

## Basis for Conclusions on AASB 2019-8

*This Basis for Conclusions accompanies, but is not part of, AASB 16. The Basis for Conclusions was originally published with AASB 2019-8 Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary Leases.*

### Introduction

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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

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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 originally required 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 that some not-for-profit entities are encountering 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 Board considered the prevalence and magnitude of concessionary leases in the not-for-profit sector, and in December 2018 issued AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* to provide a temporary option for not-for-profit lessees to measure a class (or classes) of right-of-use assets at initial recognition at cost or at fair value arising under concessionary leases.

BC5 Subsequently the Board received feedback that public sector entities preparing Whole of Government and General Government Sector financial statements would need to revalue their right-of-use assets arising under concessionary leases (and other leases) at fair value at subsequent measurement to satisfy the requirements of AASB 1049 *Whole of Government and General Government Sector Financial Reporting* to elect accounting treatments in Accounting Standards that align with the principles in the ABS GFS Manual. The Board considered the issue and decided to provide an option for the Whole of Government and the General Government Sector to measure right-of-use assets arising under concessionary leases at cost or at fair value in subsequent measurements, which is an extension of the existing temporary relief provided in AASB 2018-8 in relation to initial recognition.

BC6 Stakeholders also requested clarification of whether right-of-use assets arising under concessionary leases can be treated as a separate class of right-of-use assets to right-of-use assets arising under other leases so that entities can have the option to measure right-of-use assets arising under concessionary leases under a different basis to right-of-use assets arising under other leases. The Board decided to amend the Standards to clarify this.

### Subsequent measurement of right-of-use assets of Whole of Government and General Government Sector

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BC7 The Board received feedback from stakeholders that public sector entities apply the revaluation model in AASB 116 *Property, Plant and Equipment* to measure their property, plant and equipment at fair value to align with Government Finance Statistics (GFS) principles (ie measurement of assets at current market value). They are concerned that, to satisfy the requirements in paragraph 13 of AASB 1049, public sector entities would be required to also apply the revaluation model to measure right-of-use assets arising under concessionary leases at fair value at subsequent measurement.

- BC8 As stated in paragraph BC6 of AASB 2018-8, temporarily permitting not-for-profit entities to elect to measure right-of-use assets arising under concessionary leases at either cost or fair value at initial recognition was intended to avoid not-for-profit entities, including those in the public sector, incurring undue cost and effort in applying the principles of AASB 13 to measure the fair value of right-of-use assets arising under concessionary leases in the absence of further guidance on fair value measurement. However, stakeholders commented that limiting the relief only to initial measurement did not appear to have achieved this for public sector not-for-profit entities.
- BC9 The Board noted that there is precedent for deferring measurement requirements for the not-for-profit public sector. For example, the Board deferred the requirement to recognise defence weapons platforms at fair value when the ABS GFS Manual was amended to treat defence weapons platforms as assets rather than immediate expenses. Paragraph BC3 to the amending Standard AASB 2012-8 *Amendments to AASB 1049 – Extension of Transitional Relief for the Adoption of Amendments to the ABS GFS Manual relating to Defence Weapons Platforms* (appended to AASB 1049) suggested that the Board considered the magnitude and complexity of the valuation exercise for defence weapons platforms and decided that an extension of transitional relief for two years would be required for the Australian Government to be able to comply. The Board also deferred the requirement to recognise land under roads (first from 31 December 2002 to 31 December 2006, then further to 31 December 2007) considering the lack of international convergence on the recognition of land under roads. When finalising AASB 1051 *Land Under Roads*, the Board considered that it might be onerous for entities to be required to retrospectively identify, assess the recognition criteria, recognise and measure land under roads previously acquired, and decided to allow entities to elect whether to recognise land under roads acquired before the end of the first reporting period ending on or after 31 December 2007 (AASB 1051, paragraph BC11).
- BC10 The Board also considered that its project on reforming the Australian public sector financial reporting framework could reduce the magnitude of having material right-of-use assets arising under concessionary leases being measured at fair value if it is determined that general purpose financial statements are not required to be prepared by all public sector entities, other than Whole of Government and General Government Sector. The Board also considered that it might also be prudent to not introduce further amendments to AASB 1049 until the planned post-implementation review of AASB 1049 has been completed.
- BC11 However, since the public sector financial reporting framework reform, the post-implementation review of AASB 1049 and the guidance on fair value measurement are not expected to be completed when public sector entities need to prepare their financial statements for the 2019/20 financial year, the Board decided to extend the current temporary relief in relation to initial measurement to provide an option for the Whole of Government and the General Government Sector to measure right-of-use assets arising under concessionary leases at cost or at fair value in subsequent measurements. The Board made this decision in accordance with *The AASB's Not-for-Profit Entity Standard-Setting Framework* (paragraph 28(d)) to avoid undue cost and effort in applying the principles of AASB 13 in measuring the fair value of these assets before the Board issues further fair value measurement guidance. The Board therefore amended paragraph 13D of AASB 1049 to remove the initial recognition proviso for measuring a class of right-of-use assets arising under concessionary leases at cost or fair value.
- BC12 The temporary relief described in paragraph BC11, in relation to subsequent measurements of right-of-use assets arising under concessionary leases, is provided only to Whole of Government and General Government Sector because AASB 1049 specifies requirements only for Whole of Government and General Government Sector financial statements. Other public sector entities, such as government agencies and local governments, are not subject to AASB 1049 and are not required by current Accounting Standards to adopt a fair-value approach in measuring non-financial assets. These entities therefore do not need the temporary relief provided under AASB 1049. Whether these entities are required to adopt a fair-value approach is a matter for the Treasury or Finance Department or other authority in each jurisdiction.
- BC13 Consistent with its decisions in AASB 2018-8 (see paragraph BC16 of AASB 2018-8), the Board considers that the additional disclosure requirements in paragraphs Aus59.1 and Aus59.2 of AASB 16 apply in the absence of fair value information at any reporting date when right-of-use assets arising under concessionary leases are measured at cost, subsequent to their initial recognition at cost. This ensures 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.

## **Class of right-of-use assets**

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- BC14 Current accounting standards (eg AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*) describe a class of assets as ‘a grouping of assets of a similar nature and use in an entity’s operations’. Some stakeholders commented that applying this description – grouping right-of-use assets of a similar nature and use in an entity’s operations – would mean that a right-of-use asset arising under a concessionary lease would be classified in the same class as right-of-use assets arising under other leases, if they exhibit the similar nature and use. Therefore, further guidance or amendments would be required to define or clarify ‘a class (or classes) of right-of-use assets’ if it was intended to provide temporary relief to not-for-profit entities by permitting them to elect to measure right-of-use assets arising under concessionary leases at cost or fair value, whether or not right-of-use assets arising under other leases that are in the same class are measured on the same basis.
- BC15 The Board considered that the amendments made to paragraph Aus25.1 of AASB 16 and the commentary in paragraph BC14 to AASB 2018-8 already distinguished a class of right-of-use assets based on whether the right-of-use assets arise under concessionary or non-concessionary leases, in addition to the requirement for a similar asset nature and use. Given the uncertainty whether the current measurement option is effective given the existing description of a class of asset, the Board decided to clarify this in the further amendment of AASB 16.

### **Options for addressing the issues**

- BC16 The Board considered three possible options for resolving the issues:
- Option 1 – permit the election of the measurement basis for right-of-use assets on a lease-by-lease basis. This option would reduce comparability between not-for-profit entities and amongst assets of an entity. The Board considered there is a risk that entities might choose a measurement method for the purpose of achieving a particular outcome;
  - Option 2 – introduce a definition of ‘class of right-of-use assets’ to clarify that concessionary leases may have a different nature and use in the entity’s operations compared with other leases. The Board was of the view that the definition created would not be consistent with the concept of a class of assets in other Standards, which looks only at the nature and use of the assets in an entity’s operations. AASB 16 paragraphs 53(a) and (j) require disclosure of the depreciation charge and the carrying amount for right-of-use assets by class of underlying asset, this will be less meaningful when the disclosures aggregate amounts for different right-of-use asset classes measured on different bases. The Board also considered that developing a new definition might require further guidance to be developed to assist preparers in applying the new definition; and
  - Option 3 – specify that right-of-use assets arising under concessionary leases may be treated as a separate class of right-of-use assets from right-of-use assets arising under other leases. As with Option 2, this option would not be consistent with the concept of a class of assets in other Standards, which looks only at the nature and use of the assets and aggregated right-of-use asset disclosures under AASB 16 may be less meaningful.
- BC17 The Board considered the advantages and disadvantages of each option and decided to adopt Option 3 – specify that right-of-use assets of not-for-profit entities arising under concessionary leases may be treated as a separate class of right-of-use assets from right-of-use assets arising under other leases. This option is expected to be the simplest to apply without limiting the scope of the exemption from the requirements to measure right-of-use assets at fair value in advance of public sector not-for-profit entity guidance on applying fair value. The Board noted specifying that right-of-use assets arising under concessionary leases can be treated as a separate class of right-of-use assets from right-of-use assets arising under other leases would not be consistent with the concept of a class of assets in other Standards, which looks only at the nature and use of the assets. However, the Board considered this would be a pragmatic and limited response to the issue for not-for-profit entities, and added paragraph Aus25.2 to AASB 16. The Board decided that this approach of treating sub-classes of assets as separate classes should not be applied by analogy in other circumstances.

## **Measuring some right-of-use assets arising under concessionary leases at cost and others at fair value**

- BC18 Some stakeholders commented that some public sector entities have been measuring at fair value leased assets arising under finance leases pursuant to AASB 117 *Leases*, and expressed a desire to continue measuring at fair value right-of-use assets related to concessionary leases that were classified previously as finance leases, and measure right-of-use assets of other concessionary leases at cost. They questioned whether right-of-use assets related to concessionary finance leases can be considered a separate class of right-of-use assets.
- BC19 Even though electing measurement models based on the GFS categories of operating lease and finance lease could achieve better GFS alignment, the Board considered that this would conflict with the accounting measurement basis for leases, given the removal of the operating and finance lease distinction for lessees. AASB 1049 paragraph 13 does not require consistency with GFS in the event of a conflict. Permitting the election of cost or fair value measurement based on GFS categories would risk prioritising GFS alignment over faithful and comparable presentation of right-of-use assets in statements of financial position. Therefore, the Board considered that lessees' election of cost or fair value measurement should not be based on the superseded categories of finance lease and operating lease for lessees.
- BC20 However, the Board concluded that it would be appropriate to permit not-for-profit public sector entities to measure separate classes of right-of-use assets based on those arising from concessionary leases and those arising under other leases on different bases. That is, one of those classes could be measured at cost and the other at fair value, if the lessee applies the revaluation model to the class of property, plant and equipment to which the right-of-use assets relate. Thus a modification to paragraph 35, which does not refer to classes of right-of-use assets, is required, and so the Board added paragraph Aus35.1 to AASB 16.
- BC21 The Board noted that entities would not be required to remeasure right-of-use assets of existing concessionary finance leases at cost if they have already applied the fair value model to those lease assets under AASB 117 and would now measure the class of right-of-use assets at cost. Under paragraph C11 of AASB 16, entities can use the AASB 117 carrying amounts (fair value) as the basis for applying AASB 16 under the modified transition approach, without having to remeasure those amounts.