Solution 71.9

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Attention: This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety.

Issue

The *inception* of the lease is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date:

(a) a lease is classified as either an operating or a finance lease; and

(b) in the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined [IAS17.4(R.05)].

The *commencement of the lease term* is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e. the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate) [IAS17.4(R.05)].

How are the dates of inception and commencement of a lease determined and what are the implications for the lease accounting?

Background

Entity A (a manufacturer/lessor) signed an agreement on 1 January 20X5 to lease specific equipment to entity B (the lessee). Entity A committed to deliver the equipment to B on 1 January 20X6. Entity A will manufacture the equipment and estimates that the fair value will be 15,000. The estimated cost to build the asset is 10,000. The lessor has not incurred any initial direct costs in negotiating and arranging the lease.

The term of the arrangement is for 4 years, commencing when the equipment is delivered. The estimated useful life of the asset is 4 years and there is no residual value.

The lease is classified as finance lease.

The lessee is obliged to make 4 annual payments of 5,000 each, payable on 1 January of each year. The first instalment is due on 1 January 20X6.

On 1 January 20X6, entity A has incurred actual costs to construct the asset of 12,000.

Solution

Inception of the lease is on 1 January 20X5, when the lease agreement is signed and commencement of the lease is on 1 January 20X6, when the leased asset is made available for use to the lessee.

At inception, entity A determines the appropriate lease classification. Entity A uses the expected present value of the minimum lease payments and the estimated fair value of the asset at the date of commencement.

Entity A determines the interest rate implicit in the lease on 1 January 20X5 by comparing the present value of minimum lease payments discounted to 1 January 20X6 and the estimated fair value of the asset on 1 January 20X6 (the residual value and initial direct costs are assumed to be zero in this example).

On 1 January 20X6, entity A recognises a lease receivable of 15,000 (which corresponds to the net present value of the minimum lease payments) and a profit on sale of 3,000 rather than 5,000 as originally estimated.