STAFF PAPER

September 2021

IFRS® Interpretations Committee meeting

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| **Project** | **Non-refundable Value Added Tax on Lease Payments (IFRS 16)** |
| Paper topic | Comment letters |

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## Introduction

1. This paper reproduces comment letters on the IFRS Interpretations Committee's tentative agenda decision 'Non-refundable Value Added Tax on Lease Payments (IFRS 16)' published in March 2021.

**Tentative Agenda Decision and comment letters: Non-refundable Value Added Tax on Lease Payments (IFRS 16)**

The IFRS Interpretations Committee (Committee) discussed the following matter and tentatively decided not to add a standard-setting project to the work plan. The Committee will reconsider this tentative decision, including the reasons for not adding a standard-setting project, at a future meeting. The Committee invites comments on the tentative agenda decision. All comments will be on the public record and posted on our website unless a respondent requests confidentiality and we grant that request. We do not normally grant such requests unless they are supported by good reason, for example, commercial confidence.

**Tentative Agenda Decision**

The Committee received a request about how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments. In the fact pattern described in the request:

a. The lessee operates in a jurisdiction in which VAT is charged on goods and services. A seller includes VAT in an invoice for payment issued to a purchaser. In the case of leases, VAT is charged when an invoice for payment is issued by a lessor to a lessee.
b. The applicable legislation:

   i. requires a seller to collect VAT and remit it to the government; and

   ii. generally allows a purchaser to recover from the government VAT charged on payments for goods or services, including leases.

c. Because of the nature of its operations, the lessee *can recover only a portion of the VAT charged on purchased goods or services.* This includes VAT charged on payments it makes for leases. Consequently, a portion of the VAT the lessee pays is non-refundable.
d. Lease agreements require the lessee to make payments to the lessor that include amounts related to VAT charged in accordance with the applicable legislation.

The request asked whether, in applying IFRS 16, the lessee includes *non-refundable VAT as part of the lease payments for a lease*.

Outreach conducted by the Committee provided limited evidence:

a. that non-refundable VAT on lease payments is material to affected lessees; and
b. of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

The Committee has therefore not [yet] obtained evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

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The International VAT/GST Guidelines (OECD, 2017) recognize (is alive to the fact) that sovereign jurisdictions have the right to to apply tax rules for limiting the right to deduct input VAT. This is provided as below:

> *2.26 The Guidelines on neutrality are not intended to interfere with the sovereignty of jurisdictions to apply tax rules for limiting the right to deduct input VAT, to exempt particular activities from VAT, or to establish specific administrative requirements for dealing with different categories of business (including foreign businesses).*
> *2.4 Tax legislation may also impose value added tax on businesses to secure effective taxation of final consumption. This might be the case when the business makes transactions that fall outside the scope of the tax (e.g. transactions without consideration) or the input tax relates to purchases that are not wholly used for furtherance of taxable business activity*
> *Jurisdictions also provide legislation that disallows input tax recovery where explicit administrative obligations are not met (e.g. insufficient evidence to support input tax deduction).*
> *2.35 Guideline 2.1 is not intended to interfere with the sovereignty of jurisdictions to apply rules for limiting or blocking the right to deduct input VAT*

Based on this sovereign right, Kenya in the Value Added Tax Act (Kenya Law Reports, 2013) has imposed a similar restriction in section 17(6) of the Act As follows:

*17(6) Subject to this Act, if a taxable supply to, or a taxable import by, a registered person during a tax period relates partly to making taxable supplies and partly for another use, the input tax deductible by the person for acquisitions made during the tax period shall be determined as follows –*
*(a) full deduction of all the input tax attributable to taxable supplies;*
*(b) no deduction of any input tax which is directly attributable to other use; and*
*(c) deduction of input tax attributable to both taxable supplies and other uses calculated according to the following formula:*

$$\frac{A \times B}{C},$$

*where –*
***A** is the total amount of input tax payable by the person during the tax period on acquisitions that relate partly to making taxable supplies and partly for another use;*
***B** is the value of all taxable supplies made by the registered person during the period; and*
***C** is the value of all supplies made by the registered person during the period in Kenya.*
*(7) If the fraction of the formula in subsection (6) for a tax period –*
*(a) is more than 0.90, the registered person shall be allowed an input tax credit for all of the input tax comprising component A of the formula; or*
*(b) is less than 0.10, the registered person shall not be allowed any input tax credit for the input tax comprising component A of the formula.*

As regards the treatment of the non-refundable input VAT in determination of lease payments:

a. Where the exact proportion of the non-claimable input VAT is known at the inception of lease, such amounts in my view may be included in the determination of the fixed payments for purposes of measurement of the lease liability, under paragraph 26;

b. Where the exact proportion of the non-claimable VAT cannot be determined with certainty, at inception, such amounts, should be expensed when the unclaimable input VAT amount is determined. This would be in line with Prudence i.e. the exercise of caution when making judgements under conditions of uncertainty (Conceptual Framework paragraph 2.16)

**Bibliography**

Kenya Law Reports. (2013). *Value Added Tax Act, 2013*. From http://kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=No.%2035%20of%202013.

OECD. (2017, September 1). *International VAT/GST Guidelines*. (OECD, Editor) From https://www.oecd-ilibrary.org/docserver/9789264271401-en.pdf?expires=1617018637&id=id&accname=guest&checksum=774FA40785DC867EBF21E035480A68B4

**Name:** Sounder Rajan SP

**Subject:** Comments on Tentative Agenda Decision and comment letters: Non-refundable Value Added Tax on Lease Payments (IFRS 16)

1) I welcome the opportunity provided for sending comments on Tentative Agenda Decision and comment letters: Non-refundable Value Added Tax on Lease Payments (IFRS 16)

2) I support the International Accounting Standard's Board to clarify accounting in respect of tax component included in lease payment.

***Question I:-***

The request asked whether, in applying IFRS 16, the lessee includes non-refundable VAT as part of the lease payments for a lease.

**Comments:-**

In India the legislation is as follows

When you rent out a residential property for residential purposes, it is exempt from Goods and Service Tax [GST]. Any other type of lease or renting out of immovable property for business would attract GST at 18%, as it would be treated as a supply of service.

As per schedule II of the CGST Act, 2017, renting of immovable property is treated as taxable services under GST. However, only a specific type of renting of immovable property is included under taxable services.

These include:

a) Any lease, tenancy, easement, license to occupy land Lease or letting out of the building including a commercial, industrial or residential complex for business or commercial purposes, either wholly or partly
b) Since the above mentioned activities are taken as 'taxable services', they are subject to GST.
c) The person paying GST on rent can usually take credit for the tax paid to pay his other tax dues. In other words, if all the provisions to claim Input tax credit are fulfilled, ITC on GST paid on rent can be claimed.

**Definition of amount to be considered as per IFRS 16**

Para 23 at the commencement date, a lessee shall measure the right-of-use asset at cost.

The cost of the right-of-use asset shall comprise:

(a) the amount of the initial measurement of the lease liability, as described in paragraph 26;

(b) any lease payments made at or before the commencement date, less any lease incentives received;

(c) any initial direct costs incurred by the lessee; and

(d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

**Initial measurement**

Para 68 the lessor shall use the interest rate implicit in the lease to measure the net investment in the lease. In the case of a sublease, if the interest rate implicit in the sublease cannot be readily determined, an intermediate lessor may use the discount rate used for the head lease (adjusted for any initial direct costs associated with the sublease) to measure the net investment in the sublease.

Para 69 Initial direct costs, other than those incurred by manufacturer or dealer lessors, are included in the initial measurement of the net investment in the lease and reduce the amount of income recognised over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease; there is no need to add them separately.

Para 83 A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the lease income.

**Definition as per IAS 16**

Elements of cost

The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

**Conclusion**

**As regards the treatment of the non-refundable input VAT in determination of lease payments:**

**Considering the joint reading of IFRS 16 and IAS 16, following treatment would be appropriate**

a) If the Tax is legally not claimable, then it is appropriate to include the tax as part of lease payment cash flow and disclose the present value of cash flow as right of use asset.
b) If the exact value of input eligibility is not clear it is appropriate to include the entire amount as cost and not to include as part of lease cash flow, as this would lead to some portion of eligible tax included as part of lease cash flow and resultant inclusion in value of right to use asset.
c) If the tax is refundable then it is not appropriate to include tax as part of lease payments, as it would lead to refundable tax getting included as part of right of use asset.

**Regards**

Sounder Rajan

**Issue – IFRS 16 & irrecoverable taxes**

Thank you for the opportunity to comment on this.

VAT is a UK sales tax applied at the point a service / good is delivered. If you buy an asset the tax point is when the good is sold but for lease payments it is added to each individual lease invoice. Most organisations are able to recover VAT in full in which case no issue arises. A significant number of organisations are not able to recover VAT either because the supply they make is not eligible or for other reasons. Then the tax is irrecoverable and a cost to the entity.

IFRS 16 contains no specific reference to taxes or duties in its guidance on either the measurement of right-of-use assets and lease liabilities, or on variable lease payments.

I have considerable concerns that if the committee judgment stands it will seriously distort the accounts of asset light organisations, understate liabilities and mean the accounting treatment will distort decision making. It may also draw into question when irrecoverable VAT is recognised for accruals and liabilities.

The issue is if we wish to obtain for example a car – selling price 30,000 + VAT (@20%)=36,000. The organisation could borrow the money to purchase asset or lease it for essentially its full life. For simplicity the borrowing costs are the same.

| | Asset | Liability | Interest | VAT |
|---|---|---|---|---|
| Purchased and borrow | £36,000 | £36,000 | Expense | In asset & liability |
| Lease and do not apply IFRIC 21 | £36,000 | £36,000 | Expense | In asset & liability |
| Lease and apply IFRIC 21 | £30,000 | £30,000 | Expense | Expense over term of lease |

I understand the committee response, but it allows an "off balance sheet" liability and will influence decision making. As such this seems to evade the whole rationale of IFRS 16, as such we see the substance of the transaction is being missed and VAT should be included in the asset and liability.

| | Pro inclusion of VAT |
|---|---|
| IFRS 16<br>• Does not explicitly address taxes, duties etc;<br>• Requires lease liability and right-of-use asset to reflect lease payments that are fixed or in substance fixed;<br>• Variable lease payments are to be expensed. | I question if VAT falls within the scope of IFRIC 21, for reasons set out below;<br>• I consider that it is "in-substance fixed" because legislation would be required to change the amount. It is highly unlikely that leasing will become zero-rated and therefore this element is, in substance, unavoidable;<br>• Exclusion of VAT will cause inconsistencies in the application of the transitional adjustments where, for example, prepayments and accruals as at 31 March 2021 included irrecoverable VAT;<br>• From an IFRS 16 perspective, the right-of-use asset is transferred to the lessee at the |

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| | commencement of the lease, and is not supplied over the lease term. Given that VAT legislation treats leasing as a service supplied over the lease term, there is a disconnect between IFRS 16 and VAT legislation, which we believe should be resolved by applying the IFRS 16 perspective;<br>• The general principle of IFRS 16 is to bring debt (and assets) on-balance sheet. If an asset was purchased using a bank loan, and if the purchaser could not recover the VAT, the asset would be capitalised gross and the amount of the bank loan |
| IFRIC 21 *Levies*<br>• Para 4-5 definition: "an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (ie laws and/or regulations)", excluding fines and penalties, taxes within the scope of other accounting standards and purchases of goods and services;<br>• Basis for Conclusions BC6: "Amounts that are collected by entities on behalf of governments (such as value added taxes) and remitted to governments are not outflows of resources embodying economic benefits for the entities that collect and remit those amounts"<br>• The obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation; The presentation of the contra entry is outside the scope of this pronouncement. | • I am not sure that the Interpretations Committee intended irrecoverable VAT to be within scope of this IFRIC, partly due to the BC6 exclusion but more significantly because the IFRIC was written to cover levies triggered by the entity's decision to trade in a specific industrial sector e.g. banking levies;<br>• If the "date specified in legislation" is the tax point, this may differ from the normal accruals point e.g. if the invoice date is 14 days or less than the date of supply of goods. The logical consequence is that the VAT element may be recognised in a different accounting period from the net element;<br>• If the "date specified in legislation" is, instead, the date when the goods/services are supplied then, for a lease contract, for accounting purposes, the recognition point would be the commencement of the lease, when the right-of-use asset is transferred to the lessee. We also note that IFRIC 21 doesn't preclude the inclusion of a tax/duty within the cost of an asset;<br>• If the "date specified in legislation" is the date when the goods/services (as interpreted in VAT legislation/case law) are supplied, then the recognition point for the VAT element may again differ from the normal accruals point. |
| IAS 16 *Property, plant and equipment*<br>• •the cost of an asset comprises "its purchase price, including import duties and non-refundable purchase taxes"<br>• This is relevant to the treatment of former finance leases, which are valued on the | • From a "control" perspective, property, plant and equipment is transferred when the purchaser receives the item; right-of-use assets are transferred at the commencement |

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| same basis as assets owned outright, and are grandfathered in at their existing values; | of the lease, when the asset is made available to the lessee;<br>• Given that IFRS 16 then refers to IAS 16 (and IAS 40) in the context of subsequent measurement, this indicates that the IASB did not see right-of-use assets as being so very different from property, plant and equipment (or investment property) assets. |
| IAS 17 *Leases*<br>• "Minimum lease payments are the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor…".<br>• Lessees initially recognised finance-leased assets at the lower of the present value of the minimum lease payments, or fair value. | • It's questionable whether VAT is "paid by and reimbursed to the lessor", if the lessor is acting as an agent of HMRC in this respect.<br>• Finance lease assets have been subsequently measured on the same basis as owned property, plant and equipment, and are therefore grandfathered into IFRS 16 right-of-use assets measured gross. |

Bari,15/05/2021

International Account Standards Board
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London

Dear Board members,

abaut the request how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments.

While the lessor, making a purchase of the asset, charges a VAT on the invoice which is actually a tax credit, the lessee is in a reverse system from VAT to the charge for the sale made to VAT credit for payments of the rents, if the leasing revenues are also determined to the extent of this component. In the event of a retroactive lease sale, the lessee may find himself in a condition of exemption from indirect tax.

If the lessee included the non-refundable VAT in the lease payments, we could in my country, enter a regime almost at the limit of the legal, in my opinion we would find ourselves in a regime of double taxation and given the prohibition of double taxation governed by the Article 163 of Presidential Decree 917/1986 according to which "the same tax cannot be applied several times according to the same hypothesis, not even against different subjects", in my opinion there is a paradox, in the case of lease Liability in Sale and Leaseback, in this case the lessee pays a VAT on the sold property and then pays a VAT on the rent of the same property, therefore the income is taxed several times in the same subject.

Prohibition certainly deriving from the reflections of the economist James Mill (late 1822) and then taken up by Fischer and Enaudi in the "thesis of the double taxation of saved income" (Cesare Cosciani book of Finance, page 158).

Personally, in the case of property leasing, especially when they constitute commercial activity locations, where renovations are accounted for in business management, I would apply a direct taxation regime on the lessor's income as a patrimonial to avoid the excessively speculative effects deriving from the acquisition. of the asset, the reimbursement of the same by means of the deferral of the fees which, if they exceed the purchase cost, can form a taxable income in my opinion.

Yours sincerely,

Dr Esther Apa

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores
المنظمة الدولية لهيئات الأوراق المالية

18 May 2021

Ms. Sue Lloyd
Chair of the IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

**Our REF: 2021/O/C1/IFRIC/MS/31**

**RE: Tentative Agenda Decision – Non-refundable Value Added Tax on Lease Payments**

Dear ~~Ms. Lloyd~~, Sue

The International Organization of Securities Commissions (IOSCO) Committee on Issuer Accounting, Auditing and Disclosure (Committee 1) thanks you for the opportunity to provide our comments on the IFRS Interpretations Committee (IFRS IC) tentative agenda decision, *Non-refundable Value Added Tax on Lease Payments* (TAD).

IOSCO is committed to promoting the integrity of the international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect the general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

We appreciate the IFRS IC addressing this topic to support preparers in their application of International Financial Reporting Standard (IFRS) 16, *Leases* to the fact pattern submitted and believe doing so can contribute to consistent application of IFRS, which is a goal of Committee 1. We observe that the TAD noted that outreach conducted by the IFRS IC provided limited evidence (a) that non-refundable Value Added Tax (VAT) on lease payments is material to affected lessees; and (b) of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments, and therefore the IFRS IC decided not to add a standard-setting project to the work plan.

We agree with the IFRS IC's decision not to add a standard-setting project to the work plan but not for the reasons cited in the TAD. In our experience, these and similar tax arrangements exist in a number of different jurisdictions, and therefore we believe the issue is likely widespread and could be material for a number of entities. Further, members of Committee 1 are aware of differing views on the appropriate accounting in the fact pattern submitted, leading us to believe that diversity in practice is likely to exist. Therefore, we recommend that as part of the final Agenda Decision, the IFRS IC include an analysis of the accounting considerations an entity would need to assess in order to conclude on the appropriate accounting.

We believe that a framework that would be useful in the final Agenda Decision could be a "decision tree" similar to the concept that was discussed by some of the IFRS IC members at the meeting on 16 March 2021. Because facts and circumstances may vary by jurisdiction, including an analysis in the final Agenda Decision could be used by issuers to evaluate their specific fact pattern which could reduce any diversity in practice.

With regards to the fact pattern submitted, a view held by some members of Committee 1 is that an assessment of which party (the lessee or lessor) is the primary obligor to the taxing authority for the non-refundable VAT should first be performed. That analysis might be similar to the principal vs agent analysis under IFRS 15 *Revenue from Contracts with Customers*. Under this approach, if the lessee is the primary obligor and the lessor is, in substance, collecting those amounts as an agent on behalf of the taxing authority, then the non-refundable VAT payments would not be part of the consideration in the lease contract (and thus not form part of the lease liability and right-of-use asset) since they are not payments to the lessor for the right to use the asset. Rather, they are part of a separate arrangement between the lessee and the taxing authority.

A second view held by some members of Committee 1 is that, by law, the lessee has the obligation to pay the amounts specified in the lease contract to the lessor, which are increased by VAT. The fact that the lessor might be acting as an agent to collect the VAT for the government does not alter the lessee's obligation to pay the full amount invoiced by the lessor (i.e., the lessee would be in default of the lease agreement if it withheld from its periodic payments the amount attributable to VAT). Since IFRS 16.26 measures the lease liability at the commencement date as the present value of the lease payments that are not yet paid, under this view the VAT is part of the payments due to the lessor and meets the definition of lease payments. Proponents of this view note the result (including VAT payments in the calculation of the right-of-use asset) is consistent with the accounting for purchases of property, plant and equipment.

Given the diversity in views and the widespread nature of this issue, we believe an explanatory analysis with references to the guidance in IFRS 16 should be provided as part of the final Agenda Decision. This would help drive comparable accounting results for those jurisdictions where diversity may exist.

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We appreciate your thoughtful consideration of the views provided in this letter.

If you have any questions or need additional information, please do not hesitate to contact Cameron McInnis, Chair of the Accounting Subcommittee of Committee 1 at +1 416-593-3675 or myself. In case of any written communication, please mark a copy to me.

Yours sincerely,

Makoto Sonoda

Chair
Committee on Issuer, Accounting, Audit and Disclosure
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INVESTOR IN PEOPLE

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20 May 2021

Dear IFRS Interpretations Committee members,

**Invitation to comment – Tentative Agenda Decision (TAD): Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)**

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above tentative agenda decision of the IFRS Interpretations Committee (the Committee) published in the March 2021 *IFRIC Update*.

The Committee discussed the question on how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments. We agree with the Committee's decision not to add a standard-setting project to the work plan.

This issue arises in a number of sectors, such as financial services, and in many jurisdictions. Thus, it is relevant to many IFRS preparers globally.

We believe that, despite the Committee's observation that it did not obtain evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected, this tentative agenda decision could be improved by clarifying what the Committee's observed practice is and whether such limited diversity in practice is a result of a consistently applied technical interpretation(s) (e.g., determining whether the VAT payments are a lessee or lessor cost). Alternatively, this could be achieved by providing educational guidance separately.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 [0]20 7951 3152.

Yours faithfully,

Ernst & Young Global Limited

Dear Sir or Madam,

I am so glad to notice there is a tentative agenda regarding the non-refundable Value Added Tax (VAT) on lease payment.

Based on my understanding, most companies have adopted the EU VAT mechanism, I,e, the VAT could be refundable if the assets or services purchased are used for VAT taxable transactions. Under this circumstance, VAT does not bother the lease treatment.

On the other hand, if the VAT related assets or services purchased are not used for VAT taxable transaction, then VAT is not refundable. Under this circumstance, how to treat the VAT is in dispute and need more guidance for lease.

Regarding the two questions in the tentative agenda, let me input some information of China:

1) that non-refundable VAT on lease payments is material to affected lessees;

   In China, the VAT on real assets lease is 5% or 9% of the transaction consideration. 5% is a preferential tax rate and 9% is a standard tax rate.

   It is very common that certain industry cannot reclaim its VAT paid for real assets lease as the lessees are enjoying VAT exemption incentives for its transaction.

2) of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

   The VAT paid is accounted as cost under the initial measurement if the services or assets purchased are used for non-VAT taxable transactions.

As the EU VAT mechanism is widely adopted in the world, looking forward to a clear guidance for non-refundable VAT treatment to clarify the disputes.

Thanks a lot.
Monica

**PRE-032/21**
May,  24 th, 2021

**IFRS Foundation**
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**Canary Wharf**
**London**
**commentletters@ifrs.org**

**Reference: Tentative Agenda Decision Non-refundable Value Added Tax on Lease Payments (IFRS 16).**

**Dear Sirs,**

The Brazilian Association of Public Companies (Abrasca, as abbreviated in Portuguese) welcomes the opportunity to submit comments on the Tentative Agenda Decision Non-refundable Value Added Tax on Lease Payments (IFRS 16). Our comments reflect the views of our 352 members, which include public companies of different sizes and different segments in Brazil.

Abrasca supports the IFRS Interpretations Committee (Committee) initiative to discuss a request received about how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments (the matter).

We noted that the Committee tentatively decided not to add a standard-setting project to the work plan because it has not yet obtained evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected.

If the Committee obtains the aforementioned evidence and decides that a broader guidance should be provided, e.g. to the matter and similar tax arrangements, we suggest that such guidance should be addressed either

by adding a standard-setting project to the work plan or as part of the Post-implementation Review (PIR) of IFRS 16.

Should the Committee decides to issue an agenda decision, in our view, its conclusion should be applied only to the particular fact pattern submitted.

If you have any questions regarding our comments, please contact us at abrasca@abrasca.org.br;milton@abrasca.org.br

Yours sincerely,

Eduardo Lucano dos Reis da Ponte

Executive president

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24 May 2021

Sue Lloyd
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IFRS Interpretations Committee
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Dear Ms Lloyd

## Tentative agenda decision – Non-refundable Value Added Tax on Lease Payments (IFRS 16)

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the March 2021 Update of the tentative decision not to take onto the Committee's agenda the request for clarification on how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda. However, we do not agree with the proposed wording of the agenda decision. We believe that the agenda decision should set out the appropriate treatment of VAT charged on lease payments and offer our thoughts on possible wording below. We believe that this would be useful as we encounter the issue of how to treat non-refundable VAT charged on lease payments regularly in practice.

In our view the appropriate treatment for the type of VAT scheme described in the agenda decision, and other similar tax schemes, is to exclude the VAT within the lease payments used to calculate the lease liability. The basis of this accounting treatment is that as an amount collected by the lessor on behalf of the tax authority (rather than a reimbursement of a cost incurred by the lessor), the VAT does not 'relate to the right to use the underlying asset'. Therefore, it does not form part of either 'lease payments' or 'variable lease payments' as defined in Appendix A to IFRS 16 and is not a cost to be included in the consideration for the contract under IFRS 16:B33. Instead, the lessee accounts for the VAT applying IFRIC 21 and recognises a VAT liability when payment is triggered under the relevant legislation.

We believe strongly that an explanation of the appropriate accounting treatment in the agenda decision would prevent diversity arising in practice.

Additionally, we would suggest that the agenda decision should refer to 'Value added tax and other similar taxes' to ensure that it is clear that this decision applies to other tax regimes with similar terms.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Deloitte.

Yours sincerely

Veronica Poole
Global IFRS Leader

Dear members of the International Accounting Standards Board,

We appreciate the opportunity to comment on the *Tentative Agenda Decision: Non-refundable Value Added Tax on Lease Payments (IFRS 16).* We are faculty members of the Department of Financial Economics and Accounting at Universidad Loyola Andalucía (Spain).

We have been studying the IFRS 16 *Leases* for a long time, and we would like to share the following specific comments on the tentative agenda decision:

**We agree with the decision not to add a project to the work plan,** but we are aware that this type of arrangements exists in Spain. The issue could affect a large number of entities that can recover only a portion of the VAT charged on purchased goods or services (the so-called VAT pro rata), including leases, and especially all entities in the banking and insurance sectors where their activities are exempt from VAT and 100% of the VAT charged cannot be recovered.

Regarding the issue raised, we believe that there could be two different interpretations:

- To consider the VAT payment as a component of the lease payment and therefore as part of the lease liability and, since it is non-recoverable, a component of the cost of the right-of-use asset (as in IAS 16.16 (b) and IAS 2.11). An additional concern to those described in the fact pattern is how the lessee should measure the right of use and the lease liability if it is probable that the pro rata rule changes throughout the term of the contract. We believe that they operate as a variable payment similar to index-related payments. Thus, the right of use and the lease liability should be subsequently reassessed considering the final percentage for the application of the pro rata rule.
- To consider the VAT payment as a payment of a fiscal nature that does not form part of the payment to the lessor for the right to use the asset and, consequently, its initial recognition would not be appropriate. Since the VAT is accrued when the invoice for payment is issued, it would be a cost incurred after the right of use has begun to "operate", and should therefore be recognized as an expense for the period and not as part of the value of the right of use. This accounting treatment would be consistent with that when the VAT is recoverable since, in that case, it is not initially recognized.

The existence of these two possible interpretations could lead to diversity in the accounting treatment in practice, and we consider that a clarification would be advisable.

Please do not hesitate to contact us for any clarification or further information.

Sincerely,

**PhD Horacio Molina-Sánchez PhD Marta de Vicente-Lama Mar Ortiz-Gómez**

**Universidad Loyola Andalucía**

MASB MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

24 May 2021

Ms. Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Ms. Lloyd,

**IFRS Interpretations Committee Tentative Agenda Decisions**

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the following Tentative Agenda Decisions:

(a) Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32 *Financial Instruments: Presentation*)

(b) Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)

We agree with the Interpretations Committee's reasons set out in the respective Tentative Agenda Decisions for not adding these items to the work plan. However, in the event that non-refundable value added tax on lease payments is found to have a widespread effect and has, or is expected to have a material effect on those affected, we recommend that the Interpretations Committee considers adding this item to the work plan, to support the consistent application of IFRS Standards.

If you need further clarification, please contact the undersigned by email at beeleng@masb.org.my or at +603 2273 3100.

Thank you.

Yours sincerely,

**TAN BEE LENG**
*Executive Director*

Unit 13A-1, Menara MBMR, No. 1, Jalan Syed Putra, 58000 Kuala Lumpur
Tel : (603) 2273-3100 Fax: (603) 2273-9400 Email : masb@masb.org.my Website : www.masb.org.my

May 24, 2021

Ms Sue Lloyd,
Chair, IFRS Interpretations Committee,
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Ms Sue,

**Subject: Comments of the Institute of Chartered Accountants of India (the ICAI) on Tentative Agenda Decision (TAD) issued by IFRS Interpretations Committee on 'Non-refundable Value Added Tax on Lease Payments (IFRS 16)'**

The Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (the ICAI) welcomes the opportunity to comment on above referred Tentative Agenda Decision of the IFRS Interpretations Committee.

With respect to the conclusions in TAD pertaining to accounting by the lessee for any non-refundable value added tax (VAT) charged on lease payments by the lessor, we have the following comments:

It may be noted that IFRS 16, *Leases* does not provide a clear guidance with regard to the accounting treatment of taxes (refundable or non-refundable) relating to lease payments as to whether non-refundable VAT should be capitalised as a part of the cost of the right of use asset on initial recognition and included in the measurement of the lease liability by a lessee. We agree with Committee's decision of not adding the above-mentioned matter as a part of standard-setting project. However, we believe that it would be useful if the agenda decision provides a clear accounting guidance on the matter. Not giving a clear decision would create uncertainty in the minds of the users of the Agenda Decision about the correct treatment of the transaction.

It may be noted that in India, Goods and Service Tax (GST) is corresponding to VAT and the incidence of GST is on supply of goods or services and it is recovered from the customer (i.e., lessee in the instant case). From the lessor's perspective, amounts collected on behalf of third parties, such as, sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity. Therefore, they are excluded from revenue.

From the lessee's perspective, GST is a consumption-based tax which is the liability of the lessee towards the Government. Although the same is paid by the lessee to the lessor, it cannot be considered as 'lease payment' since it is paid to the government by the lessor and the lessor is merely acting as a collection agent. Accordingly, we are of the view that GST payment does not meet the definition of 'lease payments' because these payments are not payments to lessor in exchange for right to use the underlying asset.

In view of the above, we believe that VAT, whether or not refundable, should not be included in the measurement of the lease liability or right-of-use asset. Accordingly, in the given case, non-refundable VAT should be charged to the profit or loss when the underlying transaction occurs.

With kind regards,

CA. M.P. Vijay Kumar

Chairman
Accounting Standards Board,
Institute of Chartered Accountants of India

**Buenos Aires, Argentina, May 24, 2021**

**IFRS Foundation**
**Columbus Building**
**7 Westferry Circus**
**Canary Wharf**
**London E14 4HD**
**United Kingdom**

**REF: IFRS IC Tentative Agenda Decisions made in the March 16 and 17, 2021 meeting**

Dear Board Members,

The "Group of Latin American Standards Setters"[1] (GLASS) appreciates the opportunity to comment on the Tentative Agenda Decisions (TAD) adopted by the IFRS IC during its meeting on March 16 and 17, 2021, which included the following topic:

- **Non-refundable value-added tax on lease payments (IFRS 16)**

This response summarizes the points of view of the members of the different countries that comprise GLASS, pursuant to the following due process.

**Due process**

The discussions regarding the Tentative Agenda Decisions of IFRS IC were held within a specified Permanent Technical Commission (PTC) created in December 2020. All GLASS country-members had the opportunity to appoint at least one member to participate in this PTC. Each standard setter represented in GLASS has undertaken different tasks in their respective countries (e.g., surveys, internal working groups). All results were summarized, and this summary was the platform for GLASS discussion process.

GLASS discussed the different points of view included in the summary through emails exchange between its members. In those emails GLASS developed a final document on the basis of the consensual responses and the technical points of view of its members. Finally, the GLASS document was submitted to and approved by the GLASS Board.

**Comments:**

**Non-refundable value-added tax on lease payments (IFRS 16)**

GLASS agrees that it is not necessary for the issue to be included as a subject on the IASB's agenda and that a response be made explicit through the Agenda Decision (DA) procedure on the proper application of the accounting treatment that should be given to VAT on leases that are not recoverable through applicable tax procedures, but it does not agree with the IFRS IC arguments for adopting this decision due to the arguments set out below.

GLASS considers that the inclusion of the subject as a DA is necessary since the subject is applicable in numerous situations in the region when the lessee, due to various situations, cannot use the tax credit that arises from the transaction, thus becoming a cost for the entity, so it is necessary to avoid diversity in practice.

GLASS agrees that, while recoverable VAT should not be added to lease payments, and therefore should not be included in the right-of-use asset, non-recoverable VAT represents an incremental cost of the right of use and therefore must be added to the lease payments and the right-of-use asset.

[1] The overall objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions with respect to all Exposure Drafts issued by the IASB. Therefore, GLASS aims to have a single regional voice before the IASB. GLASS is constituted by: Argentina (Chairman), Bolivia, Brazil (Board), Chile (Board), Colombia (Board), Costa Rica (Board), Ecuador, Guatemala, Honduras, Mexico (Vice Chairman), Panama, Paraguay, Peru (Board), Dominican Republic, Uruguay (Board) and Venezuela (Board).

This conclusion is consistent with paragraph 16 of IAS 16, *Property, Plant and Equipment*, which establishes that “The cost of an item of property, plant and equipment comprises: (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates."

GLASS considers that the existing standards to which reference was made are sufficient to justify an Agenda Decision in the indicated sense, that is, that the application by analogy of similar IFRS should lead us to the conclusion that non-recoverable VAT (or other taxes of similar characteristics with different names that exist) should be considered as an integral part of the lease payments and included in the asset for the right of use in accordance with IFRS 16.

**Contact**

If you have any questions about our comments, please contact glenif@glenif.org.

Sincerely yours,

**Jorge José Gil**
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

ICAN

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

*(Established by Act of Parliament No. 15 of 1965)*

PLOT 16, IDOWU TAYLOR STREET, VICTORIA ISLAND,
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**Tel:** 09053847510-1
**Email:** info.ican@ican.org.ng, rce@ican.org.ng
**Website:** www.icanig.org

***Registrar/Chief Executive***
AHMED M. KUMSHE (PROF.), FCA

**May 24, 2021**

ICAN/ED/R&T/MAY21/2021

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD.

Dear Sir,

**Re: Tentative Agenda Decision and comment letters: Non-refundable Value Added Tax on Lease Payments (IFRS 16)**

Please find below our responses to the Tentative Agenda Decision named above.

**Request:** The request asked whether, in applying IFRS 16, the lessee includes non-refundable VAT as part of the lease payments for a lease.
Outreach conducted by the Committee provided limited evidence:

a. that non-refundable VAT on lease payments is material to affected lessees; and

b. of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

**Responses:**

**The Nigerian VAT law provides that VAT can only be recovered on goods purchased or imported directly for resale or goods that form the stock-in-trade used for the direct production of any new product on which the output tax is charged. Therefore, in Nigeria, VAT cannot be recovered on services rather, the law provides that such VAT on overhead, services etc. should be expensed through the income statement. It also provides that any VAT to be capitalised along with the cost of a capital item and asset will not be allowed as a deduction from output tax.**

**As lease payments and capital repayments (under a finance lease) are subject to VAT, the question has arisen for our opinion on how the VAT which cannot be recovered as stated above (i.e. non-refundable) should be accounted for by the lessee.**

**VAT is chargeable on the supply of goods and services except for those specifically exempt by the Act. Based on the VAT Act, a supply is deemed to take place at the time an invoice or receipt is issued by the supplier (i.e. the lessor) or payment of consideration is due to, or received by the supplier in respect of that supply, whichever occurs first.**

**The lessor is responsible for including VAT on its invoice to the lessee who in turn is expected to make the lease payment and the associated VAT to the lessor. The obligating event to the lessee is the issue of invoice by the lessor and it is at this point that the lessee recognises a liability for the VAT on each invoice that it receives from the lessor and not at the beginning of the lease term. Therefore, VAT would not have been included as part of the right-of-use asset and lease liability at initial recognition.**

**The VAT represents the definition of a levy in line with IFRIC 21 as it represents an outflow of resources embodying economic benefits that is imposed by the government. The payment of VAT therefore does not relate to the right to use the underlying asset but relates to a payment due to the government. A lessee will therefore recognise a liability and corresponding expense for each VAT payment on each invoice date and not at the commencement of the lease term.**

**If there are companies or jurisdictions who include VAT as lease payments on initial lease recognition even when service is not invoiced, then it means that there may well be diverse treatments.**

We thank you for allowing us to contribute to the post-implementation review and we are available should there be a need for further clarification.

Yours faithfully,
For: Registrar/Chief Executive

ICAnaso

**Dr. Ijeoma Anaso**
Director, Technical & Education

PO Box 1411
Beenleigh QLD 4207
24 May 2021

Ms Sue Lloyd
Chair IFRS Interpretations Committee
International Accounting Standards Board
Columbus Building, 7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Online submission: https://www.ifrs.org/projects/work-plan/non-refundable-value-added-tax-on-lease-payments-ifrs-16/

Dear Sue

**Tentative agenda decision - Non-refundable value-added tax on lease payments (IFRS 16)**

I am pleased to make this submission on the above Tentative Agenda Decision (TAD) relating to Non-refundable value-added tax on lease payments (IFRS 16).

I have extensive experience in accounting advice on International Financial Reporting Standards across a wide range of clients, industries and issues in the for-profit, not-for-profit, private and public sectors.

My clients have included listed companies, unlisted and private companies, charitable and not-for-profit organisations, federal, state and local government departments and agencies in the public sector, and government owned corporations (government business enterprises). I also have some commercial, standard setting and academic experience.

**Overall**

I agree with issuing the tentative agenda decision as drafted for the reasons given.

I support my reasoning below with:
1. Lack of prevalence as a material issue
2. References to accounting for treatment of Australia's GST (Goods and Services Tax) – Australian Interpretation 1031
3. Transition to IFRS 16 (AASB 16) by some major Australian banks that do not recover all their GST
4. Consistency with other taxes.

# 1 Lack of prevalence as a material issue

I cannot recall the issue being raised, or raised as a major issue, amongst the various discussion groups I am involved with. These groups include representatives from large and medium-sized accounting firms, accounting professional bodies, and accounting standard setters.

Below I consider the treatment by Commonwealth Bank of Australia (CBA) of unrecoverable GST on its lease payments.

For some context, CBA, as Australia's largest bank, has:

> Net Unrecoverable GST/VAT of $243 million from a
> Group Profit Before Income Tax of $10,479 million.
>
> Source:
>
> > CBA Tax Transparency Code report 2020
> > https://www.commbank.com.au/content/dam/commbank/assets/about/opportunity-initiatives/commbank-tax-transparency-code.pdf

## 2 References to accounting for treatment of Australia's GST (Goods and Services Tax) – Australian Interpretation 1031

In Australia Goods and Services Tax (GST) cannot be reclaimed for some "input taxed" services, including financial supplies.

Australia has specific guidance for GST with Interpretation 1031 *Accounting for the Goods and Services Tax (GST).* The Interpretation was originally issued by the Urgent Issues Group before IFRS. Therefore, it was drafted before IFRIC Interpretation 21 and before AASB 16 / IFRS 16.

The consensus in the Interpretation is:

> **Consensus**
>
> **6 Revenues, expenses and assets shall be recognised net of the amount of goods and services tax (GST), except where paragraphs 7 and 8 apply.**
>
> **7 The amount of GST incurred by a purchaser that is not recoverable from the taxation authority shall be recognised as part of the cost of acquisition of an asset or as part of an item of expense.**
>
> **8 Receivables and payables shall be stated with the amount of GST included.**
>
> **9 The net amount of GST recoverable from, or payable to, the taxation authority shall be included as part of receivables or payables in the statement of financial position.**
>
> **10 Cash flows shall be included in the statement of cash flows on a gross basis, subject to paragraph 11 and to AASB 107 *Statement of Cash Flows*.**
>
> **11 The GST component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the taxation authority shall be classified as operating cash flows.**

Consequently, I often see (where disclosed) a GST policy being something similar to the above, and something similar to the GST policy in PwC's model financial statements – Value Accounts Holdings 2020:

> 25 Summary of significant accounting policies
> (ad) Goods and Services Tax (GST)
>
> Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the taxation authority. In this case it is recognised as part of the cost of acquisition of the asset or as part of the expense.
>
> Receivables and payables are stated inclusive of the amount of GST receivable or payable. The net amount of GST recoverable from, or payable to, the taxation authority is included with other receivables or payables in the balance sheet.
>
> Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the taxation authority, are presented as operating cash flows.
>
> https://www.pwc.com.au/ifrs/value-accounts.html

However, both Interpretation 1031 and common GST accounting policies (like PwCs) omit reference to the treatment of GST and unrecoverable GST for commitments.

EY includes the GST treatment in commitments in its model financial statements Good Group (Australia) 31 Dec 2020:

> **2.3 Significant accounting policies**
> ***Goods and services tax (GST)***
> Revenues, expenses and assets are recognised net of the amount of GST, except:
>
> - When the GST incurred on a sale or purchase of assets or services is not payable to or recoverable from the taxation authority, in which case the GST is recognised as part of the revenue or the expense item or as part of the cost of acquisition of the asset, as applicable
> - When receivables and payables are stated with the amount of GST included
>
> The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the statement of financial position. **Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.**
>
> Cash flows are included in the statement of cash flows on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority is classified as part of operating cash flows.
> **(emphasis added)**
>
> https://assets.ey.com/content/dam/ey-sites/ey-com/en_au/pdfs/good-group-australia-limited-december-2020-v42-71312.pdf

# 3 Transition to IFRS 16 (AASB 16) by some major Australian banks that do not recover all their GST

I researched the transition treatment of lease commitments to AASB 16 / IFRS 16 for the largest four Australian banks, and three others. This was aimed to include input-taxed entities and those that might have relatively large leases (for their declining branch network).

The research was inconclusive:

- None of the seven banks was clear as to how they accounted for non-recoverable GST on commitments – so it is not clear which banks included non-recoverable GST in their commitments under AASB 117 / IAS 17 (that were used as a base for transition disclosures to AASB 16 / IFRS 16)
- Three banks specifically included an adjustment to remove GST from their lease commitments on transition (and one possible)
- The banks removing GST from commitments and the IFRS 16 (AASB 16) lease liability did not disclose their reasoning.

None of the adjustments appears material to the lease balance, let alone to the balance sheet and P&L of the banks.

| **Name (2020 annual report)** | **Stated GST Policy** | **Commitments adjusted for GST on transition to AASB 16** |
|---|---|---|
| CBA - Commonwealth Bank of Australia | Not disclosed | Yes – To remove GST |
| National Australia Bank Limited (NAB) | Not disclosed | No |
| Westpac Banking Corporation (Westpac) | Not disclosed | Not identified as a major reconciling item |
| Australia and New Zealand Banking Group Limited | Not disclosed | No |
| Bank of Queensland Limited | Yes – But commitments treatment not disclosed | Yes – To remove GST |
| Bendigo and Adelaide Bank Limited | Yes – But commitments treatment not disclosed | Yes – To remove GST |
| Heritage Bank Limited | Yes – But commitments treatment not disclosed | Possible - Not identified as a major reconciling item – Though there is a big “other” type category |

## 4 Consistency with other taxes

I am in favour of excluding non-recoverable for a variety of reasons.

I do note that excluding GST from the lease payments appears to arrive at a different answer than if the asset was purchased (and GST included). However, the right-of-use asset was not purchased, and therefore not subject to GST on the purchase. While the lease payments are recorded as a borrowing, I note that usually loan repayments are not subject to GST – and therefore it would make sense not to include GST on the loan repayments as part of the cost of the right-of-use asset.

I also note that recognising a liability only when the rental payment is due and payable (e.g. Interpretation 21), may appear to be different to the treatment for on-costs accrued as a liability for employee benefits – specifically payroll taxes that are accrued for accounting as the employee service is provided but payable when the benefit (such as annual leave) is taken.

Yours sincerely,

David Hardidge
https://www.linkedin.com/in/davidhardidge/

Sources:

CBA - Commonwealth Bank of Australia
https://www.commbank.com.au/about-us/investors/annual-reports.html

National Australia Bank Limited (NAB)
https://www.nab.com.au/about-us/shareholder-centre/financial-disclosuresandreporting/annual-reports-and-presentations

Westpac Banking Corporation (Westpac)
https://www.westpac.com.au/about-westpac/investor-centre/annual-report/

Bank of Queensland Limited
https://www.boq.com.au/Shareholder-centre/financial-information/Annual-Report

Australia and New Zealand Banking Group Limited (ANZ)
https://www.anz.com/shareholder/centre/reporting/annual-report-annual-review/

Bendigo and Adelaide Bank Limited
https://www.bendigoadelaide.com.au/investor-centre/reports/

Heritage Bank Limited
https://www.heritage.com.au/about/financial-reports

# Notes to the financial statements

For the year ended 30 June 2020

## 1.1 General information, basis of accounting, changes in accounting policies (continued)

The following table reconciles the operating lease commitments disclosed under AASB 117 as at 30 June 2019 to the opening lease liabilities recognised under AASB 16 as at 1 July 2019.

| | Group $M | Bank $M |
|---|---|---|
| **Operating lease commitments as at 30 June 2019 under AASB 117** | **4,078** | **3,760** |
| Increase in the lease term for extension options | 566 | 536 |
| Inclusion of technology contracts not recognised as a lease under AASB 117 | 71 | 71 |
| Exclusion of leases with a remaining term of less than one year and low value leases | (96) | (92) |
| Exclusion of service components | (738) | (738) |
| Exclusion of operating lease commitments regarding contracts not yet commenced | (610) | (610) |
| Exclusion of GST | (274) | (226) |
| **Total undiscounted lease payments** | **2,997** | **2,701** |
| Effect of discounting at a weighted average incremental borrowing rate of 2.8% | (267) | (231) |
| **Total lease liabilities as at 1 July 2019 under AASB 16** | **2,730** | **2,470** |
| Provision for lease restoration obligations | 135 | 121 |
| **Total liabilities recognised on adoption of AASB 16** | **2,865** | **2,591** |

### Adoption of interpretations and amendments to existing standards

**AASB Interpretation 23 *Uncertainty over Income Tax Treatments* (Interpretation 23)**

Interpretation 23 clarifies the application of the recognition and measurement criteria in AASB 112 *Income Taxes* where there is uncertainty over income tax treatments. It requires an assessment of each uncertain tax position to determine whether it is probable that a taxation authority will accept the position. Where it is not considered probable, the effect of the uncertainty will be reflected in determining the relevant taxable profit or loss, tax bases, unused tax losses, unused tax credits or tax rates. The amount will be determined as either the single most likely amount or the sum of the probability weighted amounts in a range of possible outcomes, whichever better predicts the resolution of the uncertainty. Judgements will be reassessed as and when new facts and circumstances are presented. The previous recognition and measurement requirements applied by the Group are aligned with Interpretation 23 and hence no transition adjustment to retained earnings was required.

**Other amendments**

The following amendments to existing standards were adopted during the current year but did not have an impact on the Group:

- AASB 128 *Investments in Associates and Joint Ventures* was amended to clarify that an entity should first apply the measurement and expected credit loss requirements of AASB 9 to its long-term debt investments that form part of the net investment in an equity accounted investee, before applying the loss allocation and impairment requirements of AASB 128; and
- AASB 119 *Employee Benefits* was amended to specify the treatment of a plan amendment, curtailment or settlement that occurs during a reporting period. An entity should use the assumptions applied in the remeasurement of the net defined benefit liability or asset when determining the current service cost and the net interest in the period following the plan event.

Other minor amendments to existing standards were adopted in the current reporting period.

### Commodity financing transactions

During the financial year ended 30 June 2020, the Group amended its accounting policy in respect of certain short-term commodity financing transactions, which are not clearly captured within the scope of any accounting standard. The Group reclassified a portfolio of physical commodities, previously accounted for as inventories under AASB 102 *Inventories*, to loans designated at fair value through profit or loss under AASB 9. Significant judgement has been applied in assessing whether control of the commodities transfers to the Group on inception of the transaction. In line with evolving technical interpretation of the accounting requirements for commodity transactions, it has been determined that control of the commodities does not transfer to the Group. The transactions are therefore more fairly presented as loans. The change has been applied retrospectively and impacted the prior year financial statements of both the Group and the Bank, as follows:

- an increase in Interest income, and a corresponding decrease in Other banking income, for the year ended 30 June 2019 of $121 million (30 June 2018: $128 million); and
- an increase in Commodities financing and other lending, and a corresponding decrease in Commodities, presented within Assets at fair value through income statement, as at 30 June 2019 of $6,854 million (30 June 2018: $7,353 million).

Where relevant, comparative information has been restated. All changes have been footnoted throughout the financial statements.

# NOTE 1 BASIS OF PREPARATION (CONTINUED)

**Change in accounting policies**

The Group adopted the following new accounting standards and interpretations effective from 1 October 2019:

- AASB 16 *Leases*
- AASB 2019-3 *Amendments to Australian Accounting Standards - Interest Rate Benchmark Reform*
- AASB Interpretation 23 *Uncertainty over Income Tax Treatments*.

*AASB 16 Leases*

AASB 16 significantly changes accounting for lessees, requiring recognition of all leases (subject to certain exceptions) on balance sheet in a manner comparable to how finance leases were previously accounted for under AASB 117 *Leases*, including related interpretations. Lessor accounting remains largely unchanged compared to AASB 117.

The Group adopted AASB 16 using the modified retrospective transition option, and as a result, comparative information from prior periods has not been restated.

On transition, AASB 16 requires the lease liability to be measured based on the future lease payments and permits two options for the measurement of the right-of-use asset. The right-of-use asset may either be measured with reference to the value of the lease liability or retrospectively (independently from the lease liability). The standard allows for these measurement options to be applied on a lease-by-lease basis.

The impact of the adoption of AASB 16 was disclosed in the Group's 2019 Annual Financial Report. In making these disclosures, the right-of-use assets were measured with reference to the value of the lease liability.

Subsequently, the Group determined that retrospective measurement of the right-of-use asset provides a more accurate reflection of the remaining utility of the assets. Consequently, the Group has recalculated the right-of-use assets for its most significant building leases using the retrospective measurement option.

The impact of adopting AASB 16 as at 1 October 2019 is as follows:

| | $m |
|---|---|
| **Opening retained profits at 1 October 2019** | **16,583** |
| Right-of-use assets | 1,393 |
| Net deferred tax asset | 35 |
| Lease liabilities | (1,425) |
| Make-good provisions | (86) |
| **Net impact on retained profits** | **(83)** |
| **Adjusted retained profits at 1 October 2019** | **16,500** |

The following table reconciles the operating lease commitments disclosed under AASB 117 as at 30 September 2019 to the opening lease liabilities recognised under AASB 16 as at 1 October 2019.

| | $m |
|---|---|
| **Operating lease commitments at 30 September 2019** | **2,888** |
| Less leases committed but not yet commenced | (1,308) |
| Less short-term and low value leases | (65) |
| Add reassessments under AASB 16 | 2 |
| Effect of discounting at a weighted average incremental borrowing rate of 2.2% | (92) |
| **Opening lease liabilities at 1 October 2019** | **1,425** |

On transition the Group, as lessee, applied the following practical expedients as permitted by AASB 16:

- Relied on previous assessments of contracts that were identified as leases under AASB 117.
- Applied a single discount rate to a portfolio of leases with reasonably similar characteristics.
- Relied on previous assessments in relation to whether leases are onerous.
- Accounted for leases for which the lease term ends within 12 months of 1 October 2019 as short-term leases.
- Excluded initial direct costs from the measurement of right-of-use assets.
- Used hindsight to determine the lease term.

# Notes to the financial statements

## Note 1. Financial statements preparation

This financial report of Westpac Banking Corporation (the Parent Entity), together with its controlled entities (the Group or Westpac), for the year ended 30 September 2020, was authorised for issue by the Board of Directors on 1 November 2020. The Directors have the power to amend and reissue the financial report.

The principal accounting policies are set out below and in the relevant notes to the financial statements. The accounting policy for the recognition and derecognition of financial assets and financial liabilities precedes Note 10. These accounting policies provide details of the accounting treatments adopted for complex balances and where accounting standards provide policy choices. These policies have been consistently applied to all the years presented, unless otherwise stated.

### a. Basis of preparation

#### (i) Basis of accounting

This financial report is a general purpose financial report prepared in accordance with:

- the requirements for an Authorised Deposit-taking Institution (ADI) under the Banking Act 1959 (as amended);
- Australian Accounting Standards (AAS) and Interpretations as issued by the Australian Accounting Standards Board (AASB); and
- the Corporations Act 2001.

Westpac Banking Corporation is a for-profit entity for the purposes of preparing this financial report.

The financial report also complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and Interpretations as issued by the IFRS Interpretations Committee (IFRIC). It also includes additional disclosures required for foreign registrants by the United States Securities and Exchange Commission (US SEC).

All amounts have been rounded in accordance with ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191, to the nearest million dollars, unless otherwise stated.

#### (ii) Historical cost convention

The financial report has been prepared under the historical cost convention, as modified by applying fair value accounting to financial assets and financial liabilities (including derivative instruments) measured at fair value through income statement (FVIS) or in other comprehensive income (OCI).

#### (iii) Standards adopted during the year ended 30 September 2020

**AASB 16 *Leases* (AASB 16)**

AASB 16 was adopted by the Group on 1 October 2019. AASB 16 requires all operating leases of greater than 12 months duration be presented on balance sheet by the lessee as a right-of-use (ROU) asset and lease liability. There are no significant changes to lessor accounting.

The Group adopted the standard using the simplified approach of transition with no restatement of comparative information and no effect on retained earnings.

The lease liabilities are measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate at 1 October 2019. On transition to the new standard, the lease liability recognised in other liabilities was $3.3 billion for the Group and $3.0 billion for the Parent Entity. The associated ROU assets of $3.2 billion for the Group and $2.9 billion for the Parent Entity were measured at an amount equal to the lease liability, less previously recognised accrued lease payments of $0.1 billion for the Group and the Parent Entity. The ROU assets are recognised in property and equipment.

All leases on balance sheet give rise to a combination of interest expense on the lease liability and depreciation of the ROU asset. Interest expense is recognised in net interest income on an effective yield basis. Depreciation expense is recognised in operating expenses on a straight-line basis over the lease term.

Extension options are included in a number of lease contracts. The extension options are only included in the lease term if the lease is reasonably certain to be extended, which is assessed by the Group at the lease commencement date. The assessment is reviewed if a significant event or significant change in circumstances occurs which affects this assessment and is within the control of the Group. The Group considered the impact of COVID-19 on our assessment of extension options and concluded that they were unchanged. The Group also considered the impact of COVID-19 on the carrying value of the ROU asset and determined there was no impairment.

The Group used the incremental borrowing rate based on the remaining maturity of leases at the date of transition as the discount rate when determining present value. The weighted average incremental borrowing rate applied was 2.1%.

Operating lease commitments disclosed under AASB 117 *Leases* (AASB 117) as at 30 September 2019 were $3.7 billion for the Group and $3.4 billion for the Parent Entity compared to the lease liabilities of $3.3 billion for the Group and $3.0 billion for the Parent Entity recognised under AASB 16 as at 1 October 2019. The difference is principally due to the discounting of the contractual lease payments under AASB 16.

# 1. ABOUT OUR FINANCIAL STATEMENTS (continued)

## ACCOUNTING STANDARDS ADOPTED IN THE PERIOD (continued)

In addition, the Group elected to apply the following practical expedients as permitted under the modified retrospective transition approach:

a) Impairment of ROU assets at the transition date was assessed by relying on onerous lease provisions previously recognised as of 30 September 2019 under AASB 117;

b) Initial direct costs associated with entering leases prior to the transition date were excluded from the carrying value of ROU assets recognised at transition;

c) No ROU assets or lease liabilities were recognised for certain leases with less than 12 months remaining as of the transition date; these leases were treated as short-term leases with all lease payments recognised in rent expense as incurred; and

d) Hindsight was used to determine the lease term of contracts that contained options to extend the lease.

The following table reconciles the operating lease commitments disclosed under AASB 117 as at 30 September 2019 to the opening lease liabilities recognised under AASB 16 as at 1 October 2019.

| | $m |
|---|---|
| **Operating Lease Commitments as at 30 September 2019** | 1,656 |
| Increase in lease term for extension options | 210 |
| Exclusion of low value leases and leases of less than 12 months | (19) |
| Exclusion of service components | (10) |
| Other | (17) |
| **Total Undiscounted Lease Payments** | **1,820** |
| Effect of discounting at a weighted average incremental borrowing rate of 2.44% | (141) |
| **Total lease liabilities under AASB 16 as at 1 October 2019** | **1,679** |

During the reporting period, the Group recognised the following amounts in the income statement

| | $m |
|---|---|
| Depreciation expense on ROU assets | 394 |
| Interest expense on lease liabilities | 37 |
| Interest expense on makegood provisions | 2 |
| Rent expense in relation to low value leases and leases of less than 12 months | 35 |
| Other income in relation to subleases | 21 |

The Group's accounting policies with respect to lease arrangements where it acts as lessor have not changed under AASB 16 except where the Group subleases certain leased properties. Where the Group acts as intermediate lessor, it classifies the sublease as either a finance lease or operating lease by reference to the ROU asset of the head lease. Income from operating subleases is recognised in Other operating income in the Income Statement.

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 August 2020

## 6.9 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### (C) OPERATING LEASES

Operating leases, in which the Group is the lessor, are measured at cost less accumulated depreciation and accumulated impairment losses. Depreciation is calculated to write off the cost of operating lease assets less their estimated residual values using the straight-line basis over the term of the lease. This is generally recognised in profit or loss. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

### (D) GOODS AND SERVICES TAX

Revenues, expenses and assets are recognised net of the amount of goods and services tax (**GST**), except where the amount of GST incurred is not recoverable from the Australian Tax Office (**ATO**). In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from or payable to the ATO is included as a current asset or current liability in the Balance Sheet.

Cash flows are included in the Statements of Cash Flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from or payable to the ATO are classified as operating cash flows.

### (E) PROPERTY, PLANT AND EQUIPMENT

**(i) Recognition and initial measurement**

Items of property, plant and equipment are stated at cost or deemed cost less accumulated depreciation and accumulated impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads.

**(ii) Subsequent costs**

Subsequent additional costs are only capitalised when it is probable that future economic benefits in excess of the originally assessed performance of the assets will flow to the Group in future years. Where these costs represent separate components, they are accounted for as separate assets and are separately depreciated over their useful lives. Costs that do not meet the criteria for subsequent capitalisation are expensed as incurred.

**(iii) Subsequent measurement**

The Group has elected to use the cost model to measure property, plant and equipment after recognition. The carrying value is the initial cost less accumulated depreciation and any accumulated impairment losses.

**(iv) Depreciation**

Depreciation is charged to the profit or loss in the Income Statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment.

The estimated useful lives are as follows:

| | Years |
|---|---|
| IT equipment | 3-10 |
| Plant, furniture and equipment | 3-20 |
| Leasehold improvements [1] | 6-12 |

(1) Or term of lease if less.

The useful lives are reassessed annually.

### (F) IMPAIRMENT OF NON-FINANCIAL ASSETS

Non-financial assets, other than deferred tax assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For goodwill and intangible assets with an indefinite life, the recoverable amount is estimated at the same time each year.

The Bank conducts an annual internal review of non-financial asset values to assess for any indicators of impairment. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets – a CGU. An impairment loss is recognised in profit or loss in the Income Statement for the amount by which the asset's carrying amount exceeds its recoverable amount. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit on a pro-rata basis.

This grouping is subject to an operating segment ceiling test. Non-financial assets, other than goodwill, that suffered impairment are tested for possible reversal of the impairment whenever events or changes in circumstances indicate that the impairment may have reversed. An impairment loss in respect of goodwill is not reversed.

**(i) Calculation of recoverable amount**

The recoverable amount of a non-financial asset or CGU is the greater of its fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 August 2020

## 1.6 IMPLEMENTATION OF NEW AUSTRALIAN ACCOUNTING STANDARDS

The Group applied AASB 16 from 1 September 2019 for the first time. The impact of this standard is described below.

AASB 16 *Leases* (**AASB 16**)

AASB 16 replaced AASB 117 *Leases* (**AASB 117**) for the Group's financial year commencing on 1 September 2019.

The standard requires identification of leases that provide the Group the right to control the use of an identified asset for a period of time as a lessee. For these leases, the Group is required to recognise on-balance sheet a right-of-use (**ROU**) asset, representing the right to use the underlying asset, and a lease liability, representing the future lease payment obligations. Exemptions exist for leases of less than 12 months or of low value. Previously the rent payable was recognised as an expense over the lease term. Lessor accounting under AASB 16 remains largely unchanged from the previous standard.

**Identification of a lease**

Under AASB 16 a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. On transition, the Group elected to undertake an assessment of all applicable contracts to determine if a lease exists as defined in AASB 16. This assessment will also be completed for each new contract or change in contract going forward.

The Group has identified 3 types of leases: property leases, vehicle leases and equipment leases. Where practical the Group separates consideration in a contract between lease and non-lease components, only accounting for the lease component under AASB 16 and the non-lease component under other relevant accounting standards. For property leases it has been possible to separate lease and non-lease components but for some equipment leases the Group has elected not to separate the consideration.

The Group has further elected not to recognise ROU assets and lease liabilities for leases of low value assets (mainly IT equipment). The Group recognises these lease payments as an expense on a straight-line basis.

**Transition**

The Group has applied AASB 16 from 1 September 2019 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under AASB 117. The cumulative effect of initial application is recognised in retained profits at 1 September 2019. The ROU asset has been calculated as if the standard has always been applied for all leases.

At transition the Group recognised a lease liability in 'Accounts payable and other liabilities' of $178 million and ROU assets of $118 million as part of 'property, plant and equipment'. After adjusting lease provisions previously recorded on the balance sheet, this resulted in a reduction to retained profits of $4 million (post tax). As permitted by the standard, practical expedients were applied at transition and adjustments were not made for leases of low value assets and for short-term leases (less than 12 months).

Judgement has been applied by the Group in determining the transition adjustment which includes the determination of which contractual arrangements represent a lease, the period over which the lease exists and the incremental borrowing rate of the Group to be applied to each lease based on the lease term.

The table below presents a reconciliation of the operating lease commitments as disclosed in the Group's 31 August 2019 financial statements, to the lease liabilities recognised on the transition date:

| Consolidated | $m |
|---|---|
| Operating lease commitments as at 31 August 2019 | 199 |
| Add: assets not recognised as a lease under previous Accounting Standard (AASB 117) | 10 |
| (Less): Impact of discounting the future lease cash flows at the incremental borrowing rate (weighted average rate of 1.925%) | (12) |
| (Less): Removal of GST | (19) |
| **Lease liability recognised as at 1 September 2019** | 178 |

## 3 **Profit** (continued)

### Recognition and measurement

Operating expenses are recognised as the relevant service is rendered, or once a liability is incurred.

**Credit expenses** are measured as the difference between the carrying amount and the value of the estimated future cash flows, discounted at the financial instruments original effective interest rate. Refer to Note 10 for more information on the impairment of loans and advances.

**Staff and related costs**
Wage and salary costs are recognised over the period in which the employees provide the service. Refer to Note 29 for more information relating to staff provisions.

**Incentive payments** are recognised to the extent that the Group has a present obligation. Refer to Note 35 for further information on share based payments.

**Superannuation contributions** are made to an employee accumulation fund and expensed when they become payable. The Group also operates a defined benefits scheme, the membership of which is now closed.

**Occupancy costs**
Includes operating lease expenses relating to low value assets and short-term leases (leases that have lease terms of 12 months or less). Prior to the adoption of AASB 16 on 1 July 2019 operating lease payments were recognised as an expense on a straight line basis over the lease term.

**Amortisation**
Refer to Note 26 for information on the amortisation of intangibles.

**Depreciation**
Following the adoption of AASB 16 on 1 July 2019, expenses associated with operating leases are shown as depreciation of the Right-of-Use-Assets (ROUA). Comparatives have not been restated. Refer to Note 38 for further information on the depreciation of leased assets.

**Goods and services tax (GST)**
Revenues, expenses and assets are recognised net of the amount of GST except:

- where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from or payable to the taxation authority is included as part of receivables or payables in the Balance Sheet. Cash flows are included in the cash flow statement on a gross basis. The GST component of cash flows arising from investing and financing activities, which are recoverable from or payable to the taxation authority, are classified as operating cash flows.

## 2 **Summary of significant accounting policies** (continued)

### Changes in accounting policies

**AASB 16 *Leases***
The Group applied AASB 16 *Leases* from 1 July 2019. Prior to the adoption of AASB 16, non-cancellable operating lease payments were not recognised as liabilities but were recognised as rental expenses over the lease term on a straight line basis.

The Group applied AASB 16 using the modified retrospective approach, under which comparative information is not restated and the cumulative effect of initially applying AASB 16 is recognised as an adjustment to the opening balance of retained earnings as at 1 July 2019.

**Definition of a lease**
On initial application of AASB 16, the Group elected to apply the practical expedient to grandfather the assessment of which transactions are leases. Contracts entered into before 1 July 2019 that had previously been identified as leases under AASB 117 *Leases* and Interpretation 4 *Determining whether an Arrangement contains a Lease*, were not reassessed by the Group but were considered to also be leases under AASB 16. The definition of a lease under AASB 16 has been applied only to contracts entered into or changed on or after 1 July 2019.

**The Group as a lessee**
As a lessee the Group leases many assets including property, IT equipment and ATMs. The Group previously classified leases as operating or finance leases based on an assessment of whether the lease transferred significantly all the risks and rewards incidental to the ownership of the underlying asset to the Group.

On transition to AASB 16, right-of-use assets (ROUA) and leases liabilities have been recorded for most of the Group's leases, however, the Group applied the following practical expedients to leases previously classified as operating leases under AASB 117.

The Group:
- has not recognised ROUAs and liabilities for leases with lease term ending within 12 months of 1 July 2019;
- has not recognised ROUAs and liabilities for leases of low value assets;
- has measured the ROUAs using their carrying amount as if AASB 16 had been applied since the lease commencement date but discounted using the Group's incremental borrowing rate at 1 July 2019;
- excluded initial direct costs from the measurement of the ROUA at 1 July 2019;
- has recognised its lease liabilities by discounting the remaining lease payments as at 1 July 2019 using the incremental borrowing rate for each portfolio of leases with reasonably similar characteristics; and
- used hindsight when determining the lease term where the contract contains options to extend or terminate the lease.

There were no onerous lease contracts that would have required an adjustment to the ROUAs at the date of initial application.

**The Group as a lessor**
The Group is not required to make any adjustments on transition to AASB 16 for leases in which it acts as the lessor, except for sub-leases. The Group sub-leases some of its properties. Under AASB 117, the head lease and the sub-lease contracts were classified as operating leases.

On transition to AASB 16, the Group recognised a ROUA in relation to the head lease. The Group has assessed the classification of the sub-lease contracts with reference to the ROUA rather than the underlying asset, concluding that they are also operating leases under AASB 16. The Group has applied AASB 15 *Revenue from Contracts with Customers* to allocate consideration in the contract to each lease and non-lease component.

**Impact on transition**
On transition to AASB 16, the Group recognised ROUAs and lease liabilities on the Balance Sheet, with an adjustment being made to the opening balance of retained earnings as at 1 July 2019. The impact on transition is summarised below:

| | As at 1 July 2019<br>$m |
|---|---|
| Right-of-use assets | 226.9 |
| Deferred tax asset | 9.9 |
| Other assets | (0.4) |
| Lease liabilities | (266.1) |
| Provisions | 5.0 |
| Retained earnings | 24.7 |

The recognised ROUAs relate to the following types of assets:

| | As at 1 July 2019<br>$m |
|---|---|
| Right-of-use assets – Properties | 202.4 |
| Right-of-use assets – IT Equipment | 18.7 |
| Right-of-use assets – ATMs | 5.8 |
| **Total right-of-use assets** | **226.9** |

When measuring lease liabilities for leases that were classified as operating leases, the Group discounted lease payments using its incremental borrowing rate at 1 July 2019. The weighted-average rate applied was 2.9%.

An explanation of the differences between the operating lease commitments previously disclosed in the Group's 2019 Annual Financial Report and the lease liabilities recognised in the Balance Sheet as at 1 July 2019 is as follows:

| | $m |
|---|---|
| Operating lease commitments disclosed as at 30 June 2019 | 362.2 |
| Less: Leases with less than 12 months of lease term at transition | (2.0) |
| Less: Low-value leases | (21.4) |
| Less: Discounting effect using incremental borrowing rate | (22.5) |
| Less: Amounts included in commitments but excluded in AASB 16 [1] | (47.5) |
| Add: Extension options which are reasonably certain to be exercised | 6.8 |
| Add: Adjustment relating to changes in the index or rate affecting variable payments | (9.5) |
| **Lease liabilities recognised as at 1 July 2019** | **266.1** |

[1] Examples of amounts included in commitments but excluded from AASB 16 calculations include GST and operational expenditure.

# Notes to the Financial Statements (continued)

## 7. Accounting policies and new accounting standards

### 7.1 Accounting policies

#### (a) Basis of consolidation

The Group controls an entity when the Group is exposed to, or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity.

The Group conducts a securitisation program under an arrangement where mortgage loans equitably assigned to a separate legal entity (CSE) are converted to debt securities which are purchased by investors. The Group is entitled to any residual income of the CSEs after all payments to investors and costs of the programs have been met. The Group has the power to direct the activities and affect the variable returns of the CSEs. As a result, the CSEs are consolidated by the Group. The Group has responsibility as servicer and manager and provides a number of facilities to the CSEs. The CSEs are made up of six trust vehicles that have been established for the purpose of securitising Heritage's loans (refer Note 6.6 for further details). The parent entity financial statements include those of Heritage and the assets, liabilities, revenues and expenses of the CSEs which have not been derecognised.

#### (b) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the Statement of Financial Position are shown inclusive of GST.

#### (c) Leases

*Accounting policy applicable for prior year comparative*

The determination of whether an arrangement is a lease, or it contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Leases which do not transfer to Heritage substantially all the risks and benefits incidental to ownership of the leased items are operating leases. Operating lease payments are recognised as an expense in the Statement of Profit or Loss on a straight line basis over the lease term.

*Accounting policy applicable for current year*

At the inception of a contract, the Group assesses whether a 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. To assess whether a contract conveys the right to control the use of an identified asset, the Group uses the definition of a lease in AASB 16.

The lease liability is initially measured at the present value of lease payments outstanding at commencement date, discounted using the Group's incremental borrowing rate. The lease liability is subsequently measured at amortised cost using the effective interest method. Refer to note 2.2 for disclosure of the lease liability interest and note 6.3 for lease liability. Refer to note 5.1 (c) for the maturity profile of the lease liability.

The ROU asset is initially measured at cost which comprises the initial measurement of the lease liability. The ROU asset is subsequently measured using the cost model, being cost less depreciation and any impairment losses. The depreciation is expensed over the term of the lease. Refer to note 2.2 for disclosure of the depreciation and note 6.1 for right of use asset.

The Group has elected not to recognise right of use assets and lease liabilities for leases of low value assets (mainly IT equipment).

## 1. Basis of preparation (continued)

### 1.4 New and amended standards adopted this financial year

In these financial statements, the Group has applied AASB 16 *Leases* (AASB 16) from 1 July 2019 for the first time. The impact of this standard is described below.

#### (a) AASB 16 *Leases*

The standard requires identification of leases that provide the Group the right to control the use of an identified asset for a period of time as a lessee. For these leases, the Group is required to recognise on balance sheet a right of use (ROU) asset, representing the right to use the underlying asset, and a lease liability, representing the future lease payment obligations.

*Transition*

The Group has applied AASB 16 from 1 July 2019 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under AASB 117 *Leases*. The cumulative effect of initial application is recognised in retained profits at 1 July 2019. The ROU asset has been calculated as if the standard has always been applied for all leases.

At transition the Group recognised ROU assets of $67.958 million (less accumulated depreciation of $31.044 million, net value of $36.914 million) presented as part of 'Property, plant and equipment' and a lease liability presented in 'Accounts payable and other liabilities' of $39.619 million. The difference in value between these two amounts is as a result of the ROU asset having accumulated depreciation calculated since the inception of the leases. This difference of $2.705 million has been accounted for as a reduction to retained profits of $1.894 million and a net deferred tax asset of $0.811 million.

Judgment has been applied by the Group in determining the transition adjustment, which includes the determination of which contractual arrangements represent a lease, the period over which the lease exists and the incremental borrowing rate to be applied to each lease.

*Identification of a lease*

Under AASB 16 a contract is, or contains a lease, if it conveys the right to control the use of the identified asset for a period of time in exchange for consideration. On transition, the Group undertook an assessment of all applicable contracts to determine if a lease exists as defined in AASB 16. This assessment will be completed for each new contract or change in contract.

*Recognition and measurement*

The lease liability is initially measured at the present value of lease payments outstanding at commencement date, discounted using the Group's incremental borrowing rate. The lease liability is subsequently measured at amortised cost using the effective interest method.

The ROU asset is initially measured at cost which comprises the initial measurement of the lease liability. The ROU asset is subsequently measured using the cost model, being cost less depreciation and any impairment losses. The depreciation will be expensed over the term of the lease.

When measuring liabilities for leases that were classified as operating leases, the Group discounted lease payments using its incremental borrowing rate at 1 July 2019. The weighted average rate applied was 2.03%.

The table below presents a reconciliation of the operating lease commitments as disclosed in Note 6.7 of the 2018/19 financial statements, to the lease liabilities recognised on the transition date:

| CONSOLIDATED AND PARENT | $'000 |
|---|---|
| Operating lease commitments as at 30 June 2019 as disclosed under AASB 117 | 40,083 |
| Less: impact of discounting the future lease cash flows at the incremental borrowing rate | (1,861) |
| Less: operating lease commitment disclosed for leases not yet commenced at 1 July 2019 | (4,122) |
| Less: exclusion of operating lease commitments not required to be included per AASB 16 | (5,263) |
| Add: assets not recognised as a lease under AASB 117 | 2,471 |
| Add: increased liability attributable to a greater lease term under AASB 16 (options reasonably certain to be exercised) | 8,311 |
| **Lease liability on transition date (1 July 2019)** | **39,619** |

May 24, 2021

International Accounting Standards Board
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Committee Members:

Consejo Mexicano de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, welcomes the opportunity to submit its comments on the Tentative Agenda Decision of the IFRS Interpretations Committee (the Committee) on *Non-refundable Value-added Tax on Lease Payments* (the TAD), issued for comments in March 2021. Set forth below you will find our comments on the conclusions reached in the TAD.

**Overall comments**

We agree with the conclusions reached by the Committee in the TAD, both with respect to the technical conclusions and the decision not to add a standard-setting project to the work plan of the IASB.

**Specific comments**

In our local Transition Group for the new lease accounting standard, we observed that some lessors prepare lease payment amortization tables that include the VAT on lease payments. Nevertheless, it was observed that recoverable VAT is not included in the lease liability and accordingly is not capitalized in the related right-of-use asset.

Most indicated that, while recoverable VAT should not be included in the lease liability or the related right-of-use asset, non-recoverable VAT represents an incremental asset acquisition cost and should be added to the lease payments and, as a result, to the related right-of-use asset. This conclusion is consistent with paragraph 16 of IAS 16, *Property, Plant and Equipment*, which establishes that “The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.” As a result, existing standards are sufficient to sustain the Agenda Decision.

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Should you require additional information on our comments listed above, please contact William A. Biese at (52) 55-5433-3070 or me at (52) 55-5403-8309 or by e-mail at wbiese@cinif.org.mx or egarcia@cinif.org.mx, respectively.

Sincerely,

C.P.C. Elsa Beatriz García Bojorges
President of the Mexican Financial Reporting Standards Board
Consejo Mexicano de Normas de Información Financiera (CINIF)

Cc: Mr. Tadeu Cendon