 1 year but not later than 5 years	xx	xx
Later than 5 years	xx	xx
Total present value of minimum lease payments	xx	xx
Less: Amount due within 12 months (Note 17)	(xx)	(xx)
Amount due after 12 months	xx	xx



Finance leases

Disclosures for lessee

Lessee shall disclose the following:

- a) Contingent rents recognised as an expense in the period; and
- b) The total of future minimum sublease payments expected to be received under non-cancellable subleases at the reporting date.
- c) A general description of the lessee's material leasing arrangements including, but not limited to, the following:
 - i. The basis on which contingent rent payable is determined;
 - ii. The existence and terms of renewal or purchase options and escalation clauses; and
 - iii. Restrictions imposed by lease arrangements, such as those concerning return of net surplus, return of capital contributions, dividends, additional debt and further leasing.



Operating leases

Disclosures for lessee

General description of leasing arrangement

(a) Operating lease commitments (as lessee)

The State has entered into commercial leases of certain office space. These leases have an average tenure of [] to [] years with no renewal option or contingent rent provision included in the contracts. Minimum lease payments recognised in surplus or deficit during the financial year amounted to RM[] (20X1: RM[]).

Future minimum rentals payable under non-cancellable operating leases at the reporting date are as follows:

Lease & sublease payments recognised as an expense in the period

Total of future MLP under non-cancellable OL by 1 year, 1 – 5 year, more than 5 year

	20X2 RM'000	20X1 RM'000
Not later than 1 year	XX	XX
Later than 1 year but not later than 5 years	XX	XX
Later than 5 years	XX	XX
Total future minimum lease payable under non-cancellable operating leases	XX	XX



Operating leases

Disclosures for lessee

Lessee shall disclose the following:

- d) A general description of the lessee's material leasing arrangements including, but not limited to, the following:
 - i. The basis on which contingent rent payments are determined;
 - ii. The existence and terms of renewal or purchase options and escalation clauses; and
 - iii. Restrictions imposed by lease arrangements, such as those concerning return of net surplus, return of capital contributions, dividends, additional debt and further leasing.



Finance leases

Disclosures for lessor

Lessor shall disclose the following:

- a) A reconciliation between the total gross investment in the lease at the reporting date, and the present value of minimum lease payments receivable at the reporting date. In addition, an entity shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the reporting date, for each of the following periods:
 - i. Not later than one year;
 - ii. Later than one year and not later than five years; and
 - iii. Later than five years;
- b) Unearned finance revenue;
- c) The unguaranteed residual values accruing to the benefit of the lessor;
- d) The accumulated allowance for uncollectible minimum lease payments receivable;
- e) Contingent rents recognised in the statement of financial performance; and
- f) A general description of the lessor's material leasing arrangements.



Operating leases

Disclosures for lessor

General description of leasing arrangement

(b) Operating lease commitments (as lessor)

The State has entered into commercial property leases on its investment properties. These non-cancellable leases have remaining lease terms of between [] and [] years.

Future minimum rentals receivable under non-cancellable operating leases at the reporting date are as follows:

Total of future MLP under non-cancellable OL by 1 year, 1 – 5 year, more than 5 year

	20X2 RM'000	20X1 RM'000
Not later than 1 year	XX	XX
Later than 1 year but not later than 5 years	XX	XX
Later than 5 years	XX	XX
Total future minimum lease receivable under non-cancellable operating leases	XX	XX