XRB Te Kāwai Ārahi Pūrongo Mōwaho EXTERNAL REPORTING BOARD

Accounting for leases under NZ IFRS 16 Leases

Key areas to consider for lessees applying NZ IFRS 16 in years after first-time adoption

NZ IFRS 16 *Leases* introduced a fundamental change to lease accounting, bringing nearly all leases onto the balance sheet for Tier 1 and 2 for-profit lessees. Many entities invested significant resources when applying this standard for the first time.

It's important to remember that the accounting for leases using NZ IFRS 16 is not a 'set and forget' process, rather there are many factors you need to consider at each reporting cycle. This guide highlights the ongoing requirements of NZ IFRS 16, some of the interplay with other Standards, and is intended to help you identify areas where you may need to undertake further analysis.

At each reporting period, you should consider whether there have been any changes to lease arrangements.

New leases	Reassessments of existing leases	Modifications of leases	Termination of leases

Key on-going requirements	Areas to consider
Have you identified all new leases?	• Do you have processes in place to assess new contracts to determine whether they are, or contain, a lease? • How are you confident of completeness?
Have any of your existing leases changed?	• Do you have a process to distinguish between a reassessment and a modification and how to account for the change? • Have you assessed lease term, lease payments and discount rates?
Have you considered impairment?	• Have you considered potential impairment testing requirements for right-of-use (ROU) assets? • Have you considered how NZ IFRS 16 affects recoverable amount?
Have you determined the tax impact?	• Are you aware of the initial recognition exemption requirements? • Have you calculated deferred tax?
Have you captured all your required data for disclosures?	• Do you have processes in place to track expenditure and balances for disclosure purposes?
Have you entered into any sale and leaseback transactions?	• Have you assessed if control of the underlying asset has passed i.e. has the sale occurred for accounting purposes?

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Frequently asked questions

Have you identified all new leases?

Have you taken steps to identify all new leases entered into during the period, such as having a lease register, reviewing supplier contracts and checking 'at risk' expense codes and payments?

- Have you considered service-type arrangements which may contain a lease, such as (but not limited to) transport, warehousing, technology, or supply arrangements?

Once you have identified potential new leases do you have processes to assess whether a contract is, or contains, a lease?

- The flowchart in NZ IFRS 16, B31 provides a useful tool for making this assessment – refer to Appendix 1.

Do you have a comprehensive process for assessing new leases?

How do you assess the lease term?

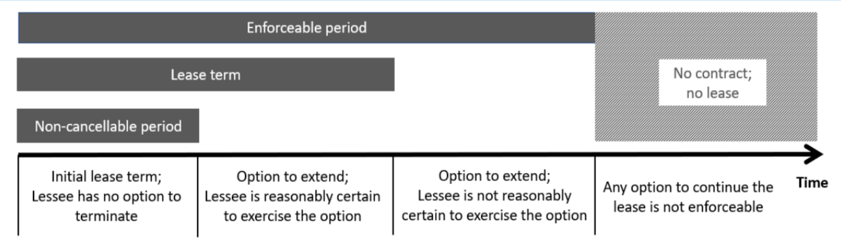


Diagram from: *IFRS Interpretations Committee agenda paper 4, 26 November 2019*

Remember to consider the contractual terms & conditions, relevant laws & regulations, and penalties* & termination rights.

*Penalties: should include the broader economics of the contract and not only contractual termination payments.

Do you know which lease payments to include or exclude in determining the lease liability ?

- For payments that depend on an index or rate, do you know not to estimate the future value of an index or rate?
- Do you know how to identify variable payments that are in-substance fixed (payments that are structured as variable lease payments, but are unavoidable)?
- For payments that depend on sales or usage do you consider whether the contract specifies minimum payments?
- Have you elected to apply the practical expedient not to separate lease and non-lease components?

Do you have a robust, repeatable process to determine discount rates, taking into account the materiality of each of your leases in the context of your overall financial statements?

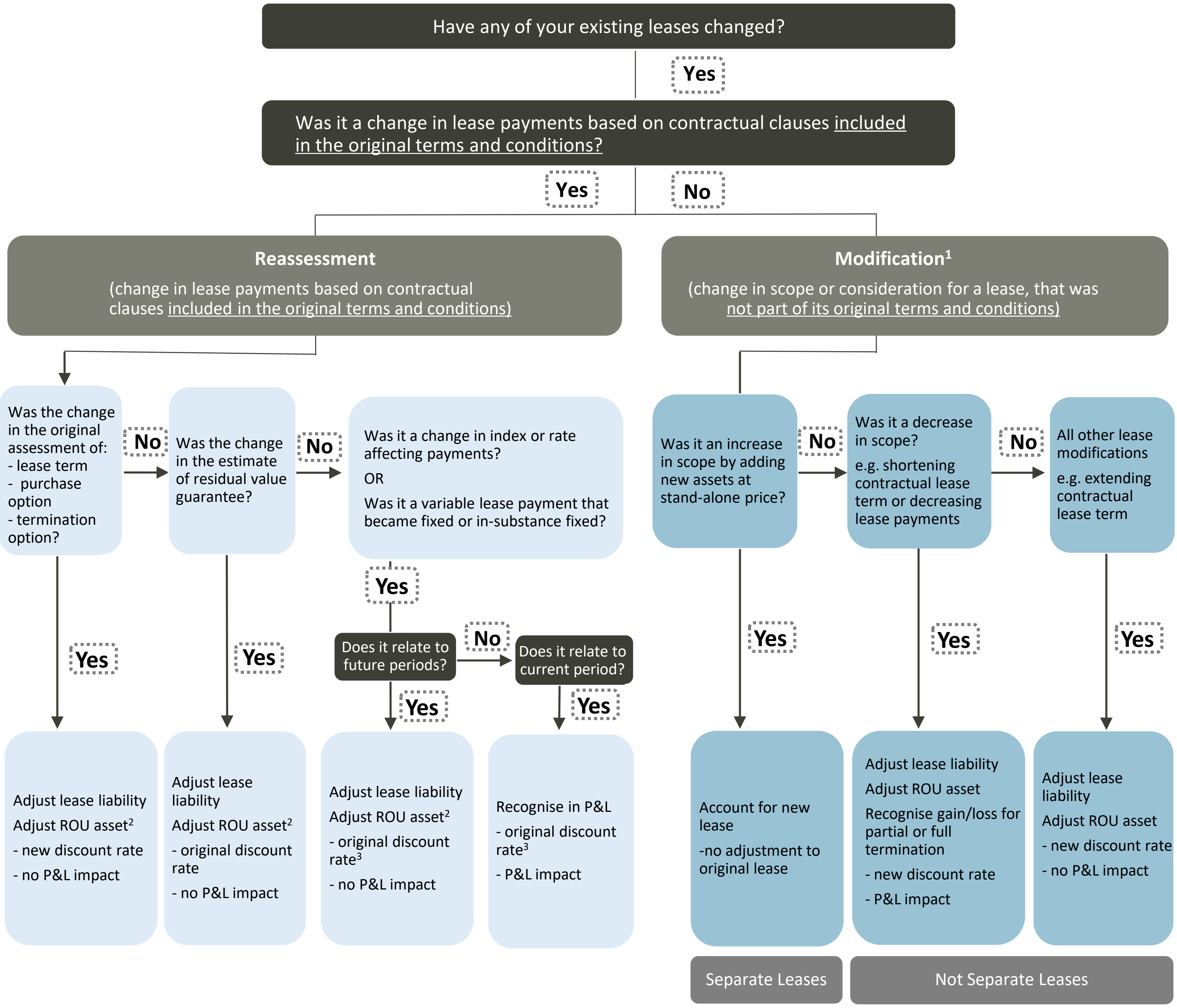
- Is your first step to check whether the interest rate implicit in the lease is readily available?
- When the interest rate implicit in the lease is not readily available how do you determine the incremental borrowing rate (IBR)? Where do you obtain relevant data points for your IBR? Do you take into account:
  - the term of the lease?
  - your credit risk as the lessee?
  - the nature and quality of the security?
  - the amount you would need to borrow to obtain an asset of a similar value to the ROU asset?
  - the economic environment?

Frequently asked questions

Have any of your existing leases changed?

Accounting for reassessments and modifications can be complex and will depend on the circumstances of the underlying change.

Changes to Existing Leases impacting lease liability / right-of-use (ROU) asset



[1]Are you aware of the practical expedient for COVID-19 related rent concessions which permits lessees not to assess whether particular COVID-19-related rent concessions are lease modifications?

[2]If the carrying amount of the ROU asset is reduced to zero, then any further reductions are recognised in profit or loss.

[3]Unless the rate is a floating interest rate in which case revise the discount rate for the floating interest rate component.

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Frequently asked questions

Have you considered impairment?

Right of use (ROU) assets are often subsequently measured under a cost model. In some circumstances a fair value model under NZ IAS 40 *Investment Property*, or a revaluation model under NZ IAS 16 *Property, Plant and Equipment* may apply. ROU assets under a cost or revaluation model require consideration of impairment under *NZ IAS 36 Impairment of Assets*.

- Have you considered whether to look for indicators of impairment, and/or whether an impairment test is required?
- Have you considered whether to test for impairment at the individual asset level, or at the cash-generating unit (CGU) level?
    - Does the ROU asset generate cash inflows that are largely independent?
- Have you considered the timing of when an impairment test should occur (if required)?

Single asset	CGU (NO goodwill or indefinite useful life intangible assets)	CGU (containing goodwill and/or indefinite useful life intangible assets)
At the end of each reporting period, only if there are indicators of impairment		At least annually, at the same time each year AND Whenever there is an indicator of impairment

- Have you considered whether to include the lease liability in the carrying amount of the CGU?
    - Would a buyer be required to assume that lease liability on disposal?
- Have you considered whether to include lease payments in recoverable amount cash flows?
    - This may differ depending on whether you are calculating fair value less costs of disposal or value in use.
- Have you considered what the appropriate discount rate is?

Have you determined the tax impact?

- Are you aware of the amendments to NZ IAS 12 *Income Taxes, Deferred Tax related to Assets and Liabilities arising from a Single Transaction*, issued in July 2021, effective for annual reporting periods beginning on or after 1 January 2023, with earlier application permitted?
    - The implication of this amendment is that the 'initial recognition exemption' cannot be used on initial recognition of leases by lessees.
- Have you elected to apply NZ IFRS 16 for tax purposes where allowed, and have you assessed the implications to deferred taxes?

Have you captured all your required information for disclosures?

- Have you presented ROU assets and lease liabilities as current and non-current?
- Do you have processes in place to track all required items, e.g. expenditure for short term and low value leases, variable lease payments, income from subleasing ROU assets?
- Have you provided appropriate qualitative information about your leasing activities, and judgements and assumptions made?
- Are your tools fit for purpose to accurately capture all required disclosure data?

Have you entered into any sale and leaseback transactions?

Have you applied the requirements in NZ IFRS 15 *Revenue from Contracts with Customers* to assess whether the seller-lessee has transferred control of the asset to the buyer-lessor? If control has not transferred (often referred to as a 'failed sale') the accounting treatment is significantly impacted.

Keep an eye out for a future guide which addresses sale and leaseback transactions in more detail.

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Appendix 1

Assessing whether a contract is, or contains, a lease

B31 of NZ IFRS 16