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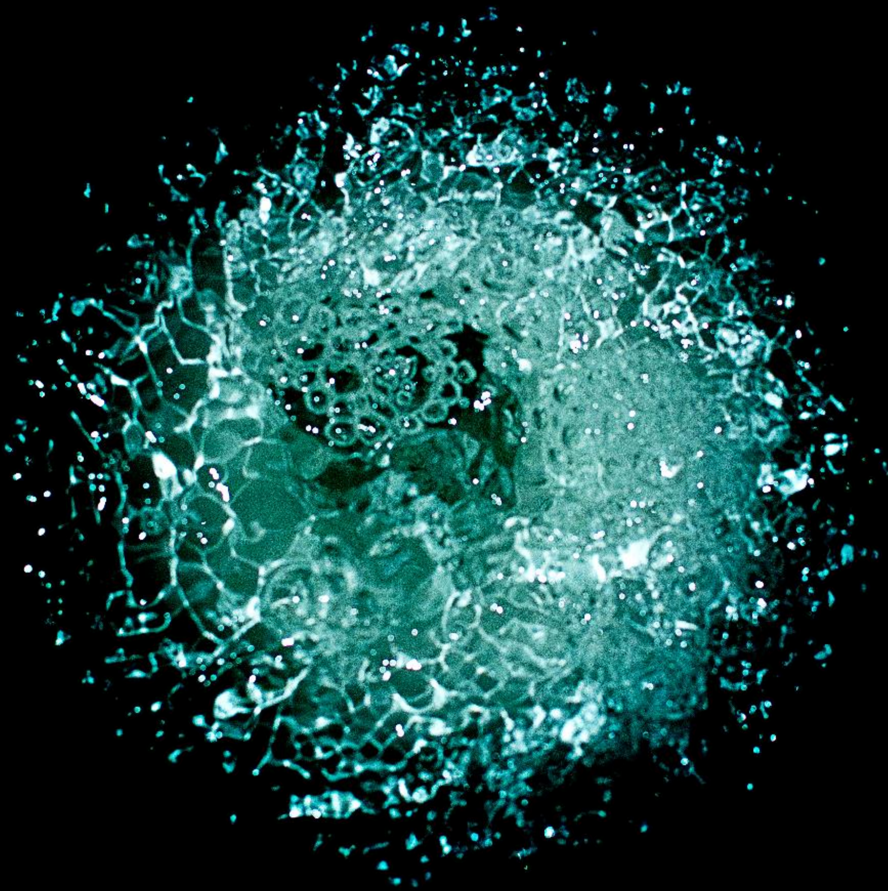

Deloitte Tax Max – The 44th Series

#ReadyMalaysia2019: A refreshed landscape

Tuesday, 27 November 2018 I One World Hotel

Celebrating 50 years Deloitte Malaysia

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Unveiling MFRS

MFRS 16 *Leases*

MFRS 16
The main changes

Two main changes are…

Lessor and Lessee | Determination of whether a contract contains or is a lease

Lessee | One single measurement model

Lessor accounting largely unchanged

Timeline to transition

Early adoption may be permitted

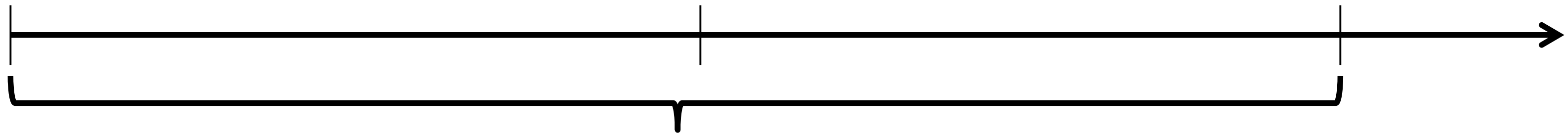
December year-ends: Retrospective application with restatement

December year-ends: Effective date

31 Dec 2017

1 Jan 2018

1 Jan 2019

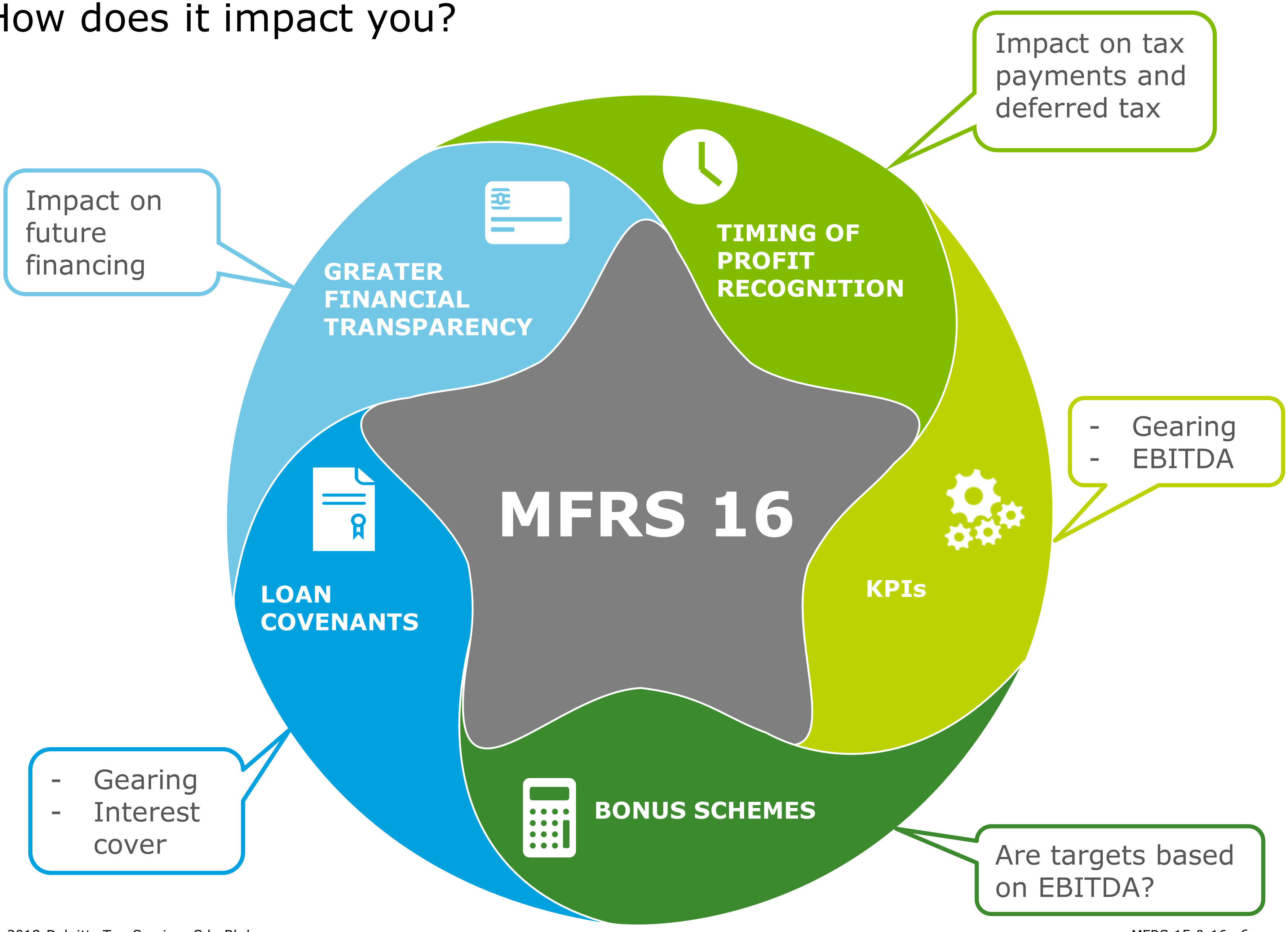


Disclosure – reasonably estimable information (up to effective date)

PRACTICAL EXPEDIENT	Permits both lessees and lessors not to reassess whether a contract is, or contains a lease at the date of initial application.

Entities can elect to apply **full retrospective approach** or a **'modified' retrospective approach** (with no restatement of comparatives)

How does it impact you?



Identification of a lease
MFRS 16 vs MFRS 117

MFRS 16 retains

Definition of a lease

A contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for consideration.

MFRS 16 changes

Application of the definition

Concept of control is introduced

Identifying a lease may require significant judgment

Definition of a lease

MFRS 16 vs MFRS 117

Is it a lease?

Whether the customer has the right to control the use of an identified asset for a period of time.

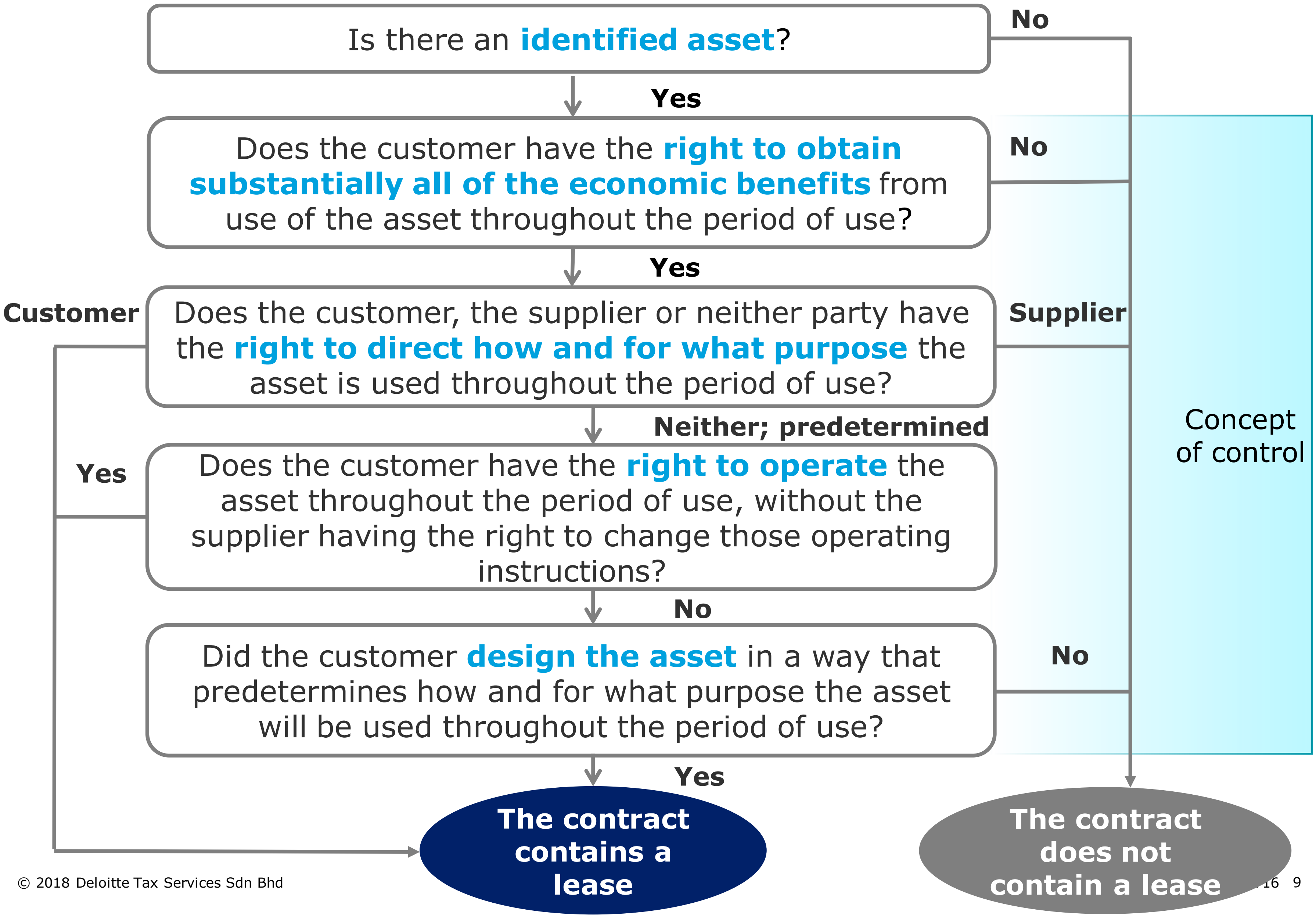
Identified asset

and

Right to control the use of identified asset

- Right to obtain substantially all economic benefits from use
- Right to direct the use

Assessing whether a contract is, or contains, a lease



Single measurement model

All leases with a term greater than 12 months are recognised "on balance sheet".

unless the underlying asset is low value

Represents the lessee's right to use the underlying leased asset.

Represents the lessee's obligation to make lease payments.

Balance sheet	**CU**
Property, plant and equipment	44,521
Lease assets	**18,757**
Other	26,703
Total non-current assets	89,981
Total current assets	38,086
Total assets	**128,067**
Borrowings	22,533
Lease liabilities	**21,233**
Other liabilities	57,264
Total liabilities	101,030
Equity	27,037
Total liabilities and equity	**128,067**

Recognition exemptions

Lease exemptions

Short-term lease

- < 12 months;
- By class of asset;
- No purchase option;
- Reassess on any change to the lease term.

Low-value asset

- Lease by lease, absolute basis;
- Not highly dependent or interrelated with other assets or sub-leasing.

Acct'g Treatment

Lease payments recognised as an expense on:

- A straight-line basis over the lease term; **or**
- Another systematic basis.

Client

- Save time and effort;
- Increase operating costs, reduce finance costs and reduce EBITDA.

Measurement

	Statement of Financial Position		Statement of Profit or Loss	
	Right-to-use asset	**Lease liability**	**Depreciation charge**	**Finance costs**
Initial measurement	At cost*	PV of outstanding lease payments	N/A	N/A
Subsequent measurement	**Cost less accumulated depreciation and impairment**	**Amortised cost**	**Recognised in operating costs** Determine the period for depreciation	**Recognised in finance costs**

- Depreciation is measured under MFRS 116.
- Impairment is assessed under MFRS 136.

Will the lessee take possession of the asset at the end of the lease?

- **Yes** – depreciate till the end of the asset's useful life.
- **No** – depreciate till the earlier of the end of the asset's useful life or the end of the lease term.

* Comprises:

- The amount of the initial measurement of the lease liability,
- Any lease payments made at or before the commencement date, less any lease incentives received,
- Any initial direct costs incurred by the lessee, and
- An estimate of costs to be incurred by the lessee in dismantling and removing the asset, restoring the site or restoring the asset to the condition required by the lease either at the commencement date or as a consequence of having used the asset during a particular period.

Illustrative example: MFRS 16 vs MFRS 117

Statement of Financial Position

	Year					
	0	1	2	3	4	5
MFRS 117 *(Operating lease)*	← No assets or liabilities are recognised. →					
MFRS 16 *(Balance sheet model)* *PV of 50,000 @4.25%*						
- Lease Liability	221,036	180,805	138,363	94,144	48,049	-
- R.O.U. Asset	221,036	176,829	132,622	88,415	44,207	-

Statement of Profit or Loss and OCI

	Year					
	0	1	2	3	4	5
MFRS 117 *(Operating lease)*						
- Lease payment *(operating exp.)*	-	50,000	50,000	50,000	50,000	50,000
MFRS 16 *(Balance sheet model)*						
- Interest expense *(finance exp.)*	-	9,768	7,559	5,781	3,905	1,951
- Depreciation *(operating exp.)*	-	44,207	44,207	44,207	44,207	44,207

R.O.U asset is depreciated

Lease liability is amortised over lease term

- Front-loaded expenses
- EBITDA ⬆

Lease liability
Measurement considerations

Present value of future lease payments

Lease liability	=	Present value of lease rentals	+	Present value of expected payments at end of lease

Most significant areas of judgment

Discount rate	• Rate implicit in the lease • Incremental borrowing rate
Lease term	Non-cancellable term of the lease **+** periods covered by an option to extend and the option to terminate the leases

These concepts have not changed

MFRS 16 case studies
Example 1 – Lease of machinery

RRS Sdn Bhd leases a machine from XYZ Sdn Bhd for a period of 3 years commencing on 1 January 2019.

The lease requires payment of RM2,000 per month for the duration of the lease term.

The net present value of the lease payments is RM54,000.

There is no option to renew the lease or purchase the machinery at the end of the lease term.

Implication on RSS ("Lessee")

	Pre-MFRS 16		MFRS 16			Tax Treatment
	DR	CR	DR	CR		
1 Jan 2019						
Statement of Financial Position						
Right-of-use ("ROU") asset			54,000		Net present value of RM72,000 (RM2,000 per month x 3 years)	No tax adjustment is required.
Lease liability				54,000		

MFRS 16 case studies

Example 1 – Lease of machinery (cont'd)

Implication on RSS ("Lessee")

	Pre-MFRS 16		MFRS 16			Tax Treatment
	DR	CR	DR	CR		
31 Dec 2019 (Yr 1)						
Statement of Financial Position						
Cash* *1 Jan 2019 to 31 Dec 2019		24,000		24,000	[2,000 x 12 months]	Tax adjustment is to be made to claim deduction on the lease rental of RM24,000.
ROU asset				18,000	[54,000 / 3 years]	ROU asset does not qualify for capital allowance.
Lease liability			14,405		[(2,000 x 12 months) – 9,595 (interest for the year)]	

MFRS 16 case studies

Example 1 – Lease of machinery (cont'd)

Implication on RRS ("Lessee")

	Pre-MFRS 16		MFRS 16			Tax Treatment
	DR	CR	DR	CR		
31 Dec 2019 (Yr 1)						
Statement of Comprehensive Income						
Lease rental	24,000					
Depreciation			18,000		[54,000 / 3 years]	Tax adjustment is to be made to disallow the depreciation.
Interest			9,595		[Based on amortisation table]	Tax adjustment is to be made to disallow the interest. Q: Does ROU interest = interest under Earning Stripping Rules?

MFRS 16 case studies

Example 1 – Lease of machinery (cont'd)

Implication on RRS ("Lessee")

	Pre-MFRS 16		MFRS 16			Tax Treatment
	DR	CR	DR	CR		
31 Dec 2020 (Yr 2)						
Statement of Financial Position						
Cash* *1 Jan 2020 to 31 Dec 2020		24,000		24,000	[2,000 x 12 months]	Tax adjustment is to be made to claim deduction on the lease rental of RM24,000.
ROU asset				18,000	[54,000 / 3 years]	
Lease liability			17,742		[(2,000 x 12 months) – 6,258 (interest for the year)]	

MFRS 16 case studies

Example 1 – Lease of machinery (cont'd)

Implication on RRS ("Lessee")

	Pre-MFRS 16		MFRS 16			Tax Treatment
	DR	CR	DR	CR		
31 Dec 2020 (Yr 2)						
Statement of Comprehensive Income						
Lease rental	24,000					
Depreciation			18,000		[54,000 / 3 years]	Tax adjustment is to be made to disallow the depreciation.
Interest			6,258		[Based on amortisation table]	Tax adjustment is to be made to disallow the interest.

MFRS 16 case studies

Example 1 – Lease of machinery (cont'd)

Implication on RRS ("Lessee")

	Pre-MFRS 16		MFRS 16			Tax Treatment
	DR	CR	DR	CR		
31 Dec 2021 (Yr 3)						
Statement of Financial Position						
Cash* *1 Jan 2021 to 31 Dec 2021		24,000		24,000	[2,000 x 12 months]	Tax adjustment is to be made to claim deduction on the lease rental of RM24,000.
ROU asset				18,000	[54,000 / 3 years]	
Lease liability			21,853		[(2,000 x 12 months) – 2,147 (interest for the year)]	

MFRS 16 case studies

Example 1 – Lease of machinery (cont'd)

Implication on RRS ("Lessee")

	Pre-MFRS 16		MFRS 16			Tax Treatment
	DR	CR	DR	CR		
31 Dec 2021 (Yr 3)						
Statement of Comprehensive Income						
Lease rental	24,000					
Depreciation			18,000		[54,000 / 3 years]	Tax adjustment is to be made to disallow the depreciation.
Interest			2,147		[Based on amortisation table]	Tax adjustment is to be made to disallow the interest.

Unveiling MFRS

MFRS 15 *Revenue from Contracts with Customers*

Overview – The core principles

Overview - The core principle

Recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Five-step model to apply the core principle:

1. **Identify the contract with a customer (Step 1)**
2. **Identify the performance obligations in the contract (Step 2)**
3. **Determine the transaction price (Step 3)**
4. **Allocate the transaction price to the performance obligations (Step 4)**
5. **Recognise revenue when each performance obligation is satisfied (Step 5)**

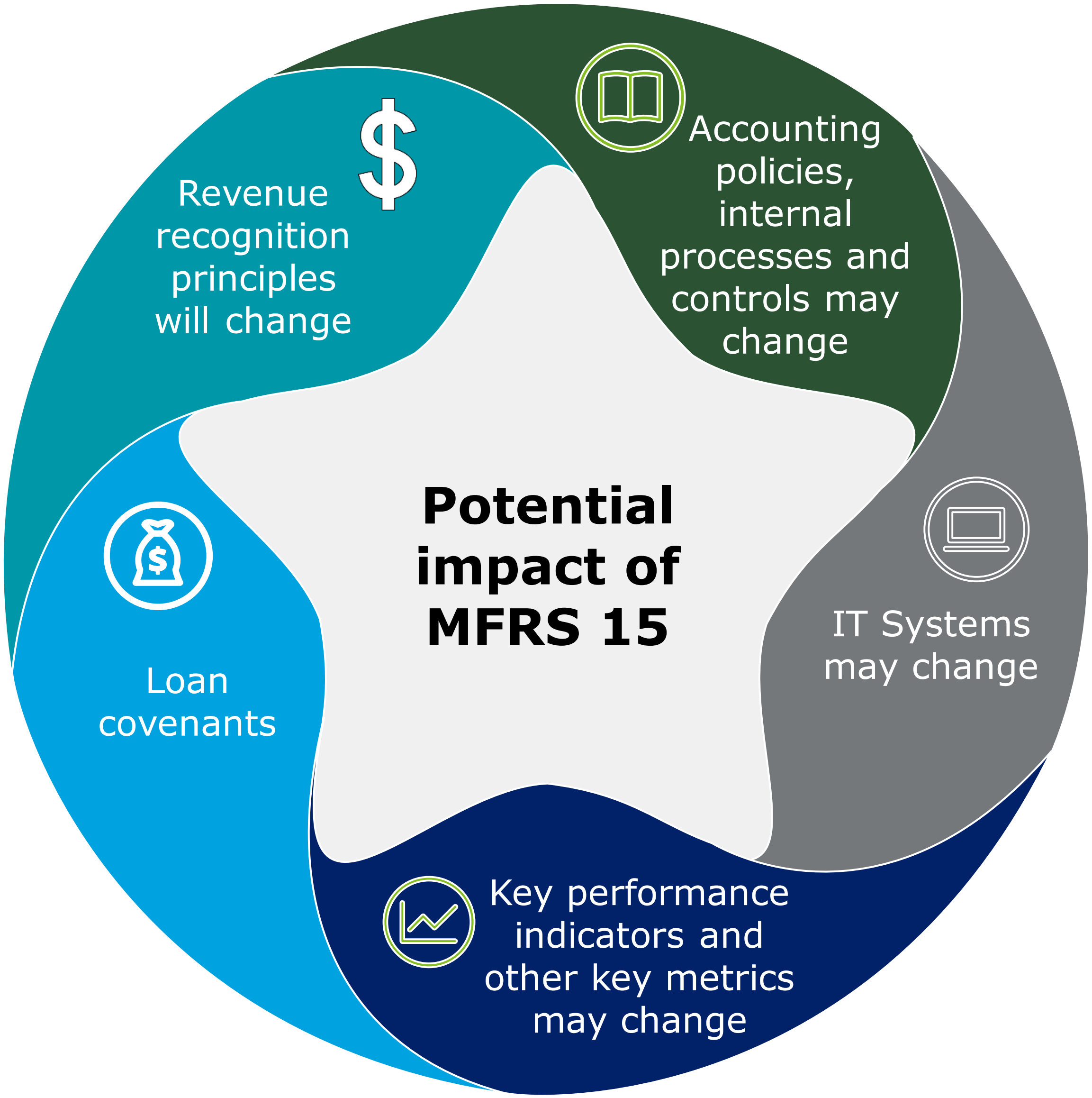
- Applied on a contract-by-contract basis
- Portfolio approach permitted in certain specified circumstances

Control approach
(differs from the risks and rewards approach under MFRS 118)

Applying the 5-Step model - example

Identify the contract (Step 1)	Identify the performance obligations (Step 2)	Determine the transaction price (Step 3) / Allocate the transaction price (Step 4)	Recognise revenue (Step 5)
Contract with customer RM 110	Deliver equipment	RM 100	Point in time
	Provide training services	RM 5	Over time
	Provide support services	RM 4	Over time
	Provide extended warranty	RM 1	Over time

The potential impact of MFRS 15



The five-step model

Step 1: Identifying the contract

Step 1 | Step 2 | Step 3 | Step 4 | Step 5

A legally enforceable contract (incl. oral or implied) must meet all of the following requirements:

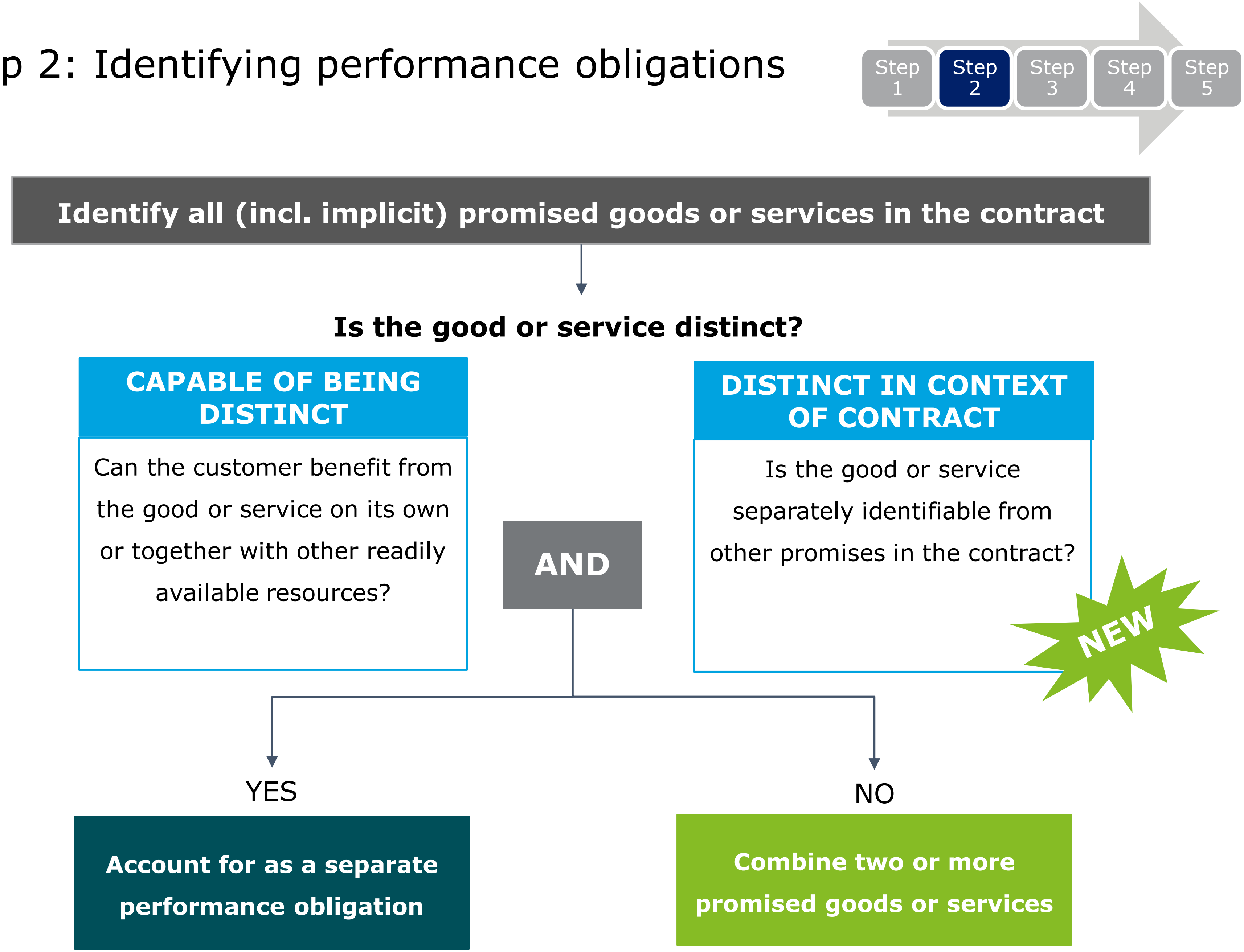
- Contracts are approved and the parties are committed to perform.
- Each party's rights can be identified.
- Payment terms can be identified.
- Commercial substance.
- It is probable that the entity will collect the consideration to which it will be entitled.

Collectability threshold

A contract is outside the scope if:

The contract is wholly unperformed **AND** Each party can unilaterally terminate the contract without compensation

Step 2: Identifying performance obligations



Distinct in the context of contract

- To determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or to transfer a combined item(s) to which the promised goods or services are inputs

Factors that indicate that promises are NOT separately identifiable

Integration	• The entity provides a significant service of integrating the goods or services with other goods or services promised in the contract
Modification or customisation	• One of more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract
Dependent or interrelated	• The goods or services are highly interdependent, or highly interrelated

Step 3: Determining the transaction price

What is the transaction price? What does it include?

Definition

Consideration amount to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.

Variable consideration

- Estimated and potentially constrained
- e.g., discounts, rebates, refunds, etc.

Exception for sales/usage based on royalties of IP

Fixed consideration

The amount is fixed and not contingent on the outcome of future events.

Consideration payable to customers

Reduces transaction price unless payment is made for a distinct good/service.

Excluding credit risk

The transaction price would not be reduced for the effects of customer credit risk.

Exception

Significant benefit of financing

- If identified, leads to adjustment in transaction price.
- Practical expedient available.

Non-cash consideration

- Consideration in a form other than cash.
- Shall be measured at FV.

Step 4: Allocating the transaction price

Step 1 | Step 2 | Step 3 | **Step 4** | Step 5

Determine standalone selling price

- Estimate the price if unobservable
- Acceptable methods :
  - > Adjusted market assessment approach
  - > Expected cost plus a margin approach
  - > Residual approach

Only allowed in limited circumstances

Maximise the use of observable inputs and apply consistently

Allocate the transaction price to each performance obligation on a relative stand-alone selling price basis.

- Allocate the transaction price to each performance obligation on a relative stand-alone selling price basis.
- Allocate discounts proportionally to **all** performance obligations unless certain criteria are met.
- Allocate variable consideration and changes in transaction price to **all** performance obligations unless two criteria are both met.
- <u>Do not</u> reallocate changes in standalone selling price after inception.

Step 5: Recognising revenue

Performance satisfied over time = Revenue recognised over time

The customer simultaneously receives and consumes the benefit of the seller's performance as the seller performs.

OR

The seller's performance creates or enhances an asset controlled by the customer.

OR

The seller creates an asset that does **not have** an alternative use to the seller and the seller **has the right to be paid** for performance to date.

IF NOT

Revenue recognised at a point in time

MFRS 15 case studies

Example 1 - Service industry

Anne entered into a 10 year membership contract with a Golf Club. The Golf Club charges its members a one-time non-refundable joining fee of RM15,000 and annual fee of RM3,000. It is assumed that there is no other performance obligation in relation to the joining fee.

MFRS 15

Joining fee is recognised as revenue over the contract period of 10 years.

	Pre-MFRS 15		MFRS 15			Tax Treatment
	DR	CR	DR	CR		
Year 1						
Cash	18,000		18,000			Cash receipt of RM18,000 is subject to tax [S 24(1)(b) of ITA]. Tax adjustment to be made to Contract liability of RM13,500.
Revenue		18,000		4,500	[Annual fee 3,000 + Joining fee 1,500 (15,000/10 years)]	
Contract liability				13,500	[Balance joining fee]	

MFRS 15 case studies

Example 1 - Service industry

Anne entered into a 10 year membership contract with a Golf Club. The Golf Club charges its members a one-time non-refundable joining fee of RM15,000 and annual fee of RM3,000. It is assumed that there is no other performance obligation in relation to the joining fee.

MFRS 15

Joining fee is recognised as revenue over the contract period of 10 years.

	Pre-MFRS 15		MFRS 15		Tax Treatment
	DR	CR	DR	CR	
Years 2 to 10					
Cash	3,000		3,000		Tax adjustment is to be made not to tax the Contract liability of RM1,500 as it was taxed upfront in Year 1.
Revenue		3,000		4,500	
Contract liability			1,500		

MFRS 15 case studies

Example 2 - Retail

Ali purchased a TV from a Shopping Mall for RM8,000. Ali was given a voucher of RM300 for future purchases (within 3 months). Ali subsequently utilised the RM300 voucher against a purchase worth RM1,000.

	Consideration Paid	Standalone Price	Allocation	
TV	8,000	8,000	7,710	[8,000/8,300 x 8,000]
Voucher	0	300	290	[300/8,300 x 8,000]
Total	8,000	8,300	8,000	

	Pre-MFRS 15		MFRS 15		Tax Treatment
	DR	CR	DR	CR	
Purchase of TV / Voucher issued					
Cash	8,000		8,000		• Cash receipt of RM8,000 is subject to tax [S 24(1)(a) of ITA]. Tax adjustment to be made to Contract liability of RM290. • Expense incurred in purchasing the voucher of RM300 is tax deductible.
Revenue		8,000		7,710	
Contract liability				290	

MFRS 15 case studies

Example 2 – Retail (cont'd)

Ali purchased a TV from a Shopping Mall for RM8,000. Ali was given a voucher of RM300 for future purchases (within 3 months). Ali subsequently utilised the RM300 voucher against a purchase worth RM1,000.

	Consideration Paid	Standalone Price	Allocation	
TV	8,000	8,000	7,710	[8,000/8,300 x 8,000]
Voucher	0	300	290	[300/8,300 x 8,000]
Total	8,000	8,300	8,000	

	Pre-MFRS 15		MFRS 15		Tax Treatment
	DR	CR	DR	CR	
Voucher (RM300) redeemed (purchase worth RM1,000)					
Cash	700		700		Tax adjustment is to be made not to tax the Contract liability of RM290 as it was taxed upfront when Ali purchased the TV.
Revenue		700		990	
Contract liability			290		

MFRS 15 case studies

Example 2 – Retail (cont'd)

Assuming Ali did not utilise the voucher and it expired after 3 months from the day it was issued.

	Consideration Paid	Standalone Price	Allocation	
TV	8,000	8,000	7,710	[8,000/8,300 x 8,000]
Voucher	0	300	290	[300/8,300 x 8,000]
Total	8,000	8,300	8,000	

	Pre-MFRS 15		MFRS 15		Tax Treatment
	DR	CR	DR	CR	
Voucher not redeemed (expired)					
Revenue				290	• Tax adjustment is to be made not to tax the Contract liability of RM290 as it was taxed upfront when Ali purchased the TV. • Voucher of RM300 if is not a realised expense, will not be tax deductible.
Contract liability			290		

MFRS 15 case studies

Example 3 – Property developer

A Property Developer sells a condominium unit with a parking lot for RM750,000 prior to its construction. The purchaser has an option to purchase the condominium unit fully furnished for an additional RM45,000 and has opted to purchase the furnishings. The whole development would take 36 months to complete.

The progress of the completion are 40% in Year 1, 30% in Year 2 and 30% in Year 3. The assumptions are:

1. It is a cash sales and collectability threshold is met;
2. Billing for the condominium unit is based on the progress of completion stage mentioned above and the furnishing when it is ready to be moved into the condominium unit; and
3. The property developer generally sells parking lot and furnishings separately for RM20,000 and RM60,000 respectively.

MFRS 15

There are 3 separate performance obligations:
Condominium unit & parking lot – assumed to satisfy MFRS15 to be recognised over time.
Furnishings (goods in nature) - revenue recognised in full when control is transferred.

	Consideration Paid	Standalone Price	Allocation	
Condominium	750,000	750,000	718,373	[750,000/830,000 x 795,000]
Parking lot (free)	0	20,000	19,157	[20,000/830,000 795,000]
Furnishings (optional)	45,000	60,000	57,470	[60,000/830,000 x 795,000]
Total	795,000	830,000	795,000	

MFRS 15 case studies
Example 3 – Property developer (cont'd)

	Pre-MFRS 15		MFRS 15			Tax Treatment
	DR	CR	DR	CR		
Year 1						
Cash	318,000		300,000		[750,000 x 40%]	• Tax revenue recognised is RM318,000 (i.e. 40% of total sale consideration of RM 795,000). • Tax adjustment is to be made to tax the furnishings based on % of completion, i.e. RM22,988 [(57,470x40%) or (318,000 – 295,012)].
Revenue		318,000		295,012	[(718,373 + 19,157) x 40%]	
Contract liability				4,988		
Year 2						
Cash	238,500		225,000		[750,000 x 30%]	• Tax revenue recognised is RM238,500 (i.e. 30% of total sale consideration of RM 795,000). • Tax adjustment is to be made to tax the furnishings based on % of completion, i.e. RM17,241 [(57,470 x 30%) or (238,500 – 221,259)].
Revenue		238,500		221,259	[(718,373 + 19,157) x 30%]	
Contract liability				3,741		

MFRS 15 case studies

Example 3 – Property developer (cont'd)

	Pre-MFRS 15		MFRS 15			Tax Treatment
	DR	CR	DR	CR		
Year 3						
Cash	238,500		270,000		[(750,000 x 30%) + 45,000]	• Tax revenue recognised is RM238,500 (i.e. 30% of total sale consideration of RM 795,000). • Tax adjustment is to exclude the furnishings of RM40,229 [278,729 – 238,500] from the amount subject to tax as the furnishings revenue had been taxed upfront in Years 1 and 2.
Revenue		238,500		278,729	[(718,373 + 19,157) x 30% + (57,470)]	
Contract liability			8,729			

MFRS 15 case studies

Example 4 – Automotive

Candy purchased a motor vehicle in cash from a car dealer for RM160,000. The contract provides:

1. Free maintenance services for 3 years; and
2. Engine warranty for 2 years which is the normal factory defect/assurance warranty.

	Consideration Paid	Standalone Price	Allocation	
Motor vehicle	160,000	160,000	158,221	[160,000/161,800 x 160,000]
Maintenance services	0	1,800 *	1,779 ^	[1,800/161,800 160,000]
Engine warranty ##	0	0	0	
Total	160,000	161,800	160,000	

* RM600 per year.

^ RM593 per year.

Not a performance obligation [merely assurance warranty and does not provide customer with good / service in addition to the assurance]

MFRS 15 case studies

Example 4 – Automotive (cont'd)

	Pre-MFRS 15		MFRS 15			Tax Treatment
	DR	CR	DR	CR		
Year 1						
Cash	160,000		160,000			Cash receipt of RM160,000 is subject to tax [S 24(1)(a) of ITA]. Tax adjustment to be made to Contract liability of RM1,186.
Revenue		160,000		158,814	[158,221 + 593]	
Contract liability				1,186	[593 x 2]	
Years 2 and 3						
Revenue				593		Tax adjustment is to be made not to tax the Contract liability of RM593 because it has been taxed upfront in Year 1.
Contract liability			593			

MFRS 15 case studies

Example 5 – Logistics

A logistic company entered into a freight contract with a customer to deliver goods for RM100/kg on 1 January 2018.

The customer is offered a price reduction of RM10/kg which applies retrospectively if the customer achieve a total chargeable weight of more than 10,000kg in a calendar year.

Q1 ended 31 March 2018: 750kg of chargeable weight is achieved, the logistic company does not expect the customer's chargeable weight will exceed the 10,000kg threshold required.

In May 2018, the customer acquired another company.

Q2 ended 30 June 2018: 5,000kg of chargeable weight is achieved, the logistic company now expects that the customer's chargeable weight will exceed the 10,000kg threshold for the calendar year.

	Pre-MFRS 15		MFRS 15			Tax Treatment
	DR	CR	DR	CR		
Q1 31 March 2018						
Trade receivables	75,000		75,000			No tax adjustment is to be made as revenue is fully recognised.
Revenue		75,000		75,000	[750kg x RM100/kg]	

MFRS 15 case studies

Example 5 – Logistics (cont'd)

	Pre-MFRS 15		MFRS 15			Tax Treatment
	DR	CR	DR	CR		
Q2 30 June 2018						
Trade receivables	500,000		500,000			Tax adjustment to be made for rebate of RM57,500. This amount is disallowed as it is a "provision" and not yet "incurred".
Revenue		500,000		442,500	[(5,000kg x RM100/kg) – 57,500]	
Trade receivables – rebate				57,500	[(5,000kg + 750kg) x RM10/kg]	