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New Standards

AASB 16 Leases

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What is a lease?

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Definition

A Lease - is a ‘contract, or part of a contract, that conveys the <u>right to use</u> an asset (the underlying asset) for a period of time in exchange for consideration’

All contracts create rights and obligations

So what does this mean?

- Need to review contracts to identify potential leases
- Contracts have varying rights and obligations
- Does the contract:
  - Have an identifiable asset (there may be more than one)
  - Provide the right for the customer to obtain all of the economic benefits from using the asset over the period of the contract
  - Provide the customer with the right to direct how and what purpose the asset is used for
- If yes – generally considered to be a lease
- If no – contract unlikely to be a lease

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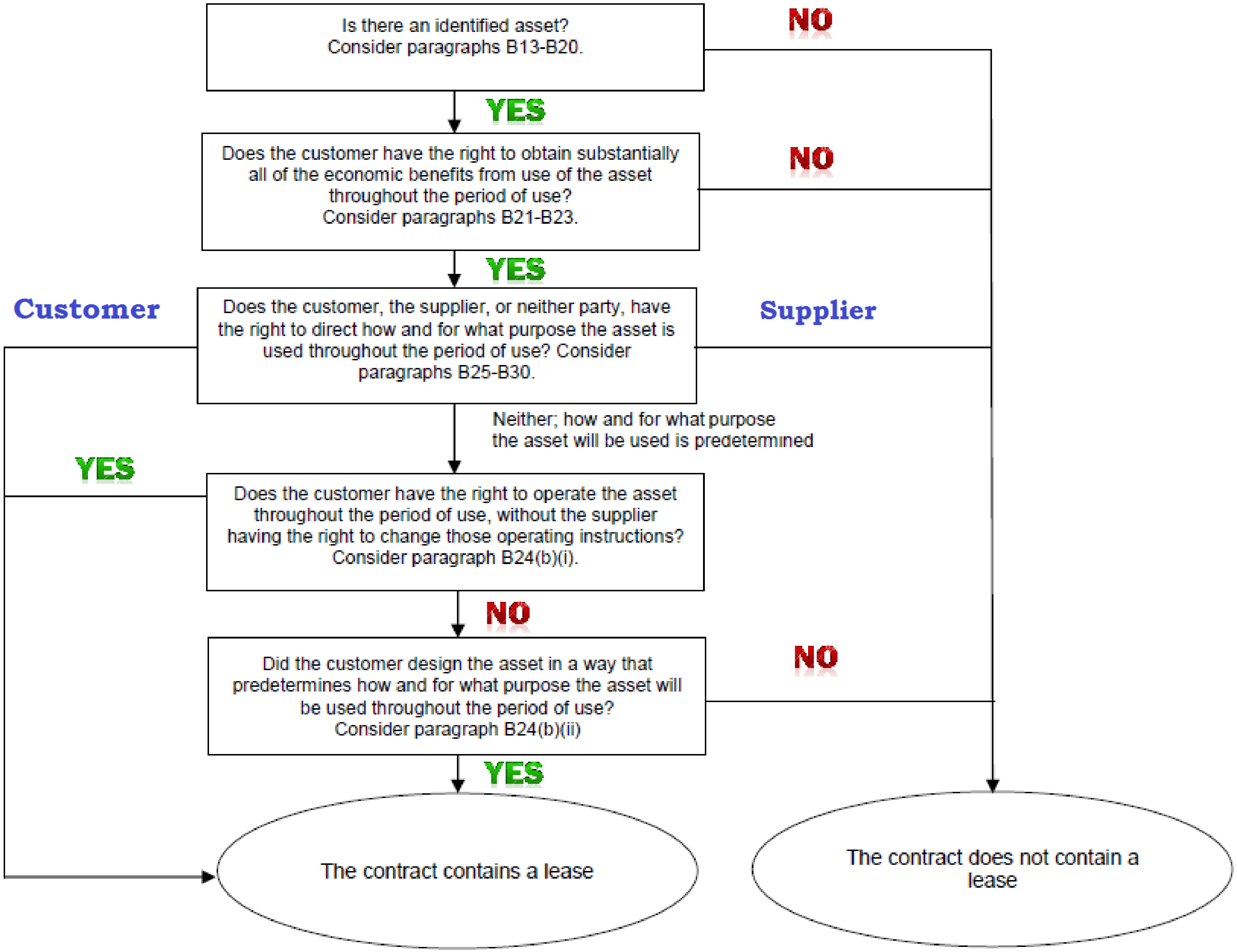

Appendix B – Application Guidance

Exercise – Is it a lease?

- Example 1 – Motor vehicle (substitution rights)
  - Supplier has right to change vehicle at any time during the term of the contract

Poll – Is it a lease?

- Example 2 – Land (decision-making rights)
  - Supplier has rights to decide what can be grown on the land

Poll – Is it a lease?

- Example 3 – Maintenance and operating practices
  - Supplier specifies how a lathe is to be operated and maintained
  - These do not impact on the ability to obtain economic benefits

Poll – Is it a lease?

Exclusions

Not required to be included in lease liabilities

- Leases of low-value assets (approx. $7,500)
- Short-term assets (<12 months)

Excluded from lease liabilities

- Variable lease payments
- Optional payments (not reasonably certain)

- Disclosure requirements apply (p53)

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Multi Lease Contracts

- Must consider that each RoUA is a separate lease component.
- Allocate consideration to each separate lease component:
  - Recognise a separate lease for each lease component with an observable stand alone price.
  - Where no observable stand alone price, bundle and recognise components as a single lease component.

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Exercise – Lease components no.1

- Net lease for office accommodation
  - Rental $300 psm per month
  - Outgoings $80 psm per month

What is recognised as part of the lease liability?

Poll

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Exercise – Lease components no.2

- Gross lease for office accommodation
  - Total rental $380 psm per month
  - Outgoings not separately identifiable

What is recognised as part of the lease liability?

Poll

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Lessee Model

- Assets & liabilities on the balance sheet, initially measured at the present value of unavoidable lease payments
- Amortisation of lease assets and interest on lease liabilities over the lease term

  (Assets – typically straight-line basis)
- Separate the total amount of cash paid into:
  - Principal portion (presented within financing activities)
  - Interest (either operating or financing activities).

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Presentation Impacts

Statement of Financial Position		
• Right-of-use asset • Lease liability	Either by:	➢ Separate line items, or ➢ In the relevant Notes and link

Income Statement
• Interest expense on the lease liability • Depreciation charge on right-of-use assets

Statement of Cash Flows	
• Cash payment on the principal	➢ Financing Activity
• Short-term, low-value and variable lease payments not included in liability measurement	➢ Operating Activity
• Interest portion	➢ Apply AASB 107 *St' of Cash Flows*

Recognition – Lease Liability

- Initial recognition at commencement date:

Present value of:

the lease payments not paid

+

Residual value guarantees

-

Lease incentives receivable

+

Exercisable Options (reasonably certain)

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Recognition – Right to Use Asset

- Initial recognition:

Lease liability as calculated previously

+

Lease payments made before commencement date

-

Lease incentives received

+

Initial direct costs of Lessee

+

PV Cost of removal and make-good at end of the lease

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Example 1 - Recognition

- Information available
  - Office accommodation – Commencing 1 July 2020
  - Term 5 years with a 5 year option expected to be exercised
  - Rent $48,000 per annum
  - Outgoings $12,000 per annum
  - Financing rate 6%
  - Lease incentive (fit-out) $20,000
    - Received $15,000
    - Receivable $5,000
  - Legal costs for lease $2,000
  - Lease payment made 1 June 2020 - $4,000
  - Residual value guarantee $Nil
  - Make Good $20,000

Example 1 - Recognition

– What is the value of the Lease Liability (ignoring the PV calculation)

– What is the value of the Right to Use Asset?

Example 1 - Recognition

- Liabilty

  + Rent $236,000 ($48,000 x 5 years less $4,000 paid)
  + Option $240,000 ($48,000 x 5 years)
  + Residual value $0
  - Lease Incentive Receivable ($5,000)
  Total $471,000 (to be discounted to Present Value)

- Asset

  + Lease liability $471,000 (to be discounted to Present Value)
  + Lease paid before commencement $4,000
  - Lease Incentive Received ($15,000)
  + Legal Fees $2,000
  + Make Good $20,000 (to be calculated and discounted under AASB 137)
  Total $482,000

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Example

Example 2

- Assumptions:
  - 3 year lease.
  - Lease payments $50,000 p.a.
  - Effective interest rate 6%.
  - Lease payments made at end of period.

Example

Example 2

- At start - RoUA and lease liability $133,651.
- At the end of each period - RoUA amortisation $44,550
- For each lease payment - cash $50,000 and:
  - Year 1; Interest expense $8,019 & principal repayment $41,981
  - Year 2; Interest expense $5,500 & principal repayment $44,500
  - Year 3; Interest expense $2,830 & principal repayment $47,170

Totals **$16,349** **$133,651**

$150,000

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Example

Example 2

	Year 1		Year 2		Year 3	
Opening Journal						
DR Right-of-use-asset	133,651					
CR Lease Liability		133,651				
Yearly Journal	**Year 1**		**Year 2**		**Year 3**	
DR Interest Expense	8,019		5,500		2,830	
DR Lease Liability	41,981		44,500		47,170	
CR Bank		- 50,000		- 50,000		- 50,000
Dr Amortisation Expense	44,550		44,550		44,550	
Cr Accumulated Amortisation		- 44,550		- 44,550		- 44,550
Statement of Financial Position						
DR Right-of-Use-Asset	133,651		133,651		133,651	
Cr Accumulated Amortisation	- 44,550		- 89,101		- 133,651	
($133,651/ 3 years = $44,550)	89,101		44,550		-	
CR Lease Liability		- 133,651		- 91,670		- 47,170
DR Lease Liability		41,981		44,500		47,170
		- 91,670		- 47,170		-

Example

Example 2

Statement of Comprehensive Income	Year 1	Year 2	Year 3
Interest Expense	8,019	5,500	2,830
Amortisation Expense	44,550	44,550	44,550
	52,569	50,050	47,380

Statement of Cash Flows			
Interest Expense	8,019	5,550	2,830
Financing Cash Flow *(Principal Repayment)*	41,981	44,500	47,170
	50,000	50,000	50,000

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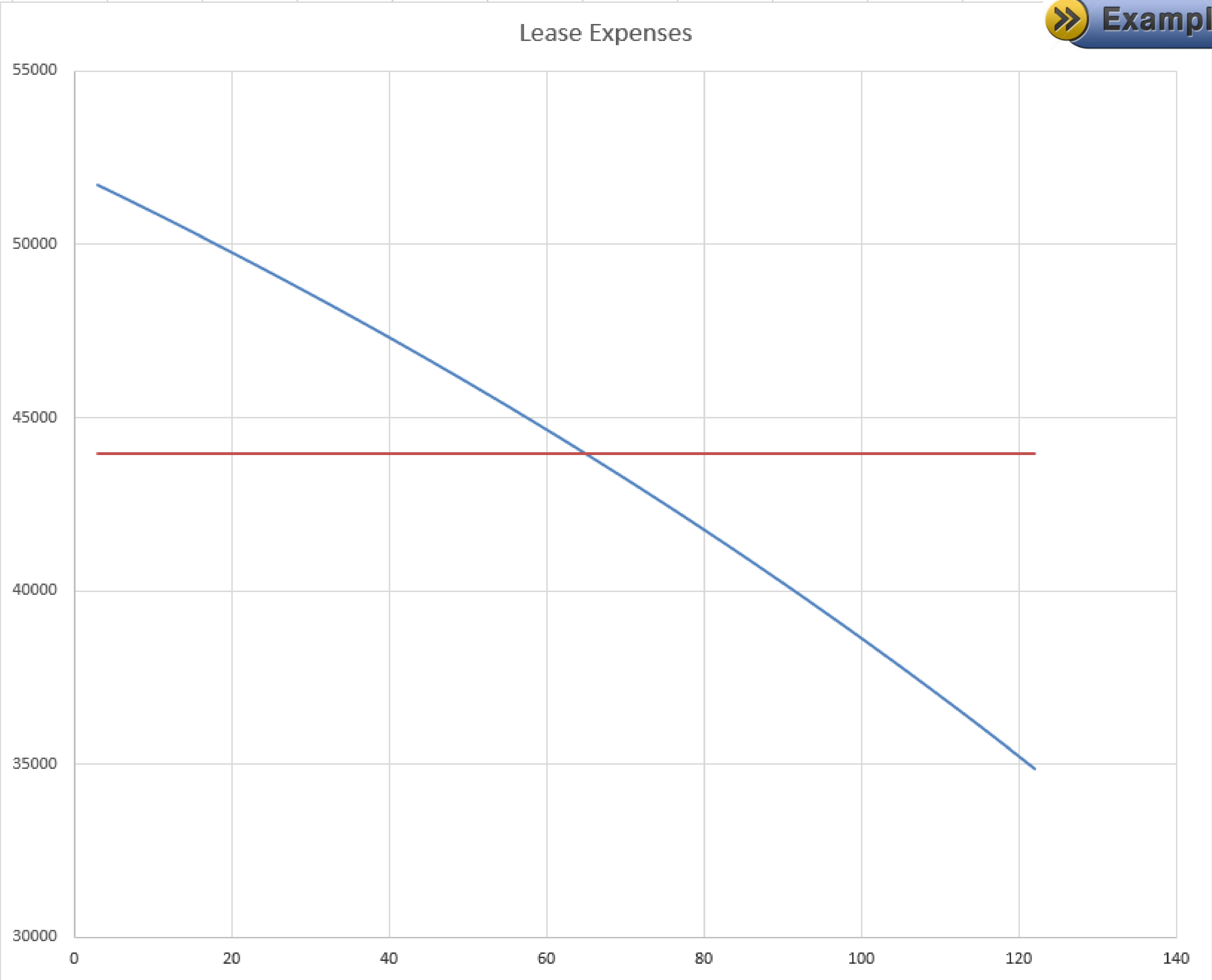
Example


Lease Expenses
55000
50000
45000
40000
35000
30000
0
20
40
60
80
100
120
140

Other Considerations

- CPI and other rate increases
- Changes to leases during lease period (modifications)
- Peppercorn Leases
- Present value calculations - determine effective interest rate (may differ between leases for similar or like assets)
- Review disclosure requirements

Example

Lease re-measurement

(for example, CPI rent increase)

		1-Jul-10		1-Jul-11
	1-Jul-10	1,000,000		
	1-Jul-11	1,000,000	1-Jul-11	1,020,000
	1-Jul-12	1,000,000	1-Jul-12	1,020,000
	1-Jul-13	1,000,000	1-Jul-13	1,020,000
	1-Jul-14	1,000,000	1-Jul-14	1,020,000
	1-Jul-15	1,000,000	1-Jul-15	1,020,000
	1-Jul-16	1,000,000	1-Jul-16	1,020,000
	1-Jul-17	1,000,000	1-Jul-17	1,020,000
	1-Jul-18	1,000,000	1-Jul-18	1,020,000
	1-Jul-19	1,000,000	1-Jul-19	1,020,000
NPV 5%	1-Jul-10	7,848,186		
NPV 5%	30-Jun-11	7,231,114	$144,623	7,375,737

Changed rent

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Example

Lease re-measurement

(for example, CPI rent increase)

		Asset	Liability		Asset	Liability
Opening balance	**1-Jul-10**	0	0	**1-Jul-11**	7,063,797	7,231,114
Adjustment		7,848,186	7,848,186		144,623	144,623
Adjusted opening balance	1-Jul-10	7,848,186	7,848,186		7,208,419	7,375,737
Interest			382,928			357,619
Repayments			-1,000,000			-1,020,000
Depreciation		-784,389			-802,641	
Closing balance	**30-Jun-11**	7,063,797	7,231,114	**30-Jun-12**	6,405,778	6,713,355

Example

Lease Modifications

Eg: Lessee has 10yr lease for 2 floors office space. In year 6 an additional floor becomes available in the market.

A separate lease if both: *(Para 44)*

(a) the modification increases the scope of the lease by adding the right to use one or more underlying assets; and

(b) Increase in consideration for the lease is commensurate with the stand-alone price of the additional RoUA to reflect the circumstances of the particular contract.

Lease Modifications

Example

Eg. *Lessee has 10 year lease for office space.*
At the end of year 6 the lessee and lessor agree to amend the original lease and extend it by 4 years.

Lessee remeasures the lease liability:

- *On an 8 year remaining lease term*
- *Recognises the difference between carrying amounts of the lease (before and after), as an adjustment to the right-of-use asset*

Example

Lease Modifications

Eg. *Lessee has 10 year lease for office space.*
At the end of year 6 the lessee and lessor agree to amend the original lease to reduce the office space from 2 floors to 1 floor.

Lessee remeasures the lease liability:

- *Decreasing carrying amount of RoUA to reflect partial or full termination of the lease*
- *Recognise any gain or loss in the profit or loss*

Peppercorn Leases (AASB 1058)

- Where a NFP lessee has a lease that at inception had significantly below-market terms, the NFP entity shall :
  - Measure the right-of-use asset at fair value
  - Measure the lease liability at the present value of lease payments not paid at that date
  - Recognise any related items in accordance with AASB 1058 (i.e. the difference)
- Crown leases may be captured

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Disclosures

a) amortisation charge for right-of-use assets by class of underlying asset

b) interest expense on lease liabilities

c) the expense relating to short-term leases accounted for applying exemption. (This expense need not include the expense relating to leases with a lease term of one month or less)

d) the expense relating to leases of low-value assets accounted for applying exemption. (excluding short-term leases of low-value assets included in (c))

(Para 53)

Disclosures (Cont.)

e) the expense relating to variable lease payments not included in the measurement of lease liabilities

f) income from subleasing right-of-use assets

g) total cash outflow for leases

h) additions to right-of-use assets

i) gains or losses arising from sale and leaseback transactions

j) the carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset.

Key dates

- Effective reporting periods commencing 1 January 2019
  - Calendar year end – 31 December 2019
  - Financial year end – 30 June 2020
- Comparatives
  - Calendar year – 31 December 2018
  - Financial year – 30 June 2019
- If using full retrospective application
  - Opening balances needed 1 January 2018 and 1 July 2018 respectively (need to gather information now)
- Early adoption permitted, provided AASB 15 *Revenue from Contracts with Customers* is also adopted

Note Treasury may not permit early adoption

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AASB 16 – *Transition*

Full Retrospective OR **Cumulative Catch-up**

Full Retrospective

how?

Apply AASB 8

- Prepare statements as if AASB 16 had always been applied
- Restate comparative information
- Disclose effect on each line item

Benefits?

Better quality of reported information in transition year

Cumulative Catch-up

how?

- Recognise cumulative effect on initial application in opening balance of retained earnings
- Do not restate comparative information
- Consider additional reliefs
- Disclose effect of applying cumulative catch-up approach

Benefits?

Significant cost relief on transition

Challenging Issues

– Identifying leases, particularly peppercorn leases
– Determining an appropriate discount rate
– Determining what is ‘low-value’
– Higher expense upfront may be difficult to explain to users/funding providers
– Determining a ‘fair value’ for leases if using the FV model, particularly peppercorns
– Errors in previous accounting – e.g. make good provisions
– To date, options on how to account for lease incentives - now clarified
– May need to re-negotiate borrowing limits
– Clients may need to amend delegations to sign up to leases (previously very low for operating leases as there was no financing impact)