

# An Introduction to the New Leases Standard



## Your presenters



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2



## Agenda

- 1) Scope
- 2) Lease model: Overview
- 3) Lessee accounting
- 4) Lessor accounting
- 5) Implementation and other issues
- 6) Next Steps

3

## AASB 16 Leases

- Application
  - Annual periods on or after 1 January 2019
  - Can be early adopted if AASB 15 also adopted
- Retrospective application
  - Some exceptions

4

## Scope

Contracts that covers the right to use an asset for a period of time in return for consideration.

- Lease:
  1. Right to use a specified asset; and
  2. During the period of use, the customer:
    - a) Obtains substantially all the benefits from **use** of the asset; and
    - b) Has the right to **direct the use** of the asset

5

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## Scope: Leases or service arrangements

- Use of assets incidental to delivery of service not a lease
  - Use of asset inseparable and non-distinct part of overall service is not a lease
  - Asset has no separate value or can't be used independently from service
  - Eg, many outsourcing arrangements
- Account for lease and non-lease components separately
  - Option to account as whole arrangement as a lease

6

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## Scope: Elections

- Short-term leases
  - Lease term (as defined) < 12 months
  - Class-of-asset election
- Leases of low-value assets
  - Phones, laptops, small equipment, but not cars
  - Lease-by-lease election
- Portfolio approach permitted
  - Similar characteristics
  - Not materially different outcome vs individual lease accounting

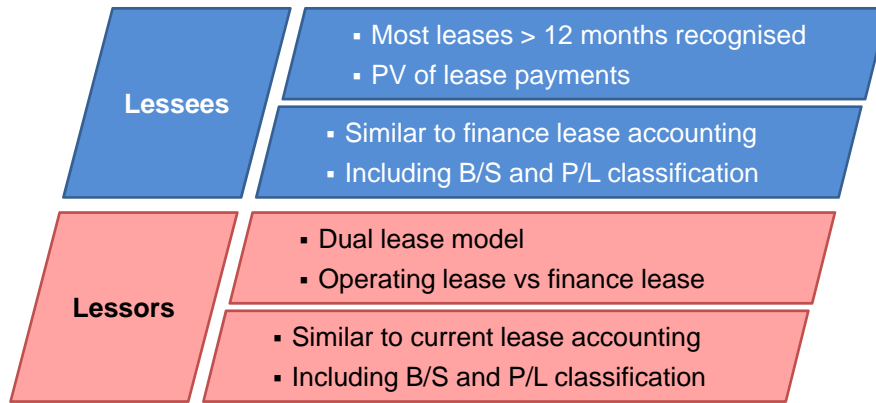
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## Lease Model: Overview

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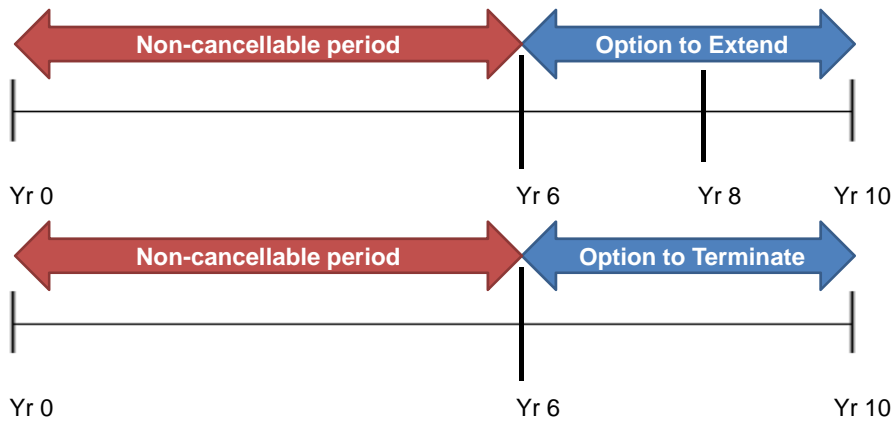
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## Lease term and payments

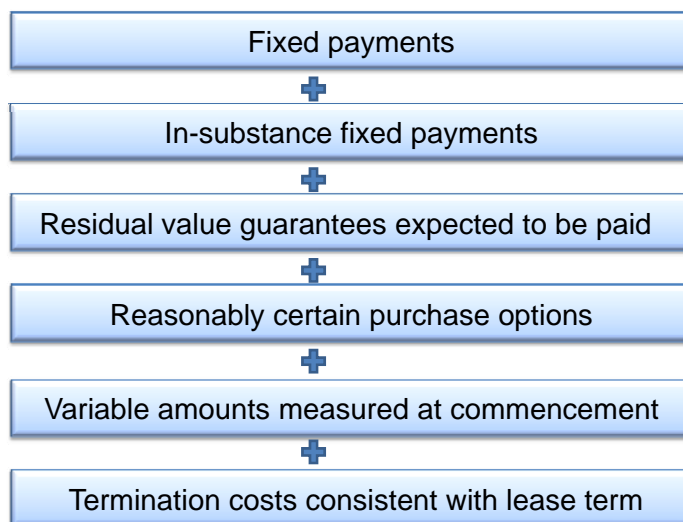
## Lease term



- Nature of asset
- Relocation, restoration, termination costs
- Market factors – eg, market rates
- Significant leasehold improvements

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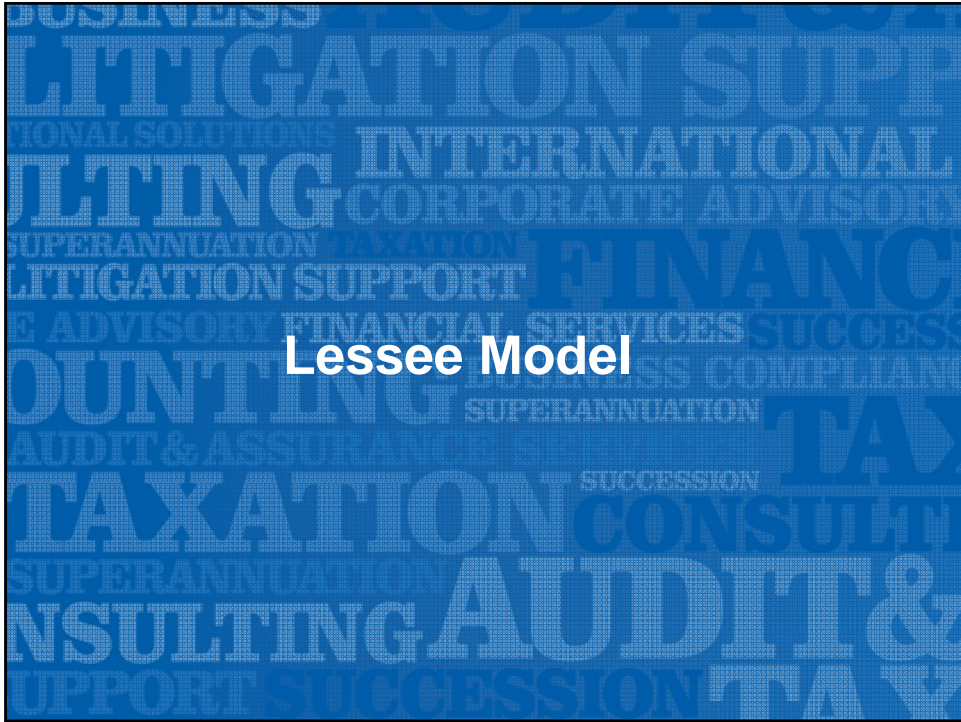
## Lease payments



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## Lessee accounting – initial measurement

- **Lease liability** = Present value of lease payments
  - fixed payments
  - variable amounts measured at commencement
  - in-substance fixed payments
  - residual value guarantees
  - purchase options
  - termination costs
- Discount at the rate charged by lessor or lessee's incremental borrowing rate

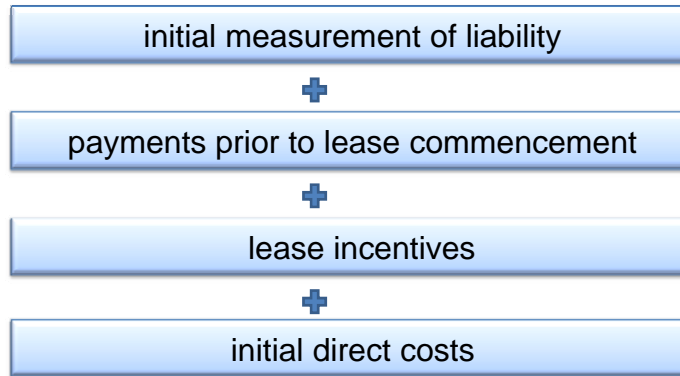
14

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## Lessee accounting – initial measurement

- Right-of-use asset =



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An entity enters into a non-cancellable 7 year equipment lease. There is no renewal option and the lessee's initial direct costs are nil. Lease payments commence at \$20,000 in year 1, increasing annually at 2%. The lessees' incremental borrowing rate is 7.0%.

Yr	Lease Payments \$	Lease Liability - Opening Balance \$	Interest expense \$ (A)	Lease Liability - Closing balance \$	Lease asset amort'n \$ (B)	Total AASB 16 expense \$ (A+B)	AASB 117 lease expense \$
1	20,000	113,862	7,968	101,832	16,266	24,234	21,241
2	20,400	101,832	7,127	88,559	16,266	23,393	21,241
3	20,808	88,559	6,198	73,949	16,266	22,464	21,241
4	21,224	73,949	5,176	57,902	16,266	21,443	21,241
5	21,649	57,902	4,053	40,306	16,266	20,319	21,241
6	22,082	40,306	2,821	21,046	16,266	19,087	21,241
7	22,523	21,046	1,477	0	16,266	17,743	21,241
	<b>\$148,686</b>		<b>\$34,823</b>		<b>\$113,862</b>	<b>\$148,686</b>	<b>\$148,686</b>

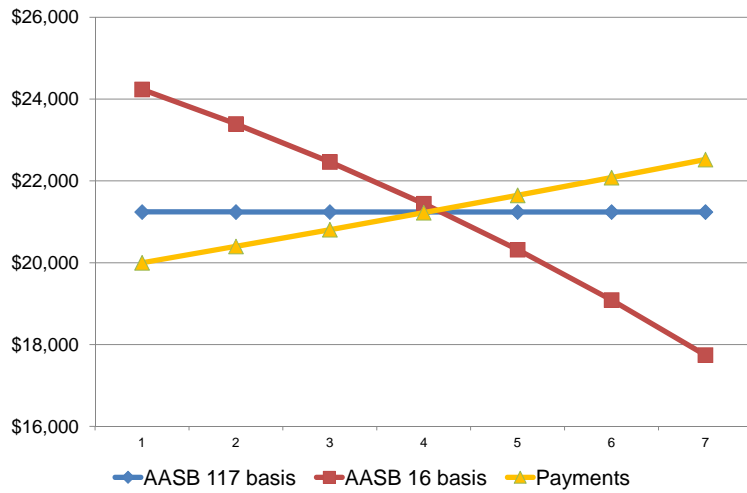
16

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## Lessee expense profile

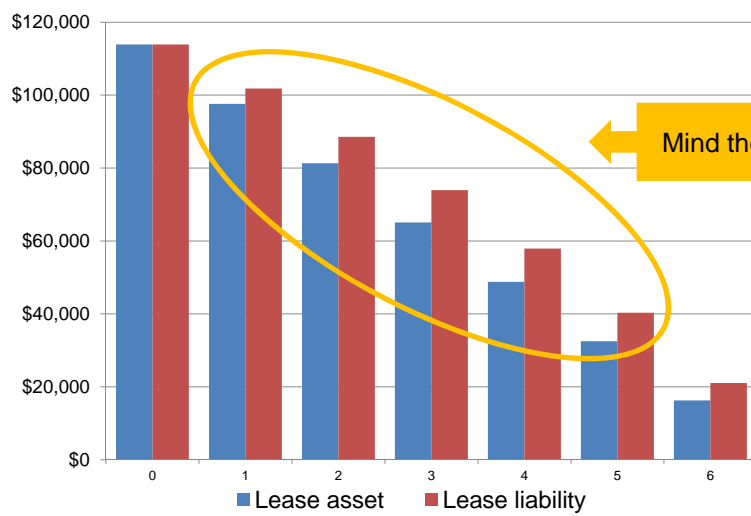


17

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## Impact on balance sheet

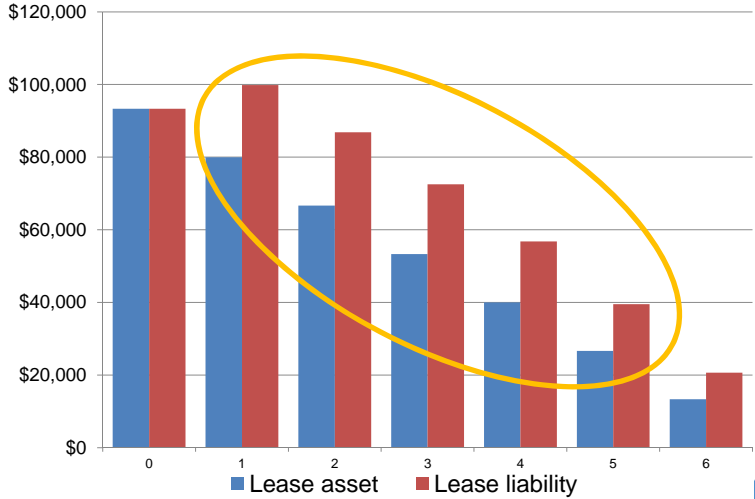


18

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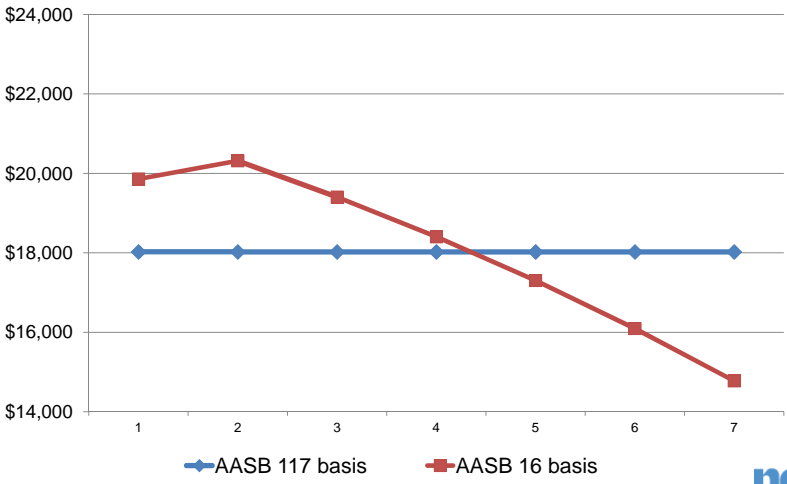


### First year rent-free – balance sheet



19

### First year rent-free – expense profile



20

## Lease remeasurement

Change in assessment of :

- lease term
- purchase option
- future lease payments

**Change to existing lease**

- Remeasure lease liability
- Adjust lease asset

- Change in scope

- Change in assets being leased

**New lease**

21

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## Lease remeasurement - example

- An entity enters into a non-cancellable 10-year equipment lease. There is no renewal option and the lessee's initial direct costs are nil.
- Lease payments commence at \$50,000 in year 1, with a CPI adjustment occurring every three years.
- Assume CPI increase is 2.5% pa
- The lessee's incremental borrowing rate is 7.0%

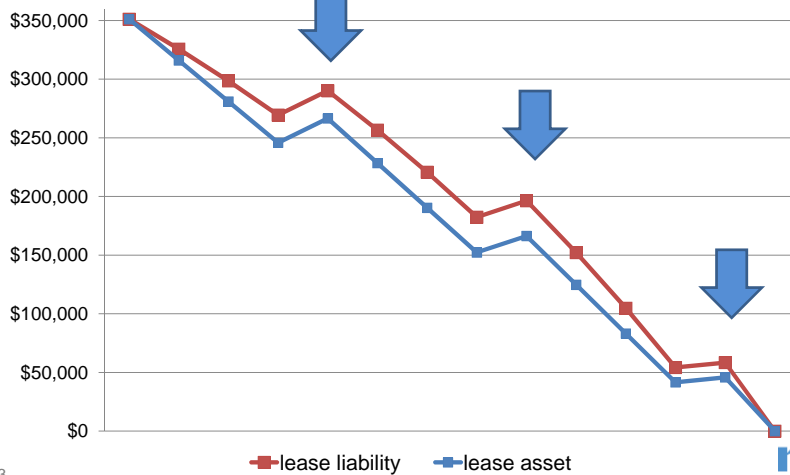
Payments years 1 – 3	\$ 50,000 pa
Payments years 4 – 6	\$ 53,845 pa
Payments years 7-9	\$ 57,985 pa
Payments year 10	\$ 62,443

22

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## Lease remeasurement



23

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## Remeasurements – discount rate

Change to future lease payments caused by:

- amounts payable under residual value guarantees
- change in index or rate, or market reviews

- Use original discount rate

Change in assessment of:

- lease term
- renewal options
- purchase option

- Revise discount rate

24

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## Presentation

- Balance sheet
  - Separately or in the notes
  - Current vs non current classification
- Income Statement
  - Interest and amortisation presented separately
- Cash Flow Statement
  - Principal repayment of liability – financing activity
  - Interest paid – financing /operating per AASB 107
  - Variable lease payments – operating activity

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## Transition and Implementation

## Transition

- 1) Full retrospective; or
- 2) Apply retrospectively from the start of the initial period
  - Measurement of lease liability
  - ROU asset
  - Identifying initial direct costs
  - Short-term leases

27

## Financial statement issues

### Impacts

- EBITDA
- EPS (timing of expense release)
- Ratios
  - ROE
  - Gearing
  - Interest times cover



### Consequences

- Covenants
- Remuneration
- Earn outs / deferred consideration on acquisitions
- Deferred tax

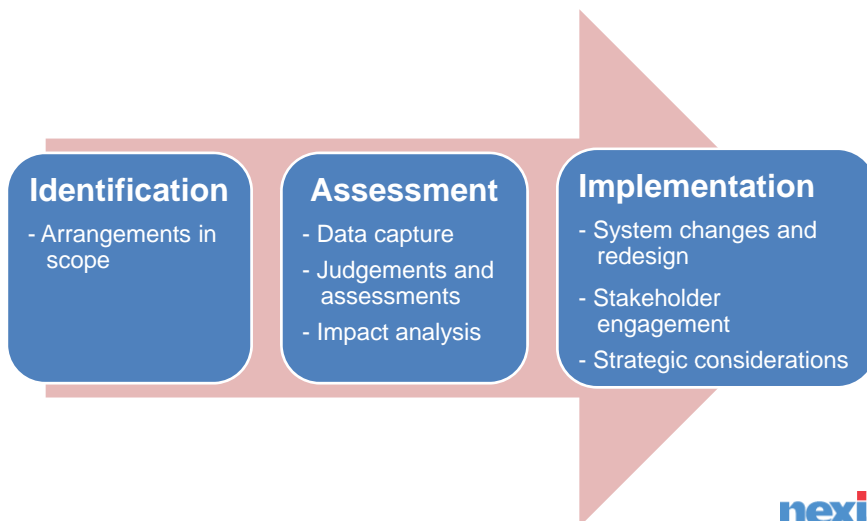
28

## In Summary ....

- Scope
  - Low value
  - Short-term leases
  - Portfolio approach
  - Lease vs service arrangements
- Sale & leaseback arrangements
- Sub-leases
- Disclosure requirements

29

## Next Steps



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**Questions?**

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33

