TC 18-05
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AASB 16 *Leases* Transition Elections

AASB 16 *Leases* will come into effect in FY19-20 and has a number of elections available, both on transition and more generally. This Circular prescribes the options that agencies are to elect. Agencies must comply with AASB 16 in full and should read the standard when applying this guidance.

This Circular applies to all entities that are reporting GSF agencies within the meaning of section 7.3 of the *Government Sector Finance Act 2018*, and to the accountable authorities for those reporting GSF agencies. For the avoidance of doubt, this policy does not apply to universities and their controlled entities, or to their accountable authorities.

Application

This Circular is issued as a mandatory policy. Accordingly, this Circular applicable to all entities that are reporting GSF agencies within the meaning of section 7.3 of the *Government Sector Finance Act 2018*, and to the accountable authorities for those reporting GSF agencies. For the avoidance of doubt, this Circular does not apply to universities and their controlled entities, or to their accountable authorities.

Discount rate

A discount rate is required to calculate the present value of the lease liability. AASB 16 para 26 states this rate is the interest rate implicit in the lease and if not readily determinable the lessee's incremental borrowing rate. Treasury does not expect agencies will always have access to an implicit interest rate, as often the inputs to this rate are not known to the lessees. Therefore, where the implicit rate cannot be determined, the lessee's incremental borrowing rate will be used.

Additionally, AASB 16 para C8 requires lessees to use the incremental borrowing rate for all leases on transition, when the partial retrospective option (AASB 116.C5(b)) has been selected.

The incremental borrowing rate is defined as "the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right of use asset in a similar economic environment." [AASB 16 Appendix A].

Agencies, including State Owned Corporations (SOCs) that borrow from the market should use the rate they would expect to pay based on borrowings with a similar term.

It is anticipated the majority of agencies within the State, particularly in the General Government sector do not borrow funds in the market. Instead they receive appropriations from the Crown in right of the State of New South Wales ("Crown") and where the Crown needs additional funding, Treasury Corporation (TCorp) will go to market to obtain these funds.

Therefore, Treasury will work with TCorp to publish rates that can be used for all agencies that do not borrow from the market. These rates will initially be forecast rates to allow agencies to estimate the impact of the standard. Once AASB 16 is effective we expect to publish incremental borrowing rates annually, for agencies to apply when entering into new lease contracts. For SOCs that use this rate, the Government Guarantee Fee (GGF) will be required to be added to these issued rates.

Subsequent measurement

AASB 16 para 29 requires a lessee entity to measure the right-of-use asset (except for right-of-use assets that meet the definition of investment property in AASB 140 *Investment Property*) applying a cost model, unless the entity elects to apply the revaluation model to right-of-use assets described in para 35.

Agencies must adopt the cost model for the subsequent measurement of right-of-use assets.

Intangibles

AASB 16 para 4 allows entities to not apply this Standard to leases of intangible assets except for those rights held by a lessee under licensing agreements as stated in para. 3e. Agencies must apply this election.

Low value asset threshold and short term leases

AASB 16 para 5 allows entities to not apply some requirements of AASB 16 to short term leases or low value assets. Specifically the requirement to create a lease liability and corresponding ROU asset.

Agencies must adopt this expedient for:

- Leases that meet the definition of short-term. i.e. where the lease term at commencement of the lease is 12 months or less. This excludes leases with a purchase option.
- Leases of assets that are valued at $10,000 or under when new. Treasury expects these items to include laptops and personal computers, telephones and office items.

Non-lease components of leases

In accordance with para. 12, agencies are to separate out, and account separately for, non-lease components within a lease contract and exclude these amounts when determining the lease liability and ROU asset amount. This will result in a more accurate lease asset and liability and depreciation expense. Therefore, agencies must not apply the practical expedient in para. 15.

In many instances, non-lease components will be identified in the contract, so there will be minimal additional work. Where non-lease components are not identified and agencies are not able to obtain this information, agencies must estimate the non-lease components.

Concessionary leases

AASB 16 para Aus25.1 allows not-for-profit entities to measure right-of-use assets on a class-by-class basis at initial recognition at fair value in accordance with AASB 13 *Fair Value Measurement* for leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives (concessionary leases).

AASB 16 para Aus25.2 allows not-for-profit entities to treat right-of-use assets arising under concessionary leases as a separate class of right-of-use assets to right-of-use assets arising under other leases.

AASB 16 para Aus35.1 allows not-for-profit entities to measure a class of right-of-use assets at cost or at fair value if the entity applies the revaluation model in AASB 116 *Property, Plant and Equipment* to the related class of property, plant and equipment. Para BC 21 of AASB 2019-8 Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary *Leases* clarifies that for existing concessionary finance leases as at 30 June

2019 that have already applied the fair value model under AASB 117, entities are not required to remeasure them at cost as at 1 July 2019 if the modified retrospective approach is adopted, even if entities choose to measure them at cost under AASB 16.

Agencies must **not** treat right-of-use assets arising from concessionary leases as a separate class of right-of-use assets. These right-of-use assets must be measured at cost for both initial recognition and subsequent measurement. For existing concessionary finance leases as at 30 June 2019 that have already applied the fair value model under AASB 117, the carrying amount of these assets are deemed to be their cost as at 1 July 2019 under AASB 16.

Presentation

AASB 16 para 47 allows entities to present right-of-use assets separately in the statement of financial position, or to include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned.

Agencies must adopt the option to present right-of-use assets separately (i.e. as a separate line item) in the statement of financial position.

Transition option

Agencies are to adopt the partial retrospective option in AASB 16.C5(b), where the cumulative effect of initially applying AASB 16 is recognised on the initial application date. For 30 June year ends, this means applying AASB 16 from 1 July 2019. The comparatives (for the year ended 30 June 2019) will not be restated.

In applying this option, agencies must apply AASB 16.C8(b)(ii) where the ROU asset is initially recorded on transition, at an amount equal to the lease liability calculated under AASB 16.C8(a).

Further transition elections under the partial retrospective transition approach:

- **Grandfathering the lease definition**

AASB 16.C3 allows an entity not to reassess whether a contract is, or contains, a lease at the date of initial application.

There is an assumption this assessment was done for contracts that **were** assessed as leases under AASB 117. Treasury will allow this practical expedient (AASB 16.C3(a)). Therefore, agencies will not be required to re-assess these contracts.

To apply the practical expedient in AASB 16.C3(b), for contracts that **were not** assessed to be leases under AASB 117, agencies will need to demonstrate for their annual audit purposes they have previously considered this leasing definition.

The level of necessary documentary evidence will vary, depending on the complexity and uniqueness of the contract and materiality. For example, for relatively simple, lower value contracts, it may be sufficient to identify key common features that impact the lease definition. However, for unique, complex and high value contracts, a separate accounting position paper or memorandum may be required. For this reason, Treasury recommends agencies engage with their Audit Office teams during their contract reviews.

For contracts where no assessment at inception was performed these will need be assessed under the new standard.

- **Onerous contracts**

A lessee may rely on its assessment of whether leases are onerous under AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, rather than performing a separate impairment review [AASB 16.C10(b)]. Agencies must apply this practical expedient.

- **Remaining lease terms of 12 months or less**

Where the lease term of an existing contract ends within 12 months of initial application, the standard allows entities to elect for these leases to be treated as short-term leases [AASB 16.C10(c)]. Agencies must apply this practical expedient.

- **Direct costs**

The standard allows entities to elect to exclude initial direct costs ie costs obtaining a lease that would not have been incurred if the lease had not been obtained, from the measurement of the ROU asset at the date of initial application [AASB 16.C10(d)]. Agencies must apply this practical expedient.

- **Use of hindsight**

The standard allows entities to elect to apply hindsight [AASB 16.C10(e)] in determining the lease term, if the contract contains options to extend or terminate the lease. Agencies must apply this practical expedient.

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