

Classification of lease assets

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Introduction

In year 2013 VVIRA Dairy yoghurt expand their production capacity to double the current production capacity to 50,000 cups a day in addition to allowing the manufacture of other milk based products. For that they lease a milk processing plant from China through a local agent as operating lease According to LKAS 17.

Discussion of the Issue

VVIRA Dairy yoghurt farm install this new plant in Kandy. This plant market value was around Rs.50mn. But VVIRA got it through a local agent under operating lease for 15 years with major modification to that plant. That modification is done by the local agent to match with VVIRA requirements. But the ownership of the plant was not transferred to VVIRA. Also the local agent had given a technician with the plant to VVIRA. The expected life of the plant was 20 years.

Currently, the monthly lease payment recognize as expense. The major part of the economic life of the plant hopes to use by VVIRA even if the ownership is not transferred to VVIRA. Also VVIRA can use this plant without any major modification. Because that major modification already done by the local agent. At the end of 15 years, there is an ability to continue the operating lease for further few years.

Conclusions and Recommendations

According to LKAS 17, lease that transfers substantially all the risks and rewards incidental to ownership of an asset, when title may or may not eventually transferred, is recognize as Finance Lease. Also after 15 years, it cannot give to another party to manufacture yoghurt.

Therefore this lease can be recognized as a '**Finance lease**'. As a result of this recognition as finance lease, VVIRA should recognize this asset as fixed asset in there fixed assets register and make necessary adjustments in financial statements.