

ACT ACCOUNTING POLICY



ACT
Government

Chief Minister, Treasury and
Economic Development

AAPP 108 - ACT Accounting Policy Paper on AASB 16 Leases (Including Transition)

**For reporting periods
Ending on or after 30 June 2020**

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1. BACKGROUND

AASB 16 *Leases* replaces the previous standard AASB 117 *Leases* and associated Accounting Interpretations. It introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value.

A lessee is required to recognise:

- a right-of-use asset representing its right to use the underlying leased asset; and
- a leased liability representing its obligations to make lease payments.

Operating lease rental charges will be replaced with interest charges on the lease liability and depreciation on the right-of-use asset.

At transition (1 July 2019), where leases are currently classified as finance leases (that do not meet either the short-term or low value exemptions), the lessee shall recognise the current carrying amount of the leased asset and finance lease liability as the carrying amount of the right-of-use asset and the lease liability.

AASB 16 substantially carries forward the lessor accounting requirements in AASB 117 *Leases* (i.e. accounting by lessors will remain largely unchanged) except for sub-lessors.

This paper outlines the ACT Government policies on transition and adoption (including practical expedients), under AASB 16. Agencies will still need to review AASB 16 in detail to ensure they understand its requirements.

This paper focuses on accounting by Lessees.

2. APPLICATION DATE

AASB 16 is applicable to annual reporting periods beginning on or after 1 January 2019. For most ACT Government agencies this will be the reporting period 2019-20 with transition adjustments at 1 July 2019.

ACT Government agencies shall not early adopt this Standard.
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3. SCOPE (AASB 16.3-16.4)

AASB16.3 requires that “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 (AASB 1059 when that becomes effective);
- (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”.

“A lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in paragraph 16.3(e)” (AASB16.4).

ACT Government agencies shall not apply this Standard to leases of intangible assets.

4. EXEMPTIONS (AASB 16.5-16.8 & B3-B8)

“A lessee may elect not to apply these requirements to:

- (a) short-term leases; and
- (b) leases for which the underlying asset is of low value.” (AASB16.5).

ACT Government agencies shall apply both these exemptions where the criteria are met.

“A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease” (Appendix A-Definitions).

ACT Government agencies shall apply a threshold of \$10,000 to determine whether an underlying asset is a low value asset.

AASB 16 itself does not provide a definition or a dollar figure for ‘low-value’ assets. However, the Basis for Conclusions on IFRS 16 (BC 16) includes the intention behind this exemption, on the basis of which a \$10,000 threshold is considered appropriate and reasonable. Applying the standard to leases below this threshold would require a lot of effort with potentially little effect on reported information. Leases below this threshold are expected to only capture ICT assets and furniture. Vehicle and accommodation leases (that have significant \$ assets) are unlikely to be exempt at this level. This threshold is also consistent with a number of other jurisdictions.

This threshold is to be applied on a lease-by-lease basis and is based on the value of the asset when new, regardless of the age of the asset being leased (B3). Hence, a short-term lease of a new car would not be a low-value lease (although it might qualify for the short-term exemption). Neither would the lease of old equipment if it is not of low value when in a new state. In assessing whether an underlying asset is a ‘low-value’ asset, agencies need to consider the price at which the lessor or a similar supplier would sell the asset (e.g. price list).

4.Exemptions continued

If this information is not readily available, agencies may consider other relevant observable information in determining the value.

Leases of assets up to the threshold qualify for the low value exemption regardless of whether these leases are material to the lessee. This assessment is not affected by the size, nature or circumstances of the lessee (B4).

An underlying asset can be of low value only if (B5):

- (a) the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
- (b) the underlying asset is not highly dependent on, or highly interrelated with, other assets.

If a lessee agency subleases, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset (B7). However, it can still be exempt as a short-term lease if it is 12-months or less and in that case the sub-lease is classified as an operating lease.

Lessee agencies are to apply the low value exemption to individual items such as computers, telephones, furniture etc., even if the total value for all the items under the contract is above the threshold (B8). There may be items within the lease which are not low value and the exemption should not be applied to them.

Accounting for leases covered by the exemptions:

“The lessee shall recognise the lease payments associated with the exempt leases as an expense on either a straight-line basis over the lease term or another systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee’s benefit” (AASB16.6).

ACT Government agencies shall recognise the lease payments associated with the exempt leases as an expense on a straight-line basis.

Agencies are required to disclose the expenses related to short-term leases and leases of low value assets.

5. TRANSITION (AASB16.C2-C11)

5.1 DATE OF INITIAL APPLICATION (C2)

The date of initial application is the beginning of the annual reporting period in which an entity first applies this Standard. For most agencies this will be 1 July 2019.

5.2 PARTIAL RETROSPECTIVE APPROACH FOR LESSEES (AASB16.C5(B))

ACT Government agencies shall apply the partial retrospective approach under C5(b) i.e. they shall not restate comparative information; and shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings at the date of initial application.

Agencies are required to apply this transitional approach consistently to all their leases.

5.2.1 DISCLOSURES (AASB16.C12)

Agencies are required to disclose the following information about initial application:

- the weighted-average incremental borrowing rate used to measure lease liabilities at the date of initial application; and
- an explanation of any difference between:
 - (a) the present value of the operating lease commitments disclosed in the previous set of annual financial statements, discounted at the rate used to calculate lease liabilities at the date of initial application; and
 - (b) the lease liabilities recognised at that date.

When an agency uses any of the practical expedients relating to operating leases, a statement of which practical expedients have been used is required to be disclosed. Refer to section 5.5 Practical Expedients (AASB16.C10)

When an agency uses the practical expedient for lease definition, then it discloses this fact. Refer to section 5.3 Identifying Lease – Applying Lease Definition to Existing Leases (AASB16.C3-C4)

5.3 IDENTIFYING LEASE – APPLYING LEASE DEFINITION TO EXISTING LEASES (AASB16.C3-C4)

As a practical expedient, an entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted to:

- (a) to apply this Standard to contracts that were previously identified as leases applying AASB 117 Leases and Interpretation 4 Determining whether an Arrangement contains a Lease.
- (b) not to apply this Standard to contracts that were not previously identified as containing a lease applying AASB 117 and Interpretation 4.

ACT Government agencies shall apply this practical expedient and are therefore not required to reassess whether a contract is, or contains, a lease at the date of initial application where the agreement was assessed under previous accounting standards and interpretations. When agencies apply this expedient, it must be disclosed and applied to all its contracts.

This practical expedient is available to both lessors and lessees.

Agencies are not required to review their existing contracts to determine whether or not they contain a lease. Accordingly, lessee agencies are allowed to assume that existing leases continue to be leases and existing service contracts continue to be service contracts.

This practical expedient is available only on transition and is to be applied to all contracts regardless of which transitional option is applied for the measurement of lease liability and right-of-use asset. However, agencies will need to make this assessment for new lease contracts entered into (or modified) on or after the date of initial application.

5.3.1 RECOGNISING LEASE LIABILITY (AASB16.C8(A))

For leases previously classified as an operating lease applying AASB 117, lessee agencies shall: recognise a lease liability at the date of initial application which is the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.

Refer section 11 for guidance on lease payments that are included in the measurement of the lease liability.

5.3.2 RECOGNISING RIGHT-OF-USE ASSET (AASB16.C8(B))

ACT Government lessee agencies shall measure the right-of-use asset by:

- applying option 2a for operating leases for accommodation (land and buildings) where historical information is readily available and 2b for operating leases for accommodation (land and buildings) where historical information is not readily available; and
- applying option 2b for all other operating leases.

The measurement of the right-of-use asset by ACT Government Agencies depends on the type of asset and whether historical information is readily available as noted above:

- **Partial Retrospective Option 2a:** Right-of-use asset is measured at its carrying amount as if the Standard had always applied (so historical lease information is required) (AASB16.C8(B)(i)).
- **Partial Retrospective Option 2b:** Right-of-use asset is measured at an amount equal to the amount of lease liability i.e. present value of remaining lease payments (so historical lease information is not required) (AASB16.C8(B)(ii)).

Government agencies are to apply option 2b to all operating leases other than accommodation leases. These are typically leases for ICT assets (computers and printers etc.), SG Fleet (vehicles and equipment) and other similar high volume low value operating leases (that are higher than the low value exemption threshold) for which the cost of applying option 2a outweighs any benefits.

The amount of depreciation expense under option 2b will be higher than under option 2a. This is because over the term of the lease, the lease liability reduces more slowly than the right-of-use asset (assuming amortisation on a straight-line-basis). Therefore, setting the asset equal to the liability part way through the lease (under option 2b) will result in a higher amount of the asset, which results in a higher depreciation expense over the remaining term of the lease.

Refer section 11 on measurement of right-of-use asset where option 2a is being used.

Lessee agencies shall apply AASB 136 *Impairment of Assets* to right-of-use assets at the date of initial application, unless the lessee applies the practical expedients (in paragraph C10(b)-refer below) (C8(c)).

5.3.2 Recognising Right-Of-Use Asset (AASB16.C8(b)) continued

There are some specific transitional requirements in relation to investment property leases in the Standard (C9). For investment property leases that were previously classified as operating leases, no adjustments are required on transition for leases previously accounted for using the fair value model in AASB 140 Investment Property. As they are not relevant to most ACT Government agencies these have been excluded from this paper.

5.4 TEMPLATE FOR ESTIMATING LIABILITY AND RIGHT-OF-USE ASSET AT TRANSITION

Attached to this paper (Appendix A) is a template to allow agencies to estimate their lease liabilities, right-of-use assets, depreciation and interest expenses. As the spreadsheet is based on a number of assumptions (for instance, annual payments at the beginning of the financial year, annual depreciation etc.) agencies will need to make adjustments to the formulae to suit the specific lease arrangements.

The estimated Territory borrowing rates included in the template were at the end of September 2018 and need to be replaced with the 1 July 2019 rates (initial implementation date). Refer to the following section for guidance on incremental borrowing rates.

5.5 PRACTICAL EXPEDIENTS (AASB16.C10)

A lessee may use one or more of the following practical expedients when applying this Standard to leases previously classified as operating leases applying AASB 117 at transition date. Refer to sections below regarding the ACT Treasury mandates on each of the transition practical expedients:

(a) Apply a Single Discount Rate

Allows a lessee to apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).

ACT Government agencies shall not apply practical expedient AASB16.C10(a) on transition, as the incremental borrowing rate at the date of initial application will not be a single rate, it will vary depending on the remaining term of the lease.

Treasury has advised agencies on the incremental borrowing rate for existing leases at the date of initial application <https://apps.treasury.act.gov.au/accounting>

Lessee's incremental borrowing rate is "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 – Definitions).

As most ACT Government agencies obtain funds through appropriation and are not permitted to borrow funds from the market, Treasury provides the incremental rates for use by ACT Government agencies.

5.5(a) Apply a Single Discount Rate continued

The *incremental borrowing rate* to be used is the estimated Territory borrowing rate for the relevant terms. The rates provided by Treasury are considered to reasonably reflect the Territory's prevailing borrowing interest rates across various terms to maturity at the time the interest rates are provided. The estimated Territory borrowing rates are provided for 1 year to 10-year terms. Leases with terms longer than 10 years will use the estimated 10-year Territory borrowing rate.

The estimated Territory borrowing rates from 1 April 2019 are in table below:

Table: ACT Territory Borrowing Rates

Quarterly Period	1 April 2019	1 July 2019	1 October 2019	1 January 2020	1 April 2020
Term Year(s)	Interest Rate %	Interest Rate %	Interest Rate %	Interest Rate %	Interest Rate %
1Yr	1.83	1.22	0.93	1.09	0.45
2Yr	1.77	1.20	0.90	1.12	0.57
3Yr	1.77	1.23	0.92	1.19	0.67
4Yr	1.82	1.30	0.97	1.28	0.77
5Yr	1.90	1.38	1.05	1.39	0.87
6Yr	2.01	1.49	1.14	1.51	0.98
7Yr	2.13	1.60	1.25	1.62	1.09
8Yr	2.25	1.72	1.37	1.74	1.21
9Yr	2.37	1.85	1.49	1.85	1.33
10Yr	2.49	1.98	1.62	1.96	1.44

Updated rates are posted periodically under Accounting Policies at <https://apps.treasury.act.gov.au/accounting>

(b) Not Undertake Impairment Review

Allows a lessee to rely on its assessment of whether leases are onerous applying AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* immediately before the date of initial application as an alternative to performing an impairment review. The lessee shall adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognised in the balance sheet immediately before the date of initial application.

This expedient allows lessees to adjust the right-of-use asset on transition by the amount of any previously recognised onerous lease provision (instead of assessing whether the right-of-use asset is impaired at the time of initial recognition).

ACT Government agencies shall use this expedient in the measurement of leases previously classified as operating leases (AASB16.C10(b)).

(c) Not apply requirements to leases ending within 12 months of the date of initial application

Allows a lessee to not apply the requirements to leases for which the lease term ends within 12 months of the date of initial application (i.e. by 30 June 2020 for a June reporting agency) (even though the original lease term might have been more than 12 months).

This expedient allows lessees to focus on leases which extend beyond 30 June 2020 rather than those which will expire by 30 June 2020.

ACT Government agencies shall apply practical expedient AASB16.C10(c) on transition.

(d) Exclude initial direct costs

Allows a lessee to exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.

This expedient allows lessees to exclude any initial direct costs that the lessee might have incurred in negotiating or securing the lease, from the measurement of the right-of-use asset at the date of initial application.

This expedient is only relevant where option 2a to calculate right of use asset is being applied.

ACT Government agencies shall apply practical expedient AASB16.C10(d) on transition.

(e) Use hindsight

Allows a lessee to use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

This expedient allows lessees to use judgement in relation to extension/ termination options in the lease, having regard to what occurred in prior periods, in determining the lease term.

ACT Government agencies shall apply practical expedient AASB16.C10(e) on transition.

5.6 EXEMPTIONS FOR LEASES (AASB16.5-8 & B3-B8)

ACT Government agencies shall apply the short-term lease and low value asset exemptions to leases on the date of initial application of this Standard.

The exemptions relating to short-term leases and low asset value leases are also to be applied to leases on the date of initial application of this Standard. (Please see further details on lease extensions in section 10).

The lessee is not required to make any adjustments on transition for such leases.

5.7 LEASES PREVIOUSLY CLASSIFIED AS FINANCE LEASES (AASB16.C11)

“For leases that were classified as finance leases applying AASB 117, the carrying amount of the right-of-use asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying AASB 117. For those leases, the lessee shall account for the right-of-use asset and the lease liability applying this Standard from the date of initial application” (AASB16.C11).

Existing balances for finance lease at 30 June 2019 will be opening balances for AASB 16 at 1 July 2019. These balances will then be subject to AASB 16 on an ongoing basis.

5.8 LESSORS (AASB16.C14-C15)

“A lessor is not required to make any adjustments on transition for leases in which it is a lessor and shall account for those leases applying this Standard from the date of initial application”(AASB26.C14).

Lessor requirements remain largely unchanged. However, additional requirements have been introduced for sublessors.

5.9 INTERMEDIATE LESSORS (AASB16.C15)

“An intermediate lessor shall:

- (a) reassess subleases that were classified as operating leases applying AASB 117 and are ongoing at the date of initial application, to determine whether each sublease should be classified as an operating lease or a finance lease applying this Standard. The intermediate lessor shall perform this assessment at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sublease at that date.
- (b) for subleases that were classified as operating leases applying AASB 117 but finance leases applying AASB 16, account for the sublease as a new finance lease entered into at the date of initial application” (AASB16.C15).

AASB 16 requires an intermediate lessor to evaluate the classification of a sub-lease by reference to the right-of-use asset arising from the head lease, rather than the underlying asset.

5.10 SALE AND LEASEBACK TRANSACTIONS BEFORE DATE OF INITIAL APPLICATION (AASB16.C16-C18)

AASB 16 includes some specific requirements in relation to sale and leaseback transactions. These are not covered here.

6. IDENTIFYING A LEASE – APPLYING THE LEASE DEFINITION (AASB 16.9-16.11 & B9-B30)

“A lease is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration” (AASB 16. Appendix A – Definitions).

“At the inception of a contract (usually the date of the lease agreement), an entity shall assess whether the contract is, or contains, a lease” (AASB16.9). It is useful if Agencies consider whether an agreement will contain a lease as part of the negotiation of the agreement to understand the financial impact.

To assess whether a contract conveys the right to control the use of an identified asset, it is necessary to assess whether the customer has both (B9):

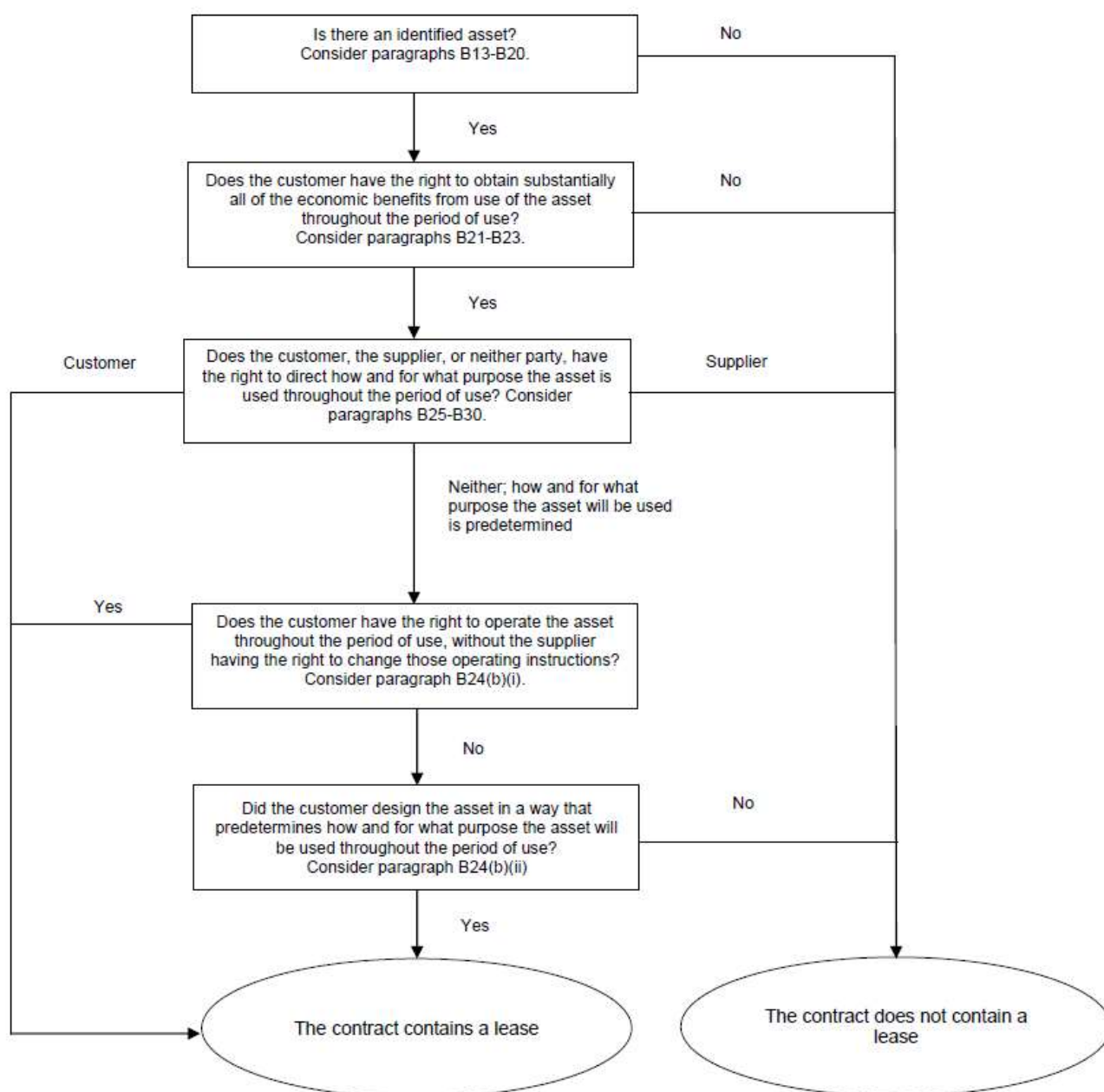
- (a) the right to obtain substantially all of the economic benefits from use of the identified asset; and
- (b) the right to direct the use of the identified asset.

If the customer controls the use of an identified asset then the contract contains a lease. In contrast, in a service contract, the supplier controls the use of any assets used to deliver the service.

“If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term” (AASB16.B10).

“An entity shall assess whether a contract contains a lease for each potential separate lease component” (AASB16.B12).

6.1 FLOWCHART FOR THE DETERMINATION OF A LEASE IN A CONTRACT (AASB16.B31)



6.2 ACT GOVERNMENT PROPERTY GROUP – AGENCY ACCOMMODATION

ACT Government agencies shall not account for a right-of-use asset or a lease liability for internal leases for standard non-specialised accommodation through ACT Property Group.

ACT Government agencies that occupy office accommodation through ACT Property Group are covered by the ACT Government Office Accommodation Policy. This policy supports the overarching ACT Government's Asset Management Strategy and is designed to provide the framework ACT Property Group and Government Directorates and Agencies use to deliver sustainable, effective and consistent property outcomes across the ACT Government's Real Estate (GRE) portfolio.

The Accommodation policy does not cover stand-alone purpose-built GRE such as clinical health facilities, schools, correctional facilities etc including non- office components of other specialist facilities, however, it applies to all other office accommodation. The purpose of the accommodation policy is to provide flexibility to include the introduction and coordination of new initiatives for the management of Territory wide property portfolio.

Included in the accommodation policy (Clause 5.1.6), "WHoG accommodation needs to take precedence over a single Directorate / Agency's preference when significant benefits to Government can be realised or when significant cost savings can be achieved."

Agencies that are currently party to a Memorandum of Understanding (MoU) with ACT Property Group (ACTPG) for accommodation (even though the agreement may have expired) have agreed that "the ACTPG may, by notice to the Directorate, terminate the occupation of the Premises and require the Directorate to vacate the Premises at any time, in the event that:

- (1) there is a change in the Territory's accommodation strategy with respect to the Building, requiring the movement of the Directorate from the Premises; or
- (2) there is a change in the Territory's policy requiring the Directorate to vacate."

ACTPG therefore, has a substantive substitution rights over those properties classified under the Accommodation policy (AASB16.B14) as ACTPG has both:

- (1) the practical ability to substitute alternative accommodation throughout the period of use which cannot be prevented by the Directorate / Agency within a reasonable timeframe; and
- (2) the ACT Government would benefit economically from exercising the right over the accommodation.

The MoUs and other agreements are not considered to constitute a lease within the agreement.

7. PORTFOLIO APPLICATION (AASB16.B1)

Although, AASB 16 specifies the accounting for an individual lease, as a practical expedient lease accounting can be applied to a portfolio of leases with similar characteristics provided that it is reasonably expected that the effects on the financial statements of applying AASB 16 to the portfolio would not differ materially from applying the lease accounting requirements to the individual leases within that portfolio. (AASB16.B1)

For instance, an agency enters into a single contract to lease 20 laptops, tablets or printers (that are individually above the \$10,000 exemption threshold discussed below). Instead of recognising 20 leases separately (for each laptop as a separate component), the agency is permitted to account for the leases as one portfolio.

8. COMBINING CONTRACTS (AASB16.B2)

An entity shall combine two or more contracts and account for them as a single lease when the contracts are:

- entered into at or near the same time;
- with the same counterparty (or related parties of the counterparty); and
- one or more of the following criteria are met:
 - (a) the contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together; or
 - (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
 - (c) the rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component (as described in paragraph B32).

This applies in circumstances where an agency enters into a number of contracts which in substance form a single arrangement. For instance, an agency enters into a one-year lease for an asset, another one-year lease for an asset with similar characteristics starting in one year's time and another similar one-year lease starting in two years' time. The agency has effectively entered into a 3 years lease for that asset.

9. SEPARATING COMPONENTS OF A CONTRACT (AASB 16.12-16.16 & B32-B33)

"For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in 16.15" (AASB16.12).

"As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component" (AASB16.15).

This practical expedient is not available to lessors as it is expected that lessors would have the necessary information.

ACT Government agencies are permitted to apply the practical expedient under 16.15 and therefore may not separate non-lease components from lease components unless the non-lease component is material.

Agencies shall account for the non-lease components in the contract applying other applicable standards.

Examples of separate components include building maintenance, access to common areas, building parking for accommodation leases or vehicle servicing and maintenance.

The right to use an underlying asset is a separate lease component if both:

- (a) the lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee; and
- (b) the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

9. Separating Components of a contract continued

“A contract may include an amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee. For example, a lessor may include in the total amount payable a charge for administrative tasks, or other costs it incurs associated with the lease, that do not transfer a good or service to the lessee. Such amounts payable do not give rise to a separate component of the contract but are considered to be part of the total consideration that is allocated to the separately identified components of the contract” (AASB16.B33).

A lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components. The stand-alone price will be determined on the basis of the price the lessor, or a similar supplier, would charge. However, if an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximising the use of observable information.

Materiality of the non-lease component is a matter of judgement for agencies and may vary between agencies. Agencies need to consider relevant guidance in AASB Practice Statement 2 *Making Materiality Judgements* (December 2017) at https://www.aasb.gov.au/admin/file/content102/c3/AASBPS2_12-17.pdf and the *Materiality Guidance for Financial Statement Simplification* (Materiality Guidance) first issued by the Accounting Branch in May 2018 and included in the ACT Government Model Financial Statements at <https://apps.treasury.act.gov.au/accounting>.

10. DETERMINING THE LEASE TERM (AASB 16.18-16.21 & B34-B41)

“An entity shall determine the lease term as the non-cancellable period of a lease, together with both:

- (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option”. (AASB16.18)

The lease term includes any rent-free periods provided to the lessee by the lessor (B36).

Examples of factors to consider include but are not limited to (B37):

- (a) contractual terms and conditions for the optional periods compared with market rates;
- (b) significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
- (c) costs relating to the termination of the lease, such as negotiation costs, relocation costs, termination penalties and costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;
- (d) the importance of that underlying asset to the lessee’s operations; and
- (e) conditionality associated with exercising the option (i.e. when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist.

10. Determining the lease Term continued

A lessee should revise its lease term if there is a change in the non-cancellable period of a lease (16.21). This would include where a lessee exercises an option not previously included or chooses not to exercise an option that has previously been included. Agencies also need to consider the penalties associated with the termination of a lease.

ACT Government agencies shall apply the short-term exemption provisions (refer to section 4) where a lease contract has expired and there is no longer a lease contract in writing.

However, in the assessment of lease terms agencies should consider both the non-cancellable period of the lease together with periods covered by an option to extend the lease if the agency is **reasonably certain to exercise the option**. The lease term should reflect the agency's reasonable expectation of the period during which the underlying asset will be used. (*IFRS Nov 2019 – Interpretation Committee Decision on leases*) available at <https://www.ifrs.org/news-and-events/updates/ifric-updates/november-2019/#3>

11. RECOGNITION AND MEASUREMENT (AASB16.22-16.46)

Some of the requirements below (for instance, on interest rate implicit in the lease) will only apply to leases that commence after the date of initial application.

A lessee is required to recognise:

- right-of-use-asset representing its right to use the underlying leased asset; and
- a lease liability representing its obligations to make lease payments.

11.1 INITIAL MEASUREMENT OF RIGHT-OF-USE ASSET (AASB16.23-16.25)

At the commencement date of the lease, a lessee shall measure the right-of-use asset at cost, which comprises the following:

- (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;
- (c) any initial direct costs incurred by the lessee (for instance, costs incurred in negotiating or securing a lease); and
- (d) an estimate of costs of dismantling or removing the asset.

11.2 INITIAL MEASUREMENT OF LEASE LIABILITY (AASB16.26-16.28 AND B42-B44)

At commencement date of the lease, a lessee shall measure the lease liability at the present value of lease payments. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

11.2 Initial Measurement of Lease Liability continued

The lease payments included in the measurement of the lease liability comprise the following payments:

- a) fixed payments, less any lease incentives receivable;
- b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- c) amounts expected to be payable by the lessee under residual value guarantees;
- d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

“Fixed lease payments are payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.

Variable lease payments are the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time” (AASB 16 Appendix A – Definitions).

For the purposes of measuring lease liability, lease payments:

- include payments that contain variability but are in substance fixed or unavoidable. For instance, lease payments linked to the consumer price index (CPI). At initial recognition, such payments are recognised using index at the commencement date without estimating changes over the remainder of the term.

Some leases have fixed annual increases over the lease term with one or more intervening market reviews. Market reviews are variable lease payments under AASB 16. In addition, paragraph 28 of AASB 16 states “variable lease payments that depend on an index or a rate described in paragraph 27(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates”.

Paragraph 27(b) of AASB 16 states that lease liabilities should initially be measured incorporating variable lease payments at the rate applicable at commencement date. Future changes to variable lease payments linked to an index such as CPI should not be estimated at lease commencement.

Paragraphs 36(c) and 42(b) of AASB 16 states that lease liabilities should be remeasured to reflect revised lease payments due to a change in index or rate only when the lease payments have changed, using the same discount rate. This may require re-measurement of the lease liability each year as the index changes. Paragraph B42 of AASB 16 states that where there are more than one set of lease payments under a lease agreement that a lessee could realistically be required to make, the lessee should use the lowest realistically possible lease payments in measuring the lease liability.

11.2 For the purposes of measuring lease liability, lease payments: continued

- include payments resulting from residual value guarantees as the lessee has an unconditional obligation which cannot be avoided.
- do not include variable payments linked to the future performance or use of the underlying asset (such payments are recognised as expenses in the period in which the event or condition which triggers the payment occurs).
- do not include incentives (such as any up-front cash payments or reimbursement of costs to the lessee). These incentives are offset against lease payments, even if not part of the formal lease agreement.
 - *Fit out expenditure undertaken or reimbursed by the lessor may be recognised as an asset by either the lessee or lessor, depending on which party controls the economic benefits from the expenditure. The expenditure may also have been promised by the lessor as an inducement for the lessee to enter the lease, or may have been undertaken by the lessor independent of the lease contract. Lessor reimbursements of lessee leasehold improvement expenditure, or direct lessor expenditure on leasehold improvements, should only be considered lease incentives under AASB 16, where:*
 - a) *the expenditure was promised in the lease contract as a condition for the lessee to enter the lease; and*
 - b) *the lessee rather than lessor primarily benefits from that expenditure and has consequently recognised the expenditure as a fit out asset.**These incentives received should be deducted from the ROU asset's initial value, consistent with paragraph 24(b) of AASB 16.*
- do not include payments allocated to non-lease components where the agency has chosen to separate lease and non-lease component.

For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the contract, a lessee may be required to make payments relating to the construction or design of the asset. The lessee shall account for those costs applying other applicable Standards, such as AASB 116 as these are not payments made by the lessee for the right to use the underlying asset (B43-B44).

The interest rate implicit in the lease is the rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor (AASB 16. Appendix A – Definitions).

For new contracts agencies are encouraged to liaise with their lessors in order to obtain the interest rate implicit in the lease, as far as possible.

Agencies may not always have access to the interest rate implicit in the lease, as the information required to determine this rate may not be available. In these circumstances, agencies can use the incremental borrowing rate to calculate the present value of the lease liability.

11.2 For the purposes of measuring lease liability, lease payments: continued

“The lessee’s incremental borrowing rate is 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 – Definitions).

As most ACT Government agencies obtain funds through appropriation and are not permitted to borrow funds from the market, Treasury has worked with the Asset Liability Management Team within Treasury to determine the incremental rates for use by ACT Government agencies. <https://apps.treasury.act.gov.au/accounting>

12. SUBSEQUENT MEASUREMENT (AASB16.29-43)

12.1 RIGHT-OF-USE ASSETS

For right-of-use assets AASB 16 requires a lessee to measure the right-of-use asset applying a cost model (unless it applies other measurement models (AASB16.34-35)), less any accumulated depreciation, any accumulated impairment loss and adjusted for any remeasurement of the lease liability (AASB16.30).

In circumstances where the lease transfers ownership at the end of the lease or contains a purchase option that will be exercised depreciation will cover the period until the end of the useful life of the underlying asset.

The right-of-use asset in the lease shall be depreciated from the commencement date to the earlier of either the useful life of the asset or the end of the lease term (AASB 16.32).

If the lessee already applies a fair value model to **investment property** and is currently valued under AASB 140 *Investment Property*, the lessee shall apply that model to all right-of-use assets that meet that definition (AASB16.34).

In subsequent measurement ACT Government agencies shall measure right-of-use assets that relate to a class of **property, plant and equipment** at cost (AASB16.Aus35.1)

In circumstances where right-of-use assets were previously measured at fair value as finance leases, they will be initially measured at their previously recorded values. Agencies can use the AASB117 carrying amounts (fair value) as the basis for applying AASB 16 under the modified transition approach without having to remeasure (AASB16.C11).

Impairment of right-of-use asset

A lessee shall apply AASB 136 *Impairment of Assets* to determine whether a right-of-use asset is impaired and to account for any impairment loss identified (AASB 16.33)

12.2 LEASE LIABILITY

After the commencement date, a lessee shall measure the lease liability by:

- (a) Increasing the carrying amount to reflect interest on the lease liability;
 - (b) Reducing the carrying amount to reflect the lease payments made; and
 - (c) Remeasuring the carrying amount to reflect any reassessment or lease modifications.
- (AASB 16.36)

The interest and variable lease payments (not included in the measurement of the lease liability) should be recognised in the operating statement (AASB 16.38)

If there are changes to the lease liability causing changes to the lease payments, agencies will need to remeasure the lease liability as an adjustment to the right-of-use asset. This may occur if there are changes in the lease term, index or rate (e.g. CPI, market rent) or there is a change in the assessment of the lease options. (AASB16.39-43)

13. LEASE MODIFICATIONS (AASB16.44-46)

Lease modifications should be accounted for as a separate lease if the modification increases the scope of the lease **and** if the consideration for the lease increases with a stand-alone price for the increase in scope.

Ensure that the change is a modification rather than a reassessment of the lease as relevant accounting treatments are different. A modification is a change in the scope of a lease or consideration for a lease that was NOT part of the original terms or conditions. Examples of these include a negotiation to reduce floor space (decrease in scope), receiving a rent rebate due to economic conditions (change in consideration), a negotiated increase in the lease term (increase in scope) or an increase in the number of vehicles rented (account for as a new lease). An increase in scope will require a remeasurement of the lease liability and an adjustment in the Right of Use Asset.

Agencies may require additional assistance accounting for lease modifications. Please contact Financial Reporting and Framework branch for further advice.

If these conditions are not met then the lease modification does not need to be accounted for as a separate lease however, an agency should:

- (a) Allocate the consideration in the modified contacts;
- (b) Determine the revised lease term for the modified contract;
- (c) Remeasure the lease liability by discounting using the revised discount rate at the time of commencement of the modification;
- (d) Decrease the carrying amount of the right-of-use asset if the modification reduces the scope of the lease; and
- (e) Make a corresponding adjustment to the right-of-use asset for all other lease modifications (AASB16.44-46).

14 CONCESSIONARY (PEPPERCORN) LEASES (AASB 2018-8)

AASB 1058 *Income of Not-for-Profit Entities* and AASB 16 require not-for-profit entities to measure right-of-use assets at initial recognition at fair value for leases that have significantly below market terms and conditions principally to enable the entity to further its objectives. (AASB 2018-8. BC2).

ACT Government agencies shall apply the concessionary lease temporary measure to leases on the date of initial application of this Standard.

AASB 2018-8 *Amendments to Australian Accounting Standards-Right-of-Use Assets of Not-for-Profit Entities* provides a temporary option for not-for-profit entities which allows electing not to measure the right-of-use assets in concessionary leases at fair value but to recognise the assets at cost in accordance with AASB 16.23–25, which incorporates the amount of the initial measurement of the lease liability. If an agency has concessionary leases and recognises at cost, there is additional disclosure requirements (AASB 2018-8 Aus59.1).

15 DISCLOSURES (AASB16.47-16.60 AND B48-B52)

AASB 16 requires entities to disclose quantitative and qualitative information in the financial statements to enable users to understand their effect on the financial results of the entity. Entities also need to disclose any significant judgements applied in applying these Standards.

The disclosure requirements are included in the ACT Government Model Financial Statements relevant for the reporting period 2019-20.

The AASB 16 Leases disclosure objective is to ensure that users of the financial statements can assess the effect that leases have on the financial statements. AASB 16 contains both quantitative and qualitative disclosures. The disclosure objective should be used by Agencies to assess whether the overall quality and extent of the lease disclosures are sufficient rather than just mechanically following the leases in the 'Example Agency' Model Financial Statements.

Generally, AASB 16 requires more disclosures than AASB 117 Leases and therefore more judgement and effort will be needed in the preparation of the disclosures. All disclosures under AASB 16.52 requires lessees to disclose information in a single note, separately in the financial statements or cross referenced throughout the notes. ACT Accounting Policy requires presentation in a single note.

For lessors, information relating to investment properties under leases are included in the investment property note.

16 MATERIALITY GUIDANCE

The AASB Practice Statement 2 Making Materiality Judgements (December 2017) should be used by agencies in their assessment of materiality. Making materiality judgements involves both quantitative and qualitative considerations. A quantitative threshold - a specified level, rate or amount used in assessing size - can be a helpful tool in making a materiality judgement. However, a quantitative assessment alone is not always sufficient to conclude that an item of information is not material. The entity should further assess the presence of qualitative factors.

Agencies are encouraged to consider materiality in preparing and streamlining their financial statements. AASB 101 defines information as material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The Australian Accounting Standards Board (AASB) re-issued AASB 101 Presentation of Financial Statements to streamline and simplify financial statements. It clarified that entities should not disclose immaterial information in their financial statements and that the presentation of information in notes can and should be tailored to provide users with the clearest story of an entity's financial performance and financial position. Agencies are strongly encouraged to undertake an annual assessment with the view to further simplify the presentation of their financial statements.

While there is no 'one size fits all' approach to streamlining financial statements, the Materiality Guidance included in the ACT Government Model Financial Statements should be considered, to determine when to:

- provide separate line items on the face of the financial statements (i.e. Operating Statement, Balance Sheet, Statement of Changes in Equity and Cash Flow Statement);
- provide separate note disclosures for a face statement line item;
- reduce immaterial detail provided in separate note disclosures; and
- provide explanations for variances between prior and current year actual figures.

The Materiality Guidance provided as part of the ACT Government Model Financial Statements is available at <https://apps.treasury.act.gov.au/accounting>

As circumstances change over time, materiality judgements should be reassessed at each reporting date.

Consultation with Audit Committee and the Audit Office

Each agency will need to exercise judgement in determining appropriate thresholds for disclosures in their financial statements. Agencies are encouraged to agree their specific thresholds for disclosures along with exceptions with their Audit Committee and the Audit Office in the process of developing their financial statements.