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| FRD 123 |  |  | Transitional requirements on the application of AASB 16 *Leases* |
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| Purpose |  | 1.1 | To prescribe the accounting for transition requirements on the application of AASB 16 *Leases*. |
| Application |  | 2.1 | Applies to all entities defined as either a public body or a department under section 3 of the *Financial Management Act 1994,* except those entities which are not controlled by the State and whose financial position and result are thus not consolidated in the Annual Financial Report for the State of Victoria. Application by State owned corporations is encouraged. |
| Operative date |  | 3.1 | Annual Reporting periods commencing on or after 1 January 2019. |
| Requirements |  |  | Initial application of AASB 16 |
|  |  | 4.1 | An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application, where contracts were previously assessed (and identified as leases or not identified as leases) using the requirements under both AASB 117 *Leases* and Interpretation 4 *Determining whether an arrangement contains a lease (IFRC 4)*.  If the contract has not previously been assessed under both AASB 117 and IFRC 4, then the contract is to be assessed under AASB 16.  This practical expedient applies to all contracts entered into (or changed) before the date of initial application. |
|  |  | 4.2 | An entity shall apply the AASB 16 requirements retrospectively with the cumulative effect of initially applying this standard as an adjustment to the opening balance of retained earnings at 1 July 2019.[[1]](#footnote-2)[[2]](#footnote-3)  This is to be applied consistently to all of its leases in which it is a lessee. |
|  |  | 4.3 | Comparative Information shall not be restated. |
|  |  | 4.4 | Leases previously classified as operating leases applying AASB 117  At the initial application date of AASB 16, the lessee shall:   1. recognise a lease liability at the date of initial application for leases previously classified as an operating lease applying AASB 117. The lessee shall measure that lease liability at the present value of the remaining lease payments, payments, discounted using the lessee’s incremental borrowing rate at the date of initial application (refer to *‘Incremental Borrowing Rate*’ Policy for guidance) ; 2. recognise a right-of-use asset at an amount equal to the lease liability calculated in (a), adjusted by the amount of any prepaid or accrued lease payments relating to that lease, recognised in the statement of financial position immediately before the date of initial application. |
|  |  | 4.5 | Practical Expedients  In applying 4.2 and 4.4 above, the following expedients shall be used:   1. apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment). 2. an entity relies on its assessment of whether leases are onerous applying AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, immediately before the date of initial application as an alternative to performing an impairment review.   The entity shall adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognised in the statement of financial position immediately before the date of initial application.   1. for leases for which the lease term ends within 12 months of the date of initial application, a lessee shall not recognise the right-of-use asset and lease liability. Instead. in this case, a lessee shall:    1. account for those leases in the same way as short-term leases (refer to 4.6 below) of which the payments are recognised as an expense on a straight line or another systematic basis; and    2. include the cost associated with those leases within the disclosure of short-term lease expense in the annual reporting period that includes the date of initial application. 2. exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application. 3. use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease. 4. no adjustment is required for leases previously accounted for as investment property using the fair value model in AASB 140 *Investment Property*. The entity shall account for the right-of-use asset and lease liability by applying AASB 16 and AASB 140 from the date of initial application and; 5. is required to measure the right-of-use asset at fair value at the date of initial application for leases previously accounted for as operating leases and that will be accounted for as investment property using the fair value model in AASB 140 from the date of initial application The lessee shall account for the right-of-use asset and lease liability arising from those leases applying AASB 16 and AASB 140 from the date of initial application. |
|  |  | 4.6 | Recognition Exemption[[3]](#footnote-4)  At the lease commencement date, entities shall recognise a right-of-use asset and a lease liability for all leases, except for:   * Short term leases – leases with a term less than 12 months; and * Low value leases – leases with the underlying asset’s fair value (when new, regardless of the age of the asset being leased) is no more than $10,000.   The election for short-term leases shall be made by class of underlying asset to which the right of use relates while the election for low value leases will be made on a lease-by-lease basis.  An entity shall recognise the lease payments associated with short term leases and low value leases as an expense on either a straight-line basis over the lease term or another systematic basis if that basis is more representative of the pattern of the lessee’s benefit. |
|  |  | 4.7 | Separating components of a contract3  An entity is required to separate out and account separately for, non-lease components within a lease contract and exclude these amounts when determining the lease liability and right-of-use asset amount |
|  |  | 4.8 | Peppercorn / Below market Leases  The Australian Accounting Standards Board (AASB) issued an amendment to AASB 16 *Leases* with the effect of providing optional relief in connection with the requirement to record below market leases at fair value.  The State mandates that entities covered by this FRD, apply the temporary option in as per paragraph 25.1to not apply the fair value measurement requirements for right-of-use assets arising from leases with significantly below-market terms and conditions principally to enable the entity to further its objectives*.* |
|  |  | 4.9 | Leases previously classified as finance leases applying AASB 117  The measurement of the right-of-use asset and the lease liability at the date of initial application shall be equal to the carrying amount of the lease asset and lease liability immediately before that date, measured applying AASB 117. |
|  |  | 4.10 | Transitional disclosures  An entity shall disclose the following information about initial application required by paragraph 28 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors:*   1. the title of the Australian Accounting Standard; 2. when applicable, that the change in accounting policy is made in accordance with its transitional provisions; 3. the nature of the change in accounting policy; 4. when applicable, a description of the transitional provisions; 5. when applicable, the transitional provisions that might have an effect on future periods; 6. the amount of adjustment relating to periods before those presented, to the extent practicable. |
|  |  | 4.11 | An entity shall disclose the following on initial application:   1. the weighted average lessee’s incremental borrowing rate applied to lease liabilities recognised in the statement of financial position at the date of initial application; and 2. an explanation of any difference between: 3. operating lease commitments disclosed applying AASB 117 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the incremental borrowing rate at the date of initial application; and 4. lease liabilities recognised in the statement of financial position at the date of initial application. |
|  |  | 4.12 | An entity shall disclose the practical expedients used in 4.1, 4.5 and, 4.6. |
|  |  | 4.13 | Transitional requirements for lessors  With the exception of sub-leases and sale and leaseback, lessors are not required to make any adjustments to leases on transition and apply AASB 16 from the initial date of application.  An intermediate lessor must reassess ongoing operating sub-leases under AASB 16 at the transition date, to determine whether the sublease should be classified as an operating lease or a finance lease applying this standard. The intermediate lessor shall perform this assessment at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sublease at that date.  If a sublease, is then reclassified as a finance lease, it should be accounted for as a new finance lease entered into at the date of initial application. |
|  |  | 4.14 | Sale and leaseback transactions  An entity is not required to reassess ongoing sale and leaseback transactions entered before the date of initial application to determine if the transfer of the asset is sale under AASB 15[[4]](#footnote-5).  For sale and leaseback transactions in existence at the transition date, the seller-lessee will need to:   * If classified as a sale and operating lease under AASB 117:   + account for the leaseback in the same way as any other operating lease that exists at transition; and   + adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognised in the balance sheet immediately before the date of initial application. * If classified as a sale and finance lease under AASB 117:   + account for the leaseback in the same way as it accounts for any other finance leases that exists at transition; and   + and continue to amortise any recognised gain on sale over the lease term. |
| Definitions |  | 5.1 | **Lease** – A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. |
|  |  |  | **Lessee –** An entity that obtains the right to use an underlying asset for a period of time in exchange for consideration**.** |
|  |  |  | **Operating Lease –** A lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset. |
|  |  |  | **Right-of-use asset –** An asset that represents a lessee’s right to use an underlying asset for the lease term. |
|  |  | 5.2 | Refer to Appendix A *Defined terms* of AASB 16 for a full listing of definitions. |
| Guidance |  | 6.1 | Supporting information and checklists have been published on the DTF website:  https://www.dtf.vic.gov.au/financial-reporting-policy/accounting-standards-checklists |
|  |  | 6.2 | An example of the transitional disclosures is illustrated in the 2019-20 Model Report for Victorian Government Departments for the relevant reporting period and is available on the DTF website:  <https://www.dtf.vic.gov.au/financial-reporting-policy/model-report> |
| Relevant pronouncements |  | 7.1 | AASB 16 *Leases* (February 2016)  AASB 117 *Leases* (August 2015)  Interpretation 4 *Determining whether an Arrangement contains a Lease* (August 2015) |
| Background |  | 8.1 | The Australian Accounting Standards Board (AASB) published AASB 16 to adopt a new approach to lease accounting that requires a lessee to recognise assets and liabilities for the rights and obligations created by leases. This FRD issued in September 2019, mandates the transitional options available and prescribes the transitional requirements of AASB 16 *Leases* on initial application. The options elected in the FRD are to ease the administrative burden of applying the new standard. |

1. 1 January 2019 for 31 December year-end reporters [↑](#footnote-ref-2)
2. This date also represents the date of initial application [↑](#footnote-ref-3)
3. This transitional requirement is also an on-going requirement [↑](#footnote-ref-4)
4. AASB 15: *Revenue from Contracts with Customers* [↑](#footnote-ref-5)