

**Accounting Standards for Enterprises No. 21 - Leases****No. 3 [2006] of the Ministry of Finance**

## Chapter I General Provisions

Article 1 With a view to regulating the recognition and measurement of leases, as well as the presentation of relevant information, the present Standards are formulated according to the Accounting Standards for Enterprises - Basic Standard.

Article 2 The term "lease" refers to an agreement under which the lessor conveys to the lessee in return for rent the right to use an asset for an agreed period of time.

Article 3 The following items shall be subject to other accounting standard:

(1) The land use right and buildings rented out by a lessor by way of operating lease shall be subject to the Accounting Standards for Enterprises No. 3 - Investment Real Estates;

(2) The licensing agreements for the use of items such as films, video recordings, plays, manuscripts, patents and copyrights shall be subject to the Accounting Standards for Enterprises No. 6 - Intangible Assets; and

(3) The impairment of long-term credits formed by the financing leases of a lessor shall be subject to the Accounting Standards for Enterprises No. 22 - Recognition and Measurement of Financial Instruments.

## Chapter II Classification of Leases

Article 4 A lessee and a lessor shall classify a lease as a financing lease or an operating lease on the lease beginning date.

The lease beginning date shall refer to the earlier one of the date of lease agreement or the date on which the parties to the lease make commitments on the key terms of lease.

Article 5 The "finance lease" shall refer to a lease that has transferred in substance all the risks and rewards related to the ownership of an asset. The ownership of it may or may not eventually be transferred.

Article 6 Where a lease satisfies one or more of the following criteria, it shall be recognized as a finance lease:

(1) The ownership of the leased asset is transferred to the lessee when the term of lease expires;

(2) The lessee has the option to buy the leased asset at a price which is expected to be far lower than the fair value of the leased asset at the date when the option becomes exercisable. Thus, on the lease beginning date, it can be reasonably determined that the option will be exercised;

(3) Even if the ownership of the asset is not transferred, the lease term covers the major part of the use life of the leased asset;

(4) In the case of the lessee, the present value of the minimum lease payments on the lease beginning date amounts to substantially all of the fair value of the leased asset on the lease beginning date; in the case of the lessor, the present value of the minimum lease receipts on the lease beginning date amounts to substantially all of the fair value of the leased asset on the lease beginning date; and

(5) The leased assets are of a specialized nature that only the lessee can use them without making

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major modifications.

Article 7The "lease term" shall refer to the period as specified in the lease agreement, during which the lease may not be canceled. Once a lease contract is signed, generally it may not be canceled except for the following circumstances:

- (1)With the consent of the lessor;
- (2)Where the lessee enters into a new lease for the same asset or asset of the same kind with the same lessor;
- (3)Where the lessee makes an additional payment of a sufficiently large amount;
- (4)Upon the occurrence of some remote contingency.

If the lessee has the option to continue to lease the asset for any further period, and it is reasonably certain on the lease beginning date that the lessee will exercise the option, the renewed period shall be included in the lease term, no matter whether rents will be paid again or not.

Article 8The term "minimum lease payment" shall refer to the payments (excluding contingent rents and execution costs) that the lessee shall, or may be required to make, for the term of lease, plus the residual values guaranteed by the lessee or a party related to the lessee.

Where the lessee has an option to buy the leased asset at a price which is expected to be far lower than the fair value on the date when the option becomes exercisable, and thus it is reasonably certain that the lessee will exercise the option on the lease beginning date, the payment required to exercise this purchase option shall be included in the minimum lease payments.

The term "contingent rent" shall refer to the rent which is not fixed in amount and calculated on the basis of factors other than the length of time, such as the sale quantity, amount of usage, price indices.

The term "execution cost" shall refer to costs incurred during the lease term for using the leased asset, such as the fees for technical consultation and services, training, maintenance and insurance.

Article 9The term "minimum lease receipt" shall refer to the minimum lease payments plus the residual values guaranteed to the lessor by a third party independent from the lessor or the lessee.

Article 10The term "operating lease" shall refer to a lease other than a financing lease.

### Chapter III Accounting Treatments of Lessees in Finance Leases

Article 11On the lease beginning date, a lessee shall record the lower one of the fair value of the leased asset and the present value of the minimum lease payments on the lease beginning date as the entering value in an account, recognize the amount of the minimum lease payments as the entering value in an account of long-term account payable, and treat the balance between the recorded amount of the leased asset and the long-term account payable as unrecognized financing charges.

The initial direct costs such as commissions, attorney's fees and traveling expenses, stamp duties directly attributable to the leased item incurred during the process of lease negotiating and signing the leasing agreement shall be recorded in the asset value of the current period.

The lease beginning date shall refer to the date on which the lessee begins to have the right to use the leased asset.

Article 12When a lessee calculates the present value of the minimum lease payments, if it can

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obtain the lessor's interest rate implicit in the lease, it shall adopt the interest rate implicit in the lease as the discount rate. Otherwise, it shall adopt the interest rate provided in the lease agreement as the discount rate.

In case the lessee cannot obtain the lessor's interest rate implicit in the lease and no interest rate is provided in the lease agreement, the lessee shall adopt the borrowing interest rate of the bank for the same period as the discount rate.

Article 13 The expression " interest rate implicit in the lease" shall refer to the discount rate that, on the lease beginning date, makes the aggregate present value of the minimum lease payments and the unguaranteed residual values equal to the sum of the fair value of the leased asset and the initial direct costs of the lessor.

Article 14 The term "guaranteed residue value" shall refer to, in the case of a lessee, the residual value of the asset which is guaranteed by the lessee or by a third party related to the lessee; and in the case of a lessor, the guaranteed residual value from the standpoint of the lessee plus the residual value of the asset which is guaranteed by a third party independent from both the lessor and the lessee.

The term "residual value of the asset" shall refer to the fair value of the leased asset when the term of lease expires as estimated on the lease beginning date.

The term "unguaranteed residue value" shall refer to the residual value of the leased asset minus the guaranteed residual value of the lessor.

Article 15 The unrecognized financing charge shall be amortized to each period during the lease term.

The lessee shall adopt the effective interest rate method to calculate and recognize the financing charge in the current period.

Article 16 In calculating the depreciation of a leased asset, the lessee should adopt a depreciation policy for leased assets consistent with that for depreciable assets which are owned by the lessee.

If it is reasonable to be certain that the lessee will obtain the ownership of the leased asset when the lease term expires, the leased asset shall be fully depreciated over its useful life.

If it is not reasonable to be certain that the lessee will obtain the ownership of the leased asset at the expiry of the lease term, the leased asset shall be fully depreciated over the shorter one of the lease term or its useful life.

Article 17 Contingent rents shall be recognized as an expense in the period in which they are actually incurred.

#### Chapter IV Accounting Treatments of Lessors in Finance Leases

Article 18 On the beginning date of the lease term, a lessor shall recognize the sum of the minimum lease receipts on the lease beginning date and the initial direct costs as the entering value in an account of the financing lease values receivable, and record the unguaranteed residual value at the same time.

The balance between the sums of the minimum lease receipts, the initial direct costs and the unguaranteed residual value, and the sum of their present values shall be recognized as unrealized financing income.

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Article 19 The unrealized financing income shall be allocated to each period during the lease term. The lessor shall calculate the financing income at the current period by adopting the effective interest rate method.

Article 20 The lessor shall, at least at the end of each year, reexamine the unguaranteed residual values.

No adjustment may be made if the unguaranteed residual value increases.

Where there is evidence showing a reduction in the unguaranteed residual value, the interest rate implicit in the lease shall be re-calculated and the associated reduction of the net investment in the lease shall be recognized as a loss for the current period.

The financing incomes for subsequent periods shall be recognized on the basis of the revised net investment in the lease and the recalculated implicit interest rate.

The net investment in the lease shall be the difference between the sum of the minimum lease receipts and the unguaranteed residual value in a finance lease and unrealized financing incomes.

Where the unguaranteed residual value for which a loss has been recognized previously is subsequently recovered, the reversal of the loss shall be limited to the amount of the loss recognized, and the interest rate implicit in the lease shall be recalculated. The financing incomes for subsequent periods shall be determined based on the revised net investment in the lease and the re-calculated implicit interest rate.

Article 21 Contingent rents shall be recorded into the profits and losses of the period in which they actually arise.

#### Chapter V Accounting Treatments of Lessees in Operating Leases

Article 22 The rents from operating leases shall be recorded by the lessee in the relevant asset costs or the profits and losses of the current period by using the straight-line method over each period of the lease term, unless there are other more reasonable methods.

Article 23 The initial direct costs incurred by a lessee shall be recognized as the profits and losses of the current period.

Article 24 The contingent rents shall be recorded into the profits and losses of the current period in which they actually arise.

#### Chapter VI Accounting Treatments of Lessors in Operating Leases

Article 25 A lessor shall include the assets subject to operating leases in relevant items of its balance sheets in light of the nature of the asset.

Article 26 The rents from operating leases shall be recorded in the profits and losses of the current period by using the straight-line method over each period of the lease term, unless there are other more reasonable methods.

Article 27 The initial direct costs incurred to a lessor shall be recorded into the profits and losses of the current period.

Article 28 As for the fixed assets subject to operating leases, the lessor shall calculate the depreciation of it by adopting depreciation policy for similar assets. As for other leased assets, systematic and reasonable methods shall be adopted for its amortization.

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Article 29 The contingent rents shall be recorded in the profits and losses of the period in which they actually arise.

#### Chapter VII Sale and Leaseback Transactions

Article 30 A lessor and a lessee shall recognize a sale and leaseback transaction as a financing lease or an operating lease according to Chapter II of the present Standard.

Article 31 Where a sale and leaseback transaction is determined as a financing lease, any balance between the sales proceeds and the carrying amount of the asset shall be deferred and amortized as an adjustment to depreciation in light of the depreciation pattern of the leased asset.

Article 32 Where a sale and leaseback transaction is determined as an operating lease, any balance between the sales proceeds and the carrying amount of the asset shall be deferred and amortized as an adjustment to the lease payments in light of the proportion of the lease payments during the lease term.

However, in case any evidence shows that the sale and leaseback transaction is based on the fair value, the balance between the sales proceeds and the carrying amount of the asset shall be recorded in the profits and losses of the current period.

#### Chapter VIII Presentation

Article 33 A lessee shall, in its balance sheet, present the balances between the long-term accounts payable minus the unrecognized financing charges related to the financing leases, long-term liabilities and long-term liabilities due within 1 year respectively.

Article 34 A lessee shall, in its notes, disclose the following information related to the financing leases:

- (1) the originally recorded carrying amounts at the beginning and the end of the period of each class of leased fixed assets, and the accumulated depreciation amount;
- (2) the minimum lease payment for each of the next 3 accounting years subsequent to the balance sheet date and the aggregate minimum lease payment thereafter; and
- (3) The unamortized balance of unrecognized financing charges and the method used to allocate the unrecognized financing charges.

Article 35 A lessor shall, in its balance sheet, present the balances between the financing lease accounts receivable minus the unrealized finance incomes as long-term liabilities.

Article 36 A lessor shall, in its notes disclose the following information related to the financing leases:

- (1) the minimum lease receipt for each of the next 3 accounting years subsequent to the balance sheet date and the aggregate minimum lease receipt thereafter; and
- (2) the unamortized balance of unrealized financing income and the method used to allocate the unrealized financing income.

Article 37 As for an important operating lease, the lessee shall, in its notes, disclose the following information:

- (1) the minimum lease payment for the irrevocable operating lease for each of the next 3 accounting years subsequent to the balance sheet date; and

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(2)the aggregate minimum lease payment thereafter for the irrevocable operating lease.

Article 38A lessor shall disclose the carrying amount of each class of leased assets in the operating leases.

Article 39A lessee and a lessor shall disclose each sale and leaseback transaction as well as the significant items in the contract on the sale and leaseback transaction.



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