

# Policy and Guidelines Paper

## Accounting Policy: Lessor classification of long-term land leases

## Preface

This policy is issued by NSW Treasury as a Policy and Guidelines Paper and clarifies how a lessor should apply Accounting Standard AASB 16 *Leases* to classify a long-term lease of land.

The policy applies to financial years ending on or after 30 June 2021. It supersedes NSW Treasury Policy and Guidelines Paper TPP 11-1 *Lessor Accounting of Long-term Land Leases* as a result of implementing AASB 16, which repeals AASB 117 *Leases*.

Implementation of this policy will achieve consistent accounting for such leases by NSW public sector lessors.

The policy 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.

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*For*

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### Note

General inquiries concerning this document should be initially directed to:  
Accounting Policy & Legislation, NSW Treasury; [accpol@treasury.nsw.gov.au](mailto:accpol@treasury.nsw.gov.au) .

This publication can be accessed from the Treasury's website [www.treasury.nsw.gov.au/](http://www.treasury.nsw.gov.au/).

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## Executive Summary

This policy is issued by NSW Treasury as a Policy and Guidelines Paper and clarifies how a lessor should apply Accounting Standard AASB 16 *Leases* to classify a long-term lease of land.

It 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.

It applies to financial years ending on or after 30 June 2021. It supersedes and withdraws the previous Treasury Policy and Guidelines Paper TPP11-1 with the same title.

A public sector agency may be a lessor in a long-term (eg 99-year) lease of land (or an interest in land). The long-term nature of such leases gives rise to questions about how they should be classified for accounting purposes.

Accounting Standard AASB 16 *Leases* retains the majority of lessor accounting requirements in the superseded AASB 117, including the lease classification and the guidance on classifying leases. This policy applies that guidance to long-term land leases.

This policy, consistent with the superseded TPP11-1, requires a lessor to classify a long-term land lease as a finance lease if it transfers to the lessee substantially all the risks and rewards incidental to ownership of the land. Implementation of this policy will achieve consistent accounting for such leases by NSW public sector lessors.

# 1. Introduction

## 1.1 Background

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A public sector agency may be a lessor in a long-term (eg 99-year) lease of land (or an interest in land). The long-term nature of such leases gives rise to questions about how they should be classified for accounting purposes.

Accounting Standard AASB 16 *Leases* is effective from 1 January 2019. It retains the majority of the lessor accounting requirements in the superseded AASB 117 *Leases*, including the requirement for lessors to classify leases into finance leases and operating leases, and the accompanying guidance on the classification. This policy applies that guidance to long-term land leases.

The implementation of AASB 16 necessitates the amendment of Treasury Policy & Guidelines Paper TPP 11-1 *Lessor Accounting of Long-term Land Leases* which was based on AASB 117.

## 1.2 Issue

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A fundamental issue for a lessor in a long-term land lease is whether the lease should be classified as a finance lease or an operating lease. The classification determines the appropriate accounting.

## 1.3 Application

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This policy applies to any NSW public sector agency that is a lessor in a long-term lease of land (or an interest in land) where the lease payments represent substantially all of the fair value of the land and the lessor retains title to the land. Long-term leases typically run for 50 years or more. Relevant legislation usually sets a maximum permissible term (including renewal options) of 99 or 100 years.

This policy applies to financial years ending on or after 30 June 2021.

It 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.

This policy supersedes, but substantially retains the content of, TPP 11-1.

## 2. Classifying the lease

AASB 16 Leases distinguishes between finance leases and operating leases and requires a different accounting treatment for each type. It is therefore important to determine at the inception of the lease whether a long-term land lease is classified as a finance lease or an operating lease.

A finance lease transfers, from the lessor to the lessee, substantially all the risks and rewards incidental to ownership of the leased asset (title may or may not eventually transfer). An operating lease does not transfer those risks and rewards [AASB 16.62].

AASB 16 provides indicators that would normally lead to a lease being classified as a finance lease [AASB 16.63 and AASB 16.64]. These include:

*at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset [AASB 16.63(d)].*

Further, the Basis for Conclusions on IFRS 16 Leases (on which AASB 16 is based), in discussing the land element of long-term leases, states:

*The [International Accounting Standards] Board noted that the lessee in leases of this type will typically be in a position economically similar to an entity that purchased the land and buildings. The present value of the residual value of the property in a lease with a term of several decades would be negligible. The Board concluded that accounting for the land element as a finance lease in such circumstances would be consistent with the economic position of the lessor [paragraph BCZ243].*

The indefinite economic life of land may suggest that the lessor retains significant risks and rewards incidental to its ownership after the expiry of the lease term. However, at lease inception when the lease is required to be classified, the present value of such risks and rewards in a long-term lease may be insignificant.

Therefore, this policy requires a lessor to classify a long-term land lease as a finance lease, if it transfers to the lessee substantially all the risks and rewards incidental to ownership of the land.

A lease will transfer substantially all of those risks and rewards to the lessee if, at the inception of the lease, the present value of:

- the lease payments amounts to at least substantially all of the fair value of the leased land (except for leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives), and
- the lessor's residual risks and rewards after the end of the lease term is not significant.

This will typically be the case where the lease term is 50 years or more.

## 3. Accounting for prepaid leases

At the inception of a long-term land lease, the lessee often prepays all of the lease payments.

A prepaid lease classified as a finance lease under this policy will effectively be accounted for as a sale. At the inception of the lease, the lessor will derecognise the land and recognise the associated gain or loss on disposal.

## 4. Transitional implications for 2019-20

AASB 16 supersedes AASB 117. However, the main changes introduced by AASB 16 relate to accounting by lessees. Lessor accounting remains largely the same as that in AASB 117. Lessors will continue to classify leases as finance leases or operating leases, based on the same classification criteria.

This means the content of this policy remains consistent with that in TPP11-1. Therefore, implementation of this policy is not expected to result in transitional changes in lessor lease classification (please note this policy does not deal with land sub-leases held by intermediate lessors to which AASB 16.C15 is applicable).

## Further information and contacts

This section is mandatory for all publications.

For further Information or clarification on issues raised in the discussion paper, please contact:

Accounting Policy & Legislation, NSW Treasury

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