

TREASURY ANALYSIS – INTERNATIONAL ACCOUNTING STANDARDS

AASB 117 “Leases” replaces AAS 17/AASB 1008 “Leases”

Major impact of changes

- AASB 117 has retained the *qualitative indicators* of when a lease is a finance lease, but does not have the *quantitative indicators* that were previously in AASB 1008.
- Long term leases of land must be accounted for as operating leases, irrespective of the lease term, unless title is expected to pass to the lessee or significant risks and rewards associated with the land at the end of the lease term pass to the lessee.

Key features of Standard

- AASB 117 substantially replicates the requirements of AAS 17/AASB 1008, except for the areas discussed under “main differences” below.

Main differences compared to previous Australian requirements

- *Classifying leases between finance and operating leases*
AASB 117 retains the principle of ‘substance over form’ and the conclusive test of ‘transfer of substantially all the risks and benefits’ for classifying a lease as a finance lease. It also retains the qualitative indicative tests of ‘the present value of the lease payments amounts to substantially all of the fair value of the asset’ and ‘the major part of the economic life of the leased asset’. However, the quantitative indicators of 90 percent of the fair value and 75 percent of the useful life that were previously in AASB 1008 (para 5.3.4(b)) have been omitted.
- *Defining ‘interest rate implicit in the lease’*
In defining the ‘interest rate implicit in the lease’, AASB 117 refers to the discount rate *at the inception of the lease* (para 4) whereas AASB 1008 referred to the rate *at the beginning of the lease term* (para 20.1). Therefore, the interest rate implicit in the lease will differ when the inception of the lease (the date of the lease agreement or the date of commitment, whichever is earlier) is not the same as the beginning of the lease term (the date from which the lessee is entitled to exercise its right to use the leased asset). This will result in different amounts recognised by lessees as assets and liabilities arising from finance leases and as interest expense. Amounts recognised by lessors as finance revenue each period will differ.
- *Option to designate leases as investment property*
Under AASB 140 *Investment Property*, a lessee can classify a property interest held under an operating lease as an investment property (See Treasury Analysis on AASB 140).
- *Lease Incentives*
UIG Abstract 115 requires lease incentives to be recognised over the term of the lease, for both lessors and lessees and both cancellable and non-cancellable operating leases. This extends the new AASB 117 (para 14) and previous AASB 1008 (para 5.3.14) which both referred only to land and building leases, and extends previous Abstract 3, which dealt only with lessees and non-cancellable operating leases.
- *Scope*
AASB 117 excludes non-regenerative resources, investment property and biological assets held by lessees under finance leases and provided by lessors under operating leases.

Recent developments

- *Contingent rentals* - In September 2006, the AASB published a 'rejected issue' note (i.e. item not taken onto the AASB's agenda) regarding 'recognition of contingent rentals'. The issue was whether contingent rentals under an operating lease should be included in the total lease payments to be recognised on a straight line basis over the lease term. IFRIC concluded that IAS 17 is unclear on this issue, but that it has not, in general, led to contingent rentals being included in the amount to be recognised on a straight line basis over the lease term. Subsequently, the IASB has tentatively decided to amend IAS 17 to clarify the intended approach i.e. to require contingent rents relating to operating leases to be recognised as incurred. The implication is that contingent rentals, in practice, are being recognised as incurred, which is consistent with the previous approach under AASB 1008. As a result, the AASB had omitted this as a difference between AASB 117 and AASB 1008.

Impact on the public sector

- *Long term leases of land that do not transfer title to the lessee*
Under AASB 117, long term leases of land must be classified as operating leases, unless title is expected to pass to the lessee or significant risks and rewards associated with the land at the end of the lease term pass to the lessee (refer AASB 117, para 14, IAS 17 Basis for Conclusions, para BC8 and March 2006 edition of *IFRIC Update*).

Previously, under Treasury Circular NSWTC 00/19, prepaid long term leases of land were effectively treated as sales or finance leases by the lessor. Consequently, as long term leases of land, which do not transfer title, are now treated as operating leases, prepaid rentals have to be amortised over the lease term rather than being recognised as sales income in one lump sum. However, the requirements for measuring the leased asset by the lessor are effectively unchanged, as the fair value of prepaid long term leases is effectively zero at commencement of the lease and an increasing (ie re-emerging) value towards the end of the lease term.

Policy and Implementation issues (see attached)

- *Lessor accounting for prepaid long term leases of land* - Treasury has issued new policy regarding prepaid long term leases of land which supersedes NSWTC 00/19 (TPP 06-3). Application of this policy will result in transitional impacts for affected agencies as the new policy must be applied retrospectively. This is further discussed in TPP 06-3.
- *Emerging interests in public private sector infrastructure (PPI)* – In the absence of any Standard, Treasury has previously agreed the accounting treatment for PPI transactions on a case by case basis using the principles in AASB 1008. However, to ensure a consistent approach, agencies are now required to adopt NSW Treasury's policy on Accounting for Privately Financed Projects (TPP 06-8). The policy is based largely on the principles in the UK Standard FRS 5 and deals with recognition of infrastructure assets or the right to receive them, recognition of up front contributions and accounting for associated land leases.

This summary has been written in general terms and is intended for reference only. Agencies should review the contents of the AASB Standard to determine its application in particular circumstances.

SUMMARY OF POLICY, IMPLEMENTATION & SYSTEM ISSUES
AASB 117 “LEASES”
TREASURY & AGENCIES

| | Issue | Treasury Policy | | System/ Implementation Issue | Mandate Options for GFS Harmonisation | Budget / Total State Sector Issues |
|---|---|-------------------|------------------------|---------------------------------|---|--|
| | | Mandate Option | Additional Guidance | | | |
| 1 | Different treatment of lease incentives | | | ✓ | | ✓ |
| 2 | Interest rate implicit in the lease will differ when the inception of the lease is not the same as the beginning of the lease term. | | | ✓ | | ✓ |
| 3 | Lessor accounting for prepaid long term leases of land | | ✓ | ✓ | | ✓ |
| 4 | Accounting for privately financed projects | | ✓ | ✓ | | ✓ |