national treasury
Department: National Treasury
REPUBLIC OF SOUTH AFRICA

GRAP 13 – Leases

Effective 1 April 2021

DEFINITION

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

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

A **finance lease** is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred

ACCOUNTING TREATMENT (operating lease)

Lessor:

- Treats contract as an executory contract
- Retains leased asset in statement of financial position
- Recognises lease revenue on a straight-line basis over the lease term

Lessee:

- Treats contract as an executory contract
- Does not recognise leased asset in statement of financial position
- Recognises lease expense on a straight-line basis over the lease term

CONSIDERATIONS TO NOTE

- A lessee may classify a property interest held under an operating lease as an investment property. If this is done, then that interest is accounted for as if it were a finance lease
- Lessors and lessees recognise incentives for the agreement of a new or renewed operating lease as a reduction in lease rental revenue or expense respectively over the lease term, on a straight-line basis
- A lease of land generally will be classified as an operating lease unless the title transfers to the lessee
- A lease of land and buildings should be treated as two separate leases, and are classified differently
- A series of linked transactions in the legal form of a lease should be accounted for based on the substance of the arrangement, the substance can be that the series of transactions is not a lease

CLASSIFICATION OF A FINANCE LEASE

Examples of situations that would ordinarily lead to a lease being classified as a finance lease (not all need to be met):

- The lease transfers ownership of the asset to the lessee by the end of the lease term
- The lease has a bargain option to purchase the leased asset at it is reasonably certain at that date of inception that the option will be exercised
- The lease term is for the major part of the economic life of the asset even if title is not transferred
- 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
- The leased assets are of such specialised nature that only the lessee can use them without major modifications
- The leased assets cannot easily be replaced by another asset

Other indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease:

- If the lessee can cancel the lease, the lessor's losses associated with the lease are borne by the lessor
- Gains or losses from the fluctuation in the fair value of the residual value accrue to the lessee
- The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent

Overriding principle:
Substance over form

ACCOUNTING TREATMENT (finance lease)

Lessor:

- Recognises lease payments as a receivable equal to net investment of the lease
- Leased asset is not recognised in the statement of financial position
- Recognises finance revenue based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease

Lessee:

- Lessee recognises the leased asset and liability, in the statement of financial position at amounts equal to the lower of the fair value of the leased asset and the PV of lease payments
- Discount rate to be used to calculate PV is implicit rate in the lease
- Minimum lease payments made are apportioned between finance charges and reduction of outstanding liability
- The finance charge is allocated to each period of the lease term to produce a constant rate of interest over the period
- A depreciation expense arises for depreciable assets