Key Steps for Accounting for Leases

This publication provides an outline of the key steps to be undertaken by lessees when accounting for leases in accordance with AASB 16 *Leases*.

Principal requirements of the standard

AASB 16 applies to annual reporting periods beginning on or after 1 January 2019. The standard introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of 'low value'.

Initial recognition and measurement

At the commencement date of the lease, a lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Key steps to achieve this outcome include:

1. Assess whether the contract is, or contains, a lease

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.

2. Identify each lease component within the contract

Each lease component within the contract must be accounted for as a lease, separately from any non-lease components of the contract[i].

(i) Unless the lessee elects, by class of underlying asset, to treat each lease component and associated non-lease component as a single lease component.

3. Allocate the consideration to each lease component

The consideration in the contract must be allocated to each lease component (being the lease payments) on the basis of the relative stand-alone price of the lease component and any non-lease components.

4. Determine the commencement date

The commencement date of the lease is the date on which the lessor makes the underlying asset available for use by the lessee.

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5. Determine the lease term

The lease term is the non-cancellable period of the lease, together with any periods covered by an option to extend (if the lessee is reasonably certain to extend) and any periods covered by an option to terminate (if the lessee is reasonably certain not to terminate).

6. Consider recognition exceptions and make elections

A lessee may elect not to recognise a right-of-use asset or a corresponding lease liability in relation to 'short-term leases' and leases for which the underlying asset is of 'low value'.

7. Measure the lease liability and right-of-use asset

At the commencement date of the lease (step 4), for each lease component identified (steps 1 and 2) other than those subject to an elected recognition exception (step 6), the lessee recognises:

- a lease liability, measured at the present value of the lease payments (step 3) for the period of the lease term (step 5) using the 'interest rate implicit in the lease' (if determinable) or otherwise using the lessee's 'incremental borrowing rate'; and
- a right-of-use asset, measured at cost, comprising the amount of the initial lease liability, plus pre-commencement date lease payments, plus any initial direct costs, plus estimated dismantling, removal and restoration costs, less any lease incentives received.

Subsequent measurement

Subsequent to the commencement date of the lease, the lessee measures:

- the right-of-use asset at cost (less any accumulated depreciation and any accumulated impairment losses, and adjusted for any remeasurement of the lease liability) or at fair value / revalued amount (under other accounting standards); and
- the lease liability at the present value of the remaining lease payments (and remeasured to reflect any reassessments or lease modifications). Interest on the lease liability is recognised as an expense[ii].

A remeasurement of the lease liability occurs in limited circumstances, as a result of such factors as:

- a reassessment of the lease term. For example, the lease term will be impacted if the lessee exercises an option to extend the lease that was not previously included in the determination of the lease term (on the basis of not being reasonably certain at the commencement date of the lease);
- a revision of the discount rate. For example, the discount rate may be impacted by a reassessment of the lease term; and
- a revision of the lease payments. For example, the lease payments will be impacted by a reassessment of the lease term, a reassessment of the likelihood of the exercise of a purchase option, or the reassessment of amounts expected to be paid under a residual value guarantee.

In addition to the subsequent measurement of the right-of-use asset and the lease liability, the lessee recognises:

- an expense for any variable lease payments not included in the measurement of the lease liability[ii]; and
- an expense (on either a straight-line basis over the lease term or another systematic basis) for any 'short-term leases' and leases for which the underlying asset is of 'low value', for which the lessee elected not to recognise a right-of-use asset or a corresponding lease liability[ii].

(ii) Unless the costs are included in the carrying amount of another asset by applying other applicable accounting standards.

Further information and assistance

Contact Pitcher Partners for further information and assistance on accounting for leases under AASB 116 *Leases*.

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