

# MEMBERS' HANDBOOK

## Update No. 75

(Issued 29 December 2009)

This Update relates to the issuance of:

- Amendment to HK-Int 4 - *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases*

Document Reference and Title	Instructions	Explanations
<b>VOLUME II</b>		
Contents of Volume II	Discard the existing page iii and replace with the new page iii.	Revised contents pages
<b>HONG KONG INTERPRETATIONS (HK-Int)</b>		
HK Interpretation 4 <a href="#"><u>Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases</u></a>	Replace the Interpretation with revised Interpretation.	Amendment to HK-Int 4 – Note

**Note:**

HK-Int 4 is revised as a consequence of amendment to HKAS 17 *Leases* made by *Improvements to HKFRSs* issued in May 2009. The amendment to HKAS 17 removes the specific guidance which stated that land held under a lease should be classified as an operating lease unless title to the land is expected to pass at the end of the lease term. The new guidance, paragraph 15A, indicates that entities should use judgment to decide whether the lease transfers the significant risks and rewards of ownership of the land in accordance with the criteria set out in HKAS 17. A lease of land is therefore classified as a finance lease if the lease transfers substantially all the risks and rewards incidental to ownership to the lessee. Following this amendment, the scope of this Interpretation has been expanded to cover all land leases, including those classified as finance leases. As a result, this Interpretation is applicable to all leases of property accounted for in accordance with HKAS 16 *Property, Plant and Equipment*, HKAS 17 and HKAS 40 *Investment Property*.

**HONG KONG (IFRIC) INTERPRETATIONS (HK(IFRIC)-Int)**

HK(IFRIC)-Int 1	<a href="#">Changes in Existing Decommissioning, Restoration and Similar Liabilities</a>	8/04(1/08)
HK(IFRIC)-Int 2	<a href="#">Members' Shares in Co-operative Entities and Similar Instruments</a>	2/05(6/08)
HK(IFRIC)-Int 4	<a href="#">Determining whether an Arrangement contains a Lease</a>	2/05(1/08)
HK(IFRIC)-Int 5	<a href="#">Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds</a>	2/05(1/08)
HK(IFRIC)-Int 6	<a href="#">Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment</a>	9/05
HK(IFRIC)-Int 7	<a href="#">Applying the Restatement Approach under HKAS 29 <i>Financial Reporting in Hyperinflationary Economies</i></a>	1/06(1/08)
HK(IFRIC)-Int 8	<a href="#">Scope of HKFRS 2</a>	5/06(7/09)
HK(IFRIC)-Int 9	<a href="#">Reassessment of Embedded Derivatives</a>	5/06(5/09)
HK(IFRIC)-Int 10	<a href="#">Interim Financial Reporting and Impairment</a>	9/06(1/08)
HK(IFRIC)-Int 11	<a href="#">HKFRS 2—Group and Treasury Share Transactions</a>	1/07(7/09)
HK(IFRIC)-Int 12	<a href="#">Service Concession Arrangements</a>	3/07(1/08)
HK(IFRIC)-Int 13	<a href="#">Customer Loyalty Programmes</a>	9/07
HK(IFRIC)-Int 14	<a href="#">HKAS 19 —The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction</a>	9/07(12/09)
HK(IFRIC)-Int 15	<a href="#">Agreements for the Construction of Real Estate</a>	8/08
HK(IFRIC)-Int 16	<a href="#">Hedges of a Net Investment in a Foreign Operation</a>	8/08(5/09)
HK(IFRIC)-Int 17	<a href="#">Distributions of Non-cash Assets to Owners</a>	12/08
HK(IFRIC)-Int 18	<a href="#">Transfers of Assets from Customers</a>	2/09
HK(IFRIC)-Int 19	<a href="#">Extinguishing Financial Liabilities with Equity Instruments</a>	12/09

**HONG KONG INTERPRETATIONS (HK-Int)\***

HK-Int 1	<a href="#">The Appropriate Accounting Policies for Infrastructure Facilities</a>	6/06
HK-Int 3	<a href="#">Revenue – Pre-completion Contracts for the Sale of Development Properties</a>	6/06 (8/08)
HK-Int 4	<a href="#">Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases</a>	6/06 (12/09)

Note: \* With effect from 24 May 2005, all Interpretations that are developed locally by the Institute are named Hong Kong Interpretations.

**HONG KONG (SIC) INTERPRETATIONS (HK(SIC)-Int)**

HK(SIC)-Int 10	<a href="#">Government Assistance – No Specific Relation to Operating Activities</a>	12/04(1/08)
HK(SIC)-Int 12	<a href="#">Consolidation – Special Purpose Entities</a>	2/05(1/08)
HK(SIC)-Int 13	<a href="#">Jointly Controlled Entities – Non-Monetary Contributions by Venturers</a>	12/04(1/08)
HK(SIC)-Int 15	<a href="#">Operating Leases – Incentives</a>	12/04(1/08)
HK(SIC)-Int 21	<a href="#">Income Taxes – Recovery of Revalued Non-Depreciable Assets</a>	3/05
HK(SIC)-Int 25	<a href="#">Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders</a>	12/04(1/08)
HK(SIC)-Int 27	<a href="#">Evaluating the Substance of Transactions Involving the Legal Form of a Lease</a>	12/04

HK Interpretation 4  
~~Issued May 2005~~ Revised December 2009

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Effective on 24 May 2005

*HK Interpretation 4*

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# **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

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

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HK Interpretation 4 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases* (HK-Int 4) 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 *Property, Plant and Equipment*
- HKAS 17 *Leases*
- HKAS 40 *Investment Property*

## Introduction

IN 1 HK-Interpretation 4 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases* was issued in May 2005.

IN 2 This Interpretation was revised in December 2009 as a consequence of amendment to HKAS 17 made by *Improvements to HKFRSs* issued in May 2009. The amendment to HKAS 17 removes the specific guidance which stated that land held under a lease should be classified as an operating lease unless title to the land is expected to pass at the end of the lease term. The new guidance, paragraph 15A, indicates that entities should use judgment to decide whether the lease transfers the significant risks and rewards of ownership of the land in accordance with the criteria set out in HKAS 17. A lease of land is therefore classified as a finance lease if the lease transfers substantially all the risks and rewards incidental to ownership to the lessee. Following this amendment, the scope of this Interpretation has been expanded to cover all land leases, including those classified as finance leases. As a result, this Interpretation is applicable to all leases of property accounted for in accordance with HKAS 16, HKAS 17 and HKAS 40.

## 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 a 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 or the cost model under HKAS 40 depending on the nature of the property interest. Under the cost or valuation model in HKAS 16, t~~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.~~
- (a) a property is held under a lease and accounted for in accordance with HKAS 17;  
(b) an investment property is accounted for using the cost model under HKAS 40; or  
(c) a property held for own use is carried under the cost or valuation model in HKAS 16.
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. [Deleted]~~

## 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. This Interpretation becomes effective on 24 May 2005.

## 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.