Frequency Asked Questions (FAQs) – AASB 16 *Leases*

On transition should an agency's current lease incentive liability be reversed out through the right of use asset balance or retained earnings?

The standard is not prescriptive on this matter and there does not appear to be a broad consensus in practice. For consistency across the sector, all agencies are required to reverse any lease liability that remains through the right-of-use asset (ROUA) that is connected to the lease incentive liability.

This will mean for those leases with a lease incentive liability the ROUA will be lower than the lease liability. This will also reduce future depreciation expense. This method has been chosen as Treasury believe it best reflects the intention of the standard.

On transition Treasury mandated (Treasury Circular 18-05) the modified retrospective approach where the ROUA is equal to the lease liability per AASB 16 C8b(ii). Are there any exceptions to this?

For leases that will be subject to accelerated, rather than straight line depreciation agencies have the option to use the modified retrospective approach where the ROUA is calculated as if the standard had always been in effect [AASB 16 para C8b(i)]. This will avoid an agency recording an impairment expense for FY19-20 which would be equal to the difference between the value as at transition date and the fair value (the fair value would reflect the higher rate of depreciation and thus be a lower amount). Therefore, under both options the ROUA will be the same value at the end of the year.

Once the standard is effective what are the discount rates to use when entering a lease?

Agencies are required to use the rate implicit in the lease in the first instance [AASB 16 para 26.] Where this cannot be determined agencies then use the incremental borrowing rate (IBR).
The IBR for transition ie 1 July 2019 and for leases entered into post transition as:

Lease Term	**Rate to be Applied as at 1 July 2019**
For leases up to 5 years	1.42%
For leases > 5 years up to 10 years	2.00%
For leases > 10 years	2.42%

Note: For State Owned Corporations (SOCs) the Government Guarantee Fee should be added to the rates above.

Treasury and Treasury Corp (TCorp) will monitor rates and publish updated IBRs as required throughout the year. At a minimum, it is expected the IBR will be updated biannually. When the IBR changes the current lease liabilities should not be updated, because this rate reflects the cost of borrowing at a point in time and should be used for the remainder on the lease term.

How will right-of-use assets (ROUA) be subsequently measured – at cost or fair value?

ROUAs will be measured at cost. Any revaluation reserve can only be utilised when the asset is carried at revalued amount according to para 60 of AASB 136 *Impairment of Assets*. Therefore, any impairment losses arising from ROUA cannot be recognised against the revaluation reserve of property, plant & equipment.

Is there any adjustment required for revaluation reserves related to previous finance lease assets upon transitioning to AASB 16?

Finance lease assets previously recognised under AASB 117 by lessees were measured at fair value and may have been revalued together with owned assets in the same asset class of property, plant & equipment. The movements in the fair value of these assets would have been recognised in the revaluation reserve of the relevant asset class.

Upon transitioning to AASB 16, finance lease assets are derecognised from Property, Plant & Equipment.

NSW Treasury has mandated the option under AASB 116 *Property, Plant and Equipment* to transfer revaluation surplus of an asset to retained earnings upon derecognition. Therefore, the revaluation reserve related to finance lease assets should be reclassified to retained earnings on 1 July 2019. If the revaluation reserve related to finance lease assets cannot be distinguished from the reserve for the rest of the PP&E in the same asset class, the reclassification adjustment should be made on a proportionate basis.

Additional procedures for an entity's owned PP&E assets leased to another government entity under a finance lease arrangement

Because NSW Treasury has mandated that right-of-use assets are subsequently measured at cost, while PP&E assets are subsequently measured at fair value, an adjustment is required at GGS/TSSA consolidation level where:

- A government lessor entity has leased its owned PP&E asset(s) to another government entity under a finance lease arrangement, and therefore has derecognised the asset(s) from its own books in accordance with AASB 16; and
- The book value of the corresponding right-of-use asset(s) recorded by the lessee entity (i.e. at cost) is significantly different from the fair value of the underlying owned PP&E asset(s).

Therefore, the following procedures should be undertaken by the lessor and lessee entities for GGS/TSSA consolidation reporting purposes:

- the lessor entity should maintain records of the owned PP&E assets leased to another government entity under a finance lease arrangement, and include these assets in its revaluation process in accordance with TPP 14-01 *Valuation of Physical Non-Current Assets at Fair Value.*
- the lessee entity should provide the lessor entity with the relevant information requested to facilitate the lessor's valuation. Examples of the relevant information include:
    - componentisation
    - quality and lifecycle costs (capital upgrades/improvements etc.) incurred by the lessee
    - any change in the nature of use
- The lessor entity should communicate the following information to TSFR team of Treasury to facilitate the consolidation adjustment at GGS/TSSA level:
    - the identification of the lessee and lessor entity
    - the asset class of the underlying asset
    - the remaining useful life of the underlying asset, if applicable
    - the fair value of the underlying asset as at 30 June and the associated valuation increment/decrement

- the depreciation expense that would have applied to the owned asset (i.e. as if the underlying asset was depreciated and not replaced by Finance Lease Receivable)
- any gain/loss recognised from derecognising the PP&E asset under the finance lease

How do agencies account for make good provisions?

Make good provisions should be accounted for under AASB 137 *Provisions, Contingent Liabilities and Contingent Assets.* There is no change to the calculation of these liabilities due to the new leasing standard.

Any dismantling or restoring costs (ie costs to make good) for the underlying asset are to be included in the cost of the relevant ROUA [AASB 16 para 24d and para 25]. Agencies may choose to identify make good costs in their own accounting systems separately from the ROUA for ease of tracking. However, for reporting purposes these make good costs will need to be included in the ROUA amount or in property, plant & equipment (PP&E) as below.

There are two types of make-good provisions related to leased assets:

1. the dismantling restoration costs related to removing the leasehold improvements, rather than the underlying asset of the ROUA – in this circumstance, the cost of the makegood would form part of the leasehold improvements under AASB 116 and therefore be included in PP&E

2. the dismantling and restoration costs related to the underlying asset (e.g. painting or replacing carpet of the leased premises etc) – in this circumstance, the make good provision should be included in the cost of the ROU asset.

Therefore, make-good provisions in respect of assets in scenario 2, need to be reclassified from leasehold improvements to the ROU asset. This may result in a reclassification on transition to AASB 16. However, whether a reclassification is required is also dependent on its materiality.