

# **Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities**

Comments to the AASB by 7 December 2018



**Australian Government**

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**Australian Accounting  
Standards Board**

## Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by 7 December 2018.

## Formal Submissions

Submissions should be lodged online via the “Work in Progress – Open for Comment” page of the AASB website ([www.aasb.gov.au/comment](http://www.aasb.gov.au/comment)) as a PDF document and, if possible, a Word document (for internal use only).

## Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: [standard@aaasb.gov.au](mailto:standard@aaasb.gov.au)

Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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ISSN 1030-5882

## Introduction

### Australian Accounting Standards

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The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards.

The AASB is a Commonwealth entity under the *Australian Securities and Investments Commission Act 2001*. AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of Australian Accounting Standards.

### Exposure Drafts

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The publication of an Exposure Draft is part of the due process that the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

### Why we are making these proposals

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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 in respect of leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives.

For ease of reference in this Introduction to the Exposure Draft, leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives are referred to as 'peppercorn leases'. The term 'peppercorn lease' is generally used to describe a lease that has nil or nominal lease payments. However, in this Introduction, the term is used to include leases with lease payments that are more than nominal but significantly below market value principally to enable the entity to further its objectives.

The AASB 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 peppercorn 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 are incorporated in the valuation of right-of-use assets arising from peppercorn leases. Whilst other assets required by other Standards to be fair valued might also be subject to restrictions on use or specialised in nature, the AASB 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 peppercorn lease arrangements.

The AASB considered the prevalence and magnitude of peppercorn leases in the not-for-profit sector, and the significance of restrictions on rights of use of the underlying assets in many cases. The AASB also noted that a temporary option for not-for-profit lessees to not measure right-of-use assets at initial recognition at fair value for peppercorn leases would avoid undue cost and effort being incurred by preparers in applying AASB 13 in the absence of additional guidance. The AASB 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 peppercorn leases will be addressed in the AASB's Fair Value Measurement for Public Sector Entities project.

The AASB 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 proposed 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.

## What we are proposing

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This Exposure Draft proposes amendments to AASB 1, AASB 16, AASB 117 and AASB 1058 to provide a temporary option for not-for-profit entities to measure right-of-use assets at initial recognition for leases with significantly below-market terms and conditions principally to enable the entity to further its objectives, either:

- (a) at cost, in accordance with AASB 16 paragraphs 23–25, which incorporates the amount of the initial measurement of the lease liability; or
- (b) at fair value, in accordance with AASB 16 paragraph Aus25.1 (as proposed in this Exposure Draft to be amended).

The existing requirement is for not-for-profit entities to measure such right-of-use assets at initial recognition at fair value.

The Exposure Draft also proposes additional disclosures in the financial statements to ensure users understand the effects on the financial position, financial performance and cash flows of the entity arising from peppercorn leases when the entity elects to measure the right-of-use assets at initial recognition at cost rather than at fair value. The additional disclosures would provide users with further information about the right-of-use assets in the absence of fair value information.

The proposed optional measurement approach 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 proposed temporary option would allow not-for-profit entities to continue their work on fair valuing right-of-use assets under peppercorn leases if they intend to measure right-of-use assets at initial recognition at fair value.

## Application date

It is proposed that the option would apply to annual periods beginning on or after 1 January 2019, with earlier application permitted, provided that AASB 1058 is also applied at the same time.

## We need your feedback

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Comments are invited on any of the proposals in this Exposure Draft by 7 December 2018. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue (whether an issue specifically identified below or another issue).

## Specific matters for comment

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The AASB would particularly value comments on the following:

- 1 Do you agree with the proposed temporary option for not-for-profit entities to not measure right-of-use assets at initial recognition at fair value for leases with significantly below-market terms and conditions principally to enable the entity to further its objectives ('peppercorn leases')? This option would permit not-for-profit entities to measure such right-of-use assets at initial recognition at cost instead of fair value. The AASB will reassess the option when further guidance has been developed to assist not-for-profit entities in fair valuing such right-of-use assets and the financial reporting requirements for not-for-profit private sector entities have been finalised. If you disagree, please provide reasons.
- 2 If you disagree with providing a temporary option, do you consider that not-for-profit entities should be permitted to measure right-of-use assets at initial recognition at either fair value or cost for peppercorn leases entered into prior to the initial application of AASB 16? In your view, should such a permanent option be provided for not-for-profit entities in the private sector, the public sector, or both sectors? Please provide your reasons.
- 3 Additional disclosure requirements are set out in the proposed paragraphs Aus59.1 and Aus59.2 of AASB 16 for application to peppercorn leases where the right-of-use assets are measured at cost rather than at fair value. In conjunction with the other disclosure requirements in AASB 16, would these additional disclosures provide adequate information for users to understand the effects on the financial position, financial performance and

cash flows of the entity arising from such peppercorn leases? If not, what additional disclosures would be appropriate?

## **General matters for comment**

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The AASB would also particularly value comments on the following general matters:

- 4 Whether *The AASB's Not-for-Profit Entity Standard-Setting Framework* has been applied appropriately in developing the proposals in this Exposure Draft?
- 5 Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Financial Statistics (GFS) implications?
- 6 Whether, overall, the proposals would result in financial statements that would be useful to users?
- 7 Whether the proposals are in the best interests of the Australian economy?
- 8 Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative? In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

## Contents

PREFACE

**[DRAFT] ACCOUNTING STANDARD  
AASB 2018-X AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS – RIGHT-OF-USE ASSETS OF  
NOT-FOR-PROFIT ENTITIES**

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[Draft] Australian Accounting Standard AASB 2018-X *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* is set out on pages 8 – 11. All the paragraphs have equal authority.

## Preface

### Standards amended by 2018-X

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This [draft] Standard makes amendments to AASB 1 *First-time Adoption of Australian Accounting Standards* (July 2015), AASB 16 *Leases* (February 2016), AASB 117 *Leases* (August 2015) and AASB 1058 *Income of Not-for-Profit Entities* (December 2016).

AASB 1058 made amendments to AASB 16 to require not-for-profit entities to measure right-of-use assets at initial recognition at fair value in respect of leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives.

However, the AASB has decided to provide a temporary option for not-for-profit entities to not measure such right-of-use assets at initial recognition at fair value, since further guidance is expected to be developed to assist not-for-profit entities in measuring right-of-use assets at fair value. The temporary option would also avoid requiring not-for-profit 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 recommendations of the ACNC Legislative Review.

### Main features of this Standard

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#### Main requirements

This [draft] Standard amends AASB 1, AASB 16, AASB 117 and AASB 1058 to provide a temporary option for not-for-profit entities to not apply the fair value initial measurement requirements for right-of-use assets arising under leases with significantly below-market terms and conditions principally to enable the entity to further its objectives. The [draft] Standard requires an entity that elects to apply the option (i.e. measures such right-of-use assets at cost rather than fair value) to include additional disclosures in the financial statements to ensure users understand the effects on the financial position, financial performance and cash flows of the entity arising from these leases.

#### Application date

This [draft] Standard applies to annual periods beginning on or after 1 January 2019, with earlier application permitted, provided that AASB 1058 is also applied at the same time.

## [Draft] Accounting Standard AASB 2018-X

The Australian Accounting Standards Board makes Accounting Standard AASB 2018-X *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* under section 334 of the *Corporations Act 2001*.

Kris Peach  
Chair – AASB

Dated ... [date]

## [Draft] Accounting Standard AASB 2018-X *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities*

### Objective

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This Standard amends:

- (a) AASB 1 *First-time Adoption of Australian Accounting Standards* (July 2015);
- (b) AASB 16 *Leases* (February 2016);
- (c) AASB 117 *Leases* (August 2015); and
- (d) AASB 1058 *Income of Not-for-Profit Entities* (December 2016);

to provide an option for not-for-profit entities to not apply the fair value initial measurement requirements for right-of-use assets arising under leases with significantly below-market terms and conditions principally to enable the entity to further its objectives. This Standard also adds additional disclosure requirements to AASB 16 for not-for-profit entities that elect to apply the option.

### Application

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The amendments set out in this Standard apply to entities and financial statements in accordance with the application of the other Standards set out in AASB 1057 *Application of Australian Accounting Standards* (as amended).

This Standard applies to annual periods beginning on or after 1 January 2019, except that the amendment to AASB 117 applies to periods beginning before 1 January 2019 if AASB 1058 is applied to such a period. Earlier application of this Standard is permitted, provided AASB 1058 is also applied to the period.

This Standard uses underlining, striking out and other typographical material to identify some of the amendments to a Standard, in order to make the amendments more understandable. However, the amendments made by this Standard do not include that underlining, striking out or other typographical material. Amended paragraphs are shown with deleted text struck through and new text underlined. Ellipses (...) are used to help provide the context within which amendments are made and also to indicate text that is not amended.

### Amendments to AASB 1 *First-time Adoption of Australian Accounting Standards* (July 2015)

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Paragraphs AusD7.1, AusD9D.1 and AusD9D.2 are amended.
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#### Deemed cost

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AusD7.1 Notwithstanding paragraphs D5–D7, where a lessee is a not-for-profit entity and the lease had at inception significantly below-market terms and conditions principally to enable the entity to further its objectives, the entity ~~shall~~ may elect to measure the right-of-use asset arising under all such leases at fair value at the beginning of the current period presented in the entity's first Australian-Accounting-Standards financial statements or at the previous GAAP valuation if that valuation broadly reflects that fair value.



...

## Leases

...

- AusD9D.1 Notwithstanding paragraphs D9B–D9D, where a lessee is a not-for-profit entity and the lease had at inception significantly below-market terms and conditions principally to enable the entity to further its objectives, all references in those paragraphs to the date of transition to Australian Accounting Standards shall be read as referring to the beginning of the current period presented in the entity’s first Australian-Accounting-Standards financial statements. Consequently, the entity shall measure the lease liability and the right-of-use asset at that date. ~~The right-of-use asset shall be measured in accordance with paragraph AusD7.1.~~
- AusD9D.2 Where a lessee is a not-for-profit entity and ~~the lease~~ elects to measure the right-of-use assets arising under all leases that had at inception significantly below-market terms and conditions principally to enable the entity to further its objectives at fair value in accordance with paragraph AusD7.1, the entity shall also recognise any related items in accordance with paragraph 9 of AASB 1058 *Income of Not-for-Profit Entities*. Any income arising shall be recognised as an adjustment to the opening balance of retained earnings (or another component of equity, as appropriate) at the beginning of the current period presented in the entity’s first Australian-Accounting-Standards financial statements.

## Amendments to AASB 16 Leases (February 2016)

Paragraphs Aus25.1, AusC5.1, AusC8.1 and AusC11.1 are amended and paragraphs Aus59.1 and Aus59.2 are added. Paragraph AusC5.2 has not been amended but has been included for ease of reference.

- Aus25.1 ~~Notwithstanding paragraphs 23–25, where the lessee is a not-for-profit entity, and the lease has significantly below-market terms and conditions principally to enable the entity to further its objectives, the right-of-use asset shall initially be measured~~ the lessee may elect to measure right-of-use assets at initial recognition at fair value in accordance with AASB 13 *Fair Value Measurement* for all leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives. AASB 1058 *Income of Not-for-Profit Entities* addresses the recognition of related amounts.

...

- Aus59.1 In addition to the disclosures required in paragraphs 53–59, where a lessee is a not-for-profit entity and elects to measure right-of-use assets at initial recognition at cost in accordance with paragraphs 23–25 for all leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives, the lessee shall disclose additional qualitative and quantitative information about those leases necessary to meet the disclosure objective in paragraph 51. This additional information shall include, but is not limited to, information that helps users of financial statements to assess:
- (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.

- Aus59.2 The disclosures provided by a not-for-profit entity in accordance with paragraph Aus59.1 shall be provided individually for each material lease that has significantly below-market terms and conditions principally to enable the entity to further its objectives or in aggregate for such leases involving right-of-use assets of a similar nature. An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics.

...

AusC5.1 Not-for-profit entities electing to measure right-of-use assets at initial recognition at fair value and applying this Standard retrospectively in accordance with paragraph C5(a) to leases that at inception had significantly below-market terms and conditions principally to enable the entity to further its objectives shall:

- (a) measure the right-of-use asset at fair value;
- (b) measure the lease liability in accordance with this Standard; and
- (c) recognise any related items in accordance with paragraph 9 of AASB 1058 *Income of Not-for-Profit Entities*.

Any income arising shall be recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the earliest prior period presented.

AusC5.2 Notwithstanding paragraph AusC5.1, not-for-profit entities that adopted AASB 1058 in an earlier reporting period are not required to remeasure the fair value of the right-of-use asset arising from leases that (1) at inception had significantly below-market terms and conditions principally to enable the entity to further its objectives and (2) were previously classified as finance leases applying AASB 117. Instead, the entity shall transition those leases in accordance with paragraph C11, regardless of which transition option in paragraph C5 is applied.

...

AusC8.1 Not-for-profit entities electing to measure right-of-use assets at initial recognition at fair value and applying this Standard retrospectively in accordance with paragraph C5(b) to leases that (1) at inception had significantly below-market terms and conditions principally to enable the entity to further its objectives and (2) were previously classified as operating leases applying AASB 117 shall:

- (a) notwithstanding paragraph C8(b), measure the right-of-use asset at fair value at the date of initial application of this Standard;
- (b) measure the lease liability in accordance with paragraph C8(a); and
- (c) recognise any related items in accordance with paragraph 9 of AASB 1058.

Any income arising shall be recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application of this Standard.

...

AusC11.1 Subject to paragraph AusC5.2 and notwithstanding paragraph C11, not-for-profit entities electing to measure right-of-use assets at initial recognition at fair value and applying this Standard retrospectively in accordance with paragraph C5(b) to leases that (1) at inception had significantly below-market terms and conditions principally to enable the entity to further its objectives and (2) were previously classified as finance leases applying AASB 117 shall:

- (a) measure the right-of-use asset at fair value at the date of initial application of this Standard;
- (b) measure the lease liability in accordance with this Standard; and
- (c) recognise any related items in accordance with paragraph 9 of AASB 1058.

Any income arising shall be recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application of this Standard.

## Amendments to AASB 117 Leases (August 2015)

The amendment to AASB 117 applies to periods beginning before 1 January 2019. This means that the amendment applies only if AASB 1058 is applied to an earlier period.

Paragraph Aus20.1 is amended.

### Finance Leases

#### Initial recognition

...

Aus20.1 Notwithstanding paragraph 20, a not-for-profit entity may elect to measure the leased asset ~~shall initially be measured at initial recognition at fair value in accordance with AASB 13 *Fair Value Measurement* for all leases~~ where:

- (a) at inception the lease has significantly below-market terms and conditions principally to enable the lessee to further its objectives; and
  - (b) the lessee applies AASB 1058 *Income of Not-for-Profit Entities* to the period.
- AASB 1058 addresses the recognition of related amounts.

## Amendments to AASB 1058 *Income of Not-for-Profit Entities* (December 2016)

Paragraphs C10 and C11 are amended and paragraph C10A is added.

### Leases with significantly below-market terms and conditions

...

#### Leases classified as finance leases

- C10 If an entity elects to measure right-of-use assets at initial recognition at fair value and applies this Standard before applying AASB 16, for leases that (1) at inception had significantly below-market terms and conditions principally to enable the entity to further its objectives and (2) were classified as finance leases in accordance with AASB 117, and if an entity elects to apply this Standard in accordance with:
- (a) paragraph C3(a) – the entity shall:
    - (i) measure the leased asset at fair value at the beginning of the earliest period presented;
    - (ii) measure the lease liability in accordance with AASB 117;
    - (iii) recognise any related items in accordance with paragraph 9; and
    - (iv) recognise any income arising as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the earliest period presented; or
  - (b) paragraph C3(b) – the entity shall:
    - (i) measure the leased asset at fair value at the date of initial application of this Standard;
    - (ii) measure the lease liability in accordance with AASB 117;
    - (iii) recognise any related items in accordance with paragraph 9; and
    - (iv) recognise any income arising as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application of this Standard.
- C10A If an entity elects not to measure right-of-use assets at initial recognition at fair value and applies this Standard before applying AASB 16, for leases that (1) at inception had significantly below-market terms and conditions principally to enable the entity to further its objectives and (2) were classified as finance leases in accordance with AASB 117, the entity shall continue to apply its accounting policy under AASB 117 to those finance leases. On transition to AASB 16, the entity shall apply the transition requirements of that Standard to leases classified as finance leases in accordance with AASB 117.
- C11 An entity applying paragraph C10 may, as a practical expedient, apply the paragraph ~~C10~~ to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements of this approach would not differ materially from applying paragraph C10 to the individual leases within that portfolio. If accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

### Commencement of the legislative instrument

For legal purposes, this legislative instrument commences on 31 December 2018.