

Accounting Procedure - Leases

Section 1 - Background and Purpose

(1) This Procedure is applied in the preparation and the presentation of the consolidated financial statements of the group of entities under the control of the University. The financial statements include separate financial statements for the University as an individual entity and the consolidated entity (the “Group”) consisting of the University and its controlled entities.

This Procedure deals with leases and its classification as a finance lease or an operating lease, and the accounting treatment of leases based on its classification in the hands of a lessor and a lessee.

Part A - Scope

(2) Refer to the [Accounting \(Financial\) Policy](#).

Part B - Policy Statement

(3) Refer to the [Accounting \(Financial\) Policy](#).

Part C - Procedure

Part D - Classification of Leases

(4) A lease can be either a finance lease or an operating lease.

(5) Classification is made at the inception of the lease. The classification of leases is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee.

(6) Rewards may be represented by the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.

(7) A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

(8) Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract.

(9) Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- a. the lease transfers ownership of the asset to the lessee by the end of the lease term;
- b. the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;

- c. the lease term is for the major part of the economic life of the asset even if title is not transferred;
- d. at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- e. the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

(10) Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

- a. if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- b. gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
- c. the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

Part E - Financial Leases

The University as a Lessee

Measurement

(11) At the commencement of the lease term, finance leases are recognised as assets and liabilities in the balance sheet 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 the inception of the lease. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the University's incremental borrowing rate shall be used. Any initial direct costs of the University are added to the amount recognised as an asset.

(12) Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge shall be allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rents shall be charged as expenses in the periods in which they are incurred.

(13) A finance lease gives rise to depreciation expense for depreciable assets as well as finance expense for each reporting period. If there is no reasonable certainty that the University will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

The University as a Lessor

Measurement

(14) The University shall recognise assets held under a finance lease in its balance sheet and present them as a receivable at an amount equal to the net investment in the lease, and subsequently recognise finance income based on a pattern reflecting a constant periodic rate of return on that net investment.

Part F - Operating Leases

The University as a Lessee

Measurement

(15) The University shall recognise lease payments as an expense on a straight-line basis over the lease term.

The University as a Lessor

Measurement

(16) The University shall present assets subject to operating leases in its balance sheet according to the nature of the asset. Lease income from operating leases shall be recognised in the income statement on a straight-line basis over the lease term.

(17) Initial direct costs incurred by the University in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income. The depreciation policy for depreciable leased assets shall be consistent with the University's normal depreciation policy for similar assets.

Part G - Sale and Leaseback Transactions

(18) A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

(19) If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount shall not be immediately recognised as income by the University as a seller-lessee. Instead, it shall be deferred and amortised over the lease term.

(20) If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss shall be recognised immediately. If the sale price is below fair value, any profit or loss shall be recognised immediately except that, if the loss is compensated for by future lease payments at below market price, it shall be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value shall be deferred and amortised over the period for which the asset is expected to be used. If the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value shall be recognised immediately.

Section 2 - Definitions

- a. 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.
- b. A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.
- c. The lessee's incremental borrowing rate is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.
- d. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:
 - i. for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or
 - ii. for a lessor, any residual value guaranteed to the lessor by:
 - iii. the lessee;
 - iv. a party related to the lessee; or
 - v. a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

- e. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.
- f. Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease.
- g. A non-cancellable lease is a lease that is cancellable only:
 - i. upon the occurrence of some remote contingency;
 - ii. with the permission of the lessor;
 - iii. if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
 - iv. upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.
- h. An operating lease is a lease other than a finance lease.
- i. The University means La Trobe University.

Status and Details

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| Unit Head | Mark Smith Chief Finance and Operations Officer |
| Author | Joe Dimasi Finance Manager - Central +61 3 9479 3772 |
| Enquiries Contact | Finance |