

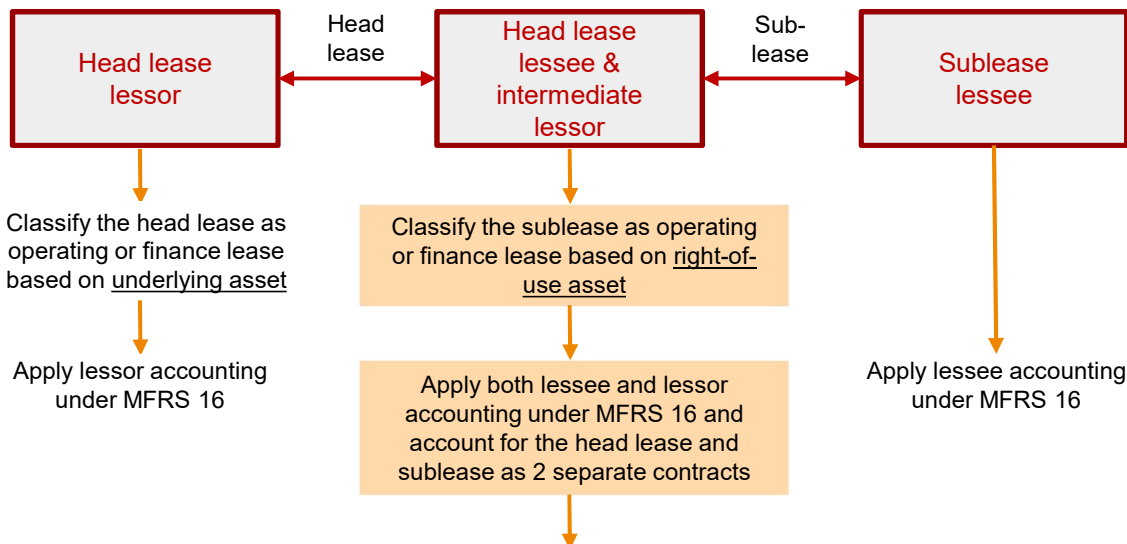
## How would MFRS 16 change sublease accounting for intermediate lessors?

Applicable MFRS	MFRS 16 Leases
Effective date	Annual reporting periods beginning on or after 1 January 2019



### Key provision

Lease classification will be based on the asset which the lessor controls. MFRS 16 requires that, when classifying a sublease, an intermediate lessor should evaluate the sublease by reference to the right-of-use asset arising from the head lease and not the underlying asset.



Head lease

#### Accounting as the lessee

Recognise a right-of-use asset and a lease liability

Sub-lease

#### Accounting as the intermediate lessor

Sublease classified as finance lease

- recognise a new asset representing a net investment in the sublease, which is the sum of present value of lease payments receivable by the intermediate lessor and the unguaranteed residual value of the right-of-use asset accruing to the intermediate lessor
- derecognise all or a portion of the right-of-use asset from the head lease

Sublease classified as operating lease

- retain the right-of-use asset from the head lease

*If the intermediate lessor, as the head lease lessee applies the short-term lease exemption provided in MFRS 16, the sublease shall be classified as an operating lease.*



## Key provision (continued)

### Reasons for the new guidance on sublease arrangements

1. The intermediate lessor controls the right-of-use asset and not the underlying asset which is controlled by the head lessor. Accordingly, the lease classification is made with reference to the right-of-use asset, and not the underlying asset.
2. Classification with reference to the right-of-use asset would reflect the risk that an intermediate lessor is exposed to. For example, a right-of-use asset could be converted into credit risk (of the sublessee) if the intermediate lessor transfers to the sublessee substantially all of the risks and rewards incidental to the right-of-use asset.



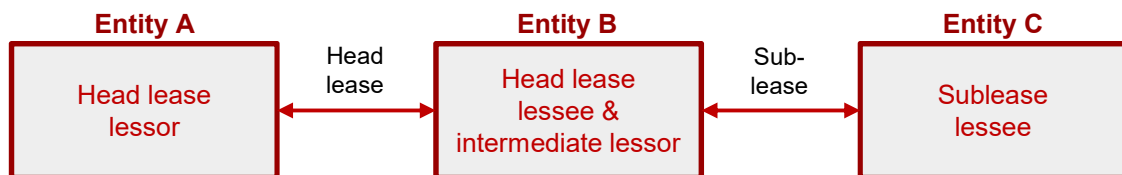
## Key impact

More intermediate lessors will need to classify subleases as finance leases under MFRS 16.



## Illustrative example

### Background



Entity B enters into a head lease of a building with Entity A. At the same time, Entity B subleases the building to Entity C. This example assumes the following facts.

	Head Lease	Sub-lease
Lease term	10 years	8 years
Lease liability = present value of lease payments	RM1.0m	RM0.9m

### Assessment by Entity B as the intermediate lessor

Entity B classifies the sublease based on the right-of-use asset.

Indicators considered include:

- comparing 8 years (sublease term) against 10 years (head lease term). The building's economic life of, say, 25 years is not relevant to Entity B's assessment; and
- comparing RM0.9m (PV of sublease payments) against RM1.0m (right-of-use asset fair value). The building's fair value of, say, RM3.0m is not relevant to Entity B's assessment.

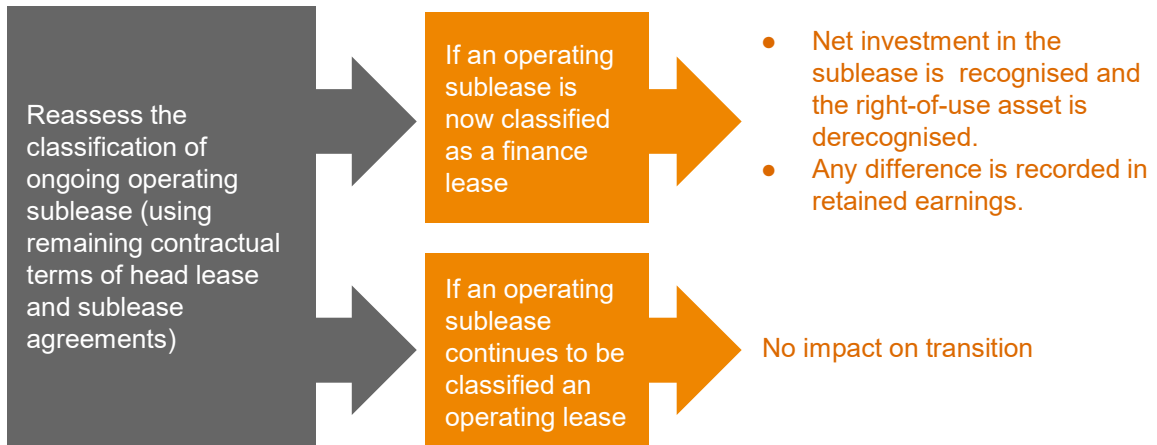
### Conclusion

Entity B classifies the sublease as a finance lease on the basis that it has transferred substantially all the risks and rewards incidental to ownership of the right-of-use asset. This conclusion may be different for a previous assessment performed under MFRS 117 "Leases" (which was superseded by MFRS 16 with effect from 1 January 2019). For example, had Entity B compared the sublease term of 8 years against the building's economic life of 25 years, Entity B would have classified the lease as an operating lease.



## Transition

At the date of initial application of MFRS 16, an intermediate lessor shall:



The change in sublease guidance must be considered for both:

- transition to MFRS 16; and
- new subleases entered into after the adoption of MFRS 16.

