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Department of Finance

FINANCE POSITION PAPER

Implementation Options for AASB 16 *Leases*

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Purpose

Accounting standards issued by the Australian Accounting Standards Board (AASB) apply to annual financial statements for Commonwealth entities and the Australian Government Consolidated Financial Statements (CFS) under Paragraphs 42(2)(a) and 48(2)(a) respectively of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

The AASB has introduced AASB 16 *Leases* (AASB 16 or the Standard), removing the distinction between operating and finance leases for lessees and requiring the recognition of a right-of-use (ROU) asset and lease liability on the balance sheet for most leasing arrangements. AASB 16 is the Australian equivalent to the IASB's IFRS 16, which was introduced over concerns about the lack of transparency and information about lease obligations[1].

For most Commonwealth entities, the initial application of AASB 16 will be for the 2019-20 financial year.

This paper identifies the Department of Finance's (Finance) position on the options available for implementation of AASB 16. This will ensure consistency among entities which is necessary for the preparation of the CFS. Where the accounting treatments are prescriptive they will be mandated by amendments to the PGPA Financial Reporting Rule from 2019-20 onward. Application of all requirements is subject to the principles of materiality.

Scope

The scope of this paper is limited to the implementation of AASB 16. Explanations of lease accounting and detailed guidance on the application of AASB 16 will be addressed through other documents.

Overall, there are nine transition options available for the initial application of AASB 16 and seven non-transition elections related to general requirements (including two options outlined in Appendix B of AASB 16).

Relevant Accounting Pronouncements

The following documents are relevant:

- AASB 16 *Leases* (AASB 16 or this standard);
- AASB 117 *Leases* (AASB 117);
- AASB 140 *Investment Property* (AASB 140);
- AASB 136 *Impairment of Assets* (AASB 136);
- AASB 137 *Provision, Contingent Liabilities and Contingent Assets* (AASB 137);
- AASB 116 *Property, Plant and Equipment* (AASB 116);
- AASB 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049);

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[1] https://economia.icaew.com/news/january-2016/ifrs-16-will-bring-2trn-pounds-on-balance-sheet#sthash.rs35Swte.dpuf

- AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* (AASB 108);
- *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015* (FRR).
- AASB *Interpretation 4: Determining whether an Arrangement contains a Lease*

Transition Options

Option 1: No reassessment of previous lease contracts

Entities are permitted:

(a) to apply AASB 16 to contracts that were previously identified as leases under AASB 117 *Leases* and Interpretation 4 *Determining whether an Arrangement Contains a Lease*. The entity shall apply the transition requirements as set out in Appendix C of AASB 16.

(b) not to apply this Standard to contracts that were not previously identified as containing a lease under AASB 117 and Interpretation 4[2].

This must be applied to all contracts and a consistent accounting policy will need to be adopted for the preparation of the CFS. Entities have previously conducted a review of arrangements in accordance with Interpretation 4. Electing to not reassess the previous lease contracts and associated transition arrangements will reduce the workload for entities. A reassessment would not be expected to result in any material change in the assessment previously conducted. This approach will facilitate the implementation of AASB 16.

FINANCE POSITION 1

Entities are required to opt for the ‘no reassessment of previous leases’.

Option 2 (for Lessees only): The modified model to be applied

Where an entity has selected the option of not reassessing leases from the previous years, a lessee may:

“recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application (DIA).”[3] (the modified model)

Or to apply this standard

“retrospectively to each prior reporting period presented in accordance with AASB 108 Accounting Policies: Changes in Accounting Estimates and Errors”[4] (the full retrospective model).

A lessee is required to apply the selected option above consistently to **all its leases**[5].

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[2] AASB 16, Appendix C, C3, C4
[3] AASB 16, Appendix C, C5(b),C7
[4] AASB 16, Appendix C, C5(a)
[5] AASB 16, Appendix C, C6

Finance proposes that entities apply the modified model[6]. Entities may not have the required information to apply the full retrospective model[7]. The full retrospective approach would also involve a significant cost to preparers of statements, but would not result in more meaningful information for users of financial statements than the modified approach.

If the modified model is used, the following transition options, including practical expedients, relate to the treatment by lessees for leases previously classified as operating leases.

FINANCE POSITION 2

Entities are required to apply the modified model on initial application of AASB 16.

Option 3 (for leases previously classified as operating leases): measuring ROU assets

When the modified model has been selected, a lessee can choose to measure ROU assets on a lease-by-lease basis for its existing operating leases at:

> *"(i) its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application; or*
>
> *(ii) an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application."*[8]

The option of measuring the ROU asset based on the lease liability (option ii above) would not result in material differences to the alternative method (option i) and will reduce the amount of work on initial application as it is expected that a lessee would have already calculated the amount for the lease liability in accordance with AASB 16. Accordingly, Finance will allow entities to apply this option.

FINANCE POSITION 3

Lessees may measure ROU assets based on either of the methods specified in paragraph C8 of AASB 16, on a lease-by-lease basis.

Option 4: Leases of 'low value' assets or accounted previously under AASB 140

Under the transition arrangements, a lessee is not required to make adjustments on transition for leases:

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[6] AASB 1058, Appendix C, C3(b)

[7] Preliminary work from the states indicates that the relevant information for restating prior periods may not be available.

[8] AASB 16, Appendix C, C8 (b)

"for which the underlying asset is of low value (as described in paragraphs B3-B8)"[9]. *In this instance, a lessee must "recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis"*[10]; *or*

"previously accounted for as investment property using the fair value model in AASB 140 Investment Property."[11]

This is a policy option, so a consistent approach will be required for the CFS. Adopting this option will greatly reduce the workload for most entities in implementing AASB 16 and the impact will be immaterial.

FINANCE POSITION 4

Lessees are required to select the 'no adjustment on transition' option for leases of 'low value' assets or previously accounted for as investment property under AASB 140.

Option 5: Apply a single discount rate to a portfolio of leases

When an entity groups leases by portfolio, AASB 16 allows a lessee "*to apply a single discount rate to a portfolio of leases*" on transition.[12]

However, such grouping is only permitted if leases within the portfolio have "*reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).*"[13] The *Standard Parameters for use in Financial Statements*[14] published on the Finance internet will provide a list of bond rates to assist entities in selecting the appropriate discount rate for various lease terms on the initial application of the Standard.

Note that the single discount rate approach can only be applied because of the modified model selected under Option 2.

FINANCE POSITION 5

Entities may apply a single discount rate to a lease portfolio in accordance with AASB 16 on transition.

[9] AASB 16, Appendix C, C9(a)
[10] AASB 16, paragraph 6
[11] AASB 16, Appendix C, C9(b)
[12] AASB 16, Appendix C, C10(a)
[13] AASB 16, Appendix C, C10(a)
[14] https://www.finance.gov.au/resource-management/reporting-accounting/

Option 6: Adjust the ROU asset for onerous leases recognised under AASB 137

A lessee can elect, on a lease-by-lease basis, to *"rely on its assessment of whether leases are onerous applying AASB 137 Provision, Contingent Liabilities and Contingent Assets immediately before the date of initial application as an alternative to performing an impairment review."*[15] AASB 16 requires a "*lessee to apply AASB 136 Impairment of Assets to determine whether the right-of-use asset is impaired and to account for any impairment loss identified*"[16]. AASB 137 defines an onerous contract as a *"contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it."*[17] If the lessee elects the AASB 137 assessment, it must adjust the ROU asset *"at the date of initial application by the amount of any provision for onerous leases recognised in the statement of financial position immediately before the date of initial application."*[18]

Relying on the previous assessment will be more efficient and cost effective than performing a full impairment review under AASB 136. Similarly, the International Accounting Standards Board (IASB) has concluded that this option is likely to be more cost effective without significant impact on users of financial statements.[19]

When the entity relies on the previous assessment (and the treatment for an onerous lease is retained), in accordance with the paragraph C8 transition arrangement, the requirement to comply with AASB 136 impairment does not apply[20] and the right-of-use asset is adjusted for the provision recognised under AASB 137.

FINANCE POSITION 6

Entities may rely on their previous assessment on whether a lease is onerous, rather than performing an impairment review.

Option 7: 'Short-term' leases

A lessee can elect, on a lease-by-lease basis, to apply the short-term lease accounting treatment to leases with terms ending within 12 months of the date of initial application.[21] In this instance, it must comply with the short-term lease requirements, which entails the lessee to *"recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis and include the cost associated with those leases within the disclosure of short-term lease expense."* [22]

[15] AASB 16, Appendix C, C10(b)
[16] AASB 16, paragraph 33
[17] AASB 137, paragraph 10
[18] AASB 16, Appendix C, C10(b)
[19] IFRS 16, Basis for Conclusions, BC287
[20] AASB 16, Appendix C, C8(c)
[21] AASB 16, Appendix C, C10 (c)(i)
[22] AASB 16, paragraph 6

It is likely that applying the short-term lease option will simplify the process, noting that the related costs may be greater than under the alternative approach of applying AASB 16 general principles.

FINANCE POSITION 7

Entities may apply the 'short-term' transition option for leases with terms ending within 12 months of the date of initial application.

Option 8: Exclude initial costs from the ROU asset at DIA

A lessee can elect on a lease-by-lease basis to *"exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application (DIA)"*[23].

This will reduce the value of the ROU asset and its associated depreciation expense. This option will also reduce the initial work on application of the Standard because information on direct costs may not be available.

FINANCE POSITION 8

Entities may exclude initial costs from the ROU asset at the date of initial application.

Option 9: Use of hindsight

If an entity decides to opt for the modified model[24], the lessee can elect, on a lease-by-lease basis, to use hindsight in applying AASB 16 on existing leases.[25] For example, a lessee could determine the lease term in accordance with AASB 16, having regards to what occurred in prior periods (e.g. for options to extend or terminate the lease). Hindsight may provide supporting evidence for audit purposes. The decision on this matter is best determined by each entity using its judgement depending on the circumstances for each lease.

FINANCE POSITION 9

Entities may use the hindsight option.

[23] AASB 16, Appendix C, C10 (d)
[24] AASB 16, Appendix C, C5 (b)
[25] AASB 16, Appendix C, C10 (e)

Non-transition Options (General Requirements)

Option 10: Lease of intangible assets

A lessee may elect not to apply AASB 16 to leases of intangible assets other than those reflecting "…*the rights held by a lessee under licensing agreements within the scope of AASB 138 Intangible Assets for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.*"[26]

For consolidation consistency purposes, and to limit changes at the time of the AASB 16 implementation, entities are required to continue to apply the same standard they used in the previous year to these types of leases.

At the WoG level, the impact of this option will likely be immaterial.

FINANCE POSITION 10

Subject to AASB 16 exclusion, lessees are required to continue to apply the same standard they used in the previous year to leases of intangible assets.

Option 11: Apply the 'short-term' or 'low value' exemption

A lessee may elect not to comply with AASB 16 leases recognition requirements to:[27]

- short-term leases (i.e. a lease that has a lease term of 12 months or less at the commencement date); and
- leases for which the underlying asset is of low value.[28]

In this instance, the lessee must recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis.[29]

The election for the short-term lease exemption must be made based on the class of the underlying asset to which the ROU relates; for 'low value' leases, it will be made on a lease-by-lease basis.[30]

Low value is an absolute concept, unrelated to the finances of the entity, and is not related to an entity's materiality threshold. Finance proposes a low value of AUD$10,000 per asset[31], which is broadly consistent with the basis for conclusion on the international standard.

[26] AASB 16, paragraph 4
[27] AASB 16, paragraph 22 - 49
[28] AASB 16, paragraph 5
[29] AASB 16, paragraph 6
[30] AASB 16, paragraph 8
[31] The value applies to each individual asset. Thus a lease of 200 computers with a value of $200 each, will be "low value", because each individual asset is below $10,000. The standard contains requirements for low value assets in B3-B8.

These exemptions are likely to reduce the administrative burden of recognising such leases under the full AASB 16 requirements.

FINANCE POSITION 11

Entities are required to apply the 'short-term' or 'low value' exemption in accordance with AASB 16. Low value will be assets of AUD$10,000 or less.

Option 12: Single lease practical expedient

"As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component."[32]

Entities may apply the single lease practical expedient only when the non-lease component is assessed to be immaterial to the lease. This is to ensure that, at a WoG level, the recognition of non-lease components combined into a single lease does not significantly alter WoG leases measurement and associated expenses. For example, without this restriction, major service agreements could be included as leases in the WoG consolidated financial statements using this method.

FINANCE POSITION 12

The single lease practical expedient, which combines the lease component and the non-lease component, shall only be used by a lessee when the non-lease component is considered immaterial to the lease.

Option 13: Apply AASB 116 revaluation model to ROU assets

AASB 16 requires that *"After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies either of the measurement models described in paragraphs 34 and 35."*[33]

AASB 16 permits a lessee the option to apply the AASB 116 revaluation model to **all its ROU assets that relate to a class of property, plant and equipment**, if the lessee already applied this model to that class of property, plant and equipment.[34]

AASB 116 revaluation model states that after *"recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount,*

[32] AASB 16, paragraph 15
[33] AASB 16, paragraph 29
[34] AASB 16, paragraph 35

being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses."[35]

ROU assets' subsequent valuation at fair value is consistent with the requirements for the valuation of other non-financial assets. Finance will issue further guidance on valuation techniques through a Resource Management Guide (RMG).

In contrast, under AASB 16, the AASB 140 fair value model is not an option, but a requirement.[36] AASB 16 requires that *"if a lessee applies the fair value model in AASB 140 Investment Property to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in AASB 140."*[37]

To ensure the WoG consolidation complies with AASB 1049, a lessee should elect the AASB 116 revaluation model option and apply it to **all its ROU assets that relate to a class of property, plant and equipment** if it already applied this model to that class of property, plant and equipment.

For-profit entities may elect not to value their ROU assets at fair value. This is consistent with the option under FRR paragraph 17(7), which allows for-profit entities to elect not to value their non-financial assets at fair value[38]. Fair value information may still be required for WoG consolidation.

FINANCE POSITION 13

Not-for-profit entity lessees are required to elect the AASB 116 revaluation model option for their ROU assets that relate to a class of property, plant and equipment.

Option 14: Presentation and Disclosure

AASB 16 requires that a lessee elect to either present in the statement of financial position or disclose in the notes, the ROU assets separately from other assets (excluding the investment property ROU assets)[39] and the lease liabilities separately from other liabilities.[40]

As this is a presentation decision, this will be left to entities to decide. However, Finance notes that providing such information in the notes will enhance comparability with the CFS for users and reduce the clutter in financial statements.

FINANCE POSITION 14

Finance's recommendation is that entities disclose lease information in the note. However, this is not mandatory.

[35] AASB 116, paragraph 31
[36] AASB 16, paragraph 34
[37] AASB 16, paragraph 34
[38] Public Governance, Performance and Accountability (Financial Reporting) Rule 2015, paragraph 17 (7)
[39] AASB 16, paragraph 47(a)
[40] AASB 16, paragraph 47(b)

Option 15: Portfolio option

AASB 16 permits such grouping of leases on an ongoing basis **only** if leases within the portfolio have *"reasonably similar characteristics (such as leases with a similar remaining lease term for similar class of underlying asset in a similar economic environment)."*[41]

In addition, this option is **only** available when an entity can argue that the outcome *"would not differ materially from applying this Standard to the individual leases within that portfolio."*[42]

For entities with significant number of leases, holding portfolios of leases will reduce the administrative burden of AASB 16 application.

FINANCE POSITION 15

Where relevant, entities may apply the portfolio option in accordance with paragraph B1 of Appendix B, AASB 16.

Option 16 (for lessors only): Treat land and building leases as a single lease[43]

A lessor *"may treat the land and buildings as a single unit for the purpose of the lease classification and classify it as a finance lease or an operating lease in accordance with paragraphs 62-66 and B53-B54"*[44] and if *"the land element is immaterial to the lease"*[45]. In this instance, the economic life of buildings will be regarded as the economic life of the entire underlying asset.[46]

Paragraphs 62-66 cover AASB 16 requirements for lessors' classification of leases as finance leases or operating leases.

In addition, the AASB 16 application guidance provides further requirements to lessors for the classification of a lease of land and buildings as follows:

- Lessors must *"assess the classification of each element as a finance lease or an operating lease separately"*.[47]
- Lessors must, when necessary, *"allocate lease payments… between the land and the buildings elements in proportion to the relative fair values of the leasehold interest in the land element and buildings element of the lease at the inception date. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease."*[48]

[41] AASB 16, Appendix C, C10(a)
[42] AASB 16, Appendix B, B1
[43] AASB 16, Appendix B: Application guidance "*is an integral part of the Standard….and has the same authority as the other parts of the Standard.*"
[44] AASB 16, Appendix B, B57
[45] AASB 16, Appendix B, B57
[46] AASB 16, Appendix B, B57
[47] AASB 16, Appendix B, B55
[48] AASB 16, Appendix B, B56

Applying the standard to a single unit rather than the separate components will reduce the work required. As this approach is virtually identical to the equivalent provisions of AASB 117, it is not expected to result in any change to existing practice.

FINANCE POSITION 16

As this is a clarification on the application of the materiality concept to leases containing a land component, entities may choose whether to combine or separate the land and building components.

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Appendix – Illustrative Examples

Example 1 Initial measurement of the ROU asset and the lease liability

Lessee enters into a 10-year operating lease of a floor of a building. Lease payments are $64,752 per year, all payable at the end of each year.
The interest rate implicit in the lease is not readily determinable. The Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the ROU asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payments at the end of each year and measures the lease liability at the present value of the remaining payments of $64,752, discounted at the interest rate of 5 per cent per annum.
Lessee accounts for the reimbursement of leasehold improvements from Lessor applying other relevant standards and not as a lease incentive applying AASB 16. This is because costs incurred on leasehold improvements by Lessee are not included within the cost of the ROU asset.

Under AASB 117

No asset or liability recognised. Lessee records lease payment expense each year:

Lease payment expense	$64,752	
Cash		$64,752

Under AASB 16

Lessee initially recognises assets and liabilities in relation to the lease as follows.

ROU asset	$500,000	
Lease liability		$500,000

Calculation of the right-of-use asset and the lease liability from Year 1 to Year 10

Lease liability						ROU asset		
Year	Beginning balance	Lease payment	5% interest expense	Ending balance		Beginning balance	Depreciation charge	Ending balance
1	500,000	(64,752)	25,000	460,248		500,000	(50,000)	450,000
2	460,248	(64,752)	23,012	418,508		450,000	(50,000)	400,000
3	418,508	(64,752)	20,925	374,681		400,000	(50,000)	350,000
4	374,681	(64,752)	18,734	328,663		350,000	(50,000)	300,000
5	328,663	(64,752)	16,433	280,344		300,000	(50,000)	250,000
6	280,344	(64,752)	14,017	229,608		250,000	(50,000)	200,000
7	229,608	(64,752)	11,480	176,337		200,000	(50,000)	150,000
8	176,337	(64,752)	8,817	120,401		150,000	(50,000)	100,000
9	120,401	(64,752)	6,020	61,669		100,000	(50,000)	50,000
10	61,669	(64,752)	3,083	0		50,000	(50,000)	0

Comparison

	AASB 117		AASB 16	
Year 1	**Operating Statement** *(Operating result worsen by $10,248 in Y1)*			
	Operating Expense	$64,752	Interest	$25,000
			Depreciation	$50,000
	Operating result	-$64,752	Operating result	-$75,000
	Cash Flow Statement *(Impact: nil)*			
	Operating Payment	$64,752	Operating Payment	$25,000
			Financing Payment	$39,752
	Cash outflow	-$64,752	Cash outflow	-$64,752
	Balance Sheet *(Impact: Equity/net asset worsen by $10,248)*			
	Cash	$64,752	Assets	$450,000
			Cash	-$64,752
			Liability	-$460,248
	Equity	-$64,752	Equity	-$75,000

	AASB 117		AASB 16	
Year 5	**Operating Statement** *(Operating result worsen by $1,681 in Y5)*			
	Operating Expense	$64,752	Interest	$16,433
			Depreciation	$50,000
	Operating result	-$64,752	Operating result	-$66,433
	Cash Flow Statement *(Impact: nil)*			
	Operating Payment	$64,752	Operating Payment	$16,433
			Financing Payment	$48,319
	Cash outflow	-$64,752	Cash outflow	-$64,752
	Balance Sheet *(Impact: Equity/net asset worsen by $30,344)*			
	Cash	$64,752	Assets	$250,000
			Cash	-$64,752
			Liability	-$280,344
	Equity	-$64,752	Equity	-$95,096

Impact over the Lease Term Compared to Existing Standard

Year	Operating Statement – Operating Result		Balance Sheet - Equity	
1	Worsen	$10,248	Worsen	$10,248
2	Worsen	$8,260	Worsen	$18,508
3	Worsen	$6,173	Worsen	$24,681
4	Worsen	$3,982	Worsen	$28,663
5	Worsen	$1,681	Worsen	$30,344
6	Improve	$735	Worsen	$29,608
7	Improve	$3,272	Worsen	$26,337
8	Improve	$5,935	Worsen	$20,401
9	Improve	$8,732	Worsen	$11,669
10	Improve	$11,669	Nil	$0
Overall		**$0**		**$0**

Note that there is nil impact on cash, but classification in the Cash Flow Statement will change.

Example 2 Adjustment to the opening balance (the modified model)

Lessee entered into a 10-year operating lease of a floor of a building 5 years ago. Lease payments were $50,000 per year, all payable at the end of each year. At the date of initial application of AASB 16, Lessee is in the beginning of Year 6 of this operating lease.
The interest rate implicit in the lease was not readily determinable. Lessee's incremental borrowing rate was 5 per cent per annum at the commencement of this lease. At the date of the initial application of AASB 16, Lessee's incremental borrowing rate is 4 per cent per annum, lower than 5 years ago due to the improved borrowing environment.

At the initial application date of AASB 16, Lessee measures the lease liability at the present value of the remaining payments of $50,000 each year, discounted at the interest rate of 4 per cent per annum, which is $222,591.

Lessee recognises assets and liabilities in relation to the lease at the initial application date as follows.

ROU asset	$222,591	
Lease liability		$222,591

Calculation of the ROU asset and the lease liability from Year 6 (initial application date) to Year 10

Lease liability						ROU asset		
Year	Beginning balance	Lease payment	4% interest expense	Ending balance		Beginning balance	Depreciation charge	Ending balance
6	222,591	(50,000)	8,904	181,495		222,591	(44,518)	178,073
7	181,495	(50,000)	7,260	138,755		178,073	(44,518)	133,555
8	138,755	(50,000)	5,550	94,305		133,555	(44,518)	89,036
9	94,305	(50,000)	3,772	48,077		89,036	(44,518)	44,518
10	48,077	(50,000)	1,923	0		44,518	(44,518)	0

Note that implementation of AASB 16 will worsen the Lessee's operating result at the initial application date (i.e. Year 6 of the lease term) by $3,422. Operating results will improve over the last two years of the lease.