

3 September 2025

Dr K Kendall
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

Dear Dr Kendall

AASB Invitation to Comment ITC 55 *Post-implementation Review of AASB 16 Leases*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on AASB Invitation to Comment ITC 55 *Post-implementation Review of AASB 16 Leases*. The views expressed in this submission represent those of all Australian members of ACAG, unless specifically identified.

The attachment to this letter addresses the AASB's specific matters for comment outlined in the ITC. Also attached is ACAG's response to the International Accounting Standards Board (IASB) Request for Information *Post-implementation Review of IFRS 16 Leases*.

Overarching feedback

ACAG found that the implementation of AASB 16 in public sector agencies has presented numerous audit challenges, particularly regarding the completeness and accuracy of lease data, documentation of accounting judgments, and quality assurance processes. Additionally, certain elements of the standard are not well understood by public sector entities, making it difficult for them to apply in practice.

The submission notes various areas where additional guidance or examples could be provided to provide more clarity to preparers and auditors and drive greater consistency in application of AASB 16 in the public sector.

The ongoing costs of auditing operating leases for lessees under AASB 16 are generally higher than under AASB 117, particularly for entities with a significant number of leases. While including leases on balance sheet does provide more transparent information on leases and helps comparability between entities, it is unclear whether the benefits have been fully realised by users of the public sector's financial statements.

Notwithstanding the issues raised above, the costs of implementing any proposed changes to the framework should be considered when making decisions about any amendments to AASB 16. Further, the majority of ACAG jurisdictions support keeping the accounting policy choice for concessionary leases. One jurisdiction that supports the FV approach for concessionary ROU assets has shared their rationale in Topic 5 of the attachment.

Once again, thank you for the opportunity to comment on this post-implementation review. I hope you will find ACAG's comments, helpful when assessing whether the effects of applying the requirements are as intended.

Yours sincerely



Rachel Vagg
Chair
ACAG Financial Reporting and Accounting Committee

SECTION 1 – AASB GENERAL MATTERS FOR COMMENT

General Matter for comment 1

Are there any regulatory issues or other issues arising in the Australian environment that adversely affect the application of AASB 16 *Leases*?

The application of AASB 16 creates convergence differences with the Australian Government Finance Statistics (GFS) Manual, as GFS continues to distinguish between operating and finance leases for lessees and does not recognise operating leases in the Statement of Financial Position.

ACAG is not aware of any other regulatory or other issues in the Australian environment that adversely affect the application of AASB 16.

General Matter for comment 2

Does the application of the requirements in AASB 16 result in major auditing or assurance challenges?

Implementation of AASB 16 in public sector agencies has presented numerous audit challenges, particularly regarding the completeness and accuracy of lease data, documentation of accounting judgments, and quality assurance processes. Additionally, certain elements of the standard are not well understood by public sector entities, making it difficult for them to apply in practice.

Key issues identified by ACAG in the implementation of AASB 16 include:

- **Completeness and accuracy of lease calculations:** auditors faced challenges in verifying the accuracy and completeness of lease calculations as agencies:
 - struggled to identify contracts that may contain leases
 - were parties to arrangements that were undocumented
 - did not formally document, approve, or maintain key lease accounting interpretations and assessments for individual lease contracts. This often made it difficult to determine whether the asset in a long-term contract was subject to a lease and should be recognised as a right-of-use asset (ROU) asset or as property, plant and equipment (PPE). For example, in certain jurisdictions, some government departments have historically leased land to government agencies without documentation. These agencies use the land and constructed significant public sector assets on it. The issue is whether the land should be recognised as an ROU asset or PPE, and if it is a lease what the lease term should be
 - had incomplete and/or inaccurate lease data held centrally (e.g. future market rent reviews, fixed rate increases, and lease incentives) which resulted in material adjustments to lease calculations
 - did not have information from lessors regarding the value of non-lease components
 - applied the standard incorrectly e.g. omission of fixed rent and/or market rent review increases, application of lease incentives and non-lease components
 - inconsistently applied the impairment requirements for ROU assets measured at cost subsequent to initial recognition.

These issues were more prevalent when the standard was first introduced and have reduced since this time. However, the following areas still require significant judgement each time a new lease is entered, to calculate the lease liability to be recognised:

- consideration of what constitutes a non-lease component versus a lease component or an 'amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee'
- estimation of stand-alone selling prices for non-lease components
- allocation of 'amounts payable by the lessee for activities and costs that do not transfer a good or service to the lessee.'

While this separation is not mandatory it is in most entity's interests to separate the lease components to reduce the liability, and the ongoing depreciation expense associated with the right-of-use asset.

- **Judgment and complexity in lease accounting:** ACAG found the standard inherently difficult to audit given the extensive judgment required in determining enforceability of leases, particularly intra-government leases, lease terms, including 'reasonably certain to extend' and 'no more than an insignificant penalty'.

There are often practical challenges for determining whether a lease exists. One of the criteria is whether the lessee receives the substantial economic benefits. In the public sector, for leases between departments and agencies, as both entered into the arrangements with the aim of providing services to the public it is difficult to assess who received substantially all of the benefits. For example, in social housing both parties enter into these arrangements with the aim of providing social housing. It is difficult to assess which party receives substantially all the benefits from the arrangement.

These areas continue to cause interpretation challenges.

The main audit challenge for subsequent measurement of leases is the accounting for lease modifications. ACAG found that these requirements are not well understood or applied by public sector agencies due to the complex concepts in the standard. The specific challenges we have noted are set out in our response to question 5.

General Matter for comment 3

Are the requirements in the best interests of the Australian economy?

ACAG is unable to comment on whether the proposals are in the best interests of the Australian Economy.

SECTION 2 – NFP AND PUBLIC SECTOR TOPICS FOR COMMENT

Topic 1 – Application of AASB 16 by NFP and public sector entities

1. In respect of NFP and public sector entities:
 - (a) are the ongoing costs of applying AASB 16 and auditing and regulating its application significantly greater than expected?
 - (b) are the benefits to users significantly lower than expected?
 - (c) overall, do you have any comments about whether AASB 16 results in financial statements that are more useful than financial statements prepared under the previous Standard AASB 117 *Leases*?

Please explain the reasons for your views on the above matters. Examples to illustrate your responses are also most helpful.

- 1(a) ACAG has found the costs of auditing operating leases for lessees under AASB 16 are generally higher than under AASB 117, especially for agencies with a significant number of leases. This is because AASB 16 introduces more complex ongoing accounting and auditing requirements for leases compared to AASB 117. These include the review and accounting of:
 - changes to the lease term
 - changes to ROU assets and lease liabilities resulting from changes in lease payments due to an index or rate
 - changes to leases as a lease modification or as a separate lease (including impacts from changes in the discount rate)

- annual impairment assessments (for jurisdictions opting for the cost model subsequent to initial recognition) or undertaking revaluations (for jurisdictions opting for revaluation model) of non-concessionary ROU assets. The one ACAG Office that supports the revaluation model for valuing ROU assets arising out of non-concessionary leases, are of the view that fair value is necessary to meet the market value concept under AASB 1049. This is despite the AASB staff's position (as outlined in [Agenda paper 14.1 \(M172\)](#)) which states that adoption of fair value of ROU asset would not resolve the divergence between the GFS and reporting framework under Australian Accounting Standards. Therefore, this jurisdiction believes a clarification in this regard will be helpful.

The exceptions for low-value and short-term leases have been effective in managing some of these costs.

We have found agencies often struggle with the requirements of the standard, particularly lease modifications, leading to increased audit costs for entities with material leases.

- 1(b) AASB 16 (based on IFRS 16) was designed for the private sector, with the changes from AASB 117 primarily focused on the information needs of investors. In the public sector, the users and their information needs differ from those in the private sector, as they focus on decisions related to providing resources to the entity rather than returns on investments. Our understanding is that public sector users did not specifically request these changes. While the new requirements may provide some additional transparency, it is unclear whether the benefits of recording operating leases on the balance sheet have been fully realised by users of the public sector's financial statements.

ACAG has found that while the users understand the concept of lease liability, they often struggle to understand the concept of ROU asset and the classification of lease payments in the statement of cash flows.

ACAG recommends the AASB consult with both preparers and users to determine whether the information on operating leases in individual agencies' financial statements is used or relied upon by users.

- 1(c) Refer to the response for question 1(b).

Topic 2 – Determining the lease term

Regarding determining the lease term, do you have any comments about:

2. the application of the requirements in practice by NFP and public sector entities?
3. whether differences in application exist in practice in the NFP and public sector?
4. whether the current requirements and guidance in AASB 16 for determining the lease term are sufficient for NFP and public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

2. ACAG has identified the following issues in the application of the lease term.

Interpretation of 'insignificant penalty'

In its agenda decision from November 2019, the IFRS Interpretations Committee noted that when applying paragraph B34 of IFRS 16 to determine the enforceable period of a lease, an entity must consider the wider economics of the contract (and not only termination payments as stated in the contract), and whether each of the parties has the right to terminate the lease without the other party's permission with no more than an insignificant penalty.

Determining whether a penalty for terminating a lease is 'insignificant' involves a high level of judgment and can be challenging to apply in practice to the specific terms and conditions of lease agreements. Due to this level of judgment, there are variations in how this is applied in practice. For example, one jurisdiction is encountering diverse views when interpreting 'insignificant penalty' for buildings with options to terminate at 'market value.' Some interpret the penalty as contractual payments and other lost assets (per the IFRIC Agenda Decision), while others consider the penalty on a wider economic basis, looking at wider economic gains and losses.

This jurisdiction is also currently facing challenges interpreting 'insignificant penalty' in the context of social housing with options to terminate at 'market value'. For example, a government department provided a government grant to an operator to construct a building that is then used (by that operator under the direction of the government department / lessee) for government purposes, with a termination clause. Under the termination clause, the operator can terminate the agreement at any time if there is a repayment of the initial government funding and the government's share of the fair value increase in property. This interpretation is crucial in determining the non-cancellable period. If the repayment of the government grant is considered an 'insignificant penalty' because the provider is repaying funding, then the lease term would be considered nil.

The IFRIC Agenda decision was developed for private sector entities. It is unclear in a NFP context whether 'insignificant penalty' extends beyond financial penalties and economic incentives to include the impact on an agency's service objectives.

Determining whether there is a lease and related lease term

Assessing whether a NFP public sector entity is reasonably certain to exercise an option can be challenging. Beyond uncertainties in funding, which are subject to government budgetary approval process, there are other specific factors and circumstances within the public sector that contribute to this challenge. Government policy directions or objectives may affect an entity's operations, such as where an entity should locate its operations, and how it should conduct them. Since government directions can often be released and take immediate effect, this can create challenges for preparers of financial statements to conclude that the entity will reasonably exercise the extension options until the time for exercising the options approaches.

Therefore, ACAG suggests the AASB provides additional guidance on how to interpret 'insignificant penalty' and 'reasonable' certainty over lease extension options including their application in the NFP public sector context.

In one jurisdiction, some departments have historically leased land to other government agencies without supporting documentation or with lease agreements for a fixed period. In the latter case, at the end of the term the lessee has the option to continue to occupy the premises on a monthly basis with the approval of the landlord. The agencies use the land and constructed significant public sector assets on it. The issues that arise are:

- whether the land should be recognised as an ROU asset or PPE for the agency
- if it is a lease, what is the lease term as the lease term cannot be indefinite.

The departments have historically rolled forward the lease agreements when they expire, indicating their intention to continue the lease for a foreseeable period. Should the lease term be equal to the lease term mentioned in the agreement or should it be the useful life of the asset constructed, as the termination will result in more than an insignificant penalty as the lessee has constructed significant structures on the leased land and it may disrupt public services?

3. ACAG is unable to comment on whether there are application differences between the NFP public and NFP private sectors.
4. Refer to the response for question 2.

Topic 3 – Lease modifications

Regarding the accounting for lease modifications, do you have any comments about:

5. the application of the requirements in practice by NFP and public sector entities?
6. whether differences in application exist in practice in the NFP and public sector?
7. whether the current requirements and guidance in AASB 16 for lease modification are sufficient for NFP and public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

5. ACAG has found that the lease modification requirements are not well understood or applied by public sector agencies due to the complex concepts in the standard. ACAG has noted specific challenges in determining whether arrangements contain new leases or are a lease modification. Some issues ACAG has encountered, where we believe that additional guidance is needed, include:

- **Master / umbrella agreement that cover the lease of many individual items with one monthly payment** – when new assets were included in the master / umbrella agreement, the agency interpreted that the lease modification provisions (including using an updated discount rate) applied as the payment changed, without understanding that these changes relate to a new item / lease and should not affect the existing ROU asset and lease liability. While initial AASB 16 training often discussed modifications and lease to lease agreements, the above situation (more common in the public sector, for example under public, private partnership arrangements) was not directly covered.
- **Intra-government lease contracts that contain a continuous supply of assets (i.e. assets that are planned to be upgraded or constructed in future years)** – agencies interpreted that the lease calculations should be updated each year for the new assets constructed and made available for use. However, since the new assets are not available at the lease commencement, their payments should be accounted for as a separate lease and excluded from the existing lease liability and ROU asset.

While not necessarily unclear within the standard, due to the general complexity of accounting for lease modifications or other adjustments we have also noted differences in accounting for the following scenarios:

- **'New' contracts signed** – agencies accounting for these as a separate lease rather than as a lease modification (extension of lease term), despite being for the same asset. In this regard, often before the old lease ends, the lessee and the lessor enter into a new lease agreement for the same premises which begin post the balance sheet date. The question that arises at the balance sheet date is whether this new contract should be accounted for as a modification of the old lease (with the ROU asset and the lease liability updated for the term of the new lease agreement) or accounted for as a separate lease. This often brings into question whether the lease term determined at inception was correct or has not taken into consideration the nature of the asset, the entity's dependency on that asset and application of paragraph B34 of AASB 16.
 - **Changes in rental payments under variable payments** – agencies interpreting that the lease modification provisions (including using an updated discount rate) applied, without understanding that the variable lease payments should be accounted for under the remeasurement provisions. Initial AASB 16 training often did provide specific details on this issue, or make it clear what to do when the next year's lease rental increased.
 - **Adjustments for lease modifications** – agencies putting adjustments through profit or loss rather than adjusting the ROU asset when required.
6. ACAG is unable to comment on whether there are application differences between the NFP public and NFP private sectors.

7. ACAG believes it would be beneficial to include additional guidance and examples on lease modifications, taking into account some of the challenges and examples noted above.

Topic 4 – Measurement of lease liabilities – determining an incremental borrowing rate

Regarding the measurement of lease liabilities and determining an incremental borrowing rate, do you have any comments about:

8. the application of the requirements in practice by NFP private sector entities, including how these entities are currently determining the incremental borrowing rate in practice?
9. whether differences in application exist in practice in the NFP private sector?
10. whether the current requirements and guidance in AASB 16 for the measurement of lease liabilities are sufficient for NFP private sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

8. ACAG is unable to comment on the practices of NFP private sector entities.
9. ACAG is unable to comment on the practices of NFP private sector entities.
10. ACAG is unable to comment.

Topic 5 – NFP public sector concessionary leases

Regarding NFP public sector concessionary leases, do you have any comments about:

11. whether there are any reasons to remove the current accounting policy choice to measure initially concessionary ROU assets at either cost or fair value?
12. whether the temporary accounting policy choice for NFP public sector entities should be made permanent?
13. whether the disclosures prepared in accordance with paragraphs Aus59.1 and Aus59.2 of AASB 16 are sufficient in providing useful information to financial statement users regarding concessionary leases when the ROU assets are measured at cost?

If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

11. The majority of ACAG jurisdictions have not identified any reasons to remove the current accounting policy choice as it is functioning effectively and the factors supporting its adoption remain present.

The choice allows central regulatory bodies to decide whether they provide public sector agencies with a choice or mandate the measurement base. In practice, treasuries have mandated concessionary leases be measured at cost both on initial recognition and subsequent measurement.

The accounting policy choices means that NFP public sector can avoid the complexities of fair valuing leased assets such as:

- identifying market participants (private sector or public sector) or how much they are willing to pay
- specialised assets and those with restrictions
- dealing with variable and contingent rentals, early termination provisions etc.

ACAG does not believe that the concessionary leases component of the IPSASB's Leases project adequately addresses the issues raised above. ACAG raised concerns on the IPSASB's proposals to account for concessionary leases in IPSASB Exposure Draft ED 84 'Concessionary Leases and Right-of-Use Assets In-Kind' (Amendments to IPSAS 43 and IPSAS 23) and IPSASB Exposure Draft ED 88 'Arrangements Conveying Rights over Assets (Amendments to IPSAS 47 and IPSAS 48)'.

However, while acknowledging there may be costs associated with fair valuing complex ROU assets including challenges to fair value these in a non-revaluation year, one jurisdiction supports fair value approach as:

- in their view fair value (CRC) is conceptually about current cost accounting i.e. showing the current cost of service delivery not the historic cost, so that asset users can set fees and charges accordingly. To lose this information would remove this price signal and potentially increase the financial burden on future generations
 - the value of resources received by a public sector organisation is important for users' understanding and informed decision making, whether that user be the government, Parliament, public sector or community. This aligns with the expectations of AASB 1058 as it relates to assets provided free of charge
 - there are other examples, such as volunteer services or complex intangible assets that are transferred whose fair value may be difficult to determine, but there is no similar exception for those types of assets, so a narrower exception for concessionary leases does not seem justified
 - if fair value is not adopted for concessionary leases, then it could give rise to an anomaly where the lessor grants a concessionary finance sublease (therefore derecognising the asset) and the lessee chooses the cost option and recognises the asset at a nominal consideration. Therefore, the fair value of the asset is not shown in the agencies' financial statements. This has the potential of omitting useful information for the users
 - the cost versus benefit argument may not be justifiable as determining fair value for a number of non-financial physical assets is equally complex
 - the bigger challenge currently faced is capability. Some preparers perceive the fair value approach is the fair value of the underlying asset, not the right to use the asset through the lease arrangement. Greater clarity and guidance is required by standard-setters on this
 - providing an option on a permanent basis does not align with the IPSASB's approach.
12. The majority of ACAG jurisdictions recommend making the temporary accounting policy choice permanent, with one jurisdiction supporting the fair value approach for the reasons outlined in question 11.
13. Disclosures on concessionary leases measured at cost are important for financial statement users to understand the impact of these arrangements. ACAG is not aware of any issues raised by preparers on the sufficiency of these disclosures.

Topic 6 – Sale and leaseback arrangements

Regarding sale and leaseback arrangements, do you have any comments about:

14. the application of the requirements in practice by public sector entities?
15. whether differences in application exist in practice in the public sector?
16. whether the current requirements and guidance in AASB 16 for sale and leaseback arrangements are sufficient for public sector entities?

If so, please provide your views on those requirements, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

14. One jurisdiction has encountered arrangements where the 'leaseback' period is rent-free under the 'lease' contract. These arrangements are often bundled into one or more contracts that include the sale price. This jurisdiction found the standard is unclear about whether any of the total proceeds should be considered 'lease payments' in these circumstances or how to differentiate the components of the sale price. Additionally, paragraph 101 of AASB 16 is unclear about whether it applies to the buyer-lessor, the seller-lessee or both. This has led to different interpretations by the agency and the audit team. This jurisdiction believes additional guidance is required when there is nil or nominal consideration for the 'leaseback', as the current guidance is insufficient.

The other jurisdictions have either not encountered sale and leaseback arrangements or have not encountered related issues in applying the requirements.

15. ACAG is not aware of any difference in application. The majority of ACAG jurisdictions have not encountered any major sale and leasebacks since the new standard was introduced.

16. Refer to the response in question 14.

Topic 7 – Other matters

17. Are there any other NFP and public sector matters that should be brought to the attention of the AASB as it undertakes a PIR of AASB 16?

If so, please provide your views on those matters, relevant circumstances and their significance, and areas where you believe changes or additional guidance are needed. Examples to illustrate your responses are also most helpful.

The following issues have been encountered by some jurisdictions.

Lessor accounting – Inclusion of non-cash consideration in the net investment in a lease

AASB 16 does not explicitly set out whether lease payments include forms of non-cash consideration, while other standards such as AASB 15 and AASB 1058 (AASB 15.66 and AASB 1058.BC61) require entities to measure any non-cash consideration at fair value in determining the transaction price in respect of a contract.

In the NFP public sector non-cash consideration, such as works-in-kind may be paid under agreements that contain a lease. This is common in at least one jurisdiction where the public sector offer 99-year leases of land, along with rights to develop the land. Some of the challenges include:

- distinguishing whether non-cash consideration is directly related to granting the right to use an underlying asset or whether it is a developer contribution (e.g. upgrading infrastructure within or outside of the lease boundary). This could also apply to certain levies (cash consideration) to be made under the arrangement
- whether non-cash consideration is considered a fixed payment included in the 'gross investment in a finance lease'. Determining the value of non-cash consideration that will be delivered at inception requires an estimate. The value of what is delivered will often differ to the amount estimated at inception, creating a 'true-up' entry. In contrast, if the non-cash consideration was considered a 'variable lease payment' it would be excluded from the 'gross investment in the lease' as it does not depend on an index or rate.

ACAG believes it would be beneficial if the AASB considers issuing additional guidance on how non-cash consideration should be accounted for by lessors and lessees at the point of initial recognition and measurement of lease liability and lease payments included in the net investment in the lease (paragraphs 27 and 70 of AASB 16).

Accounting for development arrangements on leased land

Another challenge in accounting for these development arrangements is determining the timing of lease commencement. The private sector will be granted differing levels of access to the underlying asset (land) in situations where there is a long-term land lease and the developer is constructing an asset on the land. For instance, construction licenses are often issued, granting the developer rights to begin building on the land, but a formal lease is not issued until the development is complete.

We've noted differing judgements being applied in these circumstances and believe additional guidance or examples may help in determining when lease commencement has occurred in complex scenarios such as detailed above.

Lessor accounting – accounting for variable lease payments in a finance lease

The lessee requirements in AASB 16 contain specific requirements for subsequently adjusting the lease liability due to changes in an index or a rate (paragraph 16.42b, with additional details in paragraphs BC188-190). While AASB 16 provides guidance for lessors on how to treat variable lease payments that depend on an index or rate at initial recognition (paragraph 70(b)), it does not address how to account for these payments in subsequent years when the cash flows change due to variations in the index or rate. Although the lessor requirements in AASB 16 remain largely unchanged from AASB 117, the removal of minimum lease payment and contingent rent concepts in AASB 16 now mean it is unclear whether lessors need to remeasure their lease income when the cash flows change due to index or rate variations in the same way as a lessee or recognise the income in the period it occurs (similar to approach for recognising contingent rent under AASB 117) or account for the variable receipts as an embedded derivative.

ACAG has seen this applied differently in practice and believe it would be helpful to provide guidance on how these changes should be accounted for.

Perpetual leases / In-substance purchases (finance leases)

The public sector has numerous land grants (e.g. Deeds of Grant in Trust (DOGIT) and reserve land) between the state government, public sector entities and local government.

Occasionally, issues arise regarding whether the land should be accounted for under AASB 116 or AASB 16. These issues mainly pertain to the technical difference between freehold land and leasehold land – even if in-substance the leasehold land is economically the same as freehold land aside from some valuation differences because of their different legal nature.

Generally, these assets are accounted for under AASB 116, using the various valuation options for subsequent measurement, and the various options under AASB 16 for initial measurement (i.e. fair value or cost such as peppercorn).

We note the IASB decided not to provide guidance distinguishing a lease from a sale or purchase of an asset.

3 September 2025

Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

By email: commentletters@ifrs.org

IASB Request for Information *Post-implementation Review of IFRS 16 Leases*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on IASB Request for Information *Post-implementation Review of IFRS 16 Leases*. The views expressed in this submission represent those of all Australian members of ACAG, unless specifically identified.

The attachment to this letter addresses the AASB's specific matters for comment outlined in the Request for Information.

Overarching feedback

The Australian public sector applies AASB 16 'Leases' which incorporates IFRS 16 'Leases' as issued by the IASB. ACAG found IFRS 16 has generally met its objective of requiring lessees to recognise leases on the balance sheet, with clear core principles and effective exemptions for low-value and short-term leases. The transition provisions also worked well, providing significant cost relief for entities implementing the standard.

The submission notes areas where additional guidance or examples could be provided to provide more clarity to preparers and auditors and drive greater consistency in the application of IFRS 16.

The ongoing costs of auditing operating leases for lessees under IFRS 16 are generally higher than under IAS 17, particularly for entities with a significant number of leases.

While including leases on balance sheet does provide more transparent information on leases and helps comparability between entities, it is unclear whether the benefits have been realised by users of the public sector's financial statements.

Notwithstanding the issues raised above, the costs of implementing any proposed changes should be considered when making decisions about any amendments to AASB 16.

Once again, thank you for the opportunity to comment on this post-implementation review. I hope you will find ACAG's comments, helpful when assessing whether the effects of applying the requirements are as intended.

Yours sincerely



Rachel Vagg
Chair
ACAG Financial Reporting and Accounting Committee

IASB SPECIFIC MATTERS FOR COMMENT

Question 1 – Overall assessment of IFRS 16

- (a) In your view, is IFRS 16 meeting its objective (see page 9) and are its core principles clear? If not, please explain why not.
- (b) In your view, are the overall improvements to the quality and comparability of financial information about leases largely as the IASB expected? If your view is that the overall improvements are significantly lower than expected, please explain why.⁸
- (c) In your view, are the overall ongoing costs of applying the requirements and auditing and enforcing their application largely as the IASB expected? If your view is that the overall ongoing costs are significantly higher than expected, please explain why, how you would propose the IASB reduce these costs and how your proposals would affect the benefits of IFRS 16.

The [Effects Analysis on IFRS 16](#) describes the expected likely effects of the Standard, including benefits and implementation and ongoing costs.

- 1(a) IFRS 16 is meeting its objectives of lessees recognising leases on balance sheet. ACAG has generally found that the core principles are clear and are being applied.

The exemption for low value and short-term leases is working well in practice and helps to reduce costs. The transition provisions also worked well, providing significant cost relief for entities implementing the standard.

- 1(b) IFRS 16 was designed for the private sector, with the changes from IAS 17 primarily focused on the information needs of investors. In the public sector, the users and their information needs differ from those in the private sector, as they focus on decisions related to providing resources to the entity rather than returns on investments.

While the new requirements may provide some additional transparency, it is unclear whether the benefits of recording operating leases on the balance sheet have been fully realised by users of the public sector's financial statements. ACAG has found that while the users understand the concept of lease liability, they often struggle to understand the concept of right-of-use (ROU) asset and the classification of lease payments in the statement of cash flows.

ACAG has found the costs of auditing operating leases under IFRS 16 are generally higher than under IAS 17, especially for entities with a significant number of leases. The exceptions for low-value and short-term leases have been effective in managing some of these costs.

While the IASB expected there will be marginal costs, these expectations were from a private sector perspective, rather than the public sector. ACAG is therefore not clear if these costs were greater than expected. ACAG found:

- a significant number of public sector entities did not have sophisticated systems in place to manage and track leases, with some having large lease portfolios (some across vast geographic locations) with relatively small finance teams
- entities often struggle with the requirements of the standard, particularly lease modifications, leading to increased audit costs for entities with material leases.

The above issues resulted in numerous audit challenges, particularly regarding the completeness and accuracy of lease data, documentation of accounting judgments, and quality assurance processes. Additionally, certain elements of the standard are not well understood by public sector entities, making it difficult for them to apply in practice.

Key issues identified by ACAG during implementation include:

- **Completeness and accuracy of lease calculations:** auditors faced challenges in verifying the accuracy and completeness of lease calculations as entities:
 - struggled to identify contracts that may contain leases
 - were parties to arrangements that were undocumented
 - did not formally document, approve, or maintain key lease accounting interpretations and assessments for individual lease contracts. This often made it difficult for long-term contracts to determine whether the asset was subject to a lease and should be recognised as a ROU asset or as property, plant and equipment (PPE)
 - had incomplete and/or inaccurate lease data held centrally (e.g. future market rent reviews, fixed rate increases, and lease incentives) which resulted in material adjustments to lease calculations
 - did not have information from lessors regarding the value of non-lease components
 - applied the standard incorrectly e.g. omission of fixed rent and/or market rent review increases, application of lease incentives and non-lease components
 - inconsistently applied the impairment requirements for ROU assets measured at cost subsequent to initial recognition.

These issues were more prevalent when the standard was first introduced and have reduced since this time. However, the following areas still require significant judgement each time a new lease is entered, to calculate the lease liability to be recognised:

- consideration of what constitutes a non-lease component versus a lease component or an 'amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee'
- estimation of stand-alone selling prices for non-lease components
- allocation of 'amounts payable by the lessee for activities and costs that do not transfer a good or service to the lessee.'

While this separation is not mandatory it is in most entity's interests to separate the lease components to reduce the liability, and the ongoing depreciation expense associated with the right-of-use asset.

- **Judgment and complexity in lease accounting:** ACAG found the standard inherently difficult to audit given the extensive judgment required in determining enforceability of leases, particularly intra-government leases, lease terms, including 'reasonably certain to extend' and 'no more than an insignificant penalty'.

These areas continue to cause interpretation challenges.

The main audit challenge for subsequent measurement of leases is the accounting for lease modifications. ACAG found that these requirements are not well understood or applied by entities due to the complex concepts in the standard. The specific challenges we have noted are set out in our response to question 2(b).

Question 2 – Usefulness of information resulting from lessees' application of judgement

- (a) Do you agree that the usefulness of financial information resulting from lessees' application of judgement is largely as the IASB expected? If your view is that lessees' application of judgement has a significant negative effect on the usefulness of financial information, please explain why.¹³
- (b) Do you agree that the requirements in IFRS 16 provide a clear and sufficient basis for entities to make appropriate judgements and that the requirements can be applied consistently? If not, please explain why not.

- (c) If your view is that the IASB should improve the usefulness of financial information resulting from lessees' application of judgement, please explain:
- (i) what amendments you propose the IASB make to the requirements (and how the benefits of the solution would outweigh the costs); or
 - (ii) what additional information about lessees' application of judgement you propose the IASB require entities to disclose (and how the benefits would outweigh the costs).

The [Effects Analysis on IFRS 16](#) describes the expected likely effects of the Standard, including benefits and implementation and ongoing costs.

2(a) ACAG expects that there is likely to be diversity in accounting by lessees as:

- the terms 'reasonably certain' and 'no more than an insignificant penalty' are subject to a significant amount of judgement and can often be difficult to apply in practice to the individual terms and conditions of lease agreements resulting in diverse accounting treatments
- lease modifications, are quite complex and often difficult to understand. As a result, we have found entities have interpreted these requirements incorrectly requiring adjustments to their financial statements.

Whether this diversity impacts the usefulness of the information is best answered by preparers and users of the financial statements.

2(b) As stated in question 2(a), ACAG has identified issues with the consistent application of lease modifications and the terms 'reasonably certain' and 'no more than an insignificant penalty'.

Lease modifications

ACAG has found the lease modification requirements are not well understood or applied by entities due to the complex concepts in the standard, leading to inconsistent interpretations and material adjustments to financial statements. ACAG has noted specific challenges in determining whether arrangements contain new leases or are a lease modification. Some issues ACAG has encountered, where we believe that additional guidance is needed, include:

- **Master / umbrella agreement that cover the lease of many individual items with one monthly payment** – when new assets were included in the master / umbrella agreement, the entity interpreted that the lease modification provisions (including using an updated discount rate) applied as the payment changed, without understanding that these changes relate to a new item / lease and should not affect the existing ROU asset and lease liability. While initial IFRS 16 training often discussed modifications and lease to lease agreements, the above situation (more common in the public sector, for example under public, private partnership arrangements) was not directly covered.
- **Intra-government lease contracts that contain a continuous supply of assets (i.e. assets that are planned to be upgraded or constructed in future years)** – entities interpreted that the lease calculations should be updated each year for the new assets constructed and made available for use. However, since the new assets are not available at the lease commencement, their payments should be accounted for as a separate lease and excluded from the existing lease liability and ROU asset.

While not necessarily unclear within the standard, due to the general complexity of accounting for lease modifications or other adjustments we have also noted differences in accounting for the following scenarios:

- **'New' contracts signed** – agencies accounting for these as a separate lease rather than as a lease modification (extension of lease term), despite being for the same asset. In this regard, often before the old lease ends, the lessee and the lessor enter into a new lease agreement for the same premises which begin post the balance sheet date. The question that arises at the balance sheet date is whether this new contract should be accounted for as a modification of the old lease (with the ROU asset and the lease liability updated for the term of the new lease agreement) or accounted for as a separate

lease. This often brings into question whether the lease term determined at inception was correct or not taking into consideration the nature of the asset and the dependency of the entity on that asset and application of paragraph B34 of IFRS 16.

- **Changes in rental payments under variable payments** – entities interpreting that the lease modification provisions (including using an updated discount rate) applied, without understanding that the variable lease payments should be accounted for under the remeasurement provisions. Initial IFRS 16 training often did provide specific details on this issue, or make it clear what to do when the next year's lease rental increased.
- **Adjustments for lease modifications** – entities putting adjustments through profit or loss rather than adjusting the ROU asset when required.

Insignificant penalties

Determining whether a penalty for terminating a lease is 'insignificant' involves a high level of judgment and can be challenging to apply in practice to the specific terms and conditions of lease agreements. Due to this level of judgment, there are variations in how this is applied in practice. For example, ACAG has seen diverse views when interpreting 'insignificant penalty' for buildings with options to terminate at 'market value.' Some interpret the penalty as contractual payments and other lost assets (per the IFRIC Agenda Decision), while others consider the penalty on a wider economic basis, such as repayment of a government grant not being an insignificant penalty, and looking at wider economic gains and losses.

Reasonable certainty over lease extension options

Assessing whether an entity is reasonably certain to exercise an option can be challenging due to the significant judgement involved as some entities are interpreting reasonably certain at a higher threshold than others for similar circumstances. This could have a material effect on ROU asset and lease liabilities.

- 2(c) ACAG believes it would be beneficial for the IASB to provide additional guidance and practical examples on lease modifications and the terms 'reasonably certain' and 'no more than an insignificant penalty', taking into account some of the challenges and examples noted above. This would help entities apply these concepts to the individual terms and conditions of lease agreements, potentially reducing diversity and improving consistency in their key judgments.

Question 3 – Usefulness of information about lessees' lease-related cash flows

Do you agree that the improvements to the quality and comparability of financial information about lease-related cash flows that lessees present and disclose are *largely* as the IASB expected? If your view is that the improvements are *significantly lower* than expected, please explain why.

ACAG does not have any specific comments on lease-related cash flows (whether presented as operating or financing) as the primary focus for public sector entities is on their operating activities. Additionally, presenting the interest portion of the lease payments as a financing activity is not relevant for most NFP public sector entities as they do not generally borrow funds for service delivery.

Question 4 – Ongoing costs for lessees of applying the measurement requirements

- (a) Do you agree that the ongoing costs of applying the measurement requirements in IFRS 16 are largely as the IASB expected? If your view is that the ongoing costs are significantly higher than expected, please explain why, considering how any entity-specific facts and circumstances (such as IT solutions) add to these costs.
- (b) If your view is that the ongoing costs are significantly higher than expected, please explain how you propose the IASB reduce these costs without a significant negative effect on the usefulness of financial information about leases.

4(a) ACAG has found the costs of auditing operating leases for lessees under IFRS 16 are generally higher than under IAS 17, especially for entities with a significant number of leases. This is because IFRS 16 introduces more complex ongoing accounting and auditing requirements for leases compared to IFRS 17. These include the review and accounting of:

- changes to the lease term
- changes to ROU assets and lease liabilities resulting from changes in lease payments due to an index or rate
- changes to leases as a lease modification or as a separate lease (including impacts from changes in the discount rate)
- annual impairment assessments of ROU assets.

The exceptions for low-value and short-term leases have been effective in managing some of these costs.

The accounting for the above changes can be complex and the standards are unclear in some areas, such as indexation and market rent review combinations. This is made more difficult as many entities do not have leasing software and rely on spreadsheets. This requires ongoing review and monitoring to ensure the models are robust.

ACAG has also found that the lease modification requirements are not well understood or applied by entities due to the complex concepts in the standard, leading to inconsistent interpretations and material adjustments to financial statements. Question 2(b) contains details on the issues ACAG has identified.

4(b) ACAG does not have any specific suggestions. As all the requirements work together, any changes may impose costs from introducing a change to the framework.

Question 5 – Potential improvements to future transition requirements

Based on your experience with the transition to IFRS 16, would you recommend the IASB does anything differently when developing transition requirements in future standard-setting projects? If so, please explain how your idea would ensure:

- (a) users have enough information to allow them to understand the effect of any new requirements on entities' financial performance, financial position and cash flows; and
- (b) preparers can appropriately reduce their transition costs when implementing new requirements for the first time.

ACAG believes that the transitional provisions and exemptions in IFRS 16 have been effective. The inclusion of the modified retrospective approach, along with various simplifications and practical expedients, has provided significant cost relief for entities implementing the standard without the loss of information for users. Additionally, the extended lead time before the standard's implementation was beneficial.

ACAG recommends evaluating the option to use the modified retrospective approach and the decision not to mandate comparatives on a case-by-case basis for each new standard.

Question 6.1 – Applying IFRS 16 with IFRS 9 to rent concessions

- (a) How often have you observed the type of rent concession described in Spotlight 6.1?
- (b) Have you observed diversity in how lessees account for rent concessions that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?
- (c) If your view is that the IASB should act to improve the clarity of the requirements, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

6.1(a) ACAG has not frequently observed this type of rent concession in the public sector.

6.1(b) ACAG is not aware of any rent concession issues.

6.1(c) Not applicable.

Question 6.2 – Applying IFRS 16 with IFRS 15 when assessing whether the transfer of an asset in a sale and leaseback transaction is a sale

- (a) How often have you observed difficulties in assessing whether the transfer of an asset in a sale and leaseback transaction is a sale?
- (b) Have you observed diversity in seller–lessees’ assessments of the transfer of control that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?
- (c) If your view is that the IASB should act to help seller–lessees determine whether the transfer of an asset is a sale, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

6.2(a) ACAG has not seen many major sale and leasebacks in the public sector and is not aware of any issues in practice.

6.2(b) ACAG has not seen many major sale and leasebacks in the public sector and is not aware of any issues in practice.

6.2(c) Not applicable.

Question 6.3 – Applying IFRS 16 with IFRS 15 to gain or loss recognition in a sale and leaseback transaction

- (a) Do you agree that restricting the amount of gain (or loss) an entity recognises in a sale and leaseback transaction results in useful information?
- (b) What new evidence or arguments have you identified since the IASB issued IFRS 16 that would indicate that the costs of applying the partial gain or loss recognition requirements, and the usefulness of the resulting information, differ significantly from those expected?
- (c) If your view is that the IASB should improve the cost–benefit balance of applying the partial gain or loss recognition requirements, please describe your proposed solution.

6.3(a) ACAG has no specific comments.

6.3(b) ACAG has no specific comments.

6.3(c) Not applicable.

Question 6.4 – Other matters relevant to the assessment of the effects of IFRS 16

Are there any further matters the IASB should examine as part of the post- implementation review of IFRS 16? If so, please explain why, considering the objective of a post-implementation review as set out on page 5.

ACAG has identified the following matters that the IASB should examine as part of the post-implementation review.

Lease incentives

In November 2019, as part of the Annual Improvements to IFRS Standards 2018-2020, the IASB deferred addressing the complexities and diverse views on lease incentives. ACAG recommends the IASB prioritise resolving these issues.

The underlying principle can be difficult to apply in practice given the various ways in which lessors may structure lease arrangements, and what they commonly refer to as lease incentives.

While most jurisdictions now have their own guidance and entities have established their accounting policies as to how to account for lease incentives (including where internal government 'leases' fail to meet the definition of a lease), issues faced on implementation included:

- confusion due to what the leasing profession would refer to as a lease incentive not actually resulting in a reduction to the ROU asset (for example rent-free periods or rent reductions because these are already effectively taken into account in determining the lease liability)
- how to account for fit-out, including whether the lessee or lessor control the fit-out, and difficulties determining whether the lease payments inherently include an amount to compensate for this, and should therefore result in adjustments to the ultimate lease related expenses recognised.

The standards as they currently stand continue to lack clarity about what comprises a lease incentive, and how to account for lease incentives at the point they are received. This lack of clarity is likely to result in inconsistent accounting treatments.

Lessor accounting – Inclusion of non-cash consideration in the net investment in a lease

IFRS 16 does not explicitly set out whether lease payments include forms of non-cash consideration, while other standards such as IFRS 15 (IFRS 15.66) requires entities to measure any non-cash consideration at fair value in determining the transaction price in respect of a contract.

ACAG has identified instances where non-cash consideration such as works-in-kind may be paid under agreements that contain a lease. This is common in at least one jurisdiction where the public sector offer 99-year leases of land, along with rights to develop the land. Some of the challenges include:

- distinguishing whether non-cash consideration is directly related to granting the right to use an underlying asset or whether it is a developer contribution (e.g. upgrading infrastructure within or outside of the lease boundary). This could also apply to certain levies (cash consideration) to be made under the arrangement
- whether non-cash consideration is considered a fixed payment included in the 'gross investment in a finance lease'. Determining the value of non-cash consideration that will be delivered at inception requires an estimate. The value of what is delivered will often differ to the amount estimated at inception, creating a 'true-up' entry. In contrast, if the non-cash consideration was considered a 'variable lease payment' it would be excluded from the 'gross investment in the lease' as it does not depend on an index or rate.

ACAG believes it would be beneficial if the IASB considers issuing additional guidance on how non-cash consideration should be accounted for by lessors and lessees at the point of initial recognition and measurement of lease liability and lease payments included in the net investment in the lease (paragraphs 27 and 70 of IFRS 16).

Accounting for development arrangements on leased land

Another challenge in accounting for these development arrangements is determining the timing of lease commencement. The private sector will be granted differing levels of access to the underlying asset (land) in situations where there is a long-term land lease, and the developer is constructing an asset on the land. For instance, construction licenses are often issued, granting the developer rights to begin building on the land, but a formal lease is not issued until the development is complete.

ACAG has noted differing judgements being applied in these circumstances and believe additional guidance or examples may help in determining when lease commencement has occurred in complex scenarios such as detailed above.

Lessor accounting – accounting for variable lease payments in a finance lease

The lessee requirements in IFRS 16 contain specific requirements for subsequently adjusting the lease liability due to changes in an index or a rate (paragraph 16.42b, with additional details in paragraphs BC188-190). While IFRS 16 provides guidance for lessors on how to treat variable lease payments that depend on an index or rate at initial recognition (paragraph 70(b)), it does not address how to account for these payments in subsequent years when the cash flows change due to variations in the index or rate. Although the lessor requirements in IFRS 16 remain largely unchanged from IAS 17, the removal of minimum lease payment and contingent rent concepts in IFRS 16 now mean it is unclear whether lessors need to remeasure their lease income when the cash flows change due to index or rate variations in the same way as a lessee, or recognise the income in the period it occurs (similar to approach for recognising contingent rent under IAS 17) or, account for the variable receipts as an embedded derivative.

ACAG has seen this applied differently in practice and believe it would be helpful to provide guidance on how these changes should be accounted for.