

FAQs on Notifiable and Connected Transaction Rules relating to Lease Transactions of Listed Issuers adopting HKFRS/IFRS 16 “Leases” (or similar accounting standards in other jurisdictions)

Release Date (Last Update Date)	Main Board Rules	GEM Rules	Series No.	FAQ No.	Query	Response
Leases where listed issuers act as lessees						
28/09/2018	14.04(1)(a), 14.04(1)(c), 14.04(1)(d), 14.04(1)(g), 14.07, 14.22, 14.23, 14A.24(1), 14A.24(3), 14A.31	19.04(1)(a), 19.04(1)(c), 19.04(1)(d), 19.04(1)(g), 19.07, 19.22, 19.23, 20.22(1), 20.22(3), 20.29	N/A	045-2018	<p>An issuer will enter into a lease transaction as a <u>lessee</u> and recognise the right-of-use asset according to HKFRS/IFRS 16.</p> <p>(a) How should the issuer classify the lease under the definition of “transaction”?</p> <p>(b) Does the revenue exemption under Main Board Rule 14.04(1)(g) apply to the lease?</p> <p>(c) How should it calculate the percentage ratios for the lease?</p> <p>(d) If the lease is entered into by the issuer with a connected person, will it be treated as a one-off connected transaction or continuing connected transaction?</p>	<p>(a) The issuer will recognise an asset representing its right to use the leased asset. This will be regarded as an acquisition of asset under the definition of transaction set out in Main Board Rule 14.04(1)(a).</p> <p>The classification of transaction into a finance lease or operating lease under Main Board Rule 14.04(1)(c) or 14.04(1)(d) will not apply where the issuer acts as lessee.</p> <p>(b) No. The transaction is of a capital nature.</p> <p>(c) Listed issuers are required to compute the assets and consideration ratios. The numerator will be the value of the right-of-use asset recognised by the issuer (which includes the present value of lease payments) according to HKFRS/IFRS 16.</p> <p>(d) Where the lease is subject to an agreement with fixed terms, it is treated as a one-off connected transaction (i.e. an acquisition of capital assets).</p>
17/04/2020	14.04(1)(a), 14.07	19.04(1)(a), 19.07	N/A	045A-2018	<p>An issuer (as a lessee) has entered into a 5-year contract to lease a warehouse from a third party and recognized the right-of-use asset according to HKFRS/IFRS16.</p> <p>If the issuer subsequently proposes to early terminate the lease by the end of</p>	<p>(a) The proposed termination of lease will result in a decrease in the amount of right-of-use asset recognised by the issuer. This will be regarded as a disposal of asset under the definition of transaction set out in Main Board Rule 14.04(1)(a).</p> <p>(b) The issuer should compute (i) the assets ratio</p>

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					<p>the third year,</p> <p>(a) how should the issuer classify the termination of the lease under the definition of “transaction”?</p> <p>(b) how should it calculate the percentage ratios for the termination of lease?</p>	<p>based on the value of the remaining right-of-use asset; and (ii) the consideration ratio based on the penalty or fee, if any, payable by the issuer for terminating the lease.</p>
28/09/2018	14.22, 14.23, 14A.24(1), 14A.24(3), 14A.31	19.22, 19.23, 20.22(1), 20.22(3), 20.29	N/A	046-2018	<p>An issuer from time to time enters into leases (e.g. leases of properties, or leases of machinery and equipment) that are necessary for its business operations.</p> <p>Will the issuer be required to aggregate its lease transactions entered into with the same party within a period of 12-months?</p>	<p>There will be no change in the application of the aggregation Rules to lease transactions after the issuer adopting HKFRS/IFRS 16.</p> <p>In the circumstances described, generally the Exchange would not require aggregation of the lease transactions solely because they are made with the same party. When applying the aggregation Rules, the Exchange would consider whether the lease transactions are connected or related in substance and whether there is a concern about “splitting” of a lease transaction into smaller ones to circumvent the notifiable/connected transaction requirements. It would take into account relevant factors including:</p> <ul style="list-style-type: none"> - whether the leases are made under a master agreement or negotiated and concluded at the same time; - whether the leased assets form part of one asset, and/or - whether the leases would together lead to substantial involvement by the issuer in a new business activity.

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						<p>(See also Listing Decisions LD76-3 (2009) and LD64-1 (2008) where the principles and guidance provided also apply to leases of properties or fixed assets by issuers.)</p> <p>Nevertheless, as the Exchange would have to consider all relevant facts and circumstances of the particular case when determining whether aggregation of transactions is required, the issuer should consult the Exchange as required under Main Board Rule 14.23B or 14A.84.</p>
07/12/2018	14.04(1)(a), 14.07, 14A.24(1), 14A.31	19.04(1)(a), 19.07, 20.22(1), 20.29	N/A	046A - 2018	<p>An issuer will enter into a lease transaction as a <u>lessee</u> (e.g. lease of retail outlets for operating its retail business).</p> <p>Under the agreement, the annual lease payment will include: i) a fixed dollar amount (fixed lease payments); and ii) a variable amount determined as a percentage of the issuer’s annual sales generated from the leased properties (variable lease payments).</p> <p>According to HKFRS/IFRS 16, the issuer will recognize a right-of-use asset taking into account the fixed lease payments. The actual variable lease payments linked to sales will be recognized as expenses in the issuer’s profit or loss accounts in the periods in which they are incurred.</p> <p>(a) How should the issuer calculate the</p>	<p>(a) The recognition of a right-of-use asset in relation to the fixed lease payments will be regarded as an acquisition of asset under the definition of transaction set out in Main Board Rule 14.04(1)(a). The issuer is required to compute the assets and consideration ratios by using the value of the right-of-use asset as the numerator. (see FAQ045-2018(a) and (c))</p> <p>The variable lease payments linked to sales will be expenses incurred by the issuer in its ordinary and usual course of business. They are revenue in nature and are not subject to Chapter 14.</p> <p>(b) Where the lessor is a connected person:</p> <p>(i) The recognition of a right-of-use asset will constitute a one-off connected acquisition. The issuer is required to compute the assets and consideration ratios by using the value of the right-of-use asset as the numerator (see FAQ045-2018(d))</p>

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					<p>percentage ratios for the lease under Chapter 14 of the Main Board Rules?</p> <p>(b) If the lessor is a connected person, how should the issuer classify the lease under Chapter 14A of the Main Board Rules?</p>	<p>(ii) The variable lease payments linked to sales will be recorded as expenses by the issuer over the term of the lease. They will be treated as a continuing connected transaction under Main Board Rule 14A.31.</p> <p>The issuer is required to set annual caps on the variable lease payments to be made each year under the agreement, and calculate the revenue, assets and consideration ratios.</p> <p>The lease will be classified under Chapter 14A by reference to the largest percentage ratio.</p> <p><i>(Note: There are other types of variable lease payments (e.g. variable lease payments depending on an index or rate) that are included in the initial measurement of right-of-use asset under HKFRS/IFRS 16. The treatment would be the same as fixed lease payments for the purpose of Chapters 14 and 14A.)</i></p>
28/09/2018 (07/12/2018)	14A.31, 14A.53	20.29 20.51	N/A	047-2018	<p>An issuer enters into a framework agreement with a connected person for leases over a period of time (say 3 years).</p> <p>Will the transactions be treated as continuing connected transactions? If yes, how should the issuer set the annual caps?</p>	<p>Yes. The leases under the framework agreement will be treated as continuing connected transactions after HKFRS/IFRS 16 becoming effective.</p> <p>The issuer acting as lessee will be required to set annual caps on the total value of right-of-use assets relating to the leases to be entered into by the issuer in each year under the framework agreement. It should calculate each of the assets ratio and the consideration ratio using the maximum annual cap as the numerator.</p>

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						<p>Where the framework agreement will also cover leases with variable lease payments linked to sales that will be recognised as expenses (and not right-of-use assets) in the issuer’s accounts (e.g. leases as described in FAQ046A-2018), the issuer must also set annual caps for the variable lease payments to be made by it each year. It should calculate each of the revenue ratio, the assets ratio and the consideration ratio using the maximum annual cap as the numerator.</p> <p>The framework agreement will be classified under Chapter 14A by reference to the largest percentage ratio.</p>
28/09/2018	14.04(1)(a), 14.04(1)(c), 14.04(1)(d), 14A.24(1), 14A.24(3), 14A.31	19.04(1)(a), 19.04(1)(c), 19.04(1)(d), 20.22(1), 20.22(3), 20.29	N/A	048-2018	<p>HKFRS/IFRS 16 will become effective for annual accounting periods beginning on or after 1 January 2019.</p> <p>When listed issuers apply HKFRS/IFRS 16 retrospectively to recognise the right-of-use assets arising from existing leases, are they required to re-comply with the notifiable or connected transaction Rules for these leases?</p>	<p>Listed issuers are not required to re-comply with the notifiable or connected transaction Rules for leases under fixed terms or framework agreements entered into by the issuers before the adoption of HKFRS/IFRS 16. Where existing leases have been classified as continuing connected transactions under Chapter 14A of the Main Board Rules, the issuers should continue to comply with the relevant Rule requirements.</p>
Leases where listed issuers act as lessors						
28/09/2018	14.04(1)(d), 14.07	19.04(1)(d), 19.07	N/A	049-2018	<p>Under Main Board Rule 14.04(1)(d), the definition of transaction includes entering into or terminating operating leases which have a significant impact</p>	<p>Yes. Under HKFRS/IFRS 16, lessors will continue to classify leases into operating leases or finance leases and account for the two types of leases differently.</p>

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					<p>on the operations of the listed issuer concerned.</p> <p>Does this Rule apply to an operating lease entered into by an issuer acting as lessor?</p>	
28/09/2018	14A.24(3), 14A.31	20.22(3), 20.29	N/A	050-2018	<p>An issuer will enter into an operating lease (acting as a lessor) with a connected person.</p> <p>(a) Will it be treated as a one-off connected transaction or continuing connected transaction?</p> <p>(b) How should the issuer calculate the percentage ratios for the lease?</p>	<p>(a) The operating lease will be a continuing connected transaction for the issuer. The issuer will be required to set an annual cap on the annual rental income to be received each year under the agreement.</p> <p>With reference to the accounting treatment, the classification is different from lease transactions with connected persons where the issuer is the lessee (see FAQ045-2018(d) above).</p> <p>(b) The issuer should calculate each of the assets ratio, consideration ratio and revenue ratio using the maximum annual cap (or the actual annual rental income) as the numerator.</p>
28/09/2018	14.04(1)(c), 14.07	19.04(1)(c), 19.07	N/A	051-2018	<p>Under Main Board Rule 14.04(1)(c), the definition of transaction includes entering into or terminating finance leases.</p> <p>Does this Rule apply to a finance lease where the issuer acts as a lessor? If yes, how should the issuer calculate the percentage ratios?</p>	<p>Main Board Rule 14.04(1)(c) applies. Under HKFRS/IFRS 16, lessors will continue to classify leases into operating leases or finance leases and account for the two types of leases differently.</p> <p>The issuer should calculate the percentage ratios for (i) the disposal of the underlying asset and (ii) the provision of financial assistance, and classify the finance lease based on the highest percentage ratio.</p>

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Sale and leaseback transactions						
28/09/2018	14.04(1)(a), 14.04(1)(e)	19.04(1)(a), 19.04(1)(e)	N/A	052- 2018	<p>Under a proposed transaction, Company A will transfer the legal ownership of an asset to Company B and lease the asset back from Company B. Company A has an option to buy back the asset at the end of the lease period.</p> <p>According to HKFRS/IFRS 16, the proposed transaction will be accounted for as a financing arrangement by each of Company A and Company B (and not a sale and leaseback transaction).</p> <p>How should Company A and Company B classify the proposed transaction under Chapter 14?</p>	<p>The transfer of the legal ownership of the asset constitutes a disposal of asset by Company A and an acquisition of asset by Company B under Main Board Rule 14.04(1)(a).</p> <p>For Company B, the proposed transaction also involves provision of financial assistance under Main Board Rule 14.04(1)(e).</p>