



17 March 2005

To: **Members of the Hong Kong Institute of CPAs**
All other interested parties

Draft Interpretation 25

Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases

Comments to be received by 22 April 2005

***Issued by the Council,
Hong Kong Institute of Certified Public Accountants***

The Hong Kong Institute of Certified Public Accountants' Council (Council) has issued for consultation Draft Interpretation 25 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases*.

Council invites comments on the Draft Interpretation from any interested party and would like to hear from both those who do agree and those who do not agree with the proposals contained in the Draft Interpretation. Comments should be supported by specific reasoning and should preferably be submitted in written form.

The Draft Interpretation proposes to allow any changes resulting from applying it to be accounted for either as a change in an accounting policy in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or prospectively over the remaining lease term. Council wishes to seek comments specifically on the above proposed transitional arrangement. If commentators consider that the above proposed transitional arrangement is not appropriate, they are encouraged to state their reasons and provide alternative(s) for consideration.

Comments are requested to be received by **22 April 2005** and may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

17 March 2005
Exposure Draft

Response Due Date
22 April 2005

Draft Interpretation 25

Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

**LEASES – DETERMINATION OF THE LENGTH OF
LEASE TERM IN RESPECT OF
HONG KONG LAND LEASES**

(Response Due Date 22 April 2005)

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Interpretation 25 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases* is set out in paragraphs 1-13. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

References

- HKAS 16 (SSAP 17) *Property, Plant and Equipment*
- HKAS 17 (SSAP 14) *Leases*

Background

1. HKAS 17 requires the lease payment under a land lease classified as an operating lease to be recognised as an expense on a straight-line basis or other systematic basis over the lease term. HKAS 17 also provides that, if the lease payment for a property cannot be allocated reliably between the land and building components, the entire lease should be classified as a finance lease, unless it is clear that both elements are operating leases. In the case where the entire lease is classified as a finance lease, the related leasehold property interest can be accounted for using the cost or valuation model under HKAS 16 if such property interest meets the definition of property, plant and equipment under HKAS 16. Under the cost or valuation model in HKAS 16, the depreciable amount of that leasehold property interest should be allocated on a systematic basis over its useful life and the lease term would normally provide an indication of the useful life of that property interest.
2. Lease term is defined in HKAS 17 as the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option. In the light of the current land policy of the Government of the Hong Kong Special Administrative Region (the HKSAR Government), concern has been expressed as to how the length of the lease term of a Hong Kong land lease should be determined for the purpose of applying the requirements under HKAS 16 and HKAS 17, as appropriate. Concern has also been expressed, in the absence of authoritative guidance, that diverse or unacceptable practices would undermine the relevance, reliability or comparability of financial statements.
3. This Interpretation provides guidance on the determination of the length of the lease term of a Hong Kong land lease for the purpose of applying the amortisation (depreciation) requirements under HKAS 16 and HKAS 17, as appropriate.
4. This Interpretation does not address the assumptions that should be made when arriving at the current fair value of a property for accounting purposes.

Scope

5. This Interpretation applies where a property is classified as being held under an operating lease in accordance with HKAS 17.
6. This Interpretation also applies where the lease payment for an owner-used property cannot be allocated reliably between the land and building components on a fair value basis at the inception of the lease and thus the property is classified as a finance lease and accounted for using either the cost or valuation model under HKAS 16.

Issue

7. This Interpretation addresses the issue of how the length of the lease term of a Hong Kong land lease should be determined for the purpose of applying the amortisation (depreciation) requirements under HKAS 16 and HKAS 17, as appropriate.

Conclusions

8. The lease term of a Hong Kong land lease for the purpose of applying the amortisation (depreciation) requirements under HKAS 16 and HKAS 17, as appropriate, shall be determined by reference to the legal form and status of the lease. Renewal of a lease is assumed only when the

lessee has a renewal option and it is reasonably certain at the inception of the lease that the lessee will exercise the option. Options for extending the lease term that are not at the discretion of the lessee shall not be taken into account by the lessee in determining the lease term.

9. Consequently, lessees shall not assume that the lease term of a Hong Kong land lease will be extended for a further 50 years, or any other period, while the HKSAR Government retains the sole discretion as to whether to renew. Any general intention to renew certain types of property leases expressed by the HKSAR Government is not sufficient grounds for a lessee to include such extensions in the determination of the lease term for amortisation (depreciation).
10. Similarly, for the leases in the New Territories expiring shortly before 30 June 2047, the legal limit in these leases shall be assumed to be the maximum lease term.
11. For those leases which extend beyond 30 June 2047 (e.g. those with an original lease term of 999 years), lessees shall assume that any legal rights under the leases that extend the lease term to beyond 30 June 2047 will be protected for the full duration of the lease in the absence of any indication to the contrary.

Effective date

12. An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Interpretation for a period beginning before 1 January 2005, it shall disclose that fact.

Transition

13. Any changes resulting from applying this Interpretation shall be accounted for either as a change in an accounting policy in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or prospectively over the remaining lease term.