Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Right-of-use assets of not-for-profit entities under concessionary leases**	**Meeting:**	M184 (November 2021)
Topic:	**Initial measurement of right-of-use assets under concessionary leases**	**Agenda Item:**	11.2
Contact(s):	Patricia Au pau@aasb.gov.au Fridrich Housa fhousa@aasb.gov.au	**Project Priority:** **Decision-Making:** **Project Status:**	Medium High Initial deliberations

Objective of this paper

1 The objective of this paper is for the Board to reconsider the initial measurement requirement of right-of-use (ROU) assets arising from concessionary leases held by not-for-profit (NFP) lessees.[1] Specifically, staff ask the Board to **decide**:

(a) whether NFP lessees should be required to initially measure concessionary ROU assets at fair value (which was the Board's decision when it issued AASB 1058 *Income for Not-for-Profit Entities* in 2016); or

(b) if not, whether relief from the fair value measurement requirement should be provided to:

(i) ROU assets arising from existing concessionary leases, but requiring ROU assets arising from new concessionary leases to be initially measured at fair value; or

(ii) ROU assets arising from all concessionary leases; and

(c) whether the same relief should be provided to NFP lessees in the private and public sector.

Background and reasons for the Board to consider this issue at this meeting

2 When the Board issued AASB 1058 in December 2016, the Board decided to specify that the right-of-use asset be initially measured at the fair value of the right to use the underlying asset in accordance with the terms and conditions of the lease. The Board's rationale for requiring concessionary ROU assets to be initially measured at fair value is discussed in Section 1 of this paper. The difference between the value of the ROU asset and the lease liability is recognised as income at day 1. This requirement reflected the AASB 1058 approach for NFP entities to recognise assets acquired at below-market terms and conditions principally to enable the NFP entity to further its objectives at fair value.

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". Right-of-use assets arising under concessionary leases are referred to as "concessionary ROU assets".

3 However, following the release of the requirements, the Board received comments from stakeholders in the NFP sector expressing difficulties in applying the principles in AASB 13 *Fair Value Measurement* in determining the fair value of ROU assets discussed by the Board at the November 2018 Board meeting - Agenda Paper 8.1 that resulted in the issuance of ED 286 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* proposing temporary option to measure concessionary ROU assets at cost.

4 Subsequently, the Board issued AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* and AASB 2019-8 *Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary Leases* to further amend AASB 16 to provide relief from the requirement to fair value concessionary ROU assets at initial recognition, and also subsequent measurement for NFP public sector lessees.

5 Consequently, NFP lessees currently have an accounting policy choice to initially measure a class of concessionary ROU assets at:

(a) cost, or

(b) fair value (AASB 16 para. Aus25.1).

Entities electing the cost option are required to prepare additional disclosures (AASB 16 paras. Aus59.1–Aus59.2).

6 In making its decision to provide relief, the Board noted that:

(a) it planned to develop guidance, as part of its Fair Value Measurement for Not-for-Profit Entities project (FVM project), to assist NFP entities in applying the principles in AASB 13 in measuring the fair value of concessionary ROU assets (AASB 2018-8 para. BC7); and

(b) the relief would avoid requiring NFP private sector entities at the lower level of the reporting thresholds to apply the fair value initial measurement requirements of AASB 16 when they might not be required to apply these requirements in the future as a result of the Board's Not-for-Profit Financial Reporting Framework project (AASB 2018-8 para. BC8).

7 ED 286 included a question about the temporary relief noted in paragraph 5, as well as a question on whether stakeholders would support grandfathering concessionary leases entered into prior to the initial application of AASB 16. When considering the comments received on ED 286, the Board decided to defer consideration of grandfathering of existing leases, or permanent relief from the fair value requirement, at a later time. The Board noted that all stakeholders agreed that NFP entities should be given some form of relief to not measure ROU assets for concessionary leases at initial recognition at fair value, and while some agreed that the relief should be provided only on temporary basis, others were of the view that the option to elect to measure concessionary ROU assets should be available on a permanent basis for NFP entities in public and private sector.

8 Therefore, in para. BC10 of AASB 2018-8, the Board noted that the accounting policy choice is only temporary relief from the fair value requirement and that the Board would reassess the initial measurement requirement of concessionary ROU assets when the two projects noted in paragraph 6 were finalised. A summary of comments received on ED 286 regarding grandfathering of existing leases and permanent relief is provided in the Appendix.

9 During recent outreach activities (including as part of the narrow-scope project on AASB 1058) and the NFP Project Advisory Panel (PAP), there have been requests made to review the terms of the accounting policy choice noted in paragraph 5, for example:

(a) NFP private sector stakeholders have requested (including some of those who responded to ED 286) the Board to consider making the accounting policy choice available permanently for all concessionary leases;

(b) The NFP PAP members in September and October 2021 were supportive of a permanent accounting policy choice for NFP private sector entities; and

(c) A majority of stakeholders at the AASB Update at ACNC Adviser Forum in October 2021 supported permanent accounting policy choice for NFP entities. This was supported by the recent discussion at ACNC Sector Forum in October 2021 where members (some of them users of the financial statements) did not object to maintain cost option and the existing disclosure requirements.

10 The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) representing NFP public sector entities (preparers), has requested the Board consider grandfathering existing concessionary leases from the fair value requirement (i.e. prospective application of the fair value requirement), if the accounting policy choice to initially measure a class of concessionary ROU assets at cost will be removed in the future (Agenda Paper 13 for the September 2020 AASB meeting).

11 The Board considered several implementation issues raised by NFP stakeholders in the short-term narrow-scope project on AASB 15 *Revenue from Contracts with Customers* and AASB *1058 Income of Not-for-Profit Entities* at the AASB September 2021 meeting (Agenda Paper 5.1). As a result, the Board decided to add a narrow-scope project to the AASB work program to reassess the initial measurement requirement of concessionary ROU assets, after feedback from NFP private sector stakeholders indicates that they would like certainty regarding when the Board would reassess the initial measurement requirement. Feedback suggests current uncertainty in the NFP private sector associated with any potential changes of the requirements in future is of concern to the sector, and NFP private sector entities have been advised to gather fair value information for any new leases, if available.

Summary of staff recommendations

12 Staff recommend:

(a) The current accounting policy choice to elect to initially measure a class of concessionary ROU assets at cost or at fair value to be retained permanently for all NFP private sector lessees.

(b) Due to the ongoing IPSASB Leases project (which would address concessionary leases and other arrangements similar to leases), for NFP public sector entities:

(i) retaining the current accounting policy choice to elect to initially measure a class of concessionary ROU assets at cost or at fair value;

(ii) only consider whether to reassess the initial measurement requirement of concessionary ROU assets when the Board decides whether additional guidance on how to measure the fair value of concessionary ROU assets is needed, upon consideration of the outcome of the concessionary leases part of the IPSASB's Leases project and the Board's forthcoming Exposure Draft that would propose modifications to AASB 13 (FVM ED) (this is discussed in Agenda Paper 3.2 for this meeting); and

(iii) if, in the future, the Board decides to remove the current accounting policy choice to elect to initially measure a class of concessionary ROU assets at cost, to require the fair value initial measurement requirement to be applied prospectively to new concessionary leases only.

(c) Adding a comment in the Basis of Conclusions section of the forthcoming Exposure Draft arising from the narrow-scope project on AASB 1058 and NFP guidance to AASB 15, and in related Specific Matters for Comment, regarding the proposed relief from the fair value requirement noted in (a) and (b).

Structure of this paper

13 This staff paper is set out as follows:

(a) Section 1: The Board's rationale for requiring concessionary ROU assets to be initially measured at fair value (paragraphs 14–16)

(b) Section 2: Stakeholders' concerns about measuring concessionary ROU assets at fair value (paragraphs 17–22)

(c) Section 3: Benefits and costs of requiring NFP private sector lessees to initially measure any concessionary ROU assets at fair value (paragraphs 23–33)

(d) Section 4: Request from public sector entities to grandfather existing concessionary leases (paragraphs 34–41)

(e) Next steps (paragraph 42)

(f) Appendix: Overview of ED 286 respondents' comments regarding permanent relief from fair value requirement

Section 1: The Board's rationale for requiring concessionary ROU assets to be initially measured at fair value

14 Prior to AASB 16, many NFP lessees did not recognise leased assets and lease liabilities from concessionary leases (as noted at the November 2018 Board meeting - Agenda Paper 8.1). This is because, assuming minimum lease payments are negligible, under the superseded AASB 117 *Leases*:

(a) a lessee under an operating lease does not recognise a leased asset or a lease liability; and

(b) no material asset or liability would be recognised by the lessee under a finance lease as the present value of minimum lease payments is negligible.[2]

15 At the time of issuing AASB 1058, the Board considered that there would be increased costs associated with the requirement to measure more assets at fair value at initial recognition, but that the benefits would outweigh the cost because:

(a) AASB 16 measures the ROU asset with reference to the lease liability. The Board noted that, where an entity enters into a concessionary lease, it is unlikely that the lease liability would reflect an appropriate starting point to measure the ROU asset and accurately reflect the substance of the lease transaction (AASB 1058 para. BC84);

(b) AASB 1058 (and AASB 16) does not require assets, including concessionary ROU assets, to be measured at fair value on an ongoing basis, but only on initial recognition (or in some instances, on transition to AASB 1058 or AASB 16);

2 AASB 117 paragraph 20 required a lessee, at commencement of the lease term, to recognise a finance lease asset and an equivalent lease liability measured at the lower of the fair value of the leased asset and the present value of the minimum lease payments.

(c) concessionary leases were of particular interest for stakeholders (AASB 1058 para. BC85) and requiring previously unrecognised assets, such as many concessionary leases, to be recognised at fair value would better reflect the value transferred to the entity; and

(d) the Standards do not require the valuations to be conducted by a professional valuation expert (AASB 1058 paras. BC28–BC30).

16 When finalising AASB 1058, the Board 'grandfathered' assets acquired prior to the transition date for significantly less than fair value (except for concessionary ROU assets). As a practical expedient, an NFP entity was not required to remeasure such assets at fair value on transition to AASB 1058 (AASB 1058 para. C8). However, the Board decided not to provide such grandfathering transitional relief to concessionary ROU assets. This was because:

(a) the Board was concerned that the financial position of an NFP entity may be misrepresented, and was concerned about the lack of comparability between entities regarding concessionary leases entered into before and after adoption of AASB 1058 (AASB 1058 para. BC153);

(b) the Board expected an entity to have undertaken fewer transactions involving leases and that the terms and conditions of these transactions to be clearly identifiable, compared to acquisitions of other assets at a discount to fair value (AASB 1058 para. BC149); and

(c) a lessee may not have recognised an amount in its statement of financial position in respect of the ROU asset in an operating lease. This is in contrast to other assets acquired for significantly less than fair value which are already recognised (generally at cost on initial recognition) in the statement of financial position. The Board further noted that there is unlikely to be any deferred income to recognise in future periods in accordance with AASB 1058 in relation to these assets (AASB 1058 para. BC147).

Section 2: Stakeholders' concerns about measuring concessionary ROU assets at fair value

17 The Board received 21 submissions in response to ED 286 (that became AASB 2018-8), which proposed the relief discussed in paragraph 5. In addition to comments received regarding the temporary relief, 14 of the 21 respondents also shared their views regarding consideration of permanent relief from the fair value requirement, or grandfathering of concessionary leases entered into prior to the initial application of AASB 16 from the fair value requirement.

18 Whilst the Board noted stakeholder's comments relating to permanent relief or grandfathering of existing concessionary leases when deciding on the temporary relief, staff consider the comments received on ED 286 to be relevant for the consideration whether to make the temporary relief permanent, given the more recent stakeholder feedback. Also, at the time of issuance of AASB 2018-8, the Board expected that the fair value measurement project and the NFP (private sector) financial reporting framework project would be completed or nearing completion. However, at the time of writing, this is not the case.

19 The Appendix includes the list of respondents who provided feedback on ED 286 and provides a high-level overview of respondents' views and reasons for those views, if any, regarding possible permanent relief of the initial fair value measurement requirement. Of the 14 respondents (out of a total of 21 submissions) who provided comments about consideration of permanent relief, it was noted that while one responded disagreed with the permanent relief and three respondents considered that existing concessionary leases should be grandfathered from the initial fair value measurement requirement, 10 respondents thought that all concessionary ROU assets should not be required to be initially measured at fair value.

20 Staff note that the views of respondents to ED 286 may have changed since December 2018 and therefore considered feedback from stakeholders obtained since then noted in paragraph 21 below.

21 As outlined in paragraphs 9 and 11 above, since the issuance of AASB 2018-8, staff received consistent feedback that the current uncertainty in the NFP private sector associated with any potential changes of the requirements in future is of concern to the sector. Stakeholders were concerned, that if, or when, the cost exemption is lifted then it will be a retrospective application rather than prospective and they will be required to obtain fair value information for leases currently in place. In addition, the relief from providing this information has made it harder to obtain information since more time has passed. Public sector representatives also expressed desire to obtain certainty on this matter for financial reporting purposes for the existing concessionary leases as well as to get forward-looking certainty for planning and budgeting purposes. Staff think that in accordance with the *AASB Due Process Framework for Setting Standards* (paragraph 7.2.4), the feedback collected to date provides sufficient basis to develop and consider the options to address the issues raised.

Questions for Board members:

Q1: Do Board members agree with staff recommendation in paragraph 21 that it is appropriate at this time to revisit the temporary ability for NFP entities to measure concessionary ROU assets at cost?

If not, does the Board prefer staff to conduct further outreach or research on this matter?

If not, how does the Board want to proceed with the project?

22 Subject to the Board's response to Question 1 above, staff have identified three potential options to address the ongoing stakeholder concerns considering requirements of AASB Not-for-Profit Standard Setting Framework (para. 32) and circumstances when NFP-specific amendment is warranted:

(a) Retain the accounting policy choice for NFP entities to initially measure concessionary ROU assets **at either cost or fair value** because:

(i) The related projects referred by the Board when providing the temporary relief are still in progress which may be different to the Board's expectations at the release of ED286 and AASB 2018-8 (e.g. exposure draft on the FVM project was at that time expected in Q3 2019 as indicated in the February 2019 Work Program);
(ii) Stakeholder feedback suggests the need for certainty of the financial reporting requirements;
(iii) Prevalence of concessionary leases is significant across both the private and public NFP sectors;
(iv) Timing would be appropriate to reconsider whether the option should be made permanent or removed given ongoing stakeholder feedback.

(b) Require NFP entities to measure all new concessionary ROU assets **at fair value**:

(i) This option would be in line with the fundamental principles of AASB 1058 in respect of the initial measurement of other types of assets;
(ii) Based on the feedback received to date, the cost of obtaining data and performing the valuation is likely to be significant;

(iii) Stakeholders expressed concerns about the Day 1 accounting outcome recognising the income with the depreciation being recognised over the life of the lease, which is causing concern for funding since NFPs are generally not funded for depreciation.

(c) <u>Require NFP entities to measure all new concessionary ROU assets **at cost**:</u>

(i) This option would prohibit any NFP from using fair value and therefore apply the different treatment for the measurement on initial recognition of ROU compared to other assets acquired at below-market terms;

(ii) There is little support for this option, albeit that stakeholder feedback indicates the number of entities using fair value for the ROU is minimal.

Staff have further analysed the considerations of the arguments outlined above in the sections below, separately for NFP private (Section 3) and public sector entities (Section 4).

Section 3: Benefits and costs of requiring NFP private sector lessees to initially measure any concessionary ROU assets at fair value

23 Based on the information presented in Sections 1 and 2 above, staff consider that the cost of requiring NFP private sector lessees to initially measure any concessionary ROU assets at fair value would likely outweigh the benefits.

24 Staff acknowledge that requiring concessionary ROU assets to be initially measured at fair value would be consistent with the accounting treatment applied to other assets acquired at below-market terms and conditions, and would reflect better the value of concessionary ROU assets obtained by the lessee on profit or loss and the balance sheet. However, most NFP private sector entities may not have sufficient knowledge about AASB 13 requirements because they do not generally measure non-financial assets at fair value under the revaluation model. Further, these entities may not have the skills and financial capabilities to learn the requirements of AASB 13 to determine the fair value of concessionary ROU assets. The cost and effort required to understand AASB 13 requirements for the one-off purpose of initially recognising a concessionary lease might be considered unjustified.

25 Staff's reasons for this view are set out in paragraphs 26-33 below.

Additional fair value guidance is unlikely to reduce cost for NFP private sector lessees

26 Staff note that, even if the Board develops guidance in assisting NFP lessees in applying the principles of AASB 13 to measure the fair value of concessionary ROU assets (Agenda Paper 3.2 for this meeting contains staff recommendation on this matter), it is likely still entail additional cost and resources of NFP private sector lessees to measure the fair value of concessionary ROU assets. This is because:

(a) if a NFP private sector entity is currently not applying AASB 13 (or applies the Standard to simpler fair value measurement), it would likely need to hire qualified staff to understand and apply the principles of AASB 13, or to engage a professional valuation expert, to obtain the required fair value measurements (even though the Board noted in AASB 1058 para. BC29(c) that accounting standards do not require fair valuations to be conducted by a professional valuation expert). This is more prevalent for smaller organisations that rely to a large extent on volunteers and might not have the financial resources to hire the needed capabilities to measure the fair value of concessionary ROU assets; and

(b) fair value measurement involves a lot of judgement and auditors might require extra time and cost to audit the application of AASB 13 and get comfort over judgement areas such as the 'highest and best use' of the ROU asset.

Disclosures might provide sufficient information to users

27 Some stakeholders, in response to ED 286 and subsequent outreach activities, including the October 2021 NFP PAP meeting, commented additional disclosures required under AASB 16 paras. Aus59.1–Aus59.2 appear to provide adequate information to users of financial statements about concessionary leases to understand the effects on the financial position, financial performance and cash flow of the entity, in the absence of fair value information.

28 AASB 16 paras. Aus59.1–Aus59.2 require the following information to be disclosed:

(a) the entity's dependence on leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives; and

(b) the nature and terms of the leases, including:

(i) the lease payments;

(ii) the lease term;

(iii) a description of the underlying assets; and

(iv) restrictions on the use of the underlying assets specific to the entity.

Recognition of income resulting from initially measuring concessionary ROU assets at fair value might not meet users' needs

29 As mentioned in paragraph 22(b)(iii) above, some stakeholders consider that the income arising from recognising concessionary ROU assets at fair value, and the subsequent depreciation/amortisation of that ROU assets, would make it difficult for users to understand from the financial statements how the entity has performed or how the entity should be funded.

30 This view is also shared by most stakeholders who responded to outreach activities – that they are not aware that users of NFP private sector entities' financial statements have a particular interest in the fair value of concessionary ROU assets and instead prefer the financial statements reflecting the cash flow commitments associated with concessionary leases. This was supported by the recent discussion at ACNC Sector Forum in October 2021, where members (some of the users of the financial statements) did not object to maintaining the cost option and the existing disclosure requirements.

31 Based on the analysis in paragraphs 24–30, staff are of the view that the cost of requiring NFP private sector lessees to initially measure any concessionary ROU assets at fair value would likely outweigh the benefits if disclosures required by AASB 16 paras. Aus59.1–Aus59.2 provide adequate information for users regarding concessionary leases.

32 In respect of the staff view noted in paragraph 24 – that the cost and effort required for NFP private sector entities to understand AASB 13 requirements for the one-off purpose of initially recognising a concessionary lease might be considered unjustified – staff note that an alternative view could argue that some of these entities may have experience in fair valuing other non-financial assets that are acquired at below fair value (e.g. donated assets); and therefore, that view expressed by staff is not valid. However, staff observed that:

(a) those donated assets are likely to be equipment rather than property or plant. The market sales price of identical equipment would likely be readily accessible (e.g. obtaining a sale price on the internet). Therefore, an NFP entity is unlikely to need to apply the principles in AASB 13 to estimate the fair value of such donated assets using measurement techniques; and

(b) many concessionary leases are leases of property or plant with restrictions imposed on the use of the asset. Estimating the fair value of such assets are likely to require the application of measurement techniques under AASB 13 because market prices of rental of identical property or plant with the same restrictions might not be readily available.

33 Therefore, for the reasons in paragraphs 24–32, staff recommend:

(a) not requiring NFP private sector entities to initially measure ROU assets arising from any concessionary leases at fair value;

(b) adding a comment in the Basis for Conclusions (BC) section of the forthcoming Exposure Draft on narrow-scope amendments to AASB 1058 and AASB 15 NFP guidance proposing to provide the current policy choice granted in AASB 16 paras. Aus25.1–Aus25.2 (for NFP entities to elect to initially measure a class of concessionary ROU assets at cost or fair value) permanently for NFP private sector entities; and

(c) adding a Specific Matter for Comment asking for feedback about whether the disclosures required by AASB 16 paras. Aus59.1–Aus59.2 provide adequate information for users regarding concessionary leases in the absence of fair value information.

Questions for Board members:

Q2: Do Board members agree with staff recommendations to:

(a) not require NFP private sector entities to initially measure ROU assets arising from any concessionary leases at fair value;

(b) add a comment in the BC section of the forthcoming Exposure Draft to propose providing the current policy choice granted in AASB 16 paras. Aus25.1–Aus25.2 permanently for NFP private sector entities; and

(c) add a Specific Matter for Comment in the forthcoming Exposure Draft to ask feedback about whether the disclosures required by AASB 16 paras. Aus59.1–Aus59.2 provide adequate information for users regarding concessionary leases in the absence of fair value information?

Section 4: Request from public sector entities to grandfather existing concessionary leases

34 As summarised in paragraph 16(b), the Board's rationale for not grandfathering concessionary leases issued prior to the effective date of AASB 16 from the initial fair value requirement was that the Board expected:

(a) an entity to have undertaken fewer transactions involving leases; and

(b) the terms and conditions of these lease transactions to be clearly identifiable, compared to acquisitions of other assets at a discount to fair value.

35 However, in contrast to that Board rationale, staff note that:

(a) HoTARAC (and NFP private sector entities) have informed staff that concessionary leases are quite common,[3] and many historical, long-term concessionary leases do not have a documented lease contract.[4] Therefore, the terms and conditions of those leases are not clearly identifiable; and

(b) fair valuing those concessionary ROU assets would likely incur significant effort and cost and would not serve users of financial statements well. HoTARAC suggested most entities would encounter difficulties in determining the fair value of historical concessionary ROU assets due to the specialised nature of the assets, significant lessor restrictions and the inability to determine lease terms where these arrangements have not been recorded in formal agreements.

3 This has been noted in the AASB submission on IPSASB Request for Information – Concessionary Leases and Similar Arrangements

4 HoTARAC submission on ED 286

36 Public sector entities have requested grandfathering of existing concessionary leasing arrangements on the basis that valuing these arrangements would not provide requisite benefits to justify the additional costs and efforts involved. These entities commented that one of the key challenges with retrospective application of the fair value requirement that it is often difficult to identify all concessionary leases held by a NFP public sector entity when some arrangements do not have formal agreements.

37 Staff consider merit in grandfathering existing concessionary leases from the fair value requirement because it would be difficult to ensure completeness of those fair value measurements if lease arrangements are not formally documented. Staff also consider that even if the Board develops guidance on how to apply the principles of AASB 13 in measuring concessionary ROU assets, measuring the fair value of concessionary leases where the leased asset is of a specialised nature or where the lease terms have restrictions might require extra effort and costs. Without a documented formal agreement, it would create extra challenges in measuring the fair value of ROU assets associated with those arrangements.

38 Staff also considered whether there is merit in relieving NFP public sector entities from the initial fair value requirement for new concessionary leases on a permanent basis, particularly because Government Finance Statistics (GFS) do not recognise ROU assets arising from operating leases. Requiring fair value measurement of ROU assets arising from concessionary operating leases would create divergence from GFS.

39 However, staff consider that the decision about the initial measurement of new concessionary leases (and the assessment of whether the benefits of requiring ROU assets arising from new concessionary leases to be measured at fair value would outweigh the costs to prepare such valuations) should be deferred until the Board decides whether additional guidance on how to measure the fair value of concessionary ROU assets is needed. This is because:

(a) whilst public sector entities have knowledge and experience in applying AASB 13 principles in measuring the fair value of other non-financial assets, the additional guidance might still be necessary to help reduce cost and effort in estimating the fair value of concessionary ROU assets, particularly leases with restrictions or leases of specialised assets;

(b) if the Board decides to issue such additional guidance, and if it agrees with grandfathering existing concessionary leases from the fair value requirement, the cost to obtain fair value measurements of ROU assets of new concessionary leases might not be significant because lessees would be able to ensure the necessary terms and conditions are appropriately documented in the lease agreement of any new concessionary leases; and

(c) some lessors might be another public sector entity; consequently, the NFP public sector lessee would likely be able to obtain fair value information about the lease asset from the lessor, which may assist in measuring the fair value of the associated ROU asset.

40 As mentioned in Section 8 of Agenda Paper 3.2 of this meeting, staff recommend that the Board defer consideration of developing its own fair value guidance on concessionary ROU assets until it considers the outcome of the IPSASB's Leases project relating to concessionary leases, as well as the outcome of the forthcoming FVM ED.

41 If the Board agrees with that recommendation in Agenda Paper 3.2, staff recommend that for NFP public sector lessees:

(a) to retain the current accounting policy choice to elect to initially measure a class of concessionary ROU assets at cost or fair value;

(b) only consider whether to reassess the initial measurement requirement of concessionary ROU assets when the Board decides whether additional guidance on how to measure the fair value of concessionary ROU assets is needed, upon consideration of the outcome of the concessionary leases part of the IPSASB's Leases project and the forthcoming FVM ED; and

(c) if, in the future, the Board decides to remove the current accounting policy choice to elect to initially measure a class of concessionary ROU assets at cost, to require the fair value initial measurement requirement to be applied prospectively to new concessionary leases only.

Questions for Board members:

Q3: For NFP public sector lessees, do Board members agree:

(a) to retain the current accounting policy choice to elect to initially measure a class of concessionary ROU assets at cost or at fair value;

(b) only consider whether to reassess the initial measurement requirement of concessionary ROU assets when the Board decides whether additional guidance on how to measure the fair value of concessionary ROU assets is needed, upon consideration of the outcome of the concessionary leases part of the IPSASB's Leases and the forthcoming FVM ED; and

(c) if, in the future, the Board decides to remove the current accounting policy choice to elect to initially measure a class of concessionary ROU assets at cost, to require the fair value initial measurement requirement to be applied prospectively to new concessionary leases only?

Next steps

42 If the Board agrees with staff recommendations in Questions 1–4, staff recommend documenting the Board's rationale in the BC section of the forthcoming Exposure Draft regarding AASB 1058 and AASB 15 NFP guidance narrow-scope amendments in line with the next steps outlined in Agenda Paper 11.1 of this meeting.

Question for Board members:

Q4: Do the Board members agree with the next steps?

Appendix: Overview of ED 286 respondents’ comments regarding permanent relief from fair value initial measurement requirement

The table and comments below provide an overview of the staff assessment of the submissions received on ED 286 regarding the permanent relief from the concessionary ROU assets initial fair value measurement requirement:

Respondent	Type of organisation	Staff assessment of comments about permanent relief from fair value requirement in ED 286
1. Australasian Council of Auditors-General (ACAG)	Public sector auditors	No comment on permanent relief / Further consideration required
2. Australian Charities and Not-for-profits Commission (ACNC)	Regulator	Grandfathering existing concessionary leases
3. Australian Institute of Company Directors	Professional body	Relief from all concessionary leases
4. Chartered Accountants Australia and New Zealand members/staff	Professional body members/staff	No comment on permanent relief / Further consideration required
5. Cardell Accountants	Professional services firm	Relief from all concessionary leases
6. CPA Australia	Professional body	Relief from all concessionary leases
7. Crowe Horwath Australasia	Professional services firm	Relief from all concessionary leases
8. David Hardidge	Other	Relief from all concessionary leases
9. Deloitte	Professional services firm	No comment on permanent relief / Further consideration required
10. Ernst & Young	Professional services firm	No comment on permanent relief / Further consideration required
11. Grant Thornton Australia	Professional services firm	No comment on permanent relief / Further consideration required
12. Heads of Treasuries Accounting and Reporting Advisory Committee	Public sector preparers	Grandfathering existing concessionary leases
13. Institute of Public Accountants	Professional Body	No comment on permanent relief
14. KPMG	Professional services firm	No comment on permanent relief / Further consideration required
15. Pitcher Partners	Professional services firm	Disagree with permanent accounting policy choice
16. Redland City Council	Public sector preparer	Relief from all concessionary leases
17. Saward Dawson	Professional services firm	Grandfathering existing concessionary leases
18. State Transit Authority of NSW	Public sector preparer	Relief from all concessionary leases
19. Joint submission from Local Government Financial Consultant and Tenterfield Shire Council	Public sector preparer	Relief from all concessionary leases

Respondent	Type of organisation	Staff assessment of comments about permanent relief from fair value requirement in ED 286
20. Willoughby City Council	Public sector preparer	Relief from all concessionary leases
21. Wintringham	NFP private sector preparer	Relief from all concessionary leases

Of the 14 respondents (out of total of 21 submissions) who provided comments about consideration of permanent relief, it was noted that:

(a) One respondent disagreed with permanent relief from initially measuring concessionary ROU assets at fair value with the view that permitting NFP entities to initially measure concessionary ROU assets at cost, rather than at fair value, detracts from the usefulness of the financial statements.

(b) Three respondents considered that existing concessionary leases should be grandfathered from the initial fair value measurement requirement as they:

(i) considered it inappropriate to require charities to incur unnecessary cost to fair value their concessionary ROU assets, especially prior to the possibility of revised reporting thresholds in the NFP private sector and without any developed guidance for fair valuing ROU assets;

(ii) commented that public sector entities have identified several hundreds of concessionary leases entered into many years ago and the contractual arrangements supporting these arrangements vary in formality. Applying the fair value measurement to historical concessionary leases could involve considerable cost and effort, and is likely to outweigh the benefits; and

(iii) expressed that they do not believe the issues many NFP private sector entities are having with the application of AASB 16 will be addressed by additional guidance for AASB 13 and the significant cost in valuation fees, audit fees and internal time, which will result in less funds for an organisation’s purposes, is not justified by retrospective application of the fair value requirements for concessionary leases.

(c) 10 respondents considered that all concessionary ROU assets should not be required to be initially measured at fair value.

The reasons provided by the 10 respondents who considered that all concessionary ROU assets should not be required to be initially measured at fair value are summarised in the table below.

Reasons for supporting permanent relief from the fair value requirement for all concessionary leases	
(a) Financial statements would be distorted and potentially misleading to users	Six of the 10 respondents commented that measuring ROU assets at fair value would lead to material and incomprehensible changes to income statement and balance sheet positions. The operating results of lessees would be skewed due to inflated ROU assets and the resulting one-off 'unrealised' income arising from concessionary leases, as well as subsequent depreciation/ amortisation of the ROU assets. Respondents were of the view that this distortion could detract from meaningful financial reporting. They were concerned that the financial statements could potentially mislead users of financial statements and negatively impact on funding sources available to NFP entities, as the inflated balances are not a true reflection of the entity's operations or how they should be funded.
(b) Fair valuing concessionary ROU assets is costly	Seven of the 10 respondents commented that measuring concessionary ROU assets at fair value would entail considerable cost and resources, which would outweigh the benefits. Cost to comply with the fair value initial measurement requirement may include: (a) suitably qualified staff required to apply AASB 13; (b) extra time taken by auditors to audit the application of AASB 13 and get comfort over fair values of concessionary ROU assets; (c) time burden on accounting staff; and (d) cost of engaging external valuers to determine fair value.
(c) The fair value of ROU assets adds no value to users	Three of the 10 respondents were of the view that fair valuation of concessionary ROU assets coupled with the distortion in the financial statements, is not useful to users of financial statements.