ShineWing Australia

ALERT

IFRS 16 *Leases*

In the energy and resources sector, there are several types of arrangements that may be impacted by the introduction of IFRS 16 *Leases*. This new standard, will replace IAS 17 Leases, provides guidance and examples on assessing whether a contract contains a lease, a service or both.

The new guidance focuses on the principle of control and whether a lease has the right to control the use of an identified asset during the lease term; it may give a different classification to what is currently required under IAS 17.

The accounting for lessees will change significantly as IFRS 16 requires all leases (except for leases less than 12 months and of low value) to be recognised on the balance sheet by recognising a right of use asset and a lease liability. The impact of this on the profit or loss is that depreciation (of the right of use asset) and interest expense will be incurred.

This article looks at arrangements that allows a mining company to access a road, rail track or port and how IFRS 16 may apply to such arrangements.

Definition of a lease

A contract is 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. Under the contract, the customer has:

1. the right to obtain substantially all of the economic benefits from use of the identified asset; and
2. the right to direct the use of the identified asset.

An assessment is therefore required as to whether:

- an identified asset exists;
- the customer obtains substantially all of the economic benefits from using the asset
- the customer has a right to control the use of an identified asset.

What is an identified asset?

An Identified asset can either be implicitly or explicitly identified in an agreement. It is the specific asset that is required for the entity's exclusive use. The implicit identification of an asset usually occurs when the supplier can only fulfil its obligations by providing a specific asset. Due to the remote locations in mining, it may often be the case that a specific asset will be used because the cost of substituting that asset with another is too high for the supplier. In other words, regardless of whether an asset is implicitly or explicitly identified, if the supplier does not have the practical ability to substitute an asset during its use and would not benefit economically from this, then the asset in question is an identified asset.

For example, consider an agreement for the use of a rail track that has not been specified in the agreement. Due to the location of the mining site, there is only one track that can be used exclusively by the mining company. Therefore this rail track is an implicit identified asset.

Some arrangements may be for the right to use a portion of an asset's capacity, which can be an identified asset if it is physically distinct or it represents substantially all of the capacity of the asset.

For example, consider an agreement to use a section of a port, but a specific section had not been specified in the agreement. Due to the requirements of the mining company, only a certain section of the port can be used and the cost to substitute it for another section is too high for the supplier. Therefore, the section of a port that is used is a physically distinct identified asset.

Does the customer obtain substantially all the economic benefits from the identified asset?

A customer can obtain economic benefits from using an identified asset directly or indirectly, for example by using, holding or sub-leasing the asset. IFRS 17 does not define 'substantially all', however based on the common meaning of this term, it would be a very high threshold.

For example, consider an arrangement for an easement right to construct a road for the mining company's exclusive use. The mining company determines that it obtains substantially all of the economic benefits from using the easement because the land owner cannot use the land for any other purpose.

Does the customer have the right to control the use of the identified asset?

A customer has the right to control the use of an identified asset if either:

- the customer has the right to direct how and for what purpose the asset is used or
- the relevant decisions about how and for what purpose the asset is used are predetermined and:
  - the customer has the right to operate the asset (or direct others to operate the asset), without the supplier having the right to change those operating instructions, or
  - the customer designed the asset in a way that predetermines how and for what purpose the asset will be used.

A customer has the right to direct how and for what purpose the asset is used if it can change how and for what purpose the asset is used.

For example, consider an arrangement for the use of a rail track. The mining company has the right to direct how and for what purpose the rail track is used for (and obtains substantially all the economic benefits). Therefore, the arrangement is a lease because there is an identified asset, the mining company obtains all the benefits and can direct the use of the asset.

Let's discuss the possibilities.

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