

Basis for Conclusions on AASB 2018-8

This Basis for Conclusions accompanies, but is not part of, AASB 16. The Basis for Conclusions was originally published with AASB 2018-8 Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in this Standard. It sets out the reasons why the Board developed the Standard, the approach taken to developing the Standard and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Reasons for issuing this Standard

BC2 AASB 1058 *Income of Not-for-Profit Entities* and AASB 16 *Leases* are effective for annual reporting periods beginning on or after 1 January 2019. These Standards require not-for-profit entities to measure right-of-use assets at initial recognition at fair value for leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives.

BC3 For ease of reference in this Basis for Conclusions, leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives are referred to as ‘concessionary leases’.

BC4 The Board considered comments from stakeholders in the not-for-profit sector preparing for the implementation of AASB 16 and AASB 1058, some of whom expressed difficulties in applying the principles in AASB 13 *Fair Value Measurement* in determining the fair value of right-of-use assets arising under concessionary leases. The difficulties noted included how often-significant restrictions on the right of use of the underlying assets and the specialised nature of the underlying assets should be incorporated in the valuation of right-of-use assets arising from concessionary leases.

BC5 Whilst other assets required by other Standards to be fair valued might also be subject to restrictions on use or specialised in nature, the Board noted that the issues related to right-of-use assets for lessees might be different to the issues for owners of the assets, making it difficult to determine the fair value of right-of-use assets simply by reference to the fair value of the underlying assets. Since the principles in AASB 13 are based on market participants buying and selling assets, further guidance appears to be needed to assist not-for-profit entities in applying the principles to right-of-use assets in concessionary lease arrangements.

BC6 The Board considered the prevalence and magnitude of concessionary leases in the not-for-profit sector, and the significance of restrictions on rights of use of the underlying assets in many cases. The Board also noted that a temporary option for not-for-profit lessees to not measure a class (or classes) of right-of-use assets at initial recognition at fair value for concessionary leases would avoid undue cost and effort being incurred by preparers in applying AASB 13 in the absence of additional guidance. The Board assessed these factors with reference to *The AASB’s Not-for-Profit Entity Standard-Setting Framework* and decided to propose the temporary option. The interpretative issues arising from fair valuing right-of-use assets arising under concessionary leases will be addressed in the AASB’s Fair Value Measurement for Public Sector Entities project.

BC7 The Board also noted that the financial reporting thresholds for not-for-profit private sector entities may be revised as a result of the ACNC Legislative Review recommendations. It is possible that entities at the lower level of the reporting thresholds might not be required in future to apply the requirements of AASB 16 and AASB 1058. The temporary option would avoid such smaller entities incurring costs in measuring right-of-use assets at initial recognition at fair value when they might be exempted from this requirement in future by not being required to prepare financial statements that comply with Accounting Standards.

BC8 However, as some not-for-profit entities had already commenced the process of determining the fair value of right-of-use assets in concessionary leases, the Board decided to make the temporary relief optional. This

allows these entities to continue their work on fair valuing concessionary leases and applying the fair value initial recognition measurement requirements to measure right-of-use assets.

- BC9 Entities electing not to measure the right-of-use assets in concessionary leases at fair value will recognise the assets at cost in accordance with AASB 16 (paragraphs 23–25), which incorporates the amount of the initial measurement of the lease liability.
- BC10 The optional relief will be reassessed when further guidance has been developed to assist not-for-profit entities in fair valuing right-of-use assets and the financial reporting requirements for private sector not-for-profit entities have been finalised. The Board will consider whether to provide a permanent option for not-for-profit entities to measure a class of right-of-use assets at initial recognition either at cost or at fair value for those concessionary leases entered into prior to the application date of AASB 16 or for all concessionary leases.

Issue of ED 286 Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities

- BC11 The Board’s proposals were exposed for public comment in November 2018 through Exposure Draft ED 286 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities*.
- BC12 The Board received feedback on its proposals through 20 submissions on ED 286. The responses to ED 286 indicated that:
- (a) all respondents agreed that not-for-profit entities should be given some form of relief to not measure right-of-use assets for concessionary leases at initial recognition at fair value. Some respondents agreed that the relief should only be given on a temporary basis until further guidance has been developed to assist not-for-profit entities in fair valuing right-of-use assets and the financial reporting requirements for not-for-profit private sector entities have been finalised. However, other respondents were of the view that the option to elect either cost or fair value measurement should be made available on a permanent basis for all concessionary leases and for not-for-profit entities in both the private sector and the public sector; and
 - (b) most respondents agreed that the proposed additional disclosure requirements in AASB 16 would provide adequate information for users of the financial statements to understand the effects on the financial position, financial performance and cash flows of the entity arising from concessionary leases in the absence of fair value information. However, some respondents suggested providing further clarification to ensure not-for-profit entities understand the disclosure requirements.
- BC13 The Board considered the feedback and in December 2018 decided to finalise its decisions to provide a temporary option for not-for-profit entities to elect to measure a class of right-of-use assets arising under concessionary leases at cost or at fair value at initial recognition. At a later time, when fair value measurement guidance has been developed and the not-for-profit private sector financial reporting requirements have been finalised, the Board will consider whether the temporary option should be made permanent.

Election of measurement basis

- BC14 Some ED 286 respondents noted that there might be instances where an entity may wish to apply the option of not fair valuing right-of-use assets for concessionary leases only to some, but not all, of the right-of-use assets. This may be the case for example where the not-for-profit entity has elected to apply the revaluation model under AASB 116 *Property, Plant and Equipment* to a class of property, plant and equipment and would therefore likely elect to measure right-of-use assets that relate to that class also at fair value, as permitted by AASB 16, paragraph 35. However, this should not force the entity to also measure all other right-of-use assets arising from concessionary leases on initial recognition at fair value.
- BC15 Consequently, the Board decided that the election of the measurement basis for initial recognition of right-of-use assets of concessionary leases should be made by class of right-of-use assets. As specified in other Standards, a class is a grouping of assets of a similar nature and use in an entity’s operations.

Disclosures

- BC16 In the absence of fair value information, the Board decided that entities electing to measure a class of right-of-use assets at initial recognition at cost rather than at fair value would need to make additional disclosures. This will ensure adequate information is disclosed for users of financial statements to understand

the effects on the financial position, financial performance and cash flows of the entity arising from concessionary leases.

- BC17 A number of ED 286 respondents expressed concerns that, without reference to fair value information, it might be difficult to assess whether a concessionary lease is material and therefore requires individual disclosures under AASB 16, paragraph Aus59.2.
- BC18 AASB 101 paragraph 7 defines when information is material and AASB Practice Statement 2 *Making Materiality Judgements* provides further guidance, including in relation to disclosure requirements. When making materiality judgements, an entity needs to take into account how information could reasonably be expected to influence the primary users of its financial statements when they make decisions on the basis of those statements. In respect of not-for-profit entities, primary users of financial statements are concerned with the ability of the entity to achieve its objectives. Therefore, when assessing whether a concessionary lease is material to the financial statements, the entity could consider factors such as the significance of the concessionary lease to the entity's operations in fulfilling its objectives.
- BC19 Some respondents recommended the Board consider clarifying the extent of disclosures required in AASB 16 paragraphs Aus59.1 and Aus59.2. Consistent with AASB Practice Statement 2, an entity applies judgement in determining the level of detail necessary to satisfy the disclosure objective, including the level of aggregation or disaggregation of disclosures so that useful information is not obscured. The Board notes that AASB 16 paragraph Aus59.2 requires disclosures to be made individually for each material lease and permits aggregated disclosures for other concessionary leases involving right-of-use assets of a similar nature.

GAAP/GFS convergence

- BC20 Several respondents commented that measuring right-of-use assets at either cost or fair value could result in Government Finance Statistics (GFS) convergence differences. As the ABS GFS Manual continues to distinguish operating leases and finance leases, some of these convergence differences relate to the underlying principles of AASB 16. However, a new convergence difference would arise if right-of-use assets under concessionary leases that would previously have been classified as finance leases are measured at cost under the temporary option, rather than at fair value. On balance, the Board considered that it was appropriate to provide not-for-profit entities with the temporary option in respect of such concessionary leases.
- BC21 Consequently, the Board added an exception to AASB 1049 (paragraph 13D) to permit public sector entities to measure right-of-use assets arising under concessionary leases at initial recognition at cost, rather than fair value.