

# AASB 16: Leases

▶ Alastair Abbott | 14 March 2023



# Say 'hi' in the chat!



This is an interactive workshop!

- 01 Ask questions via Q&A
- 02 Comments and banter in the chat
- 03 Participate!

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Replays are available for VIP & Team subscribers.

# Alastair Abbott

CA, B.Comm., GradDipCA, M. Forensic Accounting, MAICD, Registered Company Auditor, Registered Self-Managed Super Fund Auditor

- ▶ Joined **Australian Audit in 2008**, rising to position of Director in 2014
- ▶ Completed his undergraduate studies at the University of Western Australia followed by the **Chartered Accounting** program.
- ▶ Completed a **Masters of Forensic Accounting** through the University of Wollongong.
- ▶ Has broad experience across all types of audits, from the smaller trust accounts, variable outgoings and strata companies through to financial statement audits for large companies, charities and financial service licensees.
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**WELCOME**

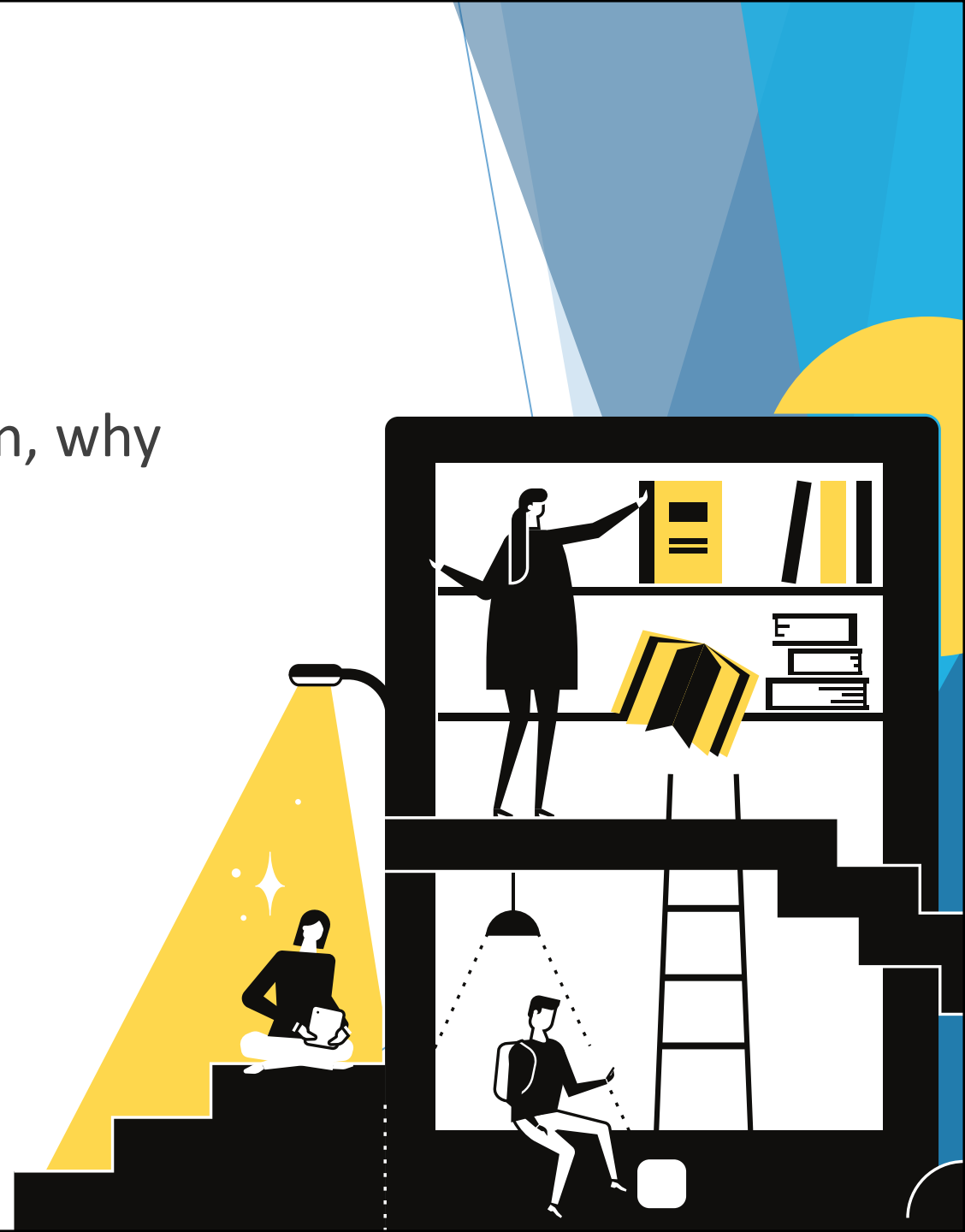
Alastair Abbott

Director, Australian Audit

# Agenda



- ▶ Introduction to this change – who, when, why
- ▶ Status quo
- ▶ What is a lease?
- ▶ Exceptions
- ▶ Accounting entries
- ▶ Implementation
- ▶ Examples



# Context

- ▶ Under the previous accounting standard, the obligation to make future payments under an operating lease arrangement was not included on the balance sheet even though the entity was committed to those future expenditures.
- ▶ The concern of many stakeholders was that this did not give an accurate reflection of the entity's true financial position.
- ▶ Example: Borders bookstore collapsed in 2011 – lease commitments were roughly 7 times higher than reported debt

# Timeline

- ▶ February 2016 – AASB16 issued
- ▶ 1 January 2019 – applicable for years beginning on or after

	December Year End	June Year End
Comparative period*	2018 year	18/19 year
Initial application date	1 January 2019	1 July 2019
Effective year ending	December 2019	June 2020
*if retrospective application		

# Who is impacted?

- ▶ This is the new normal for accounting, and will impact most organisations
- ▶ There is a common misconception among some entities that produce **special purpose financial reports**, that the new standards will not apply to them
  - ▶ as they do not consider themselves to be reporting entities.
  - ▶ As such, they believe that they can “pick and choose” which accounting standards they should apply.
- ▶ AASB16 will apply (at least on a recognition and measurement basis) if:
  - ▶ For financial statements to be ‘true and fair’
  - ▶ Applying AASB101
  - ▶ Preparing general purpose financial reports
  - ▶ Required to ‘comply with Australian Accounting Standards’
  - ▶ Incorporated Associations & ACNC (>\$500k turnover)
  - ▶ All Aboriginal Corporations



# Who is impacted?

- ▶ Lessor accounting
  - ▶ No significant changes
- ▶ Lessee accounting
  - ▶ Former operating leases capitalised like finance leases
  - ▶ Balance sheet – increased assets and liabilities
  - ▶ Income statement – decrease in operating expenses, increase in finance costs
  - ▶ Statement of cash flows – decrease in operating cash flows, increase in financing cash flows

# Status Quo

## Status quo – current lease accounting

- ▶ Operating leases not on balance sheet
- ▶ Record rent expense for each payment
  - ▶ Operating expense
  - ▶ Operating cash flow

## Example

- ▶ Office rental expense
- ▶ \$72,000 per year for 3 years
- ▶ 10% incremental borrowing rate

# Example – income statement impact

	Year 1		Year 2		Year 3	
	Current	AASB 16	Current	AASB 16	Current	AASB 16
Operating lease expense	72,000		72,000		72,000	
Interest expense		14,896		11,300		4,378
Amortisation expense		61,809		61,809		61,809
<b>Total expense</b>	<b>72,000</b>	<b>76,705</b>	<b>72,000</b>	<b>73,109</b>	<b>72,000</b>	<b>66,187</b>



# Example – balance sheet impact

	Year 1		Year 2		Year 3	
	Current	AASB 16	Current	AASB 16	Current	AASB 16
<b>Non-current assets</b>						
Right-of-use asset	0	123,617	0	61,808	0	0
<b>Current liabilities</b>						
Lease liability	0	(60,700)	0	(79,622)	0	0
<b>Non-current liabilities</b>						
Lease liability	0	(79,622)	0	0	0	0

# Example – cash flow statement impact

	Year 1		Year 2		Year 3	
	Current	AASB 16	Current	AASB 16	Current	AASB 16
Operating – payments to suppliers	(72,000)		(72,000)		(72,000)	
Financing / operating – Interest expense		(14,896)		(11,300)		(4,378)
Financing – repayment of principle		(57,104)		(60,700)		(67,622)
<b>Total</b>	<b>(72,000)</b>	<b>(72,000)</b>	<b>(72,000)</b>	<b>(72,000)</b>	<b>(72,000)</b>	<b>(72,000)</b>

# What is a Lease?



# Lease definition

## AASB 117 (extant)

- ▶ A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

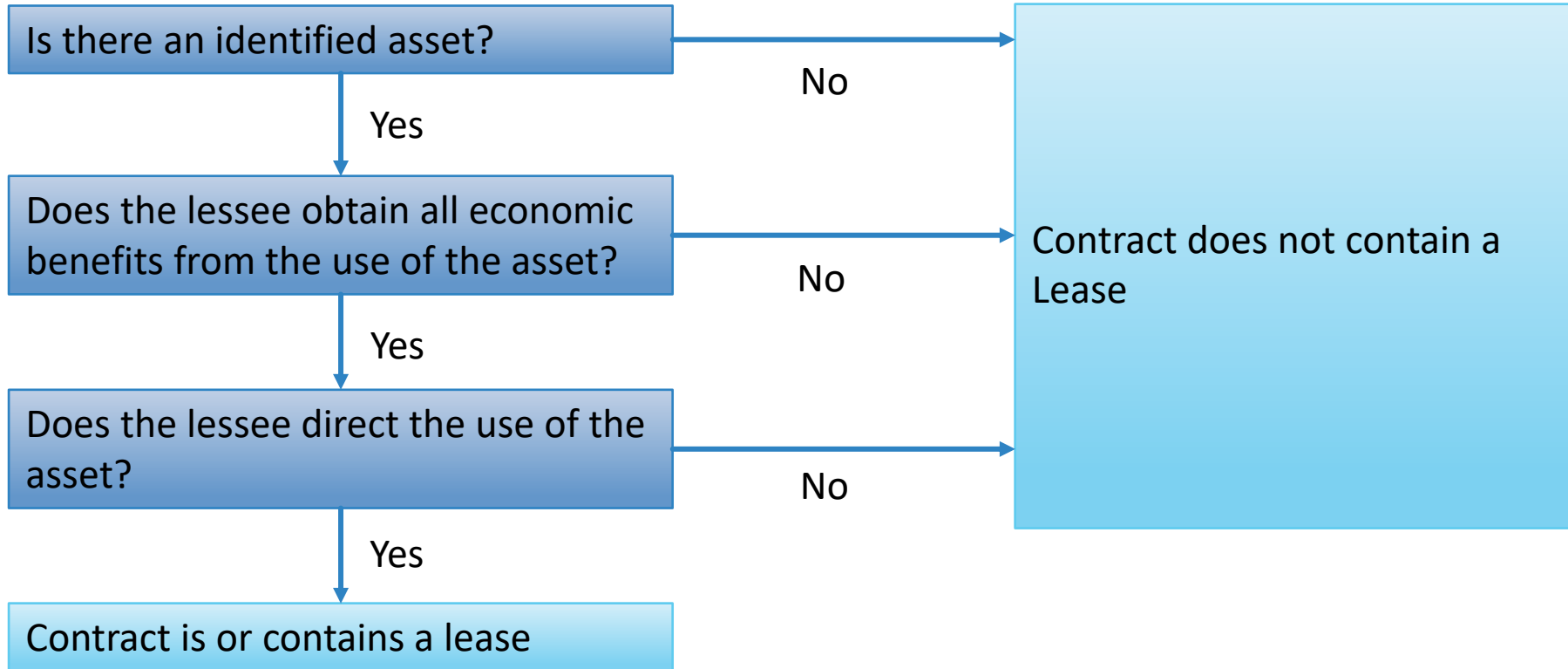
## AASB 16 (new)

- ▶ A lease is a contract or part of a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

# Lease definition (examples)

- ▶ Land / property
- ▶ Vehicles / machinery
- ▶ Server / large IT equipment
- ▶ Photocopiers
  
- ▶ May have to separate a contract
  - ▶ Car lease and car maintenance
  - ▶ Photocopier rental including regular servicing

# Lease definition



# Example – Concession space

A charity (Customer) enters into a contract with an airport operator (Supplier) to use a space in the airport to conduct fundraising & marketing for a three-year period.

The contract states the amount of space and that the space may be located at any one of several boarding areas within the airport.

Supplier has the right to change the location of the space allocated to Customer at any time during the period of use.

There are minimal costs to Supplier associated with changing the space for the Customer: Customer uses a kiosk (that it owns) that can be moved easily to each location.

There are many areas in the airport that are available and that would meet the specifications for the space in the contract.

# Example – Truck Rental

Customer enters into a contract with Supplier for the use of a truck for one week to transport cargo from Sydney to Perth.

Supplier does not have substitution rights. Only cargo specified in the contract is permitted to be transported on this truck for the period of the contract.

The contract specifies a maximum distance that the truck can be driven.

Customer is able to choose the details of the journey (speed, route, rest stops, etc.) within the parameters of the contract. Customer does not have the right to continue using the truck after the specified trip is complete.

The cargo to be transported, and the timing and location of pick-up in Sydney and delivery in Perth, are specified in the contract.

Customer is responsible for driving the truck from Sydney to Perth.

# Example – IT Network services

Customer enters into a contract with a telecommunications company (Supplier) for network services for two years.

The contract requires Supplier to supply network services that meet a specified quality level.

In order to provide the services, Supplier installs and configures servers at Customer's premises—Supplier determines the speed and quality of data transportation in the network using the servers.

Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract.

Customer does not operate the servers or make any significant decisions about their use.

# Example – IT Network services

Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years.

Supplier delivers and installs the server at Customer's premises in accordance with Customer's instructions, and provides repair and maintenance services for the server, as needed, throughout the period of use.

Supplier substitutes the server only in the case of malfunction.

Customer decides which data to store on the server and how to integrate the server within its operations.

Customer can change its decisions in this regard throughout the period of use.

# Exceptions



# Exception – short term leases

- ▶ Leases of less than 12 months
- ▶ Option period included where 'reasonably certain' to exercise
  - ▶ Then account for leases similar to current operating leases

# Exception – low value assets

- ▶ “Low value” is not defined in the accounting standard, however is below about \$5,000
- ▶ The low value election can be made on a lease-by-lease basis
- ▶ A computer is a low value asset
- ▶ A car is not a low value asset
  
- ▶ Account for low value leases similar to current operating leases

# Accounting Entries

# Accounting Entries

## ▶ Initial Recognition

- ▶ The leased asset is recognised as a right to use asset with a corresponding lease liability on the balance sheet

## ▶ Initial Measurement

- ▶ Lease liability = present value of outstanding lease payments
- ▶ The leased asset is measured at “cost”
- ▶ “Cost” = the lease liability + lease payments already made
  - lease incentives received + Lessee’s initial direct costs
  - + Lessee’s estimated dismantling costs

All at Commencement date.

Existing leases require prior period restatement or the cumulative effect on initial application is recorded as an adjustment to retained earnings.

# Accounting Entries – Lease liability

## Include

- ▶ Fixed payments
- ▶ Optional payments that are reasonably certain
- ▶ Residual value guarantee

## Exclude

- ▶ Variable lease payments – i.e. linked to sales
- ▶ Optional payments not reasonably certain
- ▶ Service payments

# Present value of outstanding lease payments

## HOW TO DETERMINE THE DISCOUNT RATE

Use interest rate implicit in lease causing this formula to balance

$$\begin{array}{ccc} \text{Present value of} & & \text{Lessor's initial} \\ \text{future lease payments} & & \text{direct costs} \\ + & & + \\ \text{Present value of} & = & \text{Underlying} \\ \text{unguaranteed residual value} & & \text{asset's fair value} \end{array}$$

Cannot determine fair value and lessor's costs?  
Use lessee's incremental borrowing rate!

# Subsequent measurement

- ▶ Right to use asset
- ▶ Default treatment

## 1. COST MODEL

=

Cost – Accumulated depreciation – Impairment losses +/- 'Lease liability remeasurements'

- ▶ if fair value model applied on non lease investment property then the fair value of the right to use asset must be estimated
- ▶ You may choose the Property Plant & Equipment option and revalue the right to use asset according to AASB 16

# Subsequent measurement

- ▶ Lease liability

**ADJUST INITIAL MEASUREMENT**  
+ Interest  
- Payments  
+/- 'Lease liability remeasurements'

- ▶ Lease liability re-measurements are caused by changes in future lease payments
- ▶ Change in lease term option
- ▶ Purchase option change
- ▶ Changes to expected residual payment amount
- ▶ Changes in future lease payment amounts



# Implementation

# Practical expedients on transition

- ▶ Lessee choice of two methods
- ▶ **Full retrospective** – restatement of comparatives in accordance with AASB 108
- ▶ **Modified retrospective** – do not restate comparatives.
  - ▶ Cumulative effect of adopting AASB 16 is recognised as an adjustment to equity on date of initial application.

# Practical expedients on transition

**Only available where you do not restate comparatives:**

- ▶ Leases ending <12 months – no adjustment required
- ▶ Simplified right of use measurement – based on outstanding lease liability
- ▶ Discount rates – portfolio basis
- ▶ Onerous leases – no impairment testing
- ▶ Initial direct costs not required
- ▶ Finance leases – no adjustment required
- ▶ Use of hindsight – RE exercising options

# Conclusion

## Other matters

- ▶ Sale and leaseback – no longer can provide ‘off balance sheet’ financing
- ▶ Sublease arrangements – become more complicated
- ▶ Peppercorn lease accounting – optional
  - ▶ Significantly below market value

# What next?

- ▶ Pause .... Breathe ... relax
  - ▶ Make a plan!
- ▶ Prepare a lease schedule of all leases and their significant terms
- ▶ Educate staff and all accounting team
- ▶ Discuss application approach with external accountants and auditors
- ▶ Discuss and minute accounting policy choices with the board

# For more information

- ▶ Read the standard – [www.aasb.gov.au](http://www.aasb.gov.au)
  - ▶ Extra material including basis for conclusions and illustrative examples
- ▶ Training seminars & guidance material
- ▶ Our Newsletter – [www.australianaudit.com.au/newsletter](http://www.australianaudit.com.au/newsletter)
- ▶ Make a plan and give yourself enough time

# Take away message

- ▶ Lease accounting is very different to before
- ▶ At very least, make a schedule of all your leases



# Q & A

Alastair Abbott

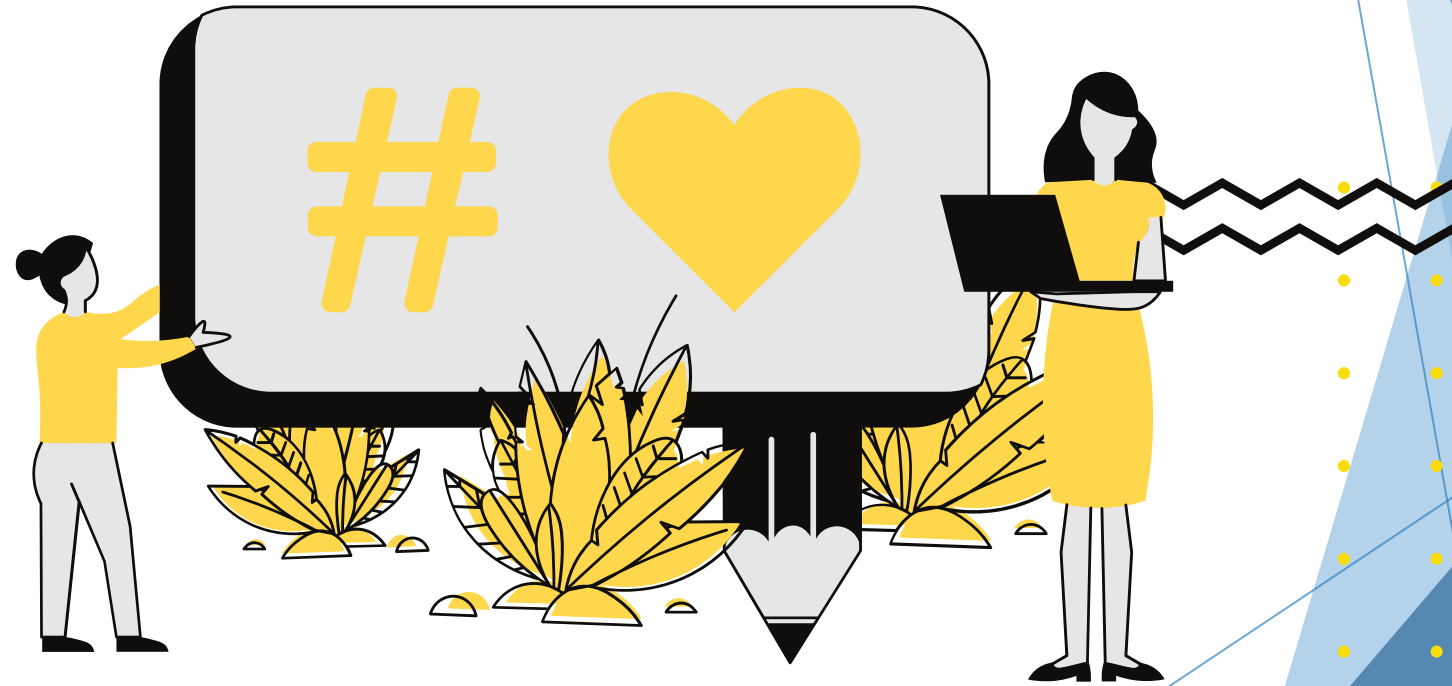
Director, Australian Audit



# What was your key takeaway?



**How would you rate today's session?  
Any feedback?**





# THANKS!

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# Contact details

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