



AASB 16: Experience the Fundamental Overhaul of Lease Accounting for Lessees

Introduction to Session

This introductory session we will:

- Explore the Principles of AASB 16
- Learn how to Identify a Lease
- Work through Illustrative Examples
- Explore Lease Accounting for Lessees under AASB 16
- Deal with Questions

We will not address:

- Accounting by Lessors
- Sale and Leaseback Transactions
- Subleases

AASB 16: Overview

“One of my great ambitions before I die is to fly in an aircraft that is on an airline’s balance sheet”

Sir David Tweedie - IASB chairman – April 2008

AASB 16: Overview

Why was AASB 16 released?

AASB 16 addresses the issue of off balance sheet financing which equates to 85% of commitments for listed entities worldwide

What is the effective date for AASB 16?

Effective for annual reporting periods beginning on or after 1 January 2019

i.e. 31 December 2019 or 30 June 2020

Early Adoption Options

May be early adopted if AASB 15 *Revenue from Contracts with Customers* is also adopted

AASB 16: Exclusions from Scope

An entity shall apply this Standard to all leases, including leases of right-of-use assets in a sublease, except for:

- (a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- (b) leases of biological assets within the scope of AASB 141 Agriculture held by a lessee;
- (c) service concession arrangements within the scope of Interpretation 12 Service Concession Arrangements;
- (d) licences of intellectual property granted by a lessor within the scope of AASB 15 Revenue from Contracts with Customers; and
- (e) rights held by a lessee under licensing agreements within the scope of AASB 138 Intangible Assets for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

AASB 16 – Impact on Lessor

AASB 117 Requirements in essence carried forward in AASB 16

Operating vs Finance Lease Classification remains

Additional disclosures under AASB 16

AASB 16 – Impact on Lessee

- Most operating leases will now be capitalised – similar to finance leases
- Increased in Right of Use (ROU) Assets & corresponding Lease Liabilities
- Decrease in Rental Expenses

Increase in Finance Costs (ROU Depreciation & Interest on Lease Liabilities)

More lease expenses recognised in the early periods of a lease and less later

- Decrease cashflows from Operating Activities, i.e. Operating Expenses

Increase cashflows from Financing Activities



AASB 16 – What is a Lease?

A contract is, or contains, a lease if the contract conveys:

- a. the right to control
- b. the use of an identified asset
- c. for a period of time
- d. in exchange for consideration.

The lease term begins on the 'commencement date' of the lease, the date on which the lessor makes an underlying asset available for use by a lessee.



AASB 16 – What is a Lease?

What is an Identified Asset?

1. Is the asset **explicitly specified** in the contract (e.g. a specific serial number or VIN Number);?
2. Is the asset **implicitly specified** when made available to customer (e.g. when there is only one asset that is capable of being used to meet the contract terms)?
3. Does the supplier have a **substantive right to substitute** another asset (e.g. the supplier is entitled to change the underlying asset at any time)?
4. Does the lease relate to a **portion of capacity** (e.g. a floor of a building)?



AASB 16 – Decision Flowchart

Handout

AASB 16 – Appendix B on Page 27



AASB 16 – Examples of Leases

Lease of Commercial Property (Example 4 of IE provided)

Stock standard lease arrangement you find in most not-for-profits

This is a lease because:

- No substantive substitution right by Landlord
- Tenant has exclusive use of the leased property
- Right to substantially all of the economic benefits from its use
- Tenant decides how the property will be used



AASB 16 – Examples of Leases

Fibre-Optic Cable (Example 3A of IE provided)

Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use three specified, physically distinct dark fibres within a larger cable connecting Hong Kong to Tokyo.

Customer makes the decisions about the use of the fibres by connecting each end of the fibres to its electronic equipment (i.e. Customer 'lights' the fibres and decides what data, and how much data, those fibres will transport).

If the fibres are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibres, but can substitute those for Customer's fibres only for reasons of repairs, maintenance or malfunction (and is obliged to substitute the fibres in these cases).



AASB 16 – Examples of Leases

Fibre-Optic Cable (Example 3B of IE provided)

Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo.

The specified amount is equivalent to Customer having the use of the full capacity of three fibre strands within the cable (the cable contains 15 fibres with similar capacities).

Supplier makes decisions about the transmission of data (i.e. Supplier lights the fibres, makes decisions about which fibres are used to transmit Customer's traffic and makes decisions about the electronic equipment that Supplier owns and connects to the fibres).



AASB 16 – Examples of Leases

Contract for network services (Example 10A from IE provided)

Customer enters into a contract with a telecommunications company (Supplier) for network services for two years. The contract requires Supplier to supply network services that meet a specified quality level. In order to provide the services, Supplier installs and configures servers at Customer's premises.

Supplier determines the speed and quality of data transportation in the network using the servers. Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract.

Customer does not operate the servers or make any significant decisions about their use.



AASB 16 – Examples of Leases

Contract for network services (Example 10B from IE provided)

Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years. Supplier delivers and installs the server at Customer's premises in accordance with Customer's instructions, and provides repair and maintenance services for the server, as needed, throughout the period of use.

Supplier substitutes the server only in the case of malfunction. Customer decides which data to store on the server and how to integrate the server within its operations.

Customer can change its decisions in this regard throughout the period of use.



AASB 16: Recognition Exemptions

The lessee may elect not to apply the requirements of AASB 16 to

(a) Short Term Leases

(b) Assets for which the underlying asset is of low value

The lessee shall recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis (if that basis is more representative of the pattern of the lessee's benefit).

Disclosures are required where the above elections have been made.



AASB 16: Recognition Exemptions

Short-Term Lease Exception

A short-term lease is defined as “a lease that, at the commencement date, has a lease term of 12 months or less”.

A lease that contains a purchase option cannot be classified as a short-term lease.

Lease term excludes any option period unless then lessee is reasonably certain to exercise the option (or reasonably certain not to exercise an option to terminate the lease)

Accounting policy choice must be made consistently for each class of underlying asset.



AASB 16: Recognition Exemptions

Examples of Short-Term Leases

- An entity has entered into a number of leases for vehicles. Each lease has a stated term of 3 years, but with break clauses allowing the entity to terminate each lease after 1 year and 2 years without penalty.
- At the commencement of each lease, the entity assesses the likelihood that it will exercise its 12 months termination option. The assessment considers all relevant facts and circumstances that creates an economic incentive not to terminate the lease early.
- Management concludes that it is not ‘reasonable certain’ that the termination option will not be exercised (or there is a realistic probability that the 12 month termination option will be exercised). They considered the following:
 - There is no significant termination penalty
 - The rentals in years 2 and 3 are not below market
 - Business transport needs changes over time



AASB 16: Recognition Exemptions

Low Value Assets

- Assess the value of the asset when new
- Suggested Low Value Threshold of US\$5,000 = approx. \$6,500
- Low value assets includes: tablets/personal computers, small items of office furniture and telephones
- Accounting policy choice on lease-by-lease basis



AASB 117: Accounting for Leases

Finance Lease

Balance Sheet - Lease Asset & Lease Liabilities recorded at the fair value of the minimum lease payments

Income Statement – Interest Expense & Depreciation on Leased Asset

Operating Lease

Balance Sheet – No entries

Income Statement – Rental Expense



AASB 16: Accounting for Leases

All Leases on Balance sheet, except for short term leases and low value assets

Balance Sheet

Right of Use Asset – Non-current tangible asset

Lease Liability

Income Statement

Interest expense and Depreciation of Right of Use Asset

Impairment of Right of Use Asset

Variable Lease Payment no dependent on an index



AASB 16: Accounting for Leases

Example of Lease Accounting under AASB 16

Lease of building – 3 year term – operating lease

- Year 1 - \$9,000 per month
- Year 2 - \$9,600 per month
- Year 3 - \$10,020 per month
- Rate implicit in the lease is 12% p.a.



AASB 16: Accounting for Leases

Year	Cash Payments \$	Interest Expense \$	Principal repaid \$	Closing Balance \$
0	-	-	-	286,002
1	108,000	30,130	77,870	208,132
2	115,200	19,844	95,356	112,776
3	120,240	7,464	112,776	-

Lease liability amortisation table over 3 years at 12% rate implicit in the lease

Initial right of use asset = \$286,002

Depreciated over 3 years = \$95,334 p.a.

Initial value of lease liability = \$286,002

(Total lease payments discounted @ 12% p.a. over 3 years per month)



AASB 16: Accounting for Leases

Journal Entries

Upon Initial Recognition

Dr.	Right of Use Asset	286,002	
Cr.	Lease Liability		286,002

At the end of Year 1

Dr.	Interest Expense	30,130	
Dr.	Lease Liability	77,870	
Dr.	Depreciation Expense	95,334	
Cr.	Bank		108,000
Cr.	Right of Use Asset: Acc Dep		95,334

AASB 16: Accounting for Leases

Journal Entries

At the end of Year 2

Dr.	Interest Expense	19,844	
Dr.	Lease Liability	95,356	
Dr.	Depreciation Expense	95,334	
Cr.	Bank		115,200
Cr.	Right of Use Asset: Acc Dep	95,334	

At the end of Year 3

Dr.	Interest Expense	7,464	
Dr.	Lease Liability	112,776	
Dr.	Depreciation Expense	95,334	
Cr.	Bank		120,240
Cr.	Right of Use Asset: Acc Dep	95,334	

AASB 16: Accounting for Leases

Separating lease components of a contract

If a contract is, or contains, a lease, an entity is required to account for each lease component within the contract as a lease separately from non-lease components of the contract.

For example, a contract for a car may combine a lease with maintenance services.

The consideration in a contract should be allocated between lease and non-lease components (if any) on the basis of the relative stand-alone price of each lease component and the aggregate stand-alone price of the non-lease components.

AASB 16: Accounting for Leases

Measurement of the Right-of-use Asset – Initial Recognition

At the commencement date, the right-of-use asset should be measured at cost.

For this purpose, cost comprises:

- a) the amount of the initial measurement of the **lease liability**;
- b) any lease payments made at or before the commencement date, less any lease incentives received (**prepaid lease payments**);
- c) any **initial direct costs** incurred by the lessee; and
- d) an **estimate of costs** to be incurred by the lessee in **dismantling and removing** the underlying asset, restoring the site on which it is located **or restoring** the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the asset during a particular period

AASB 16: Accounting for Leases

Measurement of the Right-of-use Asset – Subsequent Recognition

Lease liabilities are measured on an ongoing basis similarly to other financial liabilities, using an effective interest method, so that the carrying amount of the lease liability is measured on an amortised cost basis and the interest expense is allocated over the lease term.

Cost Model

Cost less accumulated depreciation and accumulated impairment.

AASB 140 Fair Value Model

Right of use asset is measured at fair value through profit and loss

AASB 116 Fair Value Model

Option to revalue all right of use assets that relates to that class of property, plant and equipment

AASB 16: Accounting for Leases

Measurement of Lease Liability

At the commencement date, the lease liability should be measured at the present value of the lease payments that are not paid at that date.

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

- fixed payments, less any lease incentives;
- variable lease payments that depend on an index or a rate;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option;
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease; and
- residual value guarantees.

AASB 16: Accounting for Leases

Exclusions from Lease Payments used for the Measurement of Lease Liability

- Variable lease payments linked to sales or use
e.g. Turnover Rent in Shopping Centres
- Optional payments NOT reasonably certain
e.g. conditional payments that are in the contract at the time of inception of the lease
- Service payments
e.g. Payments for the usage of the data as part of the Fibre-optic network lease

AASB 16: Accounting for Leases

Accounting for Variable Lease Payments

Variable lease payments that depend on an index or a rate

When there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments (including, for example, a change to reflect changes in market rental rates following a market rent review). In such circumstances, the lease liability should be remeasured to reflect those revised lease payments only when there is a change in the cash flows (i.e. when the adjustment to the lease payments takes effect).

Other variable lease payments (e.g. payments linked to sale or usage)

Recognise an expense in the period that the event or condition that triggers the payment occurs

In-substance fixed lease payments (i.e. contract terms ensure the payment of a fixed amount is unavoidable)

Treat as fixed lease payments

AASB 16: Accounting for Leases

Discount Rate

The lease payments should be discounted using:

- the interest rate implicit in the lease; or

Expect to see future lease agreements to contain discount rates

- if the interest rate implicit in the lease cannot be readily determined, the lessee's incremental borrowing rate.

At what rate can funds be borrowed to finance a similar asset?

AASB 16: Accounting for Leases

Revision of discount rates

A lessee remeasures the lease liability at the date of reassessment using a revised discount rate when there is:

- a change in the lease term;
- a change in the assessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset; or
- a change in floating interest rates, resulting in a change in future lease payments

A lessee does not reassess the discount rate when there is a change in future lease payments due to a change in an index – e.g. the consumer price index.



AASB 16: Accounting for Leases

Re-measurement of lease liability

Lease liability is re-measured with a corresponding adjustment to the right-of-use asset when:

- The lease term is revised
- Future lease payments based on an index or rate are revised
- The lease is modified
- There is a change in the amounts expected to be paid under residual value guarantees.



AASB 16: Accounting for Leases

Lease Term – Considerations

Rent Free Periods

The lease term includes any rent-free periods provided to the lessee by the lessor.

Lessor termination options

If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease.

Revision of lease term

An entity should revise the lease term if there is a change in the non-cancellable period of a lease.



AASB 16: Accounting for Leases

Lease Term – Considerations

Assessment of lessee extension and termination options

At the commencement date, the entity should assess whether the lessee is reasonably certain:

- to exercise an option to extend the lease; or
- to exercise an option to purchase the underlying asset; or
- not to exercise an option to terminate the lease.

In making these assessments, the entity considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option.



AASB 16: Accounting for Leases

Lease Term – Considerations

Reassessment of extension and termination options

A lessee should reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that:

- is within the control of the lessee; and
- affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term.



AASB 16: TRANSITION METHODS

Transition for lessees – choice between:

1. Full Retrospective Application

If a lessee chooses To apply AASB 16 retrospectively, it is required to apply the requirements of that Standard in full to all of its leases. This means that it is required to:

- prepare its financial statements as if AASB 16 had always been applied;
- restate comparative information for all periods presented, potentially requiring a third statement of financial position; and
- disclose the effect of applying AASB 16 on a line-by-line basis.



AASB 16: TRANSITION METHODS

2. Cumulative Catch-up Approach

If a lessee opts to use the cumulative catch-up approach:

- it recognises the cumulative effect of initial application at the date of initial application (i.e. if an entity applies AASB 16 for the first time in an accounting period beginning 1 January 2019, it recognises the cumulative effect of application by adjusting balances at 1 January 2019 or 1 July 2019);
- it does not restate comparative information – if there is a difference between the assets and liabilities introduced, an adjustment is made to opening retained earnings;
- it carries forward amounts previously recognised in respect of leases classified as finance leases;
- it is permitted to apply a number of additional transition reliefs and practical expedients for leases previously classified as operating leases; and
- it is required to disclose the effect of applying the cumulative catch-up approach.



AASB 16: Conclusion

9 Key Action Points for Management & the Board to Assess Your Entity's AASB 16 Readiness

1. Assess which of the entity's contracts are, or contain, leases.
2. Will the entity's accounting systems and processes capturing all of the required information.
3. Will the entity's accounting systems and processes be capable of monitoring leases and keeping track of the required ongoing assessments.
4. Assess the potential use of AASB 16's recognition exemptions and methods.
5. Consider which transition reliefs are available, and whether the entity will apply any of them.



AASB 16: Conclusion

9 Key Action Points for Management & the Board to Assess Your Entity's AASB 16 Readiness

6. Assess what discount rates the entity will be using for the different leases.
7. Consider the impact of the changes on financial results and financial position.
8. Assess how to communicate the impact to affected stakeholders.
9. Consider whether the entity's leasing strategy requires revision.

The lease liability calculation is not a set and forget exercise.

Where lease payments are CPI indexed, annual adjustments to ROU Assets and Lease Liabilities can be expected.



AASB 16: Resources

Resources for Lease Accounting Questions

Collins & Co – Lease Accounting Model Excel Workbook

AASB 16 – Leases

http://www.aasb.gov.au/admin/file/content105/c9/AASB16_02-16.pdf

AASB 16 – Leases – Illustrated Examples

http://www.aasb.gov.au/admin/file/content105/c9/IFRS16_IE_01-16.pdf

Deloitte – Leases – A Guide to AASB 16

<https://www2.deloitte.com/content/dam/Deloitte/au/Documents/audit/deloitte-au-audit-aasb-16-guide-220916.pdf>



Questions



Ryk Eksteen | CA | RCA
Audit Principal

127 Paisley Street, Footscray VIC 3011
T: (03) 9680 1000 | F: (03) 9689 6605
E: re@collinsco.com.au | W: www.collinsco.com.au

Download a copy of my e-book: *Your NFP Financial Statement Audit: How to avoid the common pitfalls* from <http://www.collinsco.com.au/not-for-profit>

If you would like to subscribe to the Collins & Co Not-for-Profit Quarterly Newsletter, the **Collins NFP Advisor**, please email partner@collinsco.com.au