Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	Post-Implementation Reviews	**Meeting**	May 2025 (M212)
Topic:	PIR of AASB 16 *Leases* considering NFP- and public sector-specific issues	**Agenda Item:**	6.1
		Date	15 April 2025
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Objectives of this agenda item

1 The objectives of this agenda item are:

(a) to **provide** the Board with a summary of the work undertaken on the domestic element of the Post-Implementation Reviews (PIRs) of AASB 16 *Leases*;

(b) to **outline** the key requirements of the Standard;

(c) for the Board to **consider** preliminary feedback from targeted staff outreach with key stakeholders in the not-for-profit (NFP) and public sector; and

(d) for the Board to **consider** proposed domestic content to be included in an AASB Invitation to Comment (ITC).

2 The domestic PIR will consider feedback from NFP private sector entities, NFP public sector entities and for-profit public sector entities (collectively referred to as NFP and public sector entities).

3 This PIR is limited to the application of AASB 16. It will **not** consider feedback in relation to the leases disclosure requirements in AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*. Feedback on the leases disclosure requirements in AASB 1060 will be considered as part of the AASB's separate AASB 1060 PIR project (see Agenda Paper 8.1 to this meeting).

Reasons for bringing this agenda item to the Board

4 The International Accounting Standards Board (IASB) commenced its PIR of IFRS 16 *Leases* in 2024, and a Request for Information consultation document is expected to be issued in June 2025. The IASB's review will concentrate on the experiences of for-profit private sector entities.

5 The AASB is also required to perform a PIR of new accounting requirements. The objective of a PIR is to ensure the new requirements are operating as intended and effectively achieving their stated objectives. Generally, the AASB aligns its PIR of IFRS-equivalent standards with the IASB's PIR.

6 The primary aim of this review is to rigorously evaluate the standard's practical application and determine whether it is successfully addressing the issues it was designed to resolve. It is

paramount to understand that a PIR is a distinct exercise from standard-setting. Its focus is on assessing the operational effectiveness of the existing standard; it is not a mechanism for automatic revisions or a platform to resolve every application query.

7 Therefore, given the IASB's PIR and the AASB's obligation to review its standards, this agenda item signals the start of the domestic PIR for AASB 16 *Leases*. The domestic PIR will consider the application of AASB 16 by NFP and public sector entities.

8 This coordinated approach will allow the AASB to capture the unique perspectives of NFP and public sector entities, which may have sector-specific feedback that falls outside the scope of the IASB's PIR. By aligning the international and domestic PIRs, staff consider we can achieve a comprehensive understanding of AASB 16's effectiveness across all sectors, while also providing valuable insights to the IASB's international review. This approach ensures both efficiency and the delivery of the most beneficial information to all stakeholders.

9 This agenda item provides the Board with an overview of the work conducted on the domestic component of the AASB 16 PIR to date and seeks approval from the Board to issue an ITC.

Attachments

Agenda Paper 6.2 Post-implementation Review of IFRS 16 – tentative decisions of the IASB – March 2025

Structure of this paper

10 Background (paragraphs 15 – 18);

11 Summary of feedback from initial outreach (paragraphs 19 – 96);

12 Review of academic and other literature (paragraphs 97 – 98);

13 Staff recommendations (paragraph 99); and

14 Next steps and project timelines (paragraphs 100 – 105)

Background

15 In January 2016, the IASB issued IFRS 16 *Leases*, replacing IAS 17 *Leases* to improve the accounting of leases. Effective from 1 January 2019, with early adoption permitted, IFRS 16 was issued in Australia as AASB 16 *Leases*, also effective from 1 January 2019. AASB 16 applies to for-profit and NFP and public sector entities.

16 AASB 16 introduced a single lessee accounting model that requires a lessee:

(a) initially measure right-of-use (ROU) assets at cost and subsequently measure them by applying a cost model (or other measurement model permitted under the Australian Accounting Standard applicable to the underlying asset), and to recognise these assets and corresponding lease liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value;

(b) initially measure the lease liability at the present value of the lease payments that are not paid at the commencement date and subsequently adjust it for interest accretion and lease payments, with the carrying amount of the lease liability being adjusted as necessary to reflect changes to the lease payments, lease modifications and revised in-substance fixed lease payments Depreciation of ROU assets is recognised separately from interest on lease liabilities in the income statement; and

(c) to classify cash payments for the principal portion of lease liabilities within financing activities and the interest portion of lease liabilities in accordance with the requirements in AASB 107 *Statement of Cash Flows*.

17 The lessor model in AASB 16 follows a dual accounting approach for lease accounting. The accounting is based on whether significant risks and rewards incidental to ownership of an

underlying asset are transferred to the lessee, in which case the lease is classified as a finance lease otherwise it is classified as an operating lease.

18 AASB 16 includes specific provisions for NFP and public sector entities. Key requirements include:

(a) Scope Exclusions – The standard does not apply to service concession assets (AASB 1059 *Service Concession Arrangements: Grantors*). However, public sector licensors must apply AASB 16 to licences that are in substance leases, except for intellectual property, which falls under AASB 15 *Revenue from Contracts with Customers* (Aus3.1–3.2).

(a) Measurement of ROU Assets – NFP lessees may elect to measure ROU assets at fair value instead of cost for leases with significantly below-market terms, where such leases are intended to support the entity's objectives (Aus25.1). These assets can be treated as a separate class, even if they have similar characteristics to other ROU assets (Aus25.2).[1]

(b) Revaluation Option for Public Sector Entities – NFP public sector entities can choose to measure ROU assets at cost or fair value, provided they also apply the revaluation model under AASB 116 *Property, Plant and Equipment* (Aus35.1).

(b) Additional Disclosure Requirements – If an NFP entity elects to measure below-market leases at cost, additional disclosures are required, including:

(i) the entity's reliance on below-market leases;

(ii) the nature and terms of the leases, including payments, term length, asset descriptions, and usage restrictions (Aus59.1); and

(iii) disclosures can be provided individually for material leases or aggregated for similar leases, ensuring that information remains clear and relevant (Aus59.2).

Summary of feedback from initial outreach

19 To inform discussions at this meeting, staff sought feedback from targeted stakeholders about the application of the AASB 16 model in the NFP private sector and the public sector. This included seeking feedback from members of the NFP Project and Service Performance Reporting Project Advisory Panels, auditors and advisors, public sector stakeholders and professional bodies. The feedback received from stakeholders is summarised in the following paragraphs.

20 Feedback was received from two public sector auditors, two audit and advisory firms, two professional bodies, two NFP Project Advisory Panel members and two state government departments.

21 One stakeholder acknowledged that, in their experience, certain aspects of the Standard are working well. These include:

(a) that lessees and lessors have different accounting requirements;

(b) that leases acquired in a business combination are recognised as new leases rather than an entity being required to fair value the ROU asset and lease liability as part of its business combination accounting;

(c) the various exemptions (e.g. low value, short-term leases) have worked very well and allowed practical expedients without entities having to do their own materiality assessments; and

1 For ease of reference in this paper, leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives are referred to as "concessionary leases".

(d) the ability to choose either the retrospective or modified retrospective approach to transition was beneficial as it allowed those (few) entities that wanted to retrospectively apply the Standard the ability to do so.[2][3]

22 However, many NFP and public sector stakeholders shared their concerns about the application of the Standard in these sectors.

Theme 1 Determining the lease term

23 When recognising a lease, lessees are required to determine the lease term. The lease term is the non-cancellable period of a lease, together with "… periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option."[4]

24 Feedback from three stakeholders noted that determining the lease term under AASB 16 can be particularly challenging. As the lease term affects ROU asset and lease liability calculations, there can be added complexity with minimal value for financial statement users.

Insignificant penalty

25 Feedback noted that, particularly in the public sector, lease agreements often include "holdover" clauses, which allow the lessee the continued right to use the leased asset after the contractual lease period.

26 AASB 16 paragraph B34 notes that an entity shall "… determine the period for which the contract is enforceable. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty."

27 Essentially, if both the lessee and lessor can terminate the contract without more than an insignificant penalty at any time or after the end of the non-cancellable lease term, then there are no enforceable rights and obligations beyond the non-cancellable lease term.

28 In practice, determining whether a lessor can terminate a lease with no more than "an insignificant penalty" can be difficult because determining what is an insignificant penalty can be subjective. This is because the notion of penalties seems to focus more on financial penalties rather than also considering non-financial penalties, such as reputational damage or disruption of essential services if a lessor were to cancel the lease of an NFP lessee.

Reasonably certainty over lease options

29 Feedback suggests that assessing whether it is reasonably certain that an entity will exercise an extension option can be difficult for some NFPs or smaller public sector entities who may not have certainty over funding programs. The stakeholder suggested that guidance on what constitutes an enforceable period is needed.

30 One public sector stakeholder noted considerable diversity among retailers in determining the lease terms for their shopping centres / retail spaces. This was shown in the 2020 financials of selected retailers when reconciling the lease commitments note to the lease liability. In their

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2 One stakeholder at the IASB Research Forum, during the discussion of Tylaite et al.'s paper "Practical expedients – a valid tool in IFRS standard-setting?", expressed the view that the use of practical expedients was understated. They explained that this could be because not all entities would have considered the disclosure of their use to be material and thus would not have reported it.

3 AASB Research Report 17 provides valuable insights into the transitional relief and ongoing practical expedients in IFRS 16. Based on a review of financial statements and interviews with stakeholders in Australia and Malaysia, the report indicates a general understanding and appreciation for the available relief and expedients. However, it is important to acknowledge that this research is based on a sample of 80 of the largest listed companies in these two countries. Consequently, the findings regarding the understandability and usefulness of these expedients within a for-profit, large-entity context may not be directly transferable to NFP and public sectors.

4 AASB 16 paragraph 18

view, the diversity was more than a judgement made based on specific facts and circumstances. Instead, they suggest these differences arose because some retailers were interpreting "reasonably certain" at a much higher threshold than others for similar circumstances. Differences about how to interpret reasonably certain could have a material effect on ROU assets and lease liabilities, as retail leases, including option extensions, are often long-term in nature.

Staff analysis

31 Staff note that AASB 16 does not define the term "penalty", and therefore, staff acknowledge that it is necessary to consider whether a penalty should consider only financial penalties such as termination payments or whether it should also consider penalties in a broader sense (i.e. non-financial penalties).

32 Staff note that in November 2019, the IFRS Interpretations Committee considered a request about cancellable and renewable leases. The IFRS Interpretations Committee noted that when determining the enforceable period of the lease, an entity considers "the broader economics of the contract, and not only contractual termination payments." However, the IFRS Interpretations Committee discussion appears to focus only on financial penalties because the Agenda Decision refers only to "economic incentive".

33 This is consistent with the list of factors to consider in paragraph B37, which requires that "an entity considers all facts and circumstances that create an economic incentive …" and the examples in B37(c), such as lease negotiation costs, relocation costs, costs of identifying another underlying assets and costs of integration.[5]

34 Staff acknowledge that non-financial penalties are unlikely to be relevant in the for-profit sector. However, they are likely to be very relevant for NFP entities.

35 Staff agree that a lessee's economic dependence on future funding may affect whether an entity is able to exercise a lease extension option. Further, whilst the Standard does require an entity to reassess the lease term upon the occurrence of a significant event or significant change in circumstances that is within the control of the lessee, the Standard does not consider how to address a change that is not within the control of the lessee.

36 Staff note that paragraph BC156 of IFRS 16 sets out the IASB's view that 'the lease term should reflect an entity's reasonable expectation of the period during which the underlying asset will be used because that approach provides the most useful information.'

37 In practice, staff acknowledge that it may be difficult for an entity to form a view about whether they can reasonably expect future funding and, therefore, whether they will be able to exercise a lease extension option. For example, if an NFP is providing an essential service and funding is not renewed, another entity may step in to ensure the continuity of the essential service, and the entity could exercise a lease extension option. However, another entity may not step in and the entity may be unable to exercise a lease extension option.

38 Staff note that the IASB has tentatively decided to include questions in its forthcoming consultation document about the lease term requirements.

Staff recommendation

39 Given the potential complexities for determining the lease term, **staff recommend including questions in the ITC** to assess:

5 Staff note that paragraph B37 is drafted in the context of assessing the certainty of exercising a lease renewal or purchase option as part of determining the lease term, and this is different from assessing whether there is an insignificant penalty in relation to a lease termination. However, staff consider the factors in B37 to be relevant examples of relevant facts and circumstances that could be considered in both circumstances.

(a) whether determining what constitutes a significant penalty is a common occurrence, has a material effect on NFP and public sector entities, and whether significant differences in application are arising that need to be addressed and, if so, how they should be addressed; and

(b) the effect that economic dependence on future funding may have on determining the lease term, including understanding whether it is a common occurrence, whether it has a material effect on the financial statements and whether significant differences in application are arising that need to be addressed and, if so, how they should be addressed.

Theme 2 Lease Modifications

40 A lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of its original terms and conditions. AASB 16 distinguishes between lease modifications that represent, in substance, the creation of a new lease that is separate from the original lease and those that represent, in substance, a change in the scope of, or consideration paid for, the existing lease. The accounting treatment differs, too.

41 AASB 16 paragraph 44 outlines that a lease modification is accounted for as a separate lease if both of the following conditions exist:

(a) the modification increases the scope of the lease by adding the right to use one or more underlying assets; and

(b) the consideration for the lease increases by an amount equivalent to the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

42 AASB 16 paragraphs 45 and 46 outline the accounting requirements for a lease modification that is not accounted for as a separate lease.

43 NFP public sector stakeholders provided feedback on some complexities they encounter when applying the lease modification accounting requirements.

44 Feedback noted that in the NFP public sector, where lease contracts may not reflect commercial substance, determining whether the consideration increases by an amount commensurate with the stand-alone price for the increase in scope (i.e. paragraph 41(b)) is often challenging.

45 Staff also received feedback suggesting that because of the complexity of the Standard and the lack of guidance for NPF and public sector entities, there have been incorrect accounting outcomes as entities do not have the capacity to study the requirements of the Standard in detail. Two examples that were provided are:

(a) variable lease payments that were incorrectly accounted for as lease modifications and not a remeasurement of the lease liability; and

(b) a situation where assets are leased under a master/umbrella agreement that covers the lease of many individual items, which are settled with one monthly payment. When new assets were included in the master/umbrella agreement, the monthly lease payment changed. This was incorrectly accounted for as a lease modification rather than noting that the change essentially relates to a new item/lease, and no changes should have been made to the existing ROU asset and lease liability.

Staff analysis

46 Staff do not think stakeholder feedback indicates that they have difficulties in determining the stand-alone selling price because:

(a) the notion of a stand-alone selling price is also used in:

(i) AASB 15 *Revenue from Contracts with Customers* paragraph 77, where the "stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the stand-alone selling price of that good or service." Further, "If a stand-alone selling price is not directly observable, an entity shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective in paragraph 73."; and

(ii) AASB 16 paragraph 14, where the "relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximising the use of observable information."; and

(b) stakeholders did not raise any concerns about determining the standard-alone selling price during PIR of Income of Not-for-Profit Entities.

47 However, staff acknowledge that the feedback received from stakeholders as part of this PIR is that it is difficult to determine whether an increase in price is <u>commensurate</u> with an increase in scope, particularly where leases are not always on commercial terms, not that it is difficult to <u>determine</u> the stand-alone selling price. Staff also acknowledge that AASB 16 does not address what is meant by "commensurate".

48 Staff acknowledge that some illustrative examples accompany IFRS 16. However, AASB 16 does not include any NFP- and public sector-specific illustrative examples or guidance.

49 Staff note that the IASB has tentatively decided to include questions in its forthcoming consultation document about lease modifications. However, the issues to be considered are different to the issues discussed in this agenda paper.

<u>Staff recommendation</u>

50 Given that only limited feedback has been received on how to determine what is a commensurate increase in lease payments where a lease is modified, **staff recommend adding this matter to the ITC** to seek broader stakeholder feedback about whether the issue has a material effect on the financial statements, including understanding the prevalence of the issue and whether significant differences in application are arising that need to be addressed, and if so, how they should be addressed.

51 Staff also acknowledge that only limited feedback has been received on specific application issues that have arisen in practice (i.e. the incorrect application of lease modification requirements). However, as AASB 16 does not include any NFP- and public sector-specific guidance, **staff recommend adding a matter to the ITC** to seek broader stakeholder feedback about which areas, if any, stakeholders think would benefit from NFP- and public sector-specific guidance and what sort of guidance would be helpful (e.g. guidance paragraphs explaining how to apply certain principles or illustrative examples of both).

Theme 3 Cost versus benefits of AASB 16 in the NFP and public sector

52 Most feedback received suggested that the costs of applying the Standard exceed the benefits. For example:

(a) in the NFP public sector, the intended benefits of improving comparability of the financial statements between entities that lease assets and entities that borrow to buy assets might not be applicable as NFP public sector entities typically do not borrow to buy assets. One stakeholder, in particular, suggested a preference for pre-AASB 16 lease accounting (i.e. AASB 117 *Leases*).

(b) NFP public sector stakeholders noted that there is a disconnect between government reporting and statutory reporting, resulting in entities making AASB 16 adjustments for statutory reporting purposes. This indicates that the application of AASB 16 does not necessarily provide useful and relevant information to meet the needs of financial statement users.[6]

(c) there is feedback from both the NFP private and NFP public sectors about the relatively high ongoing costs of maintaining data for AASB 16 lease calculations.

  (i) in the NFP private sector feedback suggests this is because entities are less sophisticated and less well-resourced, so they need to outsource lease calculations, and this can be costly. One stakeholder noted that they incurred a cost of approximately $600 for one lease calculation, so for entities with a large number of leases, the costs could be significant. Some suggest that because of the costs of applying AASB 16 to smaller- and medium-sized NFPs, diversity can arise with entities attempting different approaches to applying the Standard to balance costs with compliance.[7]

  (ii) similarly, in the NFP public sector, where there is a high volume of leases with different variations of complex terms and conditions, AASB 16 can be very complex to apply. Further, many public sector entities are working on dated systems and require manual spreadsheets for subsequent measurement and year/month-end journals. Many staff are involved in reviewing lease agreements and calculations and leases are also a costly area to audit. Feedback suggested that 'manual' lease accounting also occurs in the NFP private sector, and it is time time-consuming to ensure it is done correctly.

  (iii) of the major changes adopted over the past few years (AASB 16, AASB 9 *Financial Instruments* and AASB 15), Chartered Accountants have consistently flagged AASB 16 as having had a more significant impact over time.[8]

  (iv) in the NFP public sector, AASB 16 appears overly complex, given the non-commercial terms in most NFP/public sector leases. State Departments, especially healthcare and education, have a lot of leased assets, and applying this across the portfolio is very resource-intensive for them. Similar feedback was received about application in the NFP private sector, too. In one stakeholder's view, this is a fatal flaw in the application of the Standard in both sectors.

(d) substantial feedback was received from stakeholders, raising concerns about the relevance and usefulness of the information provided by AASB 16. For example:

  (i) in the NFP private sector feedback suggests that some entities have found it difficult to explain the effects of lease accounting on their financial statements to internal users such as management and the Board. For example, the recognition of ROU assets expands the balance sheet but does not necessarily provide clear benefits from a user perspective.

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6 The difference between the requirements of AASB 16 and Government Financial Statistics (GFS) rules was noted as an area of concern during the FRC-led PIR of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*

7 Staff note that Exposure Draft ED 335 *General Purpose Financial Statements – Not-for-Profit Private Sector Tier 3 Entities* proposes different lease requirements for Tier 3 entities. Feedback received from stakeholders on the ED 335 proposals in relation to leases is summarised in Agenda Paper 4.3 to this meeting.

8 [2024 Chartered Accountants IFRS Survey | CA ANZ]

(ii) in the public sector, many departments and agencies hold the view that putting office accommodation on the balance sheet is not useful, particularly when the asset and liability will already be included in the whole government (consolidated) financial statements via the lessor. For example, Brisbane Powerhouse has a long-term lease (20 years + 5-year option) of its event space from its parent. It recognises approximately $11 million (out of $18 million total assets) and $11 million (out of $16.5 million liabilities) related to leases.[9]

(iii) for some stakeholders, although the initial implementation of AASB 16 was costly, the ongoing costs are relatively not substantial. However, they continue to question whether financial statement users truly benefit from the recognition of ROU assets, and noted the added complexity does not appear to provide meaningful insights.

(iv) users of financial information continue to adjust the AASB 16 'numbers' for their analysis/decision-making depending on the nature of the underlying asset. Consistency is unlikely to be achieved with different methods of adjustment.

(v) there are divergent views between NZASB and IPSASB about the viability of the leases standard adapted and issued for the public sector.

(vi) users of government financial statements are more interested in how funding is being used for key services and purchasing assets rather than leasing them; therefore, accounting for leases on-balance sheet is not helpful. Further, public sector users were not asking for on-balance sheet accounting, and the outcomes aren't relevant in the sector. It was also noted that most leases that came on the balance sheet related to office and building leases.

(vii) accounting outcomes can be confusing. For example, at the start of the lease term, higher expenses are recognised, and towards the end of the lease term, lower expenses are usually recognised. However, in practice, lease rentals typically increase during the lease term, yet 'costs' (expenses) decrease. Essentially, the financing effect of lease accounting distorts the reported results with an underlying economic change to the entity, which affects an entity's ability to 'break even' for accounting purposes.

(e) one stakeholder noted that a significant amount of time was spent reviewing agreements that are not explicitly titled lease agreements to determine whether they may still contain a lease. Similarly, they have noted that agreements labelled as a lease agreement may not necessarily meet the AASB 16 definition of a lease. One stakeholder also noted that many entities face difficulties in accounting for undocumented lease arrangements.

(f) some stakeholders questioned the usefulness of recognising ROU assets for NFP entities, particularly when leases relate to non-substitutable or non-commercial assets, such as community facilities or premises provided under concessional terms. In these cases, stakeholders argue that ROU assets and lease liabilities do not reflect an economic substance equivalent to that in the for-profit sector, where leasing is often a financing decision. Stakeholders observed that in many instances, the ROU asset is not under the entity's control in any practical sense — they cannot sub-lease it, replace it, or buy it. Furthermore, users of financial reports in the NFP sector (such as donors, regulators, and community stakeholders) are often more interested in information about service continuity and delivery than the financial representation of lease financing. This questions the decision-usefulness of capitalising leases for certain types of NFP arrangements. However, one public sector stakeholder noted that in their experience, the centralised management of specific leases does give rise

9 See page 16 of the Brisbane Powerhouse 30 June 20204 financial statements

to substantive lease substitution rights such that the arrangements aren't considered leases under AASB 16.

53 However, three public sector stakeholders (two State Government Treasury Departments and some public sector auditors) did not express any significant concerns with one commenting that the information is useful and the benefits exceed the costs. One stakeholder also noted that any significant issues encountered through initial adoption have been addressed through the IFRS Interpretations Committee and regulator (Department of Finance) guidance.

54 Staff recognise that the conceptual basis for ROU asset recognition under AASB 16 is to reflect the lessee's right to control and benefit from an asset, consistent with an asset-liability model. However, this model assumes that leases are economically substitutable and that entities make financing decisions about leasing versus owning. In the NFP context, these assumptions may not apply.

55 Staff acknowledge that for many NFPs, leases are non-substitutable and are often linked to mission-critical services. As such, the capitalisation of these leases introduces significant complexity and compliance costs, while the resulting financial information may have limited relevance for users. Additionally, for smaller entities or entities using Tier 2 disclosure frameworks, the cost of complying with full ROU asset recognition may outweigh the perceived benefit.

56 One stakeholder noted that in the public sector, they spend a significant amount of time assessing waste management contracts for each local council to determine whether there were any embedded leases in the contracts. The conclusion was that there were not. However, lots of resources were used to complete this process. Notwithstanding that councils did not expect these contracts would include embedded leases, each assessment was still required to confirm this was, in fact, the case. They suggest that implementation would have been quicker and easier had a waste management contract example been included as NFP guidance in the Australian modifications.

57 Staff note that the IASB has tentatively decided to include questions in its forthcoming consultation document about whether the benefits to users of the information reported in accordance with IFRS 16 and the costs—particularly ongoing costs—of applying the requirements, and auditing and enforcing their application, are not significantly different from what the IASB expected.

Staff recommendation

58 A PIR evaluates whether a pronouncement is operating as intended and is effectively and efficiently meeting the pronouncement's objectives in addressing the original problem it was intended to solve.

59 Given the significant feedback suggesting that the costs of applying AASB 16 by NFP and public sector stakeholders may exceed the benefits, **staff recommend adding this matter to the ITC to seek broader stakeholder feedback** on their views about the costs versus the benefits of applying AASB 16 in the NFP and public sectors and what solutions stakeholders suggest to address their concerns.

Theme 4 Measurement of lease liabilities and ROU assets

Incremental borrowing rate (IBR)

60 One stakeholder identified challenges in determining the appropriate IBR under AASB 16. Many NFP entities do not have access to external borrowing and, therefore, lack a benchmark rate. Furthermore, the cost of engaging corporate finance services to determine a precise IBR often exceeds the perceived value for these entities. Consequently, these entities commonly obtain ad hoc quotes from financial institutions, use internal proxies, or estimate based on general market data — all of which involve a high degree of judgment and inconsistency.

61 The stakeholder noted that while these alternative rates may not strictly adhere to the IBR definition, they are generally considered to provide a materially correct calculation of lease liabilities in these circumstances.

62 However, another stakeholder noted that whilst determining the discount rate on initial application of AASB 16 required considerable effort, they have not observed any ongoing issues with this.

Lease incentives

63 One public sector stakeholder noted that, in their view, accounting for lease incentives continues to be complex, and differences in application continue to exist. Notwithstanding the IASB's decision to defer consideration of this topic (in November 2019 as part of the Annual Improvements to IFRS Standards 2018-2020), in their view, this matter should be addressed.[10]

Measurement basis and impairment testing

64 Feedback noted that in the Victorian public sector, entities are required to measure ROU assets at fair value, including subsequent measurement, which gives rise to valuation challenges.

65 Feedback also noted that other states that use the cost model also face difficulties measuring impairments of ROU assets, for example.

66 One public sector stakeholder noted an issue regarding whether to include the corresponding lease liability in cash-generating units (CGU) for impairment testing where the CGU includes the ROU asset. They noted this issue was dismissed by IASB staff, who considered it to be a pre-existing issue that doesn't need addressing in their IFRS 16 PIR process. However, the stakeholder did note that they are unaware of any ongoing accounting issues, so they presume the issue has been resolved over time.[11]

Staff analysis

67 Staff acknowledge that determining the IBR can be a somewhat technical and resource-intensive task, especially for smaller NFPs. AASB 16 includes guidance on IBR determination, and there are no specific safe harbour ranges or proxy rates for consistent application. This lack of detailed guidance may lead to variations in practice and raise concerns about comparability when different IBRs are applied to similar leases. Staff do not consider this to be an issue in the public sector noting that at least some of the states publish rates for agencies to use.

68 Staff note that in September 2019 the IFRS Interpretations Committee considered a request about the definition of lessee's incremental borrowing rate in IFRS 16. The Committee clarified that while IFRS 16 defines the IBR based on a similar term, security, asset value, and economic environment, it does not explicitly require it to reflect the interest rate of a loan with a similar payment profile. However, the Committee observed that when applying judgment to determine the incremental borrowing rate, it would be consistent with the IASB's objective for a lessee to use a readily observable rate for a loan with a similar payment profile as a starting point and then adjust it as needed to meet the definition in IFRS 16.

69 Staff note that the IASB's tentative list of inclusions in its PIR consultation document includes questions about the requirements for discount rates, including whether they provide a clear and sufficient basis for lessees to determine a discount rate (usually an incremental borrowing rate), and whether entities are able to apply the requirements consistently.

70 However, the PIR consultation document does not include questions about lease incentives or impairment.

10 IASB staff paper 12H, November 2019

11 IASB staff paper 7E, March 2025

Staff recommendation

71 Staff acknowledge that limited mixed feedback has been received in relation to determining an entity's IBR. However, because determining an entity's IBR can be highly judgemental and give rise to differences in application, **staff recommend adding this matter to the ITC** to seek broader stakeholder feedback about whether the issue has a material effect on the measurement of lease liabilities and ROU assets, including understanding the prevalence of the issue and whether significant differences in application are arising that need to be addressed, and if so, how.

72 In relation to feedback about the valuation challenges occurring when ROU assets are measured at fair value, staff consider this is outside the scope of this PIR because AASB 16 does not prescribe specific requirements for valuation and instead refers to the requirements of AASB 13 *Fair Value Measurement*. As such, **staff do not recommend adding this matter to the ITC**.

73 Feedback noted that in the Victorian public sector, entities are required to measure ROU assets at fair value, including subsequent measurement, which gives rise to valuation challenges. Other states that use the cost model also face difficulties measuring impairments, for example.

74 In relation to impairment testing, staff acknowledge stakeholder feedback suggesting this was an issue on transition but which has likely been resolved over time. As such, **staff do not recommend adding this matter to the ITC**.

Theme 5 NFP Public Sector Concessionary Leases

75 Feedback from three stakeholders acknowledged that the accounting policy choice, under AASB 16 paragraph Aus.25.1, to initially measure a class of concessionary ROU assets at cost or fair value alleviates the burden of NFPs to assess the fair value of the concessionary ROU assets. However, there is still concern that this accounting policy choice is only temporary for NFP public sector entities.

76 The feedback acknowledged that the AASB clarified in the Basis for Conclusions of AASB 2022- 3 *Amendments to Australian Accounting Standards – Illustrative Examples for Not-for-Profit Entities accompanying AASB 15* that the accounting policy choice is ongoing for private sector NFPs, but that there has still not been such clarification for public sector entities (despite the finalisation of the amendments to AASB 13 *Fair Value Measurement* for public sector NFPs).

77 The feedback also noted that the inclusion of the Basis for Conclusions on AASB 2022-3 in AASB 15 is disconnected from AASB 16, which adds to stakeholders' concerns.

78 One stakeholder provided feedback that, in their experience, most entities opt not to recognise concessionary leases at fair value, presumably due to the costs associated with doing so. They also noted that there have been instances where entities have failed to identify concessionary leases. However, in practice, this would only have a material impact on financial statement disclosures because fair value accounting is uncommon. In their view, the fair value exemption is working well.

Staff analysis

79 The Board reconsidered that accounting policy choice at its November 2021 meeting. The Board's decision on the matter is noted in paragraphs BC13–BC19 of the Basis for Conclusions to AASB 2022-3. In summary, the Board decided:

(a) for NFP private sector lessees – to retain the accounting policy choice on an ongoing basis (i.e. with no plan to reconsider the accounting policy choice) for NFP private sector lessees to elect to initially measure a class of concessionary ROU assets at cost or fair value; and

(b) for NFP public sector lessees – to defer reassessing the accounting policy choice when the Board has considered the outcomes of the concessionary leases part of the IPSASB's Leases project.

80 The IPSASB has completed its Leases project and, in October 2024, issued amending Standard *Concessionary Leases and Other Arrangements Conveying Rights over Assets (Amendments to IPSAS 43, IPSAS 47, and IPSAS 48)*. Accordingly, staff consider that it would be appropriate to include specific questions in the PIR consultation document about the accounting treatment of concessionary leases from an NFP public sector lessee perspective to assist the Board in reassessing the accounting policy choice.

The IPSASB's accounting treatment

81 The amending Standard *Concessionary Leases and Other Arrangements Conveying Rights over Assets (Amendments to IPSAS 43, IPSAS 47, and IPSAS 48)* applies to annual periods beginning on or after 1 January 2027. Under this IPSAS, a lessee is required to initially recognise:

(a) an ROU asset arising from a concessionary lease or an ROU asset in-kind, measured at the present value of payments for the lease at market rates based on the current use of the underlying asset (i.e. market-based payments) as at the commencement date;

(b) a lease liability measured at the present value of the contractual lease payments (i.e. the contractual concessionary payments); and

(c) either a liability for the difference between (a) and (b), where the lessee has a "compliance obligation", or else revenue.

82 The abovementioned accounting treatment is likely to result in a similar outcome as initially recognising concessionary ROU assets at fair value under AASB 16.

83 The IPSAS requires a lessee to make "a reasonable level of effort in determining the present value of payments for the lease at market rates". However, it provides a practical expedient – if payments for the lease at market rates are not "readily available" for the ROU asset, the lessee would be required to measure the ROU asset at cost (i.e. based on the present value of the contractual concessionary lease payments) [paragraph 26C of the amendments to IPSAS 43 *Leases*]. The accounting treatment, if the practical expedient is applied, would be the same as the initially recognising concessionary ROU assets at cost under AASB 16.

84 That is, the IPSASB's requirements would likely achieve a similar outcome as the accounting policy choice in AASB 16 paragraphs Aus25.1 and Aus25.2. However, the cost approach under IPSAS is available only after a lessee has made "a reasonable level of effort in determining the present value of payments for the lease at market rates". In contrast, the accounting policy choice under AASB 16 is not subject to any conditions.

85 At its December 2024 meeting, the NZASB decided not to adopt *Concessionary Leases and Other Arrangements Conveying Rights over Assets (Amendments to IPSAS 43, IPSAS 47, and IPSAS 48)* for Public Benefit Entities (PBE) in New Zealand. PBE lessees are required to apply NZ PBE IPSAS 43 *Leases* and to initially measure concessionary ROU assets at the present value of the contractual concessionary lease payments, not at market rates. That is, the accounting treatment is consistent with the cost approach under AASB 16.

Staff recommendation

86 Entities electing the cost approach to initially measure concessionary ROU assets are required to prepare additional disclosures as set out in AASB 16 paragraphs Aus59.1 and Aus59.2. The Board has previously obtained feedback from NFP private and public sector stakeholders that those additional disclosures are sufficient in providing useful information to users regarding concessionary leases without information about the fair value of such leases.

87 In 2022, when finalising AASB 2022-3, NFP public sector entity stakeholders commented that they support having the accounting policy choice on an ongoing basis, as it is for NFP private sector entities.

88 Staff **recommend adding this matter to the ITC** to seek stakeholder views:

(a) about whether there are any reasons to preclude the current accounting policy choice to initially measure concessionary ROU assets at cost or fair value, and whether the Board should make the temporary accounting policy choice permanent; and

(b) about whether the disclosures prepared in accordance with AASB 16 paragraphs Aus59.1 and Aus59.2 are sufficient in providing useful information to users regarding concessionary leases.

Theme 6 Other feedback

Sale and leaseback and sublease arrangements

89 A sale and leaseback transaction is one where an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) for consideration and leases that asset back from the buyer-lessor.

90 AASB 16 acknowledges that the sale transaction and ensuing lease are generally interdependent and negotiated as a package. As such, some transactions could be structured with a negotiated sales price that is above or below the asset's fair value and with lease payments that are also above or below market rates. These 'off-market' terms could distort the gain or loss on the sale and the recognition of the lease expense and lease income for the lease. To ensure that the gain or loss on the sale and lease-related assets and liabilities are appropriately accounted for, AASB 16 requires adjustments for any off-market terms on "the basis of the more readily determinable of (a) the difference between the fair value of the consideration for the sale and the fair value of the asset and the (b) difference between the present value of the contractual payments for the lease and the present value of payments for the lease at mark rates."[12]

91 One stakeholder noted that sale and leaseback and sublease arrangements are common between government agencies. They also noted that accounting for sale and leaseback arrangements is particularly challenging where the asset is sold or given for a nominal amount.

Deeds of Grant in Trust (DOGIT) and reserve land

92 In the public sector, one stakeholder noted that there are a number of land grants (e.g. DOGIT and reserve land) between the state government and public sector entities and local government.[13] The accounting treatment of these arrangements was a significant concern when AASB 16 was being developed. However, the exemptions included in the final Standard essentially permitted entities to continue with their existing pre-AASB 16 practices and no significant ongoing issues are noted. Occasionally, there are issues about whether the land is accounted for under AASB 116 *Property, Plant and Equipment* or AASB 16. However, these issues are largely related to the technical difference between freehold land and leasehold land (e.g. valuation differences between freehold land and leasehold land because of the different legal nature even though, in substance, the leasehold land is economically the same as freehold land) and generally, these assets are accounted for under AASB 116, using the various options for valuation under AASB 16 (i.e. fair value or cost such as peppercorn).

12 AASB 16 paragraph 101 and 102

13 A DOGIT is a type of property rights in land where the state grants land to a trustee who manages it for a specific purpose. The land is held in trust, meaning it can't be sold and is restricted to the purpose outlined in the DOGIT.

Staff analysis

93 Staff suggest the challenges are likely to be most relevant for lessors who may derecognise assets with significant carrying amounts and, in place, recognise a much lower value lease receivable. In such cases, the lessor would recognise a significant loss in the income statement in the period. Staff understand that such arrangements can be common, especially where public sector entities have surplus assets and leasing them at below 'market' rents is the best use of the surplus assets at the time. Staff suggest a similar accounting outcome would occur in a sublease arrangement, too.

94 Staff note that the IASB has tentatively decided not to include questions in its forthcoming consultation document about sale and leaseback arrangements.

Staff recommendation

95 Noting that sale and leaseback and sublease arrangements involving nominal consideration are common and the accounting for them can be challenging, **staff recommend adding this matter to the ITC** to seek broader feedback about whether the issue has a material effect on financial statements, including understanding the prevalence of the issue and whether significant differences in application are arising that need to be addressed, and if so, how.

96 As feedback suggests that the accounting for DOGIT and reserve land arrangements was more of a transition issue and that ongoing accounting practice is not significantly affected, staff **do not recommend adding this matter to the ITC**.

Review of academic and other literature

97 A researcher's feedback revealed that AASB 16 is widely perceived within the NFP sector, particularly among small and medium entities, as adding significant complexity without commensurate informational value. This complexity, compounded by low financial literacy among users, fosters a compliance-driven mindset, where financial reports are primarily seen as auditor sign-off rather than decision-making tools. Consequently, philanthropists are increasingly discounting complex reports, and the tiering of reporting requirements fails to address these fundamental concerns. While larger entities exhibit higher financial literacy and value AASB 16 for comparability, the overall sentiment across the sector suggests a need to reassess the standard's practical application and perceived utility.

98 Fahad and Scott (2022)[14] examined the impact of capitalising operating leases on New Zealand charities. They found that lease terms in NFP entities were typically shorter than in for-profit entities, but the capitalisation of operating leases led to a significant increase in liabilities and leverage ratios. In addition, charities showed a potential increase in their surplus to total assets, contrasting with the usual decrease seen in for-profit organisations. This is likely due to the non-profit focus on breaking even rather than maximising profits. The findings highlight key differences in the impact of lease accounting changes between the charity and for-profit sectors, which policymakers should consider.

Staff recommendations

99 Staff recommend the following NFP and public sector themes are included in the ITC:

(a) ***Theme 1 Determining the lease term***: the ITC asks for feedback on a) what constitutes a significant penalty and b) the effect that economic dependence on future funding may have on determining the lease term.

(b) ***Theme 2 Lease Modifications***: the ITC asks for feedback on a) determining what is a commensurate increase in lease payments where a lease is modified and b) which areas, if any, stakeholders think would benefit from NFP- and public sector-specific guidance

14 Fahad, N., & Scott, T. (2022). The Effect of capitalising operating leases on charities. *Australian Accounting Review*, 32(1), 141-148.

and what sort of guidance would be helpful (e.g. guidance paragraphs explaining how to apply certain principles or illustrative examples of both).

(c) ***Theme 3 Cost versus benefits of AASB 16 in the NFP and public sector***: the ITC asks for feedback on the costs versus the benefits of applying AASB 16 in the NFP and public sectors and what solutions stakeholders suggest to address their concerns.

(d) ***Theme 4 Measurement of lease liabilities and ROU assets***: the ITC asks for feedback on determining an entity's incremental borrowing rate but does not ask for feedback on a) valuation challenges occurring when ROU assets are measured at fair value and b) matters relating to impairment testing.

(e) ***Theme 5 NFP Public Sector Concessionary Leases***: the ITC asks for feedback a) whether there are any reasons to preclude the current accounting policy choice to initially measure concessionary ROU assets at cost or fair value and whether the Board should make the temporary accounting policy choice permanent and b) whether the disclosures prepared in accordance with AASB 16 paragraphs Aus59.1 and Aus59.2 are sufficient in providing useful information to users regarding concessionary leases.

(f) ***Theme 6 Other feedback***: the ITC asks for feedback on application challenges in accounting for sale and leaseback and sublease arrangements by lessors but does not ask for feedback on DOGIT and reserve land arrangements.

Next steps and project timelines

100 Following this Board meeting, and subject to Board decisions, staff intend to draft an Invitation for Comment for final editorial consideration by any Board members that would like to review it before the ITC is issued.

Structure of the ITC

101 Staff intend to structure the ITC as follows:

(a) first, the usual AASB wrap-around that is added to all IASB Requests for Information documents that are reissued in Australia by the AASB . This wrap-around includes the AASB cover page, information about how to comment on the AASB ITC, the due dates for comments to the AASB and to the IASB, the AASB's contact information and the AASB copyright notice;

(b) secondly, a section titled "AASB Request for Comments", which will:

(i) direct stakeholders to the questions in the IASB's Request for Information document;

(ii) include the usual AASB specific matters for comment – regulatory or other issues affecting implementation, whether the resulting financial statements would be useful to users, whether in the best interests of the Australian economy, and cost/benefit information; and

(iii) include clearly identified Australian-specific content requesting feedback from NFP and public sector stakeholders on the matters raised and any other issues; and

(c) lastly, the IASB's Request for Information Document in full.

102 The themes of the Australian-specific content referred to in paragraph 101(b)(iii) will be decided at this meeting following discussions with Board members.

103 As the AASB has provided the IASB with for-profit private sector feedback received from Australian stakeholders during earlier phases of the IASB's PIR process, the ITC will not include any Australian for-profit private-sector-specific material in addition to the IASB Request for Information document.

104 As noted in this paper, staff expect that some of the matters the IASB will consider during its PIR process will be relevant to NFP and public sector entities. A summary of the tentative decisions made by the IASB at its March meeting about the expected content of their Request for Information document is included in Agenda Paper 6.2.

105 The following table outlines a tentative proposed timeline for the remainder of the project for the Board's consideration. The timeline might need to change depending on the matters highlighted in the consultation document and the responses to that document.

Proposed timeline	**Project milestones based on the PIR process**
	Planning phase
Q1-Q2 2025	Steps 1, 2: Review of original project documentation and collation of identified issues.
Q1-Q2 2025	Step 3: Academic research – collate and summarise.
Q1 2025	Step 4: Seek preliminary feedback from targeted stakeholders
Q2 2025	Step 5: Prioritise issues from the planning phase to determine scope of the consultation process.
	Outreach
Board meeting: 1 May 2025	Steps 6: Discuss steps 1–5 with the Board before developing the consultation document. Step 8: Discuss proposed Australian-specific content of the consultation document with the Board and approve for issue. Staff intend to ask the Board to approve the content of an ITC at this meeting. The ITC is expected to be issued when the IASB issues its Request for Information consultation document. To align with the expected 120-day comment period of the IASB consultation document, staff suggest a comment period of approximately 90-days for the AASB's ITC. This will give staff sufficient time to consider and summarise any feedback that is relevant to the IASB before their comment due date. The IASB's Request for Information consultation document is expected to be issued in June 2025. Therefore, comments on the AASB's ITC are expected to close in August/September 2025.
Q2/Q3 2025	Step 7: Draft consultation document (i.e. Invitation to Comment). Step 9: Undertake general and targeted outreach to seek stakeholder feedback on the consultation document.
	Consideration of feedback and next steps
Q4 2025 Q1 2026	Step 10: Consultation comment period closes in August/September 2025. Step 11: Review and summarise responses received on the consultation document and through outreach. Perform follow-up processes.
Q1 2026	Step 12: Identify possible "next steps" to respond to findings. Step 13: Discuss feedback and possible next steps with the Board.

Questions for Board members

Q1 In relation to the PIR of AASB 16 *Leases*, do Board members:

(a) agree with the proposed structure of the ITC outlined in paragraph 101?

(b) agree that the NFP and public sector themes summarised in paragraph 101(b)(iii) should be included in the ITC? If not, what approach do Board members suggest?

(c) approve the issue of an AASB Invitation to Comment, which includes the IASB Request for Information consultation document?

(d) agree with a comment period of approximately 90 days (subject to the comment period of the IASB's consultation document)?

Q2 Would any Board members like to review the draft ITC before it is issued? If yes, which Board members?

Q3 Do Board members have any comments on the next steps and project timeline outlined in paragraph 105?