Guidance document: Leases

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Acronyms	Full form
AASB	Australian Accounting Standards Board
DCDD	The Department of Corporate and Digital Development
FITA	Fiscal Integrity and Transparency Act 2001
FMA	Financial Management Act 1995
GBD	Government business division
GOC	Government owned corporation
GST	Goods and services tax
NT	Northern Territory
NTTC	Northern Territory Treasury Corporation
TAFS	Treasurer's Annual Financial Statements
TEHS	Top End Health Service
TD	Treasurer's Direction

Acknowledgements

This document draws upon and or reproduces information contained in the following publications:

- A guide to AASB 16, June 2016 Deloitte Touché Tohmatsu Limited
- Lease definition, April 2017 KPMG
- 2018-19 Financial Reporting Requirements for Queensland Government Agencies, The State of Queensland (Queensland Treasury) April 2019
- Guidance for AASB 16 Leases 7 April 2017, NSW Government (The Treasury)
- Guide to implementing AASB 16 Leases June 2020 (RMG 110), Department of Finance

Contents

1. Introduction

1.1. Purpose

To provide guidance to assist accountable officers and agencies to adopt and comply with the Australian Accounting Standards Board (AASB) 16 Leases. This document should be read in conjunction with the AASB 16 Leases, Treasurer's Direction (TD) - Leases.

Material in this document is not mandatory. If a conflict arises between this guidance document and TD or other legislative requirements, the legislation takes precedence followed by the TD.

The TD generally designates responsibility to the accountable officer. Unless specifically excluded by the *Financial Management Act 1995* (FMA) or TD, accountable officers may choose to delegate certain responsibilities and functions to agency employees. This can be done through a number of mechanisms, such as accountable officer approved policies, procedures and agency delegations.

Any reference to 'agency' also includes 'government business division' unless specifically excluded.

1.2. Legislative basis and related documents

- FMA
- Australian Accounting Standards
  - AASB 9 Financial Instruments
  - AASB 16 Leases
  - AASB 15 Revenue from Contracts with Customers
  - AASB 1058 Income of Not-for-Profit Entities
- Treasurer's Directions
  - Leases
  - R2.1 Agency Financial Statements
  - R3.1 GBD Financial Statements
- Guidance document – Treasurer's delegations

1.3. Background

The FMA and the *Fiscal Integrity and Transparency Act 2001* (FITA) require the NT's whole of government consolidated financial statements to be prepared in accordance with Australian accounting standards.

The accounting standard AASB 16 is effective from 1 Jul 2019 (application date) for public sector entities and replaces the following:

- AASB 117 Leases
- Interpretation 4 Determining whether an arrangement contains a lease
- Interpretation 115 Operating leases – Incentives
- Interpretation 127 Evaluating the substance of transactions involving the legal form of a lease

Agency annual financial reports and the Treasurer's Annual Financial Statements (TAFS) must comply with the standard from the 2019-20 financial year.

The aim of this standard is to improve transparency by bringing all lease assets and liabilities onto the balance sheet. AASB 16 removes the distinction between operating and finance leases for lessees while the accounting treatment for lessors is largely unaffected.

1.4. Scope exclusions

The following types of arrangements are excluded from the scope of AASB 16 and this guidance document:

- exploration leases for minerals, oils, natural gas
- biological assets
- service concession arrangements
- licences of intellectual property granted by a lessor
- rights held by a lessee under licensing agreements within the scope of AASB 138 *Intangible assets* for example motion picture films, video recordings, plays, manuscripts, patents and copyrights.

2. Lease definition and identification

2.1. Lease definition

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

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be written, oral or implied by an entity's customary business practices.

2.2. Lease identification

At the inception of a contract, agencies must assess whether a contract is or contains a lease. Inception date is the earlier of the date of a lease agreement and the date of commitment by the parties to the terms and conditions of the lease.

Appendix A is a lease decision tree flowchart to assist agencies with determining if a contract contains a lease or not.

It is recommended that each agency's finance unit assess new contracts entered by the agency to determine if it meets the definition of a lease.

Key aspects of lease definition are that:

- the asset must be specifically identified
- and the lease must convey the right to control the use of that identified asset for a period of time.

To assess whether a contract conveys the right to control, an agency lessee must consider whether they satisfy both criteria listed below:

- the agency has the right to obtain the economic benefits from use of the identified asset
- and the right to direct the use of the identified asset.

Appendix B is a flowchart that provides an overview of what is accounted for as a lease and how each party should account for a lease.

The table below provides examples to assist agencies in conducting an assessment to determine if an arrangement contains a lease or not and must be read in conjunction with Appendix A.

Questions	Considerations	Examples
Is there an identified asset within the contract?	Is an asset specified explicitly or implicitly in the contract?	explicit - registration or chassis number of car implicit - lessor owns a fleet of vessels but only one available vessel is in the required geographic area of the lessee
	Is an asset physically distinct?	- a floor of a building - a distinct segment of a pipeline - a storage room - specific parking bay
	Does the lessee have the right to receive substantially all of the capacity of the asset?	- capacity portion of a data storage that is not physically distinct but represents substantially all of the capacity of the storage
	Does the lessor not have substantive substitution rights over an asset? Lessor's right to substitute is substantive only if both of the following conditions are met: - practical ability to substitute alternative assets throughout the period of use (for example, the lessee cannot prevent the lessor from substituting the asset and alternative assets are readily available) - lessor would benefit economically from exercising its right to substitute the asset (for example, economic benefit will exceed the costs associated with substituting the asset)	The following are not considered as substantive substitution rights: - lessor's right or obligation to substitute the asset for repair and maintenance or due to a technical upgrade - substitution right that applies only to a part of a period of use or on or after a specific date or occurrence of a particular event (for example, lessor has right to substitute the asset at any time after three years from the commencement of the contract) - cost to the lessor to exercise of the right to substitute exceeds the economic benefit (for example, lessor is required to pay the cost to relocate a tenant)
Does the lessee obtain substantially all of the economic benefits?	Does the lessee have exclusive use of the asset throughout the period?	- full access to the office building - exclusive use of car parking - exclusive use of car
	Does the lessee have the right to sub-lease the asset?	- sublease of the ground floor of an leased office building to another party
Who has the right to direct the use of the asset – who makes the 'how and for what purpose' decisions?	**What:** rights to change the type of output that is produced by the asset	Deciding whether to use a shipping container to transport goods or for storage
	When: rights to change when the output is produced	Deciding when a power plant will be used or when to access the office

Questions	Considerations	Examples
		building without any restriction from lessor
	Where: rights to change where the output is produced	Deciding on the destination of a truck, car or a ship
	Whether and how much: rights to change whether the output is produced, and the quantity of that output	Deciding whether to produce energy from a power plant and how much energy

Example 1
Agency A enters into an arrangement with company Z for the right to store items in a storage warehouse in Winnellie. Within this storage warehouse, rooms 1, 2, 3 are contractually allocated to agency A for its exclusive use. Agency A has discretion on how and what the rooms will be used for. Company Z has no substitution rights. Rooms 1, 2 and 3 represent 60 per cent of the warehouse's total storage capacity. Analysis: **Is there an identified asset within the contract?** ✓ Yes due to the following: • the rooms are explicitly specified in the contract • the rooms are physically distinct from the other storage locations within the warehouse • Company Z has no substitution rights **Does the lessee obtain substantially all of the economic benefits?** ✓ Yes, agency A has exclusive use of storage rooms 1, 2 and 3. **Who has the right to direct the use of asset – who takes the 'how and for what purpose' decisions?** ✓ Agency A (lessee) has the right to decide on how and for what purpose the rooms will be used for. Conclusion: The contract is a lease.

2.3. Separating components of a contract

Agencies must separate lease and non-lease components (for example, service fees, maintenance, security, maintenance of common areas) within a contract and account for these separately. The single lease practical expedient, which combines the lease and non-lease component, should only be used when the non-lease component is considered immaterial to the lease. This ensures the right-of-use (ROU) asset and lease liability are not inflated.

Agencies are to allocate the consideration in the contract to lease and non-lease components on the basis of their stand-alone selling prices. The stand-alone prices for the lease versus non-lease components might not be readily apparent and agencies may have to obtain information from the lessor, or use an estimate maximising the use of observable information, for example, the price charged by other suppliers or the price charged by the supplier to other customers.

In some instances, it may be difficult to ascertain the standalone price for communal spaces and services and significant judgement may be required. Where the agency anticipates the non-lease components are immaterial compared to the total value of the contract, agencies may elect not to separate the lease from non-lease component. Agencies must document the judgements made in the assessment process.

Conversely, service contracts must be assessed to identify any embedded lease element that should be accounted for under AASB 16 and TD - Leases.

Example 2
An agency enters into an agreement to lease medical equipment which includes a repairs and maintenance service for 5 years. The agency must allocate the cost of the contract between the lease of medical equipment (lease component) and the repairs and maintenance (non-lease component). The lease of medical equipment must be accounted for under AASB 16 and TD - Leases while the repairs and maintenance must be accounted for as expense when incurred.

2.4. Lease exclusions

An agency lessee must not recognise leases in the statement of financial position and expense directly in the comprehensive operating statement as a lease payment over the lease term, the following lease arrangements:

- inter-governmental leases
- short term leases
- leases of low-value assets
- leases of other intangible assets

2.4.1. Inter-governmental leases

Agencies do not have to record a lease in the statement of financial position where it is an arrangement between two NT Government agencies or consolidated entities in the general government sector. This exemption is provided to simplify accounting and reporting requirements for agencies within the same reporting sector of government and avoid overstating the statement of financial position at whole-of-government level where both the lessor and lessee agencies recognise assets and liabilities.

However, Government business divisions (GBD) are not permitted to apply this exemption.

The list of agencies that comprise the general government sector can be sourced from Budget Paper No. 2 Budget Strategy and Outlook. GBD's are identified in the Treasurer's Revocation of Determination and Determination of Government Business Divisions.

Example 3
Territory Wildlife Parks (TWP) leases motor vehicles from NT Fleet for a period of 5 years. This is an inter-governmental leases, however, TWP is a GBD and in accordance with the TD – Leases, cannot apply the inter-governmental lease exemption. As such, TWP must recognise the right of use asset and lease liability in the statement of financial position.

2.4.2. Short term lease

Agencies must not record lease arrangements with a lease term of 12 months or less with no purchase option. Where the arrangement is less than 12 months but with option to purchase, then exemption is not applicable thus lease is to be recognised in the balance sheet.

Application of this exemption is on a class-by-class basis. Agencies must apply this exemption to all class of right-of-use asset in accordance with the TD - Leases.

An agency lessee must assess the effect of an extension and termination option when assessing the lease term.

This exemption is also available for high-value assets that are leased for a short term.

2.4.3. Lease of low-value assets

Agencies must not record leased assets with a value of $10 000 or less, which are not subject to a sublease arrangement. Application of this exemption is on a lease-by-lease basis. Agencies must apply this exemption to all leases in accordance with the TD - Leases.

The low value threshold of $10 000 is based on the individual asset value when new regardless of the age of the asset being leased. For example, a lease of a car would not qualify as lease of low-value asset as a new car would typically cost more than $10 000.

Examples of low-value assets include personal computers, tablets, telephones, small items of office furniture and others.

A leased asset is low value only if the lessee can benefit from the use of the asset on its own or together with other resources that are readily available to the lessee and is not highly dependent on or highly interrelated with, other assets.

Example 4
A hospital enters into a rental contract for a large number of hospital beds. Each bed within the contract constitutes an identified underlying asset and the other conditions for identification of a lease are met. The value of an individual hospital bed would be considered 'low', even though the contract for all of the beds is not. The hospital can benefit from the use of an individual bed together with other resources that are already available, and each individual bed does not need other assets to make it functional for patients. Consequently, each bed qualifies as a low-value asset and the entity can elect to apply the low-value asset exemption to all of the beds under the contract.

2.4.4. Lease of other intangible assets

Agencies must not apply the requirements of AASB 16 and TD – Leases to a lease of intangible assets such as computer software programs. This is addition to intangible assets excluded from the scope of AASB 16 Leases detailed in section 1.4 Scope exclusions.

Agencies should continue to expense software programs with a "licence to use". A licence to use is a licence that permits the buyer to use the software for a specific term provided in the licence agreement.

Agencies must capitalise costs for software programs acquired as a "licence to own" if costs are more than $10 000. A licence to own is a licence that permits the buyer to use the software for as long as desired.

3. Lease term

A lease term is the non-cancellable period for which a lessee has the right to use an underlying asset, including:

a. periods covered by an option to extend the lease, if the lessee is reasonably certain to exercise that option and can enforce the extension without the agreement of the lessor

b. and periods covered by an option to terminate the lease, if the lessee is reasonably certain not to exercise that option or the termination option is controlled by the lessor.

A lease term begins at the commencement date and includes any rent-free periods provided.

Commencement date is the date on which the lessor makes an underlying asset available for use to a lessee. A flow chart to assist agencies determine a lease term is available at Appendix C.

Example 5
Agency enters into a 3 year lease of a building with a 2 year extension option. The agency can cancel the lease at any time without penalty by giving 12 months' notice. Analysis: • The minimum non-cancellable period is 12 months. • The agency must assess whether it is reasonably certain to not terminate the lease before the 3 year lease term is up. The agency determines that it is reasonably certain it will lease the building for the full 3 years, thus it adds 2 years to the non-cancellable lease term, bringing the lease term to 3 years. • The agency then assesses whether it is reasonably certain to exercise the 2 year extension option. It determines that it is reasonably certain to exercise this option, so the lease term is 5 years.

3.1. Indefinite lease term

Some leases may have an indefinite lease term and continue on an ongoing basis in perpetuity until a party terminates the arrangement. For such leases, agencies must consider the following to determine whether a lease in perpetuity exists:

- Agencies should first consider if, notwithstanding the absence of a specified term, there is an implied lease term (or other reliable estimated time period over which they are reasonably certain to lease the asset) that may be appropriate to use as the lease term.
- For assets with finite useful lives, such as buildings, the lease term cannot exceed the economic life of the asset itself.
- For leases of land which has an infinite life, the agency should assess whether it is reasonably certain the land will be leased indefinitely or assign a term based on other similar arrangements the agency may currently have in place which have a finite term.

Agencies must also consider any legislations or regulations the lease arrangement is subject to.

For example, for perpetual leases on Aboriginal land subject to *Aboriginal Land Rights (Northern Territory) Act 1976*, the Act mandates that the maximum term of lease is no more than 99 years. Thus, for this type of arrangement, agency must assign 99 years as the lease term.

Where unsure, the agency may consult with DTF to confirm the proposed lease term adopted and subsequent accounting treatment of the lease. Agencies should refer to section 7.2.9 Long term lease of Aboriginal land.

3.2. Reassessment of lease term

A reassessment of lease term needs to occur, if a significant event or change in circumstances that is within the control of the lessee occurs, and affects the initial assessment of "reasonably certain" criteria.

Examples of significant events or changes which may trigger a reassessment of a lease term include:

- significant leasehold improvements not anticipated at the commencement date that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable
- a significant modification to, or customisation of, the underlying asset that was not anticipated at the commencement date
- the inception of a sublease of the underlying asset for a period beyond the end of the previously determined lease term
- a business decision of the lessee that is directly relevant to exercising, or not exercising, an option (for example, a decision to extend the lease of a complementary asset, to dispose of an alternative asset or to dispose of a business unit within which the ROU asset is employed).

3.3. Revision of lease term

Agencies should revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if one of the following occurs:

- the lessee exercises an option not previously included in the agency's determination of the lease term
- the lessee does not exercise an option previously included in the agency's determination of the lease term
- an event occurs that contractually obliges the lessee to exercise an option not previously included in the agency's determination of the lease term
- or an event occurs that contractually prohibits the lessee from exercising an option previously included in the agency's determination of the lease term

Where a lease term is revised, an agency will need to remeasure its lease liability. Refer to section 7.2.5 Remeasurement on how to remeasure a lease liability.

4. Assessment of options

At the commencement date, agencies shall assess whether the lessee is reasonably certain to exercise any option to extend, terminate or purchase the underlying asset.

In making these assessments, agencies shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option.

Example of factors to consider when making these assessments include, but are not limited to:

- contractual terms and conditions for the optional periods compared with market rates, such as:
    - the amount of payments for the lease in any optional period (significant increase or decrease on rent charges)
    - the amount of any variable payments for the lease or other contingent payments, such as payments resulting from termination penalties and residual value guarantees

- o and the terms and conditions of any options that are exercisable after initial optional periods (for example, a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).

- significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable
- costs relating to the termination of the lease, such as:
  - o negotiation costs
  - o relocation costs
  - o costs of identifying another underlying asset suitable for the lessee's needs
  - o costs of integrating a new asset into the lessee's operations and
  - o termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location.
- the importance of that underlying asset to the lessee's operations (for example, whether the underlying asset is a specialised asset, the location of the underlying asset and the availability of suitable alternatives)
- conditionality associated with exercising the option (such as when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist
- other factors such as time limited funding or program related to the lease arrangement, change in the agency requirement (such as size, location, technological obsolescence).

Example 6
Agency A has signed a contract to lease a building for a non-cancellable period of five years. The arrangement also provides an option for agency A to renew the lease for a further two years at market rates. Agency A has undertaken expensive modifications to the building and these modifications are expected to have a useful economic life of 10 years. At the commencement date, agency A would be reasonably certain it will exercise the option to renew the lease term, as the leasehold improvements would still have significant value at the end of five years. Therefore, the lease term in this case would be seven years.

If both the lessee and the lessor have termination options, the lease is <u>no longer enforceable</u> when either the lessee or lessor without permission from the other party with no significant penalty can terminate the lease. On this scenario, agency should not recognise it as expense in the profit and loss statement.

The assessment of whether a contract has no significant penalty should include what is explicitly stated in the contract (for example early termination fee) as well as other kinds of economic penalties (for example remote locality of leased building, absence of alternative lease option, specialised nature of leasehold improvement) that may not be included in the contract.

Example 7
Agency B leases an office space with a non-cancellable period of 3 years and an option to extend for 2 years. The lease contract contain the clause below:

Example 7

"If the Tenant of the office continues to occupy the space after the Expiry Date (5 years after the commencement of the lease) with the Landlord's approval it does so under a monthly tenancy. Either party may terminate by giving one month's notice."

Agency B has installed highly specialised costly non-removable equipment in the office space which has a useful life of 15 years.

Analysis

The lease term of an arrangement depends on whether the arrangement is enforceable. Under AASB 16, a lease is not enforceable when both the lessee and the lessor have the right to terminate the lease without incurring more than an insignificant penalty.

Agency B must consider the economic penalty it will incur if it terminates the arrangement at the end of the 5 years as it would incur additional cost to purchase new equipment. In this case, the enforceable period of the contract could be viewed as 15 years (the useful life of the specialised equipment).

In assessing the lease term, agency B expects there will be a more technologically advanced equipment available in 10 years' time. In this case, it may be argued it is reasonably certain based on facts and circumstances at commencement date of the lease that the lessee will exercise the option to terminate the lease after 10 years.

A flowchart to assist agencies with determining a lease term is available at Appendix C.

5. Risk management

A sound risk management strategy provides a framework to identify, analyse, evaluate, and respond to risks, such as those arising from lease arrangements.

Risk is defined as any uncertain future situation or event, which could influence the achievement of the Territory's or the agency's objectives or realisation of opportunities.

The FMA requires accountable officers to establish and maintain appropriate procedures that, at all times, afford proper internal control. Use of systematic risk management methodologies can assist an agency in assessing the level and nature of its exposure to risks from lease arrangements, to ensure appropriate resources can be allocated to mitigate or minimise significant risks and evaluate the effectiveness of its risk control measures.

To recognise the potential interdependencies between different risks, it is important that risk assessments for lease arrangements are considered in the broader context of agency-wide strategic planning and risk assessment.

5.1. Risk assessment

5.1.1. Risk review

Agencies are responsible for determining the risk assessment approach most appropriate for their circumstances. To minimise the NT Government's exposure to risk, lease arrangements must not be entered unless:

- the risks assumed by the NT Government are acceptable given the objectives, scope and benefits of the lease arrangement, that is, the expected benefits objectively outweigh the level and cost of the risks
- and the risks do not present unacceptable risk exposure to the NT Government.

Agencies shall also consider the costs and rewards of buying an asset versus the costs and rewards of leasing an asset when deciding the most appropriate means of obtaining the use of an asset. The choice between these alternatives is commonly referred to as the 'buy versus lease decision'.

Taking into consideration the relative value of the asset being purchased/leased, it is best practice for agencies at a minimum, to consider the following when assessing the buy versus lease decision:

- the total cost to the NT Government over the life of the asset, taking into account such things as lease/purchase costs, installation or disposal costs and future costs (at present value)
- a direct comparison of the Territory's average cost of borrowing versus the cost of financing (interest rate implicit in the lease) from the external entity
- an assessment of other risks and rewards either to or from the agency or the Territory
- and other asset or lease specific factors that are relevant to the decision.

An agency's decision to lease agency assets to other entities under a finance lease arrangement must be made in the best interests of the Territory after considering the following:

a. is a lease arrangement the most efficient use of that asset where an asset is not required to produce outputs
b. that the leasing of assets is not generally part of an agency's core business (requires additional resources and specialist skills)
c. and the full implications of lending (for example, risk of non-payment).

5.1.2. Legal advice

Agencies must use best judgement to determine if and when (for example, during contract negotiations and risk assessments), to engage legal advisors and or the level of legal consultation required for a particular lease arrangement.

Where legal advisors are engaged, the review process may help inform an agency's decision on whether to proceed with entering into a lease arrangement.

5.2. Monitoring and evaluation

Risk management is a continuous process, rather than an activity conducted at a point in time. It demands proactive action on the part of management to continually update their understanding of risk and to develop effective solutions to manage the risk.

Prudent risk management will necessitate agencies establishing and maintaining appropriate risk identification, management, and mitigation strategies arising from the lease arrangement. It is up to the agency to determine what processes are considered appropriate. These processes must include the following at a minimum:

- transparency in the evaluation and decision making process (such as buy or lease decision, exercising options available)
- managing the ongoing risks associated with the lease arrangement, including evaluating risks and documenting the outcome of the review at least once every financial year

Where there is an increased level of risk associated with a lease arrangement, accountable officers must ensure that risks are investigated further and appropriate action is taken to reduce the risk to an acceptable level within a reasonable timeframe.

6. Accounting by lessor

Where an agency is the lessor, it must classify each of its lease agreements as either a finance or operating lease.

Lease classification is determined at the inception date and reassessed only if there is a lease modification.

Examples of lease modification, which trigger the reassessment of a lease classification, include:

- adding or terminating the right to use one or more underlying assets
- or extending or shortening the contractual lease term that were not part of the original terms and conditions of the lease.

Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the underlying assets), or changes in circumstances (for example, default by the lessee), do not trigger a lease reclassification.

6.1. Types of leases

6.1.1. Finance Leases

Finance leases are leases that transfer substantially all the risks and rewards incidental to ownership of the leased asset to the lessee. The lessor is in effect providing finance for the purchase of an asset by the lessee.

Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of profitable operation over the underlying asset's economic life or gain from appreciation in value or realisation of a residual value.

Examples of situations that individually or in combination would normally make an arrangement a finance lease include:

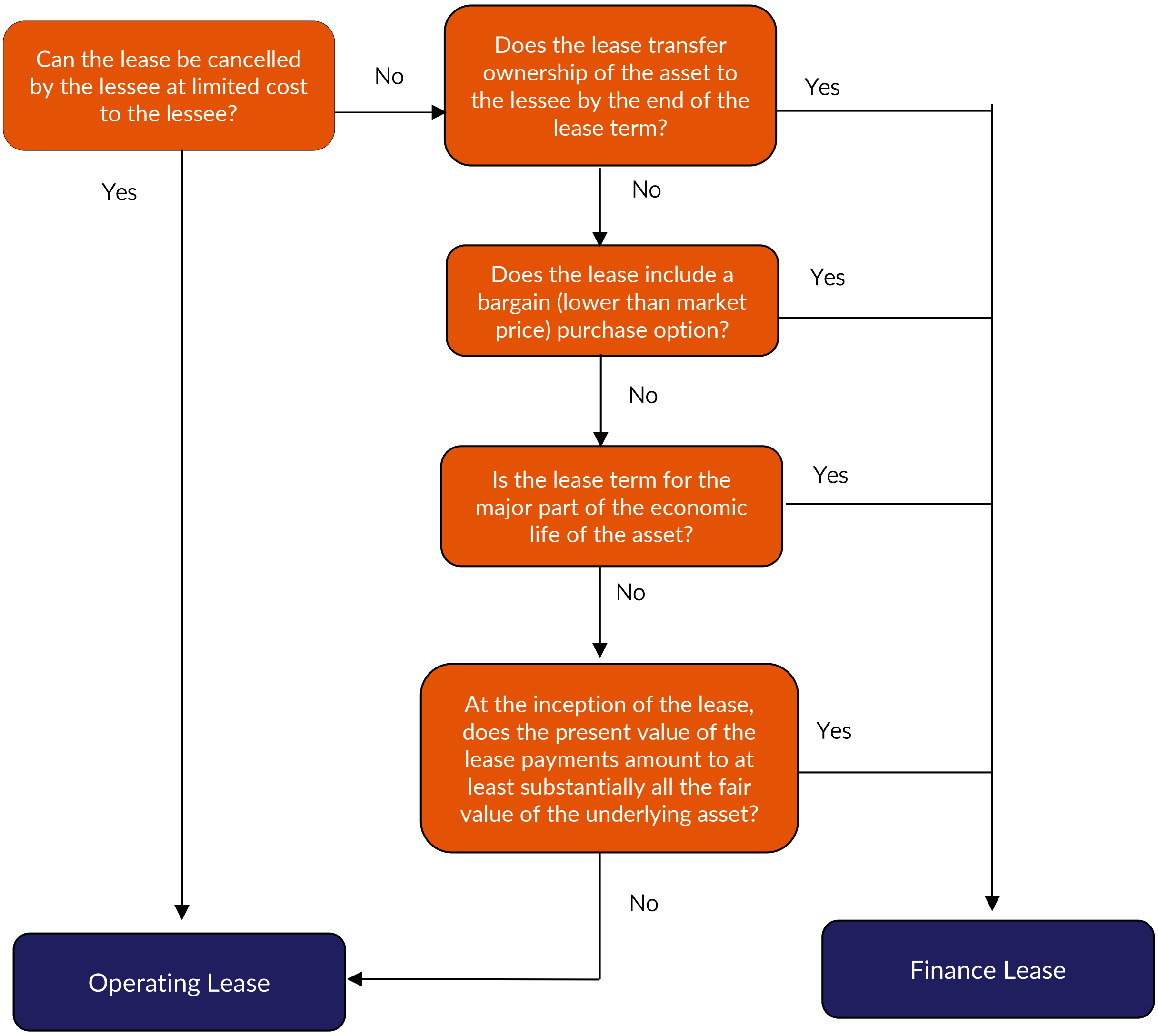
- the ownership of the asset is transferred to the lessee by the end of the lease term
- the purchase option price is sufficiently lower than the fair value at the asset at the exercise date (bargain purchase option)
- the lease term is for the major part of the economic life of the leased asset even if title is not transferred

- at the inception date, the present value of the lease payments amount to at least substantially all the fair value of the leased asset
- and the leased asset is of such a highly specialised nature that only the lessee can use it without major modifications.

Indicators that individually or in combination could also lead to a lease being classified as a finance lease are:

- if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
- gains or losses from the fluctuation in the fair value of the residual asset accrue to the lessee (for example, in the form of a rebate equalling most of the sales proceeds at the end of the lease)
- the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

The flowchart below illustrates what should be considered by a lessor when choosing to classify a lease as a finance or operating lease.



6.1.1.1. Finance lease initial measurement

At the commencement date, an agency lessor shall:

- recognise a receivable equal to the net investment in the lease
- derecognise the underlying assets
- recognise any gain or loss for the difference between the receivable and carrying amount of the underlying assets

Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease. The gross investment in the lease is the sum of lease payments receivable over the lease term plus any unguaranteed residual value accruing to the lessor.

6.1.1.2. Finance lease subsequent measurement:

An agency must recognise lease interest income and a reduction to the lease receivable equivalent to the lease receipt over the lease term, at a minimum annually.

An agency must ensure that at each reporting date:

- lease receivables are assessed for impairment and the outcome documented
- and where applicable, impairment losses are measured and recognised

Appendix D: Illustrative examples includes an example of how a lessor may account for a finance lease arrangement.

6.1.2. Operating Leases

Operating leases are leases that do not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Agency lessors must recognise lease payments from operating leases as income in the comprehensive operating statement on a straight-line basis over the lease term, unless another systematic basis is more representative.

Appendix D: Illustrative examples includes an example of how a lessor may account for an operating lease arrangement.

6.2. Approval process

Lease arrangements classified as a finance lease, is a form of lending and can only be approved in accordance with section 31 of the FMA by either:

- the Treasurer
- or a delegate authorised by section 39(1) of the FMA.

An accountable officer is a delegate authorised by section 39(1) of the FMA and may approve finance lease arrangements when all of the following criteria are met:

a. leasing the asset is the most appropriate course of action
b. the total lease receivables per contract is assessed as having a value of less than $500 000 (GST exclusive)
c. and the lease arrangement is within the accountable officer's area of responsibility.

For lease arrangements classified as operating lease, agency should refer to their internal delegation for approval process.

6.3. Sublease arrangement

Subleases are arrangements where the underlying asset is re-leased by a lessee (intermediate lessor) to another party, and the lease (head lease) between the head lessor and original lessee remains in effect.

Agencies must only account for a sublease arrangement where all the following criteria are met:

a. the sublease is to a party external to government or a government owned corporation (GOC)
b. the subleased asset is material in proportion to the entire asset
c. and is not a peppercorn lease (lease with nominal rent such as $1 per annum).

For a GBD, a sublease includes arrangements with Northern Territory Government agencies or consolidated entities in the general government sector.

An agency intermediate lessor must classify subleases as a finance lease if:

a. the lease term is more than 12 months and forms majority of the expected term of the ROU asset under the head lease arrangement
b. and is assessed and deemed as material by the accountable officer.

Where criteria discussed above is not met, the sublease must be classified as an operating lease.

The accounting treatment for a sublease arrangement depends on the classification assigned by the intermediate lessor. The table below summarises the accounting treatment for a sublease classified as a finance lease or operating lease by an intermediate lessor.

Type of sublease arrangement	Accounting treatment
Finance leases	- Derecognise the ROU assets and recognise a lease receivable equal to the net investment in the sub-lease. - Recognise the difference between the ROU assets and lease receivable as a gain or loss in the income statement. - Retain the previously recognised lease liability in capacity as lessee, and recognise interest expense thereon. - Recognise interest income on the lease receivable in capacity as intermediate finance lessor.
Operating leases	- Retain the ROU asset in capacity as lessee, and continue to recognise depreciation thereon. - Retain the lease liability in capacity as lessee, and continue to recognise interest expense thereon. - Recognise lease income from the sub-lease in capacity as intermediate operating lessor.

Appendix D: Illustrative examples includes an example of how a sublease arrangement is accounted for.

7. Accounting by lessee

7.1. Approval process

Lease arrangements, with the exception of arrangements addressed in section 2.4 Lease exclusions, are deemed as a form of borrowing and can only be approved in accordance with section 32 of the FMA by either:

a. the Treasurer
b. or a delegate authorised by section 39 of the FMA.

An accountable officer is a delegate authorised by section 39(1) of the FMA and may approve lease arrangements when all of the following criteria are met:

a. leasing the asset is the most appropriate course of action
b. the total lease liability per contract is assessed as having a value of less than $500 000 (GST exclusive)

c. and is within the accountable officer's area of responsibility

The table below outlines accountable officers with unlimited delegation for particular lease arrangement subject to conditions imposed by the TD – Leases.

Accountable Officers	Lease arrangement
Department of Corporate and Digital Development	Lease of commercial property (such as office accommodation) or Aboriginal land including those entered into on behalf of NT Government agencies
Department of Environment, Parks and Water Security	Lease of Aboriginal land for national parks
Department of Territory Families, Housing and Communities	Lease of public or government employee housing and land used for those purposes

7.2. Recognition and measurement

At the commencement date, agency lessees shall recognise a ROU asset and a lease liability in the statement of financial position.

For lease arrangements excluded under section 2.4 Lease exclusions, an agency must account for the lease payments as an expense on either a straight-line basis over the lease term or on another systematic basis if that basis is more representative of the pattern of the lessee's benefit.

Appendix D: Illustrative examples includes an example of how a lessee accounts for a lease arrangement for low value assets.

7.2.1. Accounting for ROU asset

The table below illustrates the accounting treatment of a lessee for a ROU asset.

Stages	Accounting treatment
Initial measurement	ROU asset are measured at cost on initial recognition. Cost include: - initial measurement of the lease liability - plus any prepayments less any lease incentives received - plus any initial direct costs incurred by the lessee (for example commissions, legal fees and incremental internal costs) - plus estimate of costs to be incurred by dismantling/removing the underlying asset
Subsequent measurement	ROU assets are amortised as follows: • over the lease term • or over the useful life of the underlying asset if ownership transfers to the lessee at the end of the lease term or it is reasonably certain that the lessee will exercise a purchase option On subsequent measurement, agencies must measure ROU asset at fair value using the cost approach valuation techniques where the fair value approximates cost unless another valuation technique is deemed appropriate.

Stages	Accounting treatment
	The cost approach valuation technique is appropriate for lease arrangements where market rent is paid. ROU asset must be assessed for impairment annually adjusted for any remeasurement of the lease liability due to changes in lease payments. **Exception**: Lease arrangements with significantly below market terms and conditions (such as peppercorn leases) must be measured at cost instead of fair value. Refer to section 7.2.8 Peppercorn or concessionary leases.

7.2.2. Accounting for a lease liability

The table below illustrates the accounting treatment of a lessee for a lease liability.

Stages	Accounting treatment
Initial measurement	Lease liability are measured at the present value of unpaid lease payments over the lease term on initial recognition. Lease payments include: - fixed payments (including rent escalation that provide for a fixed percentage or dollar increase) less lease incentives receivable - variable lease payments that depend on an index or rate[1] - expected residual value guarantee - option payment (purchase or termination) if reasonably certain
Subsequent measurement	Initial value of lease liability (above): - increased by interest on the lease liability - reduced by lease payments made and adjusted for remeasurement to reflect any reassessment or lease modifications (such as changes in lease term, options, change in expected residual value guarantee, change in future lease payments due to change in index or market rate)

[1]For variable lease payments that depend on an index or market rate:

- Rent escalation clauses that depend on a future index or rate (for example, consumer price index or market rental) are only included in the initial measurement of a lease liability if there is a change in cash flows. Agencies should not attempt to estimate/predict future variable increases as such should assume no change until the change occurs.
- Variable lease payments linked to future performance such as lease payments based on percentage of sales or use of an underlying asset such as additional payment if a leased vehicle exceeds a specified mileage are excluded from the initial measurement of the lease liability.

7.2.3. Discount rate

The lease payments must be discounted using the interest rate implicit in the lease arrangement. This interest rate is used to calculate the value of the leased asset and liabilities.

If the interest rate is not implicitly stated in the lease agreement or otherwise provided by the lessor, the agency must use the Northern Territory Treasury Corporation (NTTC) institutional bond rates that correspond with the lease term as the incremental borrowing rate to calculate the present value of the lease liability.

At the end of each financial year, DTF will circulate a schedule of the NTTC institutional bond rates to agencies which may be used for new lease arrangements entered into in the subsequent financial year.

Appendix D: Illustrative examples, includes an example of how a lessee measures and records ROU asset and lease liabilities.

7.2.4. Lease incentives

A lease incentive provided by a lessor may affect the measurement of ROU assets and lease liabilities.

Lease incentives are defined as payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption of costs of a lessee by a lessor. Agencies must only incorporate lease incentives which meet the definition above in the measurement of ROU assets and lease liabilities.

Fit out expenditure undertaken or reimbursed by the lessor may be recognised as asset by either the lessee or lessor to reflect the party that controls the economic benefits from the expenditure.

Lessor reimbursements of lessee leasehold improvement expenditure, or direct lessor expenditure on leasehold improvements, should only be considered lease incentives, where the:

- expenditure was promised in the lease contract as a condition for the lessee to enter the lease
- lessee (rather than lessor) primarily benefits from that expenditure and has consequently recognised the expenditure as a fitout asset.

These incentives received should be deducted from the ROU asset's initial value, consistent with paragraph 24(b) of AASB 16.

Fit out contribution incentives that remain receivable to the lessee on lease commencement should be offset against gross lease payments outstanding when calculating the initial lease liability. The incentive should be recognised as an increase in the lease liability when received.

The table below provides examples of lease incentives provided by a lessor and appropriate accounting treatment under AASB 16.

Example of lease incentives		Accounting treatment
Rent free periods, reduced rent periods A lessor provides a 1 year rent free period and 1 year reduced rent of $500 000 as incentives to an agency. The lease agreement has a further 3 years at a rent of $1 million per annum.	X	The rent free period and reduced rent period do not meet the definition of lease incentives under AASB 16. ROU asset and lease liability is measure based on the remaining lease payment over lease period of $ 3 500 000 ($500 000 x 1 year + $1 000 000 x 3 years).
Cash payment The lessor provides an up-front cash payment of $500 000. Agency has a lease arrangement for 5 years at $1 million per year.	✓	The upfront cash payment meets the definition of a lease incentive under AASB 16. As such, an adjustment of $500 000 will be applied when determining the remaining lease payments ($1 000 000 x 5 years less $500 000 lease incentive). Remaining lease payment over the lease period is $4 500 000.

Example of lease incentives		Accounting treatment
Cash contribution to fit-outs The lessor paid $400 000 for fit-outs that are controlled by the lessee at the commencement of the lease. Lessee has a lease arrangement for 5 years at $1 million per year.	✓	The $400 000 the lessor paid for fit-out meets the definition of lease incentive. The ROU asset is measured and recorded at initial measurement of lease liability of $5 000 000 less $400 000 lease incentive received. The fit-out will be recognised as leasehold improvements by the lessee.
Rent rebates (cash back)	✓	These meet the definition of lease incentives under AASB 16. Therefore, these should be considered in the measurement of ROU asset and lease liability.
Reimbursement or assumption of costs A lessor reimbursed the lessee for commission of $5 000 paid to the real estate agent for arranging a lease. The lessor also paid relocation costs of $3 000 on behalf of the lessee.	✓	These meet the definition of lease incentives under AASB 16. Therefore, these should be considered in the measurement of ROU asset and lease liability.

7.2.5. Remeasurement

Agency lessees must remeasure lease liabilities where there are changes to lease payments after the lease commencement date. The change in lease liability should generally be recognised as an adjustment to the ROU asset.

However, where the carrying amount of the ROU asset is zero and there is a further adjustment required on the lease liability such amounts should be recognised in the profit or loss.

The table below summarises remeasurement triggers and how the lease liability is affected.

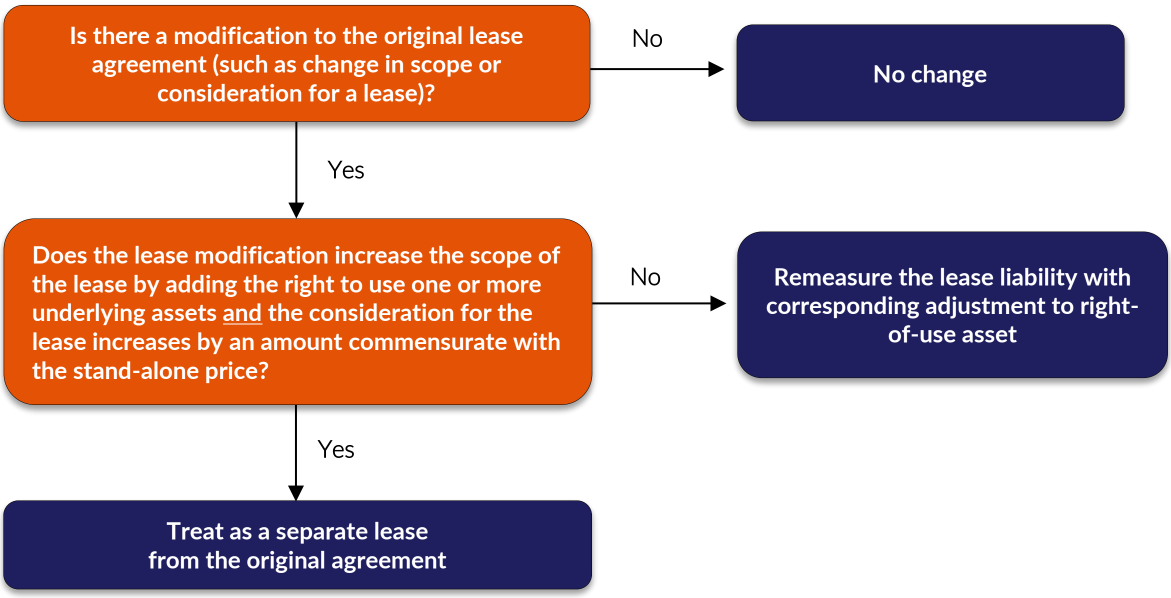
Remeasurement triggers	Lease liability remeasurement
Change in lease term or reassessment of purchase option	Recalculate the present value of the revised lease payments using a revised discount rate for the remaining of the lease term. Refer to Appendix D Illustrative example 3.1 Remeasurement arising from change in the lease term.
Change in the amounts expected to be payable under a residual value guarantee	Recalculate present value of the revised lease payments (such as reflecting the change in the residual value guarantee) using an unchanged discount rate. A revised discount rate is used only if the change in the residual value guarantee results from a change in floating interest rates.
Change in future lease payments resulting from a change in an index or a rate (for example, a change to reflect changes in market rental rates following a market rent review) resulting to change in the cash flows	Recalculate present value of the revised lease payments using an unchanged discount rate. A revised discount rate is used only if the change in the lease payments results from a change in floating interest rates. Example is when the lease payments is linked to a floating

Remeasurement triggers	Lease liability remeasurement
	interest rate which is applicable if the lease has implicit rate available. Refer to Appendix D Illustrative example 3.2 Remeasurement arising from change in future lease payments due to change in index.

7.2.6. Lease modifications

Lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (such as adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

The flowchart below outlines how lease modifications are accounted for.



Appendix D: Illustrative examples includes examples of how a lessee accounts for lease modifications.

7.2.7. Sale and leaseback

Sale and leaseback transactions arise when an entity (seller-lessee) sells an asset to another entity and simultaneously leases it back from the purchaser (buyer-lessor). Agencies shall assess whether the transfer of the asset is a sale by applying AASB 15 Revenue from Contracts with Customers (AASB 15).

Where a transfer to a buyer-lessor is deemed a sale in accordance with AASB 15:

Seller-lessee shall:

- derecognise the underlying asset
- recognise right-of-use asset related to the right of use retained - measured at the proportion of the previous carrying amount of the asset by the seller-lessee
- recognise lease liability measured at the present value of the lease payments
- and recognise any gain or loss related to the rights transferred to the buyer-lessor. This contrasts to the old lease standard where seller-lessees recognise the total gain or loss on sale of the asset.

Buyer-lessor shall:

- recognise the purchase of asset
- and apply the lessor accounting model to the leaseback transaction

If the sale is not at fair value or lease payments are off-market, the seller-lessee must make adjustments to measure the sale proceeds at fair value, as follows:

- below-market terms are treated as prepayments of lease payments (where sale price is lower than the fair value of the asset)
- or above-market terms are treated as additional financing provided by the buyer-lessor to the seller-lessee (where sale price is higher than the fair value of the asset)

Where a transfer to a buyer-lessor is not a sale in accordance with AASB 15:

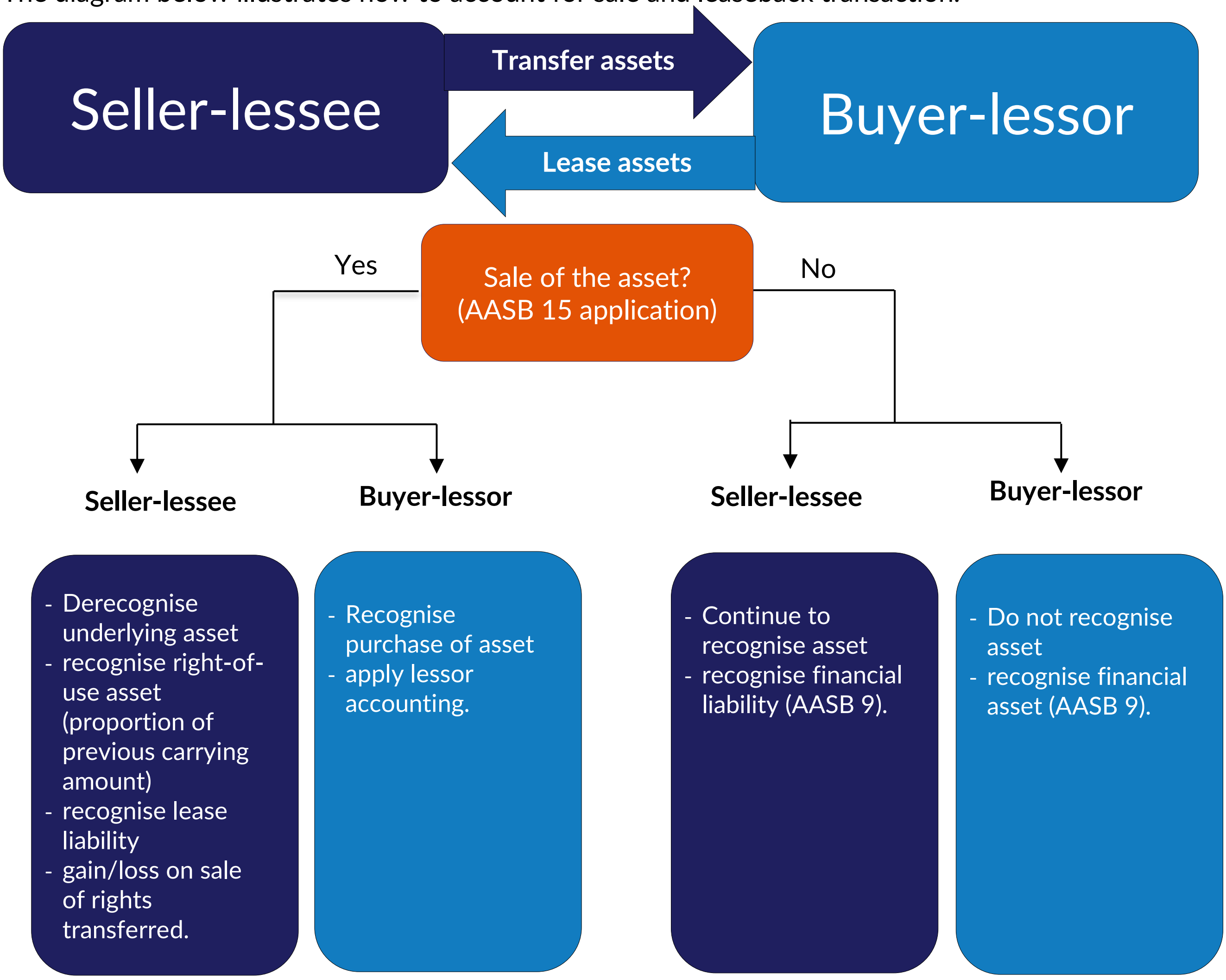
Seller-lessee shall:

- continue to recognise the transferred asset
- and recognise a financial liability equivalent to the consideration received from the buyer-lessor and account for it applying AASB 9 Financial Instruments (AASB 9).

Buyer-lessor shall:

- not recognise the transferred asset
- and recognise a financial asset equivalent to the consideration paid to the seller-lessee, measured by applying AASB 9.

The diagram below illustrates how to account for sale and leaseback transaction.



Appendix D: Illustrative examples, includes example on how to account for the sale and leaseback transaction.

7.2.8. Peppercorn or concessionary leases

Peppercorn or concessionary leases are leases which are issued significantly below market terms and conditions, principally to enable an agency further its objectives.

A peppercorn lease is where the payment is nominal (for example $1 per year). Generally, a lease payment which provides a discount of 20 per cent or more of the market rental rates are likely to be considered significantly below market value (concessionary lease) unless evidence exists to the contrary.

Where below-market terms and conditions are also available to other entities, it is unlikely that the arrangement will be classified as a concessionary lease. This is because the “principally to enable the entity to further its objectives” criteria will not be met.

A lessee agency must recognise the ROU asset of a peppercorn or concessionary lease at cost instead of fair value. This policy election is on a temporary basis pending the outcome of a project AASB is undertaking on the fair value measurement for public sector entities.

7.2.9. Long term lease of Aboriginal land

Long-term leases on Aboriginal land are to be accounted for as a lease instead of an in-substance purchase because of the legal restrictions placed by various Acts on ownership of Aboriginal Land. A long-term lease is a lease with a term of 99 years or more.

As such, the Territory Government can never legally own Aboriginal Land. An example of an Act which imposes legal restrictions on the ownership of Aboriginal land is the *Aboriginal Lands Rights (Northern Territory) Act 1976*.

8. Management and recordkeeping

Assets, including leased assets, play a key role in delivering agency outputs and as items of public property, all leased assets should be subject to appropriate management, accountability and control arrangements.

Agencies should consider the following at a minimum in developing management, accountability and control arrangements of leased assets:

a. safeguarding and protection of assets against loss or damage
b. monitoring of asset condition, use and performance
c. and asset life cycle management, taking into account asset planning, acquisition, operation including maintenance and disposal.

Where an agency leases assets (for example, equipment or vehicles) to a third party, the agency should consider registering a security interest over the assets on the Personal Properties Security Register (PPSR).

Registering a security interest in the register shows that the agency has rights over the assets and protects the agency's rights over the assets where the third party becomes insolvent or is the subject of administration or liquidation. The registration also preserves the agency's priority position against other creditors of the third party.

Without a PPSR registration over the assets, the agency may have difficulty proving ownership of the assets and will not have priority to the assets in any insolvency process. If an agency decides that the leased assets should have a security interest registered over them, the agency should seek legal advice.

An accountable officer is responsible for keeping records relating to lease arrangements (excluding leases as per section 2.4 Lease exclusions) entered into by his or her agency and, at a minimum, must:

a. establish processes to collect and manage records of lease arrangements, including documenting assumptions and calculations used to determine the recognition and measurement impact in the statement of financial position and operating statements
b. ensure records are maintained in a register of lease arrangements

The form and content of the register of lease arrangements is at the discretion of the agency. A register may include the following information.

a. description of the leased asset (and key components where appropriate)
b. manufacturer's identification numbers, if applicable (for example, serial number)
c. location
d. type of lease (operating or finance) where agency is the lessor, if applicable
e. date of lease commencement and lease cessation
f. lease options (such as extension, termination, purchase), if any
g. details in respect of any sub-leases, if applicable

h. and any other relevant information to properly manage, account and control the lease arrangement.

The register is not required where an agency has never had any lease arrangements.

The register must be replicated and updated annually to maintain a register at 30 June.

Agencies must retain records relating to lease arrangements, for the specified minimum period, in accordance with the agency's records disposal schedule.

A lease accounting software managed by DCDD is available for agencies to use. This software is compliant with the recognition, measurement, and recordkeeping (register of lease arrangement) requirements of the TD, where the agency is the lessee to the lease arrangement.

9. Reporting

An accountable officer must classify and present leases in accordance with the TD in agency financial statements.

Upon request, an accountable officer must provide DTF a copy of the leases register and any other relevant information as necessary.

9.1. Lessors presentation and disclosure

A lessor agency shall present underlying assets related to operating leases in the statement of financial position by class of the underlying asset.

A lessor agency shall disclose the following amounts:

- Finance leases:
  - finance income on the net investment in the lease
  - income from variable lease payments not included in the measurement of the net investment in the leases
  - provide a qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in finance leases
  - disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining year
  - and reconcile the undiscounted lease payments to the net investment in the lease. This reconciliation should identify the unearned finance income relating to the lease payments receivable and any discounted unguaranteed residual value.
- Operating leases:
  - lease income, separately disclosing amounts related to variable lease payments that do not depend on an index or a rate
  - property, plant and equipment subject to an operating lease should be segregated from assets held and used by the lessor
  - and disclose a maturity analysis of lease payments, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

A lessor agency should also disclose additional qualitative and quantitative information as follows:

- nature of the lessor's leasing activities
- and how the lessor manages the risk associated with any rights it retains in underlying assets. In particular, a lessor should disclose its risk management strategy for the rights it retains in underlying assets, including any means by which the lessor reduces that risk. Such means may include, for example, buy-back agreements, residual value guarantees or variable lease payments for use in excess of specified limits.

9.2. Lessees presentation and disclosure

Presentation requirements for lessees are summarised below:

Statement name	Presentation requirement		
Statement of financial position	ROU assets will be disclosed in the notes to the financial statements for property, plant and equipment. Lease liability will be disclosed in the notes to the financial statements for borrowings. *Both accounts will not be presented as a separate line item in the balance sheet.*		
Comprehensive operating statement	Interest expense on the lease liability will be presented separately from the depreciation expense from the ROU asset.		
Cash flow statement	*Payments for:* Principal portion of the lease liability	→	Financing activities
	Interest portion of the lease liability	→	Operating activities
	Short-term leases, low-value leases Variable lease payments not included in measurement of lease liability	→	Operating activities

A lessee agency shall disclose the following amount:

- depreciation charge for ROU assets by class of underlying asset
- interest expense on lease liabilities
- lease expense accounted for as short-term leases and low-value assets
- the expense relating to variable lease payments not included in the measurement of lease liabilities
- income from subleasing ROU assets
- total cash outflow for leases
- additions to ROU assets
- gains or losses arising from sale and leaseback transactions
- and the carrying amount of ROU assets at the end of the reporting period by class of underlying asset.

Other disclosure requirements as follows:

- maturity analysis for lease liabilities which should be presented separately from other financial liabilities
- qualitative and quantitative information regarding the scope of lease activities as follows:

  - the nature of the lessee's leasing activities
  - future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This includes exposure arising from variable lease payments, extension options and termination options, residual value guarantees, leases not yet commenced to which the lessee is committed
  - restrictions or covenants imposed by leases
  - and if applicable, sale and leaseback transactions.
- for each material peppercorn lease, the agency shall disclose the dependence on such leases and the nature and terms of the leases (lease payments, lease term, description of the underlying assets; and restrictions on the use of the underlying assets specific to the agency).