

NSW Treasury Policy and Guidelines: Agencies with Occupancy Agreements with Property NSW

TPG22-23

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Acknowledgement of Country

The NSW Treasury acknowledges that Aboriginal and Torres Strait Islander peoples are the First Peoples and Traditional Custodians of Australia, and the oldest continuing culture in human history.

We pay respect to Elders past and present and commit to respecting the lands we walk on, and the communities we walk with.

We celebrate the deep and enduring connection of Aboriginal and Torres Strait Islander peoples to Country and acknowledge their continuing custodianship of the land, seas and sky.

We acknowledge the ongoing stewardship of Aboriginal and Torres Strait Islander peoples, and the important contribution they make to our communities and economies.

We reflect on the continuing impact of government policies and practices, and recognise our responsibility to work together with and for Aboriginal and Torres Strait Islander peoples, families and communities, towards improved economic, social and cultural outcomes.

Artwork: 'Regeneration' by Josie Rose

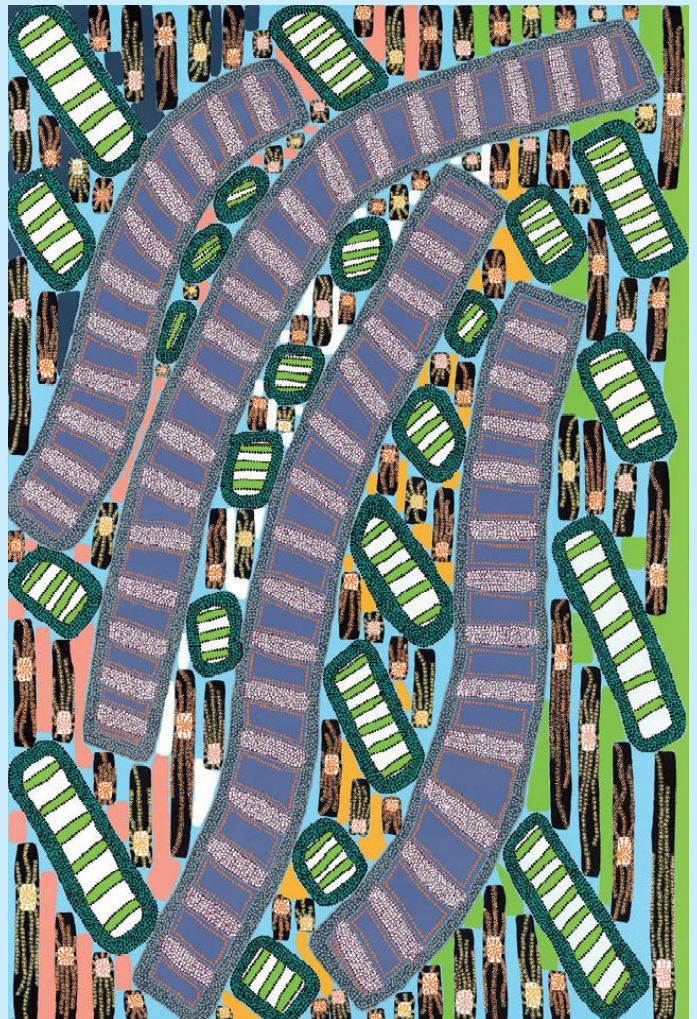


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Key information	
Treasury Policy and Guidelines (TPG) is relevant to?	<input checked="" type="checkbox"/> Government Sector Finance Agencies <input checked="" type="checkbox"/> General Government Sector <input checked="" type="checkbox"/> Public non-financial corporation <input checked="" type="checkbox"/> Public financial corporation <input checked="" type="checkbox"/> State Owned Corporations <input type="checkbox"/> Other
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Guidance for Agencies with Occupancy Agreements with Property NSW

Purpose

The purpose of this policy is to provide guidance to agencies on the applicability of AASB 16 *Leases* to Occupancy Agreements with Property NSW (PNSW). It includes proforma financial statements disclosures for the year ending 30 June 2022 and frequently asked questions in respect of the derecognition of existing right-of-use assets and lease liabilities related to office accommodation lease arrangements with PNSW.

This policy is not mandatory and NSW GGS entities should tailor the assessment and disclosures to their individual circumstances.

Background

Property NSW provides office accommodation to other NSW government agencies under various occupancy agreements. These occupancy agreements have been accounted for as leases since AASB 16 became effective from 2019/20.

During the financial year 2021/22, PNSW introduced changes to its standard occupancy agreement, referred to as a Client Acceptance Letter (CAL). The revised Standard CAL introduced “substitution right” clauses, that give PNSW the right to substitute alternative accommodation services, following a due consultation process. The “substitution right” clauses may effectively remove the ability of an agency to control the use of a specific identified office location, during the term of the agreement. Occupancy agreements between PNSW and agencies with these substitution clauses will generally not meet the definition of lease under AASB16.B14. An exception would be where there is evidence that PNSW’s substitution right is not substantive (e.g. accommodation with specialised features, such that substitution is impracticable). As a consequence, most of these revised agreements should not be accounted for as a lease under AASB 16.

The change is effective from 30 June 2022. Agencies that ‘opt in’ to PNSW’s Standard CAL with “substitution right” clauses need to assess whether the agreement is still within the scope of AASB 16. Where AASB 16 does not apply, existing right-of-use assets and lease liabilities arising from the CAL prior to the change, will need to be derecognised.

1. Determining the applicability of AASB 16 to the occupancy agreements with PNSW

STANDARD CAL

PNSW will be entering into future occupancy agreements with agencies, based on its Standard CAL. The key commercial terms of the Standard CAL are presented below and the major differences compared with the common CAL terms used prior to 30 June 2022 are identified (refer to Appendix A for the full version of the standard CAL):

Dear (Insert First Name)

Client Acceptance Letter – Leased Premises

Transaction: Provision of government office accommodation [or exercise of option or licence for car spaces etc]

Building: (Insert Street Address)

Premises: The part or parts of the building which is/are occupied by the Occupant as shown on the plan(s) attached to the Client Acceptance Letter [or as directed by the Accommodation Provider]

Occupant: (Insert Agency Name)

Cluster: (Insert Cluster Name)

Accommodation Provider: Property & Development NSW (PDNSW)

Accommodation Provider Contact Officer: (Insert Full Name)

We are pleased to confirm your agreement with the Accommodation Provider in relation to the above Premises and kindly ask you to sign and return this Client Acceptance Letter which confirms:

1. The Occupant accepts the financial and commercial terms of the Transaction as set out in the Key Commercial Terms Summary and attached Estimated Financial Commitment Schedule.
2. Further, the Occupant acknowledges the respective Roles and Responsibilities of the parties as set out in the document which is located on the Department of Planning and Environment (DPE) website, link to document included here:
<https://www.dpie.nsw.gov.au/housing-and-property/policies-and-guidelines>

References to 'lessor' and 'lessee' replaced with 'occupant' and 'accommodation provider'

Key Commercial Terms

Transaction	Provision of government office accommodation [or exercise of option or licence for car spaces etc]
Building	(Insert Street Address)
Building Owner	(Insert Building Owner Name)
Accommodation Provider	Property NSW, operating as Property & Development NSW (PDNSW)
Occupant	(Insert Agency Name)
Cluster Department	(Insert Cluster Name)
Premises	The part or parts of the building which is/are occupied by the Occupant as shown on the plan(s) attached to the Client Acceptance Letter
Net Lettable Area	(Insert Number) sqm
Car Parking	(Insert Number) reserved car space(s)

Relocation**	<p>The Accommodation Provider may, by written notice to the Occupant, require the Occupant to relocate to Alternative Premises at any time during the Term.</p> <p>Relocation will occur within a reasonable period taking account of factors including time for agency consultation, Alternative Premises search, fit out procurement and installation, staff consultation, budget approval and funding, ICT procurement and installation and physical relocation and in consultation with the Occupant and where necessary to effect NSW Government policy and / or a written Ministerial direction.</p>
Alternative Premises**	<p>The Alternative Premises will be determined in accordance with NSW Government policy and / or written Ministerial direction, noting the Accommodation Provider will ensure the Alternative Premises is fit for purpose taking account of considerations including location, building grade, condition and features and functionality of the fit-out at the Alternative Premises.</p>
Relocation Costs **	<p>When managing accommodation for whole of government and proposing a relocation, the Accommodation Provider will work with the Occupant to secure funding for the reasonable costs of relocation including search costs, consultant fees, fit-out costs, ICT costs and physical relocation costs.</p> <p>The Accommodation Provider will financially compensate the Occupant for the fit out at the Premises if relocation is initiated by the Accommodation Provider, based on the book value of the fit out at the time of the relocation.</p>
Relocation Accommodation Charges Review**	<p>Relocation to an Alternative Premises may require a review of the Accommodation Charges from the commencement of the new occupancy. The Accommodation Provider will assist the Occupant to engage with NSW Treasury to address budget variances arising from relocation to the Alternative Premises.</p>

Relocation clauses which were previously not included

This section provides guidance to assist agencies assess whether their occupancy agreements with PNSW are within the scope of AASB 16 for the purpose of their standalone financial statements.

Guidance/Information

...A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration...

[AASB16.9]

Agencies entering into a new agreement with PNSW, using either the standard CAL or a negotiated CAL, must assess whether the agreement contains a lease within the scope of AASB 16. This assessment should include whether PNSW has substantive substitution rights. Key factors relevant to substitution rights include:

- Does the agreement convey to PNSW a legal right to substitute the asset (e.g. by relocating the agency) in the agreement, either explicitly or implicitly, throughout the period of use?
- Does PNSW have the practical ability to substitute the asset, throughout the period of use? (AASB16.B14(a))
- Would a decision by PNSW to substitute the asset provide an economic benefit to PNSW (AASB16.B14(b)).

These factors only consider substitution rights, as these are the main changes in the standard PNSW CAL. However, when applying AASB 16, an agency is required to consider all relevant facts, circumstances and the terms of contractual arrangements (AASB16.2).

If the answers to all the above questions are yes, the agency does not have the right to use an identified asset, and therefore the agreement does not contain a lease defined by AASB 16.

Two examples are presented below to assist agencies assess whether their occupancy agreements are within the scope of AASB 16. The assessments should be tailored to the specific circumstances in each case. For example, the nature of accommodation, including the extent it is specialised.

Example A: Occupancy agreements using a Standard CAL

Agency A enters into an occupancy agreement with PNSW using its Standard CAL (Appendix A). The terms and conditions of the Standard CAL provide PNSW with the ultimate right to provide alternative accommodation services, i.e. relocate Agency A to different accommodation throughout the term of the agreement.

The assessment in the table below indicates that the Standard CAL, together with the specific circumstances of the accommodation, does not contain a ‘lease’ within scope of AASB 16.

AASB 16 Guidance	CAL Terminology	Assessment Guidance
<p>Identified asset [AASB 16.B13]</p> <p>‘An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer.’</p>	<p><i>Building – By address</i></p> <p><i>Premises – The part or parts of the building which is/are occupied by the Occupant as shown on the plan(s) attached to the Client Acceptance Letter</i></p> <p><i>Net Lettable Area – area specified in the CAL</i></p> <p><i>Car Parking – number of reserved car spaces specified in the CAL</i></p>	<p>Guidance note:</p> <p>Elements that could be deemed as an identified asset:</p> <ul style="list-style-type: none"> i) the Premises, consisting of the Net Lettable Area as detailed in the plan, and / or ii) the Car Parking space(s). <p>To be an identifiable asset, the <i>Net Lettable Area</i> should be <i>clearly defined and identified</i> by the area marked on the contract. The marked space within the Premises should be explicitly specified.</p> <p>Additionally, there could be reserved/unreserved car parking spaces. For reserved spaces, the area should be clearly identified and defined to be an identifiable asset. Unreserved car parking is unspecified and homogenous in nature, and therefore will not be an identified asset.</p>

AASB 16 Guidance	CAL Terminology	Assessment Guidance
Substantive substitution rights [AASB 16.B14 – B19]		
<p>B14. ‘Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier’s right to substitute an asset is substantive only if both of the following conditions exist:</p> <p>(a) the supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and</p> <p>(b) the supplier would benefit economically from the exercise of its right to substitute the asset (i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).’</p>	<p><i>Permitted Use</i> – Commercial office space for government services</p> <p><i>Relocation</i> – The Accommodation Provider may, by written notice to the Occupant, require the Occupant to relocate to Alternative Premises at any time during the Term. Relocation will occur within a reasonable period and in consultation with the Occupant and where necessary to effect NSW Government policy and/or a written Ministerial direction.</p> <p><i>Relocation costs</i> - When managing accommodation for whole of government and proposing a relocation, the Accommodation Provider will work with the Occupant to secure funding for the reasonable costs of relocation including search costs, consultant fees, fit-out costs, ICT costs and physical relocation costs. The Accommodation Provider will financially compensate the Occupant for the fitout at the Premises if relocation is initiated by the Accommodation Provider, based on the book value of fitout at the time of the relocation.</p>	<p>Assessment: This clause determines which party has the right to direct the use of the identified asset – PNSW (Accommodation Provider) or the Agency (Occupant).</p> <p>For a substantive substitution right to exist, it needs to be demonstrated that PNSW has the <i>practical ability to substitute</i> the accommodation space and would <i>benefit economically</i> through doing so.</p> <p><u><i>Practical ability</i></u> The relocation clause in the CAL provides PNSW with the legal right to relocate the Agency with a written notice at any time during the Term.</p> <p>PNSW have a portfolio of 1.3 million m² of net leasable area, giving it the capability to relocate agencies both locally and across the NSW region. Also, PNSW has demonstrated in the past its ability to relocate agencies with a historical record of relocating more than 160 agencies during the last ten years.</p> <p>The accommodation in this agreement is general in nature. It does not contain specialised features that are difficult or uneconomic to replace. [agencies should tailor this paragraph according to its own circumstances]</p>

AASB 16 Guidance	CAL Terminology	Assessment Guidance
<p><i>Framework for the Preparation and Presentation of Financial Statements</i>, para Aus49.1</p> <p>‘In respect of not-for-profit entities..., in pursuing their objectives, goods and services are provided that have the capacity to satisfy human wants and needs..... Future economic benefits is synonymous with the notion of service potential, and is used in this <i>Framework</i> as a reference also to service potential...’</p>	<p><i>Relocation Accommodation Charges Review</i> - Relocation to Alternative Premises may require a review of Accommodation Charges from the commencement of the occupancy. The Accommodation Provider will assist the Occupant to engage with NSW Treasury to address budget variances arising from relocation to the Alternative Premises.</p> <p><i>Alternative Premises</i> – The Alternative Premises will be determined in accordance with NSW Government policy and / or written Ministerial direction, noting the Accommodation Provider will ensure the Alternative Premises is fit for purpose taking account of considerations including location, building grade, condition and features and functionality of the fit-out at the Alternative Premises.</p> <p><i>Fit out</i> - Fitout is supplied and funded by the Occupant or The Accommodation Provider owns any fitout supplied to the Occupant. Fit out is owned by the Building Owner if it was paid or provided by the Building Owner by way of capital incentive.</p>	<p>Therefore, PNSW has the overall capacity and capability to substitute the type of office accommodation space it provides to this agency.</p> <p><u><i>Economic benefit</i></u> PNSW is a not-for-profit entity. Economic benefits in the not-for-profit context, are therefore not necessarily quantified by financial returns. Instead, decisions are often made to further the not-for-profit entity’s service objectives.</p> <p>PNSW’s service objectives include the following:</p> <ul style="list-style-type: none"> • Improve or retain operational and financial efficiencies, and/or achieve the policy objective(s) of the state as a whole. • Does not negatively impact an agency’s ability to perform and deliver its functions. • provide advice and support on property matters. • operate within a framework of sustainable development and social responsibility. <p>As stated in the Relocation and Alternative Premises clauses, decisions on relocation and alternative premises will be aligned with relevant Government policy and/or ministerial directions. Therefore, the possible relocations initiated by PNSW are expected to arise from the reasons such as:</p>

AASB 16 Guidance	CAL Terminology	Assessment Guidance
		<ul style="list-style-type: none"> • There is a change to the whole of government office accommodation strategy with respect to the building, requiring the movement of the Occupant from the Premises; • Where a benefit to government can be realised or cost savings can be achieved; or • There is a change in government policy requiring the Occupant to relocate. <p>They appear to be consistent with PNSW’s objectives above. The flexibility PNSW has to relocate agencies both within its portfolio and new additions to the portfolio, enables it to act on opportunities, managing the agencies dynamically, in contrast to being locked into decisions for significant periods of time. This will not only help in achieving PNSW’s broad policy objectives, but also provide opportunities for it to obtain financial savings, e.g. by reducing vacancy rates and underutilised space.</p> <p>Conclusion: In this example, PNSW has the <i>substantive right to substitute</i> the office accommodation that it provides to the Agency, throughout the period of use, and can benefit economically if it exercises that right.</p>

AASB 16 Guidance	CAL Terminology	Assessment Guidance
<p>B15. ‘If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier’s substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.’</p>	<p><i>Relocation</i> – The Accommodation Provider may, by written notice to the Occupant, require the Occupant to relocate to Alternative Premises at any time during the Term. Relocation will occur within a reasonable period taking account of factors including time for agency consultation, Alternative Premises search, fit out procurement and installation, staff consultation, budget approval and funding, ICT procurement and installation and physical relocation and in consultation with the Occupant and where necessary to effect NSW Government policy and / or a written Ministerial direction.</p>	<p>Assessment: PNSW’s right to substitute is substantive, because it can be exercised at any time, via written notice.</p>
<p>B16. ‘An entity’s evaluation of whether a supplier’s substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception of the contract, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include:</p> <ul style="list-style-type: none"> (a) an agreement by a future customer to pay an above market rate for use of the asset; (b) the introduction of new technology that is not substantially developed at inception of the contract; (c) a substantial difference between the customer’s use of the asset, or the performance of the asset, and the use or performance considered likely at inception of the contract; and 	<p><i>Permitted Use</i> – Commercial or Government Administration office or any other lawful use</p> <p><i>Commencing Accommodation Charges</i> - \$ sqm etc. Includes attachment of Estimated Financial Commitment Schedule details the inclusive charges.</p> <p><i>Review of Accommodation Charges</i> - Components of the Accommodation Charges will be reviewed during the Term by one or more methods, including but not limited to base year increase, fixed percentage, CPI and market review adjustments, as specified in the Head Lease. The Accommodation Charges may also be adjusted subject to a net lettable area survey, if required by the Head Lease.</p>	<p>Guidance Note: The above assessment of PNSW’s substantive substitution rights is based on the facts and circumstances at the inception of the agreement.</p> <p>Future events should only be considered where there is sufficient justification.</p>

AASB 16 Guidance	CAL Terminology	Assessment Guidance
<p>(d) a substantial difference between the market price of the asset during the period of use, and the market price considered likely at inception of the contract.'</p>		
<p>B17. 'If the asset is located at the customer's premises or elsewhere, the costs associated with substitution are generally higher than when located at the supplier's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset.'</p>	<p><i>Permitted Use</i> – Commercial office space for government services</p> <p><i>Relocation Costs</i>- When managing accommodation for whole of government and proposing a relocation, the Accommodation Provider will work with the Occupant to secure funding for the reasonable costs of relocation including search costs, consultant fees, fit-out costs, ICT costs and physical relocation costs. The Accommodation Provider will financially compensate the Occupant for the fitout at the Premises if relocation is initiated by the Accommodation Provider, based on the book value of fitout at the time of the relocation.</p> <p><i>Relocation Accommodation Charges Review</i> – Relocation to Alternative Premises may require a review of Accommodation Charges from the commencement of the occupancy. The Accommodation Provider will assist the Occupant to engage with NSW Treasury to address budget variances arising from relocation to the Alternative Premises.</p>	<p>Assessment: The cost vs. benefit assessment should be based on PNSW's service objectives, rather than financial benefits only, given PNSW's role of managing the property portfolio for the State in the not-for-profit context as stated above.</p> <p>The conditions that are expected to lead to a relocation outlined in the agreement (e.g. a change to the whole of government office accommodation strategy) are consistent with PNSW's service objectives, and therefore are expected to provide PNSW with economic benefits in the not-for-profit context.</p> <p>Financial benefits may not be the only or main driver for a relocation, especially when other objectives of a government accommodation strategy take priority. However, this does not preclude the possibilities of a financial benefit by PNSW. With the right to relocate occupants, PNSW can also act on cost saving opportunities by various measures, e.g. reduce vacancy rates.</p>

AASB 16 Guidance	CAL Terminology	Assessment Guidance
<p><i>B18.</i> ‘The supplier’s right or obligation to substitute the asset for repairs and maintenance if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.’</p>	<p><i>Relocation</i> – The Accommodation Provider may, by written notice to the Occupant, require the Occupant to relocate to Alternative Premises at any time during the Term. Relocation will occur within a reasonable period taking account of factors including time for agency consultation, Alternative Premises search, fit out procurement and installation, staff consultation, budget approval and funding, ICT procurement and installation and physical relocation and in consultation with the Occupant and where necessary to effect NSW government policy and/or a written Ministerial direction.</p>	<p>Assessment: The basis for determining PNSW’s substantive substitution rights is the Relocation clause. This right exists irrespective of repair and maintenance requirements, therefore paragraph B18 is not applicable.</p>

Based on the facts in Example A, PNSW has the substantive right to substitute the office accommodation and would benefit economically, through achieving its objectives as a not-for-profit entity. As a result, the Standard CAL agreement between PNSW and Agency A does not contain an identified asset and therefore does not constitute a lease for the purposes of AASB 16.

The agreement is accounted for as a service arrangement, for PNSW to provide government office accommodation to Agency A. The accommodation charges will be recognised as expenses when incurred over the agreement term.

Example B: Occupancy agreement using a Negotiated CAL

Agency B negotiates terms and conditions with PNSW that vary from the standard CAL. The occupancy agreement with PNSW is based on a Negotiated CAL.

A Negotiated CAL may contain a lease in accordance with AASB 16. Agencies can use the format of the assessment in Example A above, to assess negotiated CALs, with modifications where the terms and conditions are varied from the Standard CAL

If the Negotiated CAL meets the criteria of a lease within the scope of AASB 16, Agency B is required to recognise / continue to recognise a Right of Use Assets (RoU) and Lease Liability on their Balance Sheet at the date of commencement of the lease. Further guidance in relation to the application of AASB 16 is available in ‘Guidance for AASB16 Leases’ dated 7 April 2017.

2. Guidelines for Proforma Disclosure as at 30 June 2022

Recommendation

- This guideline provides proforma disclosures for the agencies to refer to when preparing their financial statements for the year ending 30 June 2022. The proforma disclosures relate only to the derecognition of right-of-use assets and lease liabilities for office accommodation arrangements with PNSW, if applicable.

Notes:

1. The proforma disclosures, including note numbers, correspond to the Financial Reporting Code issued by Treasury (*TPG 22-06 Financial Reporting Code for NSW General Government Sector Entities 2021-22*), and should be amended to each agency's financial statement note disclosures.
2. The proforma disclosures only relate to changes in accommodation agreements between agencies and PNSW. They do not replace other disclosures required by AASB 16 or other Accounting Standards.

Proforma disclosure for PNSW occupancy agreement change for the financial year ended 30 June 2022

Primary Financial Statements:

Impact on Statement of Comprehensive Income for the year ended 30 June 2022:

Increase/decrease of Other Gains/(Losses) due to:

- the gain or loss from the derecognition of lease arrangement(s) with PNSW

Impact on Statement of Financial Position as of 30 June 2022:

Derecognition of the net book value of:

- Right-of-use assets (related to PNSW leases only) and
- Lease liabilities (related to PNSW leases only)

Disclosure Notes:

5. Other Gains/(Losses)

	2022 \$'000	2021 \$'000
Derecognition of right-of-use assets and lease liabilities with Property NSW*	X	-
	<u>X</u>	<u>-</u>

* The net gains/(losses) are recognised from the derecognition of the right-of-use asset and lease liability with Property NSW as at 30 June 2022. Please refer to Note 18 for further details on the derecognition.

The net gain/(loss) from the derecognition of right-of-use asset and lease liability as at 30 June 2022 is reconciled as below:

	2022 \$'000
Right-of-use asset	
Gross carrying value	(XX)
Less: accumulated depreciation and accumulated impairment provision	X
Net book value	<u>(XX)</u>
Amortised balance of incentives received	(XX)
Lease liability	XX
Net Gains/(Losses)	<u>XX</u>

18. Leases

a. Entity as a lessee

.....

During financial year ended 30 June 2022, the entity has accepted changes in the office accommodation arrangements with Property NSW (PNSW). The main change is the introduction of the “substitution right” clause, that gives PNSW a right to relocate the entity during the term of the agreement. The clause provides PNSW with a substantive substitution right¹. Therefore, these agreements are not accounted for as a lease within the scope of AASB 16 (*Note: if material, the entity should disclose the judgments made in the process of applying the accounting policy for the new office accommodation arrangements, e.g. The office accommodation agreement with PNSW is no longer accounted for as a lease from 30 June 2022. This involves judgment that the “substitution right” clause in the agreement provides PNSW with a substantive substitution right. Management judgments include an assessment that PNSW can obtain benefits from exercising the substitution right through efficiencies in office accommodation at the whole-of-government level and/or its other service objectives. It is also considered practical for PNSW to exercise the substitution right, due to the non-specialised nature of the relevant office accommodation*). The corresponding right of use assets and lease liabilities have been derecognised on 30 June 2022, the effective date of the new clauses. The net impact of the derecognition is recognised in “Other Gains/(Losses)” (refer to Note 5). From 1 July 2022, the accommodation charges will be recognised as expenses when incurred over the agreement duration.

[Entities to delete if not relevant] The entity continues to be responsible to make good, and to control the fit-out during the remaining occupancy period, as the entity receives the economic benefits through using the fit-out, or through expected compensation from PNSW, if PNSW exercises its right to relocate the entity. Lease incentives received prior to the 30 June 2022 apply to the remaining occupancy period. Therefore, the entity’s accounting treatment for its make-good provisions and fit-out costs in relation to the relevant accommodation remains unchanged². A liability in relation to the amortised balance of incentives received has been recognised as a liability as at 30 June 2022 and will be amortised over the remaining occupancy period³.

¹ The entity must ensure there is no other evidence that could indicate PNSW’s substitution right is not substantive, e.g. the office accommodation has features so unique that it’s impractical for PNSW to substitute it with an alternative.

² This is only applicable to FY21/22. In future years, entities should tailor the policies based on the changed circumstances, e.g. PNSW has issued a relocation notice which includes plans for make-good and fit-out.

³ This is only applicable to FY21/22. In future years, entities should tailor the disclosure, based on changed circumstances, e.g. the amortisation should be accelerated if PNSW has issued a relocation notice.

.....Right-of-use assets under leases

Only the column for the movement of right-of-use assets related to the office accommodation agreements with PNSW is presented for the purpose of this guidance:

	Land and Buildings
	\$'000
Balance at 1 July 2021	XX
Additions	X
Depreciation expense	(X)
Derecognition of right-of-use-asset	(XX)
Balance at 30 June 2022	X⁴

Lease liabilities

Only the column for the movement of lease liabilities related to the year of the change in the office accommodation agreements with PNSW is presented for the purpose of this guidance:

	2022
	\$'000
Balance at 1 July	XX
Additions	X
Interest expenses	X
Payments	(X)
Derecognition of lease liabilities	(XX)
Balance at 30 June	X⁵

Only the column for the breakdown of items recognised in the statement of comprehensive income in respect of leases, where the entity is the lessee related to the year of the change in the office accommodation agreements with PNSW is presented for the purpose of the guidance:

	2022
	\$'000
Depreciation expense of right-of-use assets	X
Interest expense on lease liabilities	X
Expense relating to short-term leases	X
Expense relating to leases of low-value assets	X
Variable lease payments, not included in the measurement of lease liabilities	X
Income from subleasing right-of-use asset	X
Gains or losses arising from sale and leaseback transactions	X
Gains or losses arising from derecognising right-of-use assets and lease liabilities with Property NSW	X
Total amount recognised in the statement of comprehensive income	X

⁴ The closing balance will be zero if the entity only had leases with PNSW.

⁵ The closing balance will be zero if the entity only had leases with PNSW.

25. Current/Non – Current Liabilities – Borrowings

Any impact on Lease Liabilities will impact Borrowings. Entities can simply refer to Note 18 for further details on lease liabilities derecognised as a result of changes in the office accommodation arrangements with PNSW. There is no need to duplicate this information.

Changes in liabilities arising from financing activities

Only the section for the movement related to the year of the change in the office accommodation agreements with PNSW is presented for the purpose of this guidance:

	Bank overdraft	Derivatives	Treasury advances repayable	TCorp borrowing	Other loan and deposits	Leases	Service concession arrangements	Total liabilities from financing activities
1 July 2021	X	X	X	X	X	X	X	X
Cash flows	X	X	X	X	X	X	X	X
New leases						X		
Derecognition of leases						(X)		
New service concession arrangements							X	
Foreign exchange adjustments	X	X	X	X	X	X	X	X
Other	X	X	X	X	X	X	X	X
30 June 2022	X	X	X	X	X	X	X	X

Implication on the financial statement presentation from 1 July 2022

From 1 July 2022, entities should recognise occupancy charges as expenses in “Other Operating Expenses”.

Appendices

TAB	Document Name	Location
A	<i>Standard Client Acceptance Letter</i>	
B	<i>Frequently Asked Questions</i>	

Appendix A: Standard Client Acceptance Letter

(Insert Date)

(Insert Name)

(Insert Position)

(Insert Agency Name)

(Insert Mailing Address)

Dear (Insert First Name)

Client Acceptance Letter – Leased Premises

Transaction: Provision of government office accommodation [or exercise of option or licence for car spaces etc]

Building: (Insert Street Address)

Premises: The part or parts of the building which is/are occupied by the Occupant as shown on the plan(s) attached to the Client Acceptance Letter [or as directed by the Accommodation Provider]

Occupant: (Insert Agency Name)

Cluster: (Insert Cluster Name)

Accommodation Provider: Property & Development NSW (PDNSW)

Accommodation Provider Contact Officer: (Insert Full Name)

We are pleased to confirm your agreement with the Accommodation Provider in relation to the above Premises and kindly ask you to sign and return this Client Acceptance Letter which confirms:

1. The Occupant accepts the financial and commercial terms of the Transaction as set out in the Key Commercial Terms Summary and attached Estimated Financial Commitment Schedule.
2. Further, the Occupant acknowledges the respective Roles and Responsibilities of the parties as set out in the document which is located on the Department of Planning and Environment (DPE) website, link to document included here: <https://www.dpie.nsw.gov.au/housing-and-property/policies-and-guidelines>
3. The Occupant is responsible for any building, technical, consultancy and services reports that may be required to determine the suitability of the Premises [and, where required by the Occupant, for the design, procurement, funding and management of any fit out].
4. If the Occupant does not proceed with the Transaction, it must reimburse the Accommodation Provider for any fees (including legal), costs or other liabilities incurred.
5. The Occupant has the appropriate funding to enter into a binding transaction with the Accommodation Provider to the estimated value of \$(Insert) (including all fees and GST). The attached Estimated Financial Commitment Schedule provides further detail.
6. Disbursements for upfront costs incurred by the Accommodation Provider (such as valuations, market search fees, surveys, design, compliance, legal fees/disbursements, and other costs), if applicable and as estimated in the Estimated Financial Commitment Schedule or as reasonably notified by the Accommodation Provider to the Occupant, will be invoiced to the Occupant once received from the provider.

- 7. The Accommodation Provider’s transaction fee will be invoiced in two stages:
 - a. first tranche, paid on finalisation of the Heads of Agreement/or exercise of option (75%), and
 - b. second tranche paid on execution of transaction documents (25%) by the Accommodation Provider.

(Note: If the transaction is an agency back fill to an existing head lease agreement then there is no PDNSW leasing fee applicable.)

Please do not hesitate to contact the Accommodation Provider Contact Officer with any queries.

Yours sincerely

(Insert Accommodation Provider Contact Officer Name)

(Insert Position)

(Insert Accommodation Provider Name)

T: (Insert Telephone)

E: (Insert Email)

I have appropriate financial delegation and agree to the terms contained in this Client Acceptance Letter

Name -----

Position -----

Signature -----

Date -----

Attachments (delete if not relevant):

Estimated Financial Commitment Schedule

Lease Epitome

Head Lease

Heads of Agreement

Floor Plan

Key Commercial Terms	
Transaction	Provision of government office accommodation [or exercise of option or licence for car spaces etc]
Building	(Insert Street Address)
Building Owner	(Insert Building Owner Name)
Accommodation Provider	Property NSW, operating as Property & Development NSW (PDNSW)
Occupant	(Insert Agency Name)
Cluster Department	(Insert Cluster Name)
Premises	The part or parts of the building which is/are occupied by the Occupant as shown on the plan(s) attached to the Client Acceptance Letter
Net Lettable Area	(Insert Number) sqm
Car Parking	(Insert Number) reserved car space(s)
Permitted Use	Commercial or Government Administration office or any other lawful use
Commencement Date	(Insert Date)
Term	(Insert Number) Years <i>[Unless varied by the Accommodation Provider]</i>
Termination Date	(Insert Date)
Option Term	(Insert Number of Years)
Option Critical Date	(Insert Date)
Commencing Accommodation Charges (Excl. GST)	(\$ (Insert Number) pa) Office: \$xx xxxxx pa [$\$/m^2$] Car Park \$ xx xxx pa [$\$/ bay$] Storage \$xx xxxx pa [$\$/m^2$] Common Facilities \$xx xxxx pa [$\$/m^2$] PNSW Management Fees: \$xx xxxx [2.1% of gross annual charges] Cleaning Charges: \$xx xxx pa [$\$/m^2$] The attached Estimated Financial Commitment Schedule details the inclusive charges.
Review of Accommodation Charges	Components of the Accommodation Charges will be reviewed during the Term by one or more methods, <i>including but not limited to base year increase, fixed percentage, CPI and market review adjustments</i> , as specified in the Head Lease. The Accommodation Charges may also be adjusted subject to a net lettable area survey, if required by the Head Lease.
Incentive	(Type and \$)
Other Payments & Charges	Other ad-hoc charges incurred by the Accommodation Provider in relation to the use of the Premises will be recovered from the Occupant (e.g. after hours air conditioning electricity, special cleaning, service charges, etc.).
Fitout	Fitout is supplied and funded by the Occupant or The Accommodation Provider owns any fitout supplied to the Occupant. Fit out is owned by the Building Owner if it was paid or provided by the Building Owner by way of capital incentive The Occupant must maintain the Fitout in good repair and condition, having regard to the condition of the Fitout at the Commencement Date, subject to reasonable fair wear and tear. Where the fitout is owned by the Occupant, the Accommodation Provider will financially compensate the Occupant for the fitout at the Premises if relocation is initiated by the Accommodation

	Provider, based on the book value of the fitout at the time of the relocation.
Make Good	[In line with the Head Lease, the Occupant is liable for the cost of [make good] or [repair of the premises] or [removal of Occupant property from the land]. (Specify amount if available) or [In line with the Head Lease, the Occupant is not liable for the cost of make good, repair of the premises or removal of Occupant property from the land.] At termination of the agreement and vacation of the property, the Occupant is to leave the premises in a clean and tidy condition.
Relocation**	The Accommodation Provider may, by written notice to the Occupant, require the Occupant to relocate to Alternative Premises at any time during the Term. Relocation will occur within a reasonable period taking account of factors including time for agency consultation, Alternative Premises search, fit out procurement and installation, staff consultation, budget approval and funding, ICT procurement and installation and physical relocation and in consultation with the Occupant and where necessary to effect NSW Government policy and / or a written Ministerial direction.
Alternative Premises**	The Alternative Premises will be determined in accordance with NSW Government policy and / or written Ministerial direction, noting the Accommodation Provider will ensure the Alternative Premises is fit for purpose taking account of considerations including location, building grade, condition and features and functionality of the fit-out at the Alternative Premises.
Relocation Costs **	When managing accommodation for whole of government and proposing a relocation, the Accommodation Provider will work with the Occupant to secure funding for the reasonable costs of relocation including search costs, consultant fees, fit-out costs, ICT costs and physical relocation costs. The Accommodation Provider will financially compensate the Occupant for the fit out at the Premises if relocation is initiated by the Accommodation Provider, based on the book value of the fit out at the time of the relocation.
Relocation Accommodation Charges Review**	Relocation to an Alternative Premises may require a review of the Accommodation Charges from the commencement of the new occupancy. The Accommodation Provider will assist the Occupant to engage with NSW Treasury to address budget variances arising from relocation to the Alternative Premises.
Dispute Resolution	Where the parties cannot agree a matter between them in the ordinary course of their dealings, the matter is to be escalated by issuing a notice in writing to the Accommodation Provider's Deputy Secretary of Property & Development NSW and the Occupant's head of workplace services. The full dispute resolution process is set out in the Roles and Responsibilities document which is located on the Department of Planning and Environment (DPE) website: https://www.dpie.nsw.gov.au/housing-and-property/policies-and-guidelines

Appendix B: Frequently Asked Questions - Transition

Office occupancy agreements with PNSW prior to 30 June 2022 have been accounted for as leases under AASB 16. If an entity opts to accept the Standard CAL as at 30 June 2022, and the new arrangement is assessed not to be in the scope of AASB 16 (please refer to “1. Determining the applicability of AASB 16 to the occupancy agreements with PNSW” section above), accounting adjustments are required to reflect the change. The corresponding right-of-use asset and lease liability will need to be derecognised as at 30 June 2022, and net impact will be recognised as “other gains/(losses)”.

This FAQ provides guidance for the key accounting aspects relevant to the transition.

Please note this FAQ is only applicable to those transitioned to the Standard CAL as at 30 June 2022, where the new arrangement is assessed to be outside the scope of AASB 16.

Is the accumulated impairment provision of the right-of-use asset to be reversed separately or together with the write-off of the right-of-use asset and lease liability?

The accumulated impairment provision of the right-of-use asset should be written off together with related right-of-use asset and lease liability.

A right-of-use asset and corresponding liability was recognised as at 1 July 2019 for each office accommodation agreement with PNSW, upon transitioning to AASB 16. An impairment provision has been recognised for some right-of-use assets since then, due to the decline of market rents.

According to para 114 of AASB 136 *Impairment of Assets*, an impairment loss recognised in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset’s recoverable amount since the last impairment loss was recognised.

PNSW has determined that a material recovery of market rents of office accommodation, has not happened and is not expected, before transition to the Standard CAL on 30 June 2022. Therefore, the impairment loss for the relevant right-of-use assets should not be reversed; instead, the accumulated impairment provision balance should be written off together with the book value of the related right-of-use asset and lease liability. The net impact should be accounted for as the net gain/loss arising from the modification of the CAL of the lease agreement (i.e. derecognition of the right-of-use asset and lease liability) in the income statement.

Is an adjustment needed for the liability related to the entity’s make good provision recognised prior to 30 June 2022?

No. The make-good provision is not affected by the transition. The entity should continue to re-assess the estimated costs in relation to the make good obligation and adjust/unwind the amount where necessary, in the same way as that prior to 30 June 2022.

Under the Standard CAL, the entity is still liable to PNSW for the cost of make good if the obligation exists prior to 30 June 2022. Any potential relocation is at the discretion of PNSW. Therefore, the entity still has an unavoidable present obligation, although it does not have the right to use an identified office accommodation.

Is an adjustment needed for the asset related to the entity’s fit-out/leasehold improvement costs recognised prior to 30 June 2022?

No. The asset is not affected by the transition. The entity should continue to amortise the asset over the duration of remaining occupancy term or its expected remaining useful life, if shorter.

Under the Standard CAL, the entity can continue to use the existing fit-out and benefit from it until any possible relocation; upon a relocation, PNSW will financially compensate the entity for the fitout at the existing premise if the relocation is initiated by PNSW, based on the book value of fitout at the time of relocation.

Therefore, it is considered probable that the entity will be able to receive future economic benefits as at 30 June 2022, via continuous use of the fitout or financial compensation from PNSW.

Is an adjustment needed for the liability related to the incentives received by the entity recognised prior to 30 June 2022?

A liability should be recognised for the unamortised balance as at 30 June 2022 in relation to lease incentives received prior to that date. Entities should continue to amortise the liability over the remaining occupancy period.

Entities may have received lease incentives (rent-free period, rent abatement for part of the agreement duration etc.) prior to 30 June 2022. That amount reduces the total lease payments and therefore effectively reduces the corresponding lease liability and right-of-use asset for the entire lease. Although the occupancy agreement will no longer be accounted for as a lease, occupant entities are still obliged to implement the agreement until the expiry date. Incentive received generally apply to the entire agreement duration, rather than the “lease” period prior to 30 June 2022.

PNSW may “forgive” recovery of the residual value of lease incentives, if it chooses to relocate an occupant entity. However, this is at PNSW’s discretion. Therefore, entities should recognise a liability at the amount of the amortised balance of incentives received as at 30 June 2022 (recognition of this liability contributes to “other gains/(losses)” arising from derecognising the right-use-asset and lease liability), and continue to amortise the balance during the remaining occupancy period until it receives a relocation notice from PNSW. When the entity receives a relocation notice, the amortisation should be accelerated and recognised evenly over the period until the relocation date. The balance of the related liability should have been reduced to zero immediately before the relocation date (please note this is based on the expectation that PNSW will not seek compensation for the residual value from the occupant).

Treasury strongly recommends entities that have received lease incentives prior to 30 June 2022 to acknowledge the existence of a liability related to the incentives in their management representation letters. The suggested wording has been included in the management representation letter template published on the NSW Audit Office website.

Is a provision for an onerous contract required if the contract charges are above current market rates?

Not if service under the contract is still being fully utilised to fulfil the not-for-profit entity’s service objectives. This is because the expected economic benefits from fulfilling the entity’s service objectives exceeds the unavoidable cost of fulfilling the contract.

The occupancy charges were determined based on the market conditions at the time of entering the initial agreements with PNSW. There was no intention of subsidising PNSW or the entity. Subsequently, the market rates for equivalent services may fluctuate and deviate from the charge rates in the agreement.

Para 10 of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* defines an onerous contract as ‘...a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it’. According to para Aus49.1 of the *Framework for the Preparation and Presentation of Financial Statements*, in the context of not-

for-profit entities, future economic benefits is synonymous with the notion of service potential, and is used as a reference also to service potential.

Therefore, contract charges being above the market rates will not usually trigger an onerous contract provision. Entities normally use accommodation services from PNSW in the process of delivering their service objectives. They obtain the economic benefits from the service capacity contributed by the accommodation, regardless the market conditions of equivalent accommodation.

However, an onerous contract for an office accommodation service agreement may arise under other circumstances, e.g.:

- Part or all of the accommodation becomes permanently redundant to the entity and will no longer contribute to the entity's service capacity; or
- The occupant entity is a for-profit entity and there is an impairment loss of the cash generating unit that the cost of the occupancy agreement is attributable to.

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