ACAG
AUSTRALASIAN COUNCIL OF AUDITORS GENERAL

7 December 2018

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

Dear Kris

Exposure Draft 286—*Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities (NFP)*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on ED 286. The views expressed in this submission represent those of all Australian members of ACAG.

ACAG notes ED 286 is proposing amendments to AASB 1 *First-time Adoption of Australian Accounting Standards*, AASB 16 *Leases*, AASB 117 *Leases* and AASB 1058 *Income for Not-for-Profit Entities*. The amendments will give NFPs the temporary option to measure right-of-use assets at initial recognition, for leases with significantly below-market terms and conditions, either at 'cost' or 'fair value' as determined in AASB 13 *Fair Value Measurement.*

Overall, ACAG supports the proposed temporary option outlined in ED 286, however, ACAG have highlighted matters the AASB should consider clarifying prior to releasing the amending standard.

ACAG holds similar views to those expressed by the AASB regarding why the temporary option is needed. Difficulties in applying the principles of AASB 13 exist in determining the fair value of right-of-use assets under such leases for NFP public sector entities. ACAG believes it would be beneficial for the AASB to provide the temporary option until the interpretative issues arising from fair valuing right-of-use assets with significantly below-market terms and conditions have been addressed.

We would also suggest this is considered by the AASB in light of the Revised Conceptual Framework program (and Phase 2 considerations within ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems*) as it will eventually apply to the public sector.

The attachment to this letter addresses the AASB's matters for comment within the ED.

ACAG appreciates the opportunity to respond and trust that you find our comments useful.

Yours sincerely

Rod Whitehead
Chairman
ACAG Financial Reporting and Accounting Committee

Attachment

AASB specific matters for comment

The AASB is inviting specific comments on the following:

1. **Do you agree with the proposed temporary option for not-for-profit entities to not measure right-of-use assets at initial recognition at fair value for leases with significantly below-market terms and conditions principally to enable the entity to further its objectives ('peppercorn leases')? This option would permit not-for-profit entities to measure such right-of-use assets at initial recognition at cost instead of fair value. The AASB will reassess the option when further guidance has been developed to assist not-for-profit entities in fair valuing such right-of-use assets and the financial reporting requirements for not-for-profit private sector entities have been finalised. If you disagree, please provide reasons.**

ACAG agrees with the proposed temporary option outlined in ED 286. However, ACAG notes:

a) the initial application of AASB 16 provided detailed transition support and practical expedients. If making an election outlined in ED 286 is considered initial application, ACAG suggests similar transitional arrangements are put in place if fair value is mandated in the future, through removal of the temporary option.
b) in deciding which measurement option to elect, ACAG suggests that the AASB allow the option to be applied on an individual lease or lease class basis. In some jurisdictions, there are instances where public sector entities currently recognise and revalue leased assets under finance leases which are significantly below-market terms. ACAG notes that such leases are subject to similar valuation issues relating to restrictions and conditions, though the comparable asset is similar to an owned asset, than the operating lease assets to be capitalised under AASB 16. ACAG believes it would not be appropriate for these entities to amend their accounting policy for these leases in the event they enter a new 'finance lease' arrangement in the future.

2. **If you disagree with providing a temporary option, do you consider that not-for-profit entities should be permitted to measure right-of-use assets at initial recognition at either fair value or cost for peppercorn leases entered into prior to the initial application of AASB 16? In your view, should such a permanent option be provided for not-for-profit entities in the private sector, the public sector, or both sectors? Please provide your reasons.**

ACAG does not disagree with providing the temporary option, hence no further comments are required for this question.

3. **Additional disclosure requirements are set out in the proposed paragraphs Aus59.1 and Aus59.2 of AASB 16 for application to peppercorn leases where the right-of-use assets are measured at cost rather than at fair value. In conjunction with the other disclosure requirements in AASB 16, would these additional disclosures provide adequate information for users to understand the effects on the financial position, financial performance and cash flows of the entity arising from such peppercorn leases? If not, what additional disclosures would be appropriate?**

ACAG agrees that where an entity elects the temporary option, disclosure of this fact is appropriate. However, ACAG suggests that the extent of disclosure, as stipulated in paragraph Aus59.2, be redrafted. At present, it is predicated on the concept of materiality– *'the disclosures provided by the not-for-profit entity…shall be provided individually for each material lease'.* Materiality is a difficult determinant for entities to apply, given the valuation issues for these lease arrangements, and the underlying reason for these proposals. As a suggestion, the determinant could be based on the significance of the lease to the entity's operations in fulfilling its objectives, rather than trying to determine a quantitative amount.

Paragraph Aus59.2 also requires that such disclosure be provided 'individually' for each material lease. ACAG suggests that this requirement be reconsidered, as there may be entities who have leases with similar characteristics, where such disclosure could be done on a lease class or portfolio level.

4. Whether the AASB's Not-for-Profit Entity Standard Setting Framework has been applied appropriately in developing the proposals in this ED?

ACAG holds the view that the AASB have appropriately applied the concepts of the AASB's *Not-for-Profit Entity Standard Setting Framework,* by considering the need for NFP-specific amendments.

5. Whether there are any regulatory issues or other issues arising from the Australian environment that may affect the implementation of the proposals, including the Government Financial Statistics (GFS) implications?

AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires the adoption of optional treatments in Australian Accounting Standards to be aligned with the principles in the ABS Government Financial Statistics Manual (GFS). When AASB 16 becomes effective, the whole-of-government financial report under AASB 1049 will need to apply its concepts. ACAG's understanding is that the right-of-use asset arising from the capitalisation of operating leases under AASB 16 is not a GFS asset and therefore would need to be reversed out in the note reconciliation to GFS.

If elected, the cost option in ED 286 may result in further GFS adjustments in the note reconciliation dependent on the nature of the lease (the GFS Manual distinguishes between 'operating leases' and 'marketable operating leases'). ACAG suggests that specific guidance in relation to the application of AASB 1049 is provided to consider such issues.

ACAG's further understanding is that the GFS Manual currently requires finance lease assets under AASB 117 *Leases* to be recognised and measured at fair value. Consequently, the adoption of the AASB's "all or nothing" measurement proposals would have adverse consequences, unless ACAG's suggested individual lease or lease class exemption, noted in our response to Question 1 (b) above, is permitted. Specifically, a government would be prevented from adopting the "all or nothing" cost option, as AASB 1049 would require the valuation of peppercorn 'finance lease' assets at fair value. Adoption of ACAG's suggestion would allow the government to continue to value peppercorn 'finance leases' at fair value as a separate class to the newly capitalised peppercorn operating leases, being measured at cost, under AASB 16.

6. Whether, overall, the proposals would result in the financial statements that would be useful to users?

ACAG is not able to comment on whether the proposals would result in financial statements that would be useful to users.

7. Whether the proposals are in the best interests of the Australian economy?

ACAG's view is that the proposals will reduce costs to public sector entities, but is not able to comment on whether these proposals are in the best interests of the Australian economy.

8. Cost and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative?

ACAG's view is that the proposals will reduce costs to public sector entities, but is not able to comment on other quantitative or qualitative issues.

Other comments

In terms of AASB 16 *Leases* in general, ACAG suggests the AASB consider providing further guidance as to what constitutes a lease contract. Across jurisdictions there are differing interpretations of this– is the definition intended to be a 'narrow view' of a contract and excludes statutory rights of use, or a wider interpretation, similar to enforceability concepts in the implementation guidance under AASB 15 *Revenue from contracts with customers*. For example, it is not clear whether the vesting of Crown land in a public-sector entity in legislation represents a lease.

ACAG also suggests that AASB uses a term such as "concessionary leases", rather than multiple references to the wordy and confusing "right-of-use assets at initial recognition, for leases with significantly below-market terms and conditions".