The Looking Glass

The Treasury

Insights into financial reporting

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Welcome

In this edition of The Looking Glass we will reflect on the Asset Valuation Workshops that were recently delivered by the NSW Treasury Accounting Policy team. We will also take a high level view at the impact of the new standard International Financial Reporting Standard (IFRS) 16 *Leases* and key considerations for agencies. Finally, we continue our summaries of the latest financial reporting developments relevant to the public sector.

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Asset valuation workshops

During February and March, the Accounting Policy team delivered workshops that focussed on the process and the accounting requirements when conducting valuations of property, plant and equipment. Specific topics included the valuation engagement process, responsibilities of the valuer and management, disclosure requirements and practical challenges in applying Australian Accounting Standards Board (AASB) 13 *Fair Value Measurement*.

Treasury held an education session in 2014 for cluster lead agencies to assist with the first time adoption of AASB 13. Since then, we received feedback from individual agencies, the Audit Office and a Treasury group of cluster representatives on experiences implementing the standard. There was a clear message to revisit the requirements of AASB 13.

A section of the workshops focused on the considerations when applying the standard to a series of practical examples. This was well received by the participants as it provided them with the opportunity to ask questions and share their experiences.

Thank you to everyone who attended and provided feedback on the workshops. Overall feedback was positive and some participants requested seminars on other new accounting standards. Treasury is therefore considering how we can provide similar workshops in future.

If you are interested in obtaining a copy of the workshop material, please contact the Accounting Policy team at: accpol@treasury.nsw.gov.au

IFRS 16 *Leases*

In December 2015, the International Accounting Standards Board (IASB) published the new leasing standard, IFRS 16 *Leases*. IFRS 16 will be effective for annual periods beginning on or after 1 January 2019 and replaces IAS 17 *Leases*. The AASB subsequently approved the Australian equivalent, AASB 16 *Leases*, at its February 2016 board meeting.

The objective of IFRS 16 is to provide improved transparency on financial leverage and capital employed by bringing lease assets and liabilities onto the balance sheet. While accounting by lessors is substantially unchanged; there are significant impacts for lessees.

Lessees

The main impact of IFRS 16 is that lessees will be required to account for all leases on the balance sheet, subject to some exemptions. Lessees will recognise a right-of-use asset and a lease liability. The lease liability largely corresponds to finance leases under IAS 17, although there are some changes in how a lease liability is measured.

The requirement to charge interest on a lease liability means total lease expenses (interest and depreciation of the right-of-use asset) will be greater in earlier years of the lease. This 'front-loading' of expenses contrasts with the previous operating lease recognition.

Exemptions for lessees

IFRS 16 provides some relief by permitting lessees to elect to continue effectively treating leases as operating leases in the following circumstances:

(a) Leases of 12 months or less. This should be applied consistently for each class of underlying leased asset

(b) Leases of low-value assets (such as personal computers, telephones, office furniture etc.). While not defined, the Basis for Conclusions refers to a value of US$5,000. This should be applied on an individual lease basis

(c) Leases ending within 12 months of the date of first applying this standard

Definition of a lease

IFRS 16 retains the key elements of the definition of a lease from IAS 17. However new guidance focuses on whether there is control over the right to use an asset. This is important in determining whether an arrangement contains a lease or is a contract for service.

Lessors

The accounting by lessors under the standard is substantially unchanged and lessors will continue to classify all leases using the existing principles in distinguishing between operating and finance leases.

There is a minor change in the measurement of residual value guarantees. Lease payments will include the expected amounts under such guarantees, instead of maximum amount guaranteed.

Disclosures

IFRS 16 contains enhanced disclosure requirements that are both qualitative and quantitative.

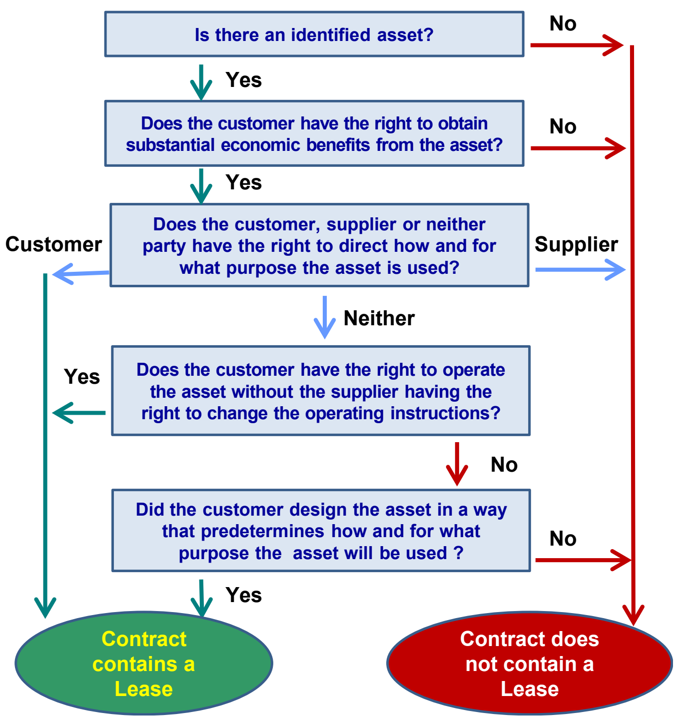
Transitional considerations

On implementation, lessees can choose to either apply the standard retrospectively to each prior period or to apply the cumulative effect from the implementation date. If applied cumulatively, the impact should be adjusted in equity and comparatives should not be restated.

Lease decision tree

The decision tree illustrated in diagram 1 provides guidance in determining whether a contract contains a lease arrangement under the new standard.

Diagram 1



Practical considerations

Matter	Considerations
Existing arrangements	To prepare for implementation, existing arrangements will need to be reviewed to determine whether they contain a lease. In particular, arrangements previously treated as operating leases.
Systems and processes	Update to appropriately account for all current and future leases, and to extract information for enhanced disclosures.
Lease or buy decisions	Treating most leases the same will reduce the importance of the accounting component in these decisions.
Regulatory compliance and credit rating	Assess the impact on credit ratings and lending covenants.

Whilst the standard is applicable only from FY 2019-20, it is important to start planning for implementation. This should include analysis of the financial reporting impacts that will need to be disclosed in financial reports in accordance with AASB.

Other developments

The table below briefly highlights some other recent technical accounting developments.

Financial reporting developments	Estimated issue date	Suggested action
Progress update – ED 261 Service Concession Arrangements: Grantor ED 261 *Service Concession Arrangements: Grantor* was last covered in the March 2015 edition of *The Looking Glass*. Since then, the AASB decided that the concept of 'significant residual interest' is a subjective judgement and it is for the entity to decide when a residual interest in a service concession asset becomes significant. They also agreed that the 'fair value' of the concession asset should be used rather than its 'current value'.	Project is still on track for completion, with a vote on the standard in October 2016.	NSW Treasury is currently taking part in a field testing with the AASB.
ED 272 Transfers of Investment Property ED 272 proposes an amendment to AASB 140 *Investment Property* that will allow an entity to transfer a property to, or from investment property, only when there is evidence of a change in the use of the property. A change in use will occur when the property meets, or ceases to meet, the definition of investment property. The AASB has stated that evidence for the change in use of a property is a prerequisite for such transfers.	ED 272 was issued in November 2015 and closed for comments on 15 February 2016.	Consider how the proposed amendments may impact your financial statement disclosures.

Questions?
Please contact Kaveh Daemi if you would like to discuss any of these standards. Please email accpol if you have any feedback or would like to subscribe to *The Looking Glass*.