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Department of Treasury and Finance

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Ms Kris Peach
Chair and Chief Executive Officer
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Dear Ms Peach

Temporary relief for concessionary leases provided by AASB 2018-8

I am writing about the recent amendments to Australian Accounting Standards (predominantly AASB 16 Leases) to provide temporary relief to the not-for-profit sector in relation to the fair value requirements for concessionary leases on initial recognition. I would appreciate you bringing this issue for discussion by the Board.

Treasury and Finance appreciates and supports the temporary relief provided by AASB 2018-8. Treasury and Finance has largely settled the Government-wide policies for the new Accounting Standards, including requiring agencies to take the option of not applying the fair value requirements on initial recognition for concessionary leases.

As part of our due diligence, Treasury and Finance has identified that it is possible for agencies and auditors to interpret AASB 2018-8 in a manner that Treasury and Finance believes to be inconsistent with the intent of the AASB.

Consistency of choice of subsequent measurement policy for leases

SA Government agencies are required to apply the revaluation model for property, plant and equipment (PPE). This supports our whole-of-government reporting requirements as set out in AASB 1049. To be consistent with the measurement of owned assets, Treasury and Finance will also require that the revaluation model is used for right-of-use (ROU) assets.

AASB 16 paragraph 35 requires the choice of measurement models to be made with reference to which class of PPE the ROU asset relates to. This choice must be applied 'to all of the right-of-use assets that relate to that class of property, plant and equipment'.

An alternative view is that this indicates ROU assets which can be measured at cost on initial recognition per AASB 2018-8 must be remeasured to fair value by reporting date where other ROU assets that relate to the same class of property, plant and equipment are held at fair value.

Treasury and Finance is of the view that this is not the AASB's intent, as indicated in paragraphs BC14 and BC15 of the Basis of Conclusions to AASB 2018-8. Despite the AASB having set out its intentions, an alternative view has been offered that suggests the current drafting of AASB 16 will not allow the option of using the cost model for subsequent measurement.

Suggested solution

The Board might consider that a Board agenda decision, or rejected Board agenda decision, might be sufficient to clarify how AASB 16 paragraph 35[1] should be interpreted.

Alternatively, the Board might consider amendment to AASB 16 is necessary. If this were to be through an Aus paragraph we suggest the following could form the basis for such a requirement:

> *Notwithstanding the requirements in paragraph 35, where a lessee is a not-for-profit entity and elects to measure a class or classes of right-of-use assets at initial recognition at cost in accordance with paragraphs 23–25 for leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives, the lessee may elect to apply a cost model to that class or those classes of right-of-use assets whether or not a cost model is applied to other right-of-use assets related to the same class of property, plant and equipment.*

Clarification of 'class of right-of-use asset'

AASB 2018-8 introduces the term 'class of right-of-use asset'. A policy choice is allowable for each class of ROU asset as to how ROU assets are measured on initial recognition. As noted in the Basis of Conclusions to AASB 2018-8, other Standards specify a class is a grouping of assets of a similar nature and use in an entity's operations.

Treasury and Finance is aware that some agencies currently hold concessionary leases at fair value where there are peppercorn rates and have been classified as finance leases under AASB 117 *Leases*. Treasury and Finance consider that continuing to hold these assets at fair value will provide more relevant information to users of financial reports than reverting to cost in accordance with the policy choices made under AASB 2018-8. To do so would require identification of these former finance lease peppercorn leases as a separate class of ROU asset from other concessionary leases.

Treasury and Finance is of the view that in the context of the relief intended to be provided by AASB 2018-8, it would be reasonable to conclude that those peppercorn leases are a separate class of ROU asset. However, an alternative view is that it is not possible to classify these peppercorn leases to be a separate class of ROU from other concessionary leases, particularly where the underlying assets are used in the same way in an entity's operations to a pre-existing asset class.

Suggested solution

Treasury and Finance suggests the AASB considers clarifying that concessionary leases held at fair value immediately prior to transition to AASB 16 can be considered a separate class of ROU asset from other similar concessionary lease ROU assets through a Board agenda decision or rejected Board agenda decision.

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[1] It may also be necessary to clarify the application of paragraph 34, however, we are not aware of any concessionary leases related to investment property.

Treasury and Finance appreciates your consideration of these issues. The relief intended to be provided by AASB 2018-8 has allowed for greater focus to be placed on other complexities in addressing new accounting standards. To ensure agencies can continue to apply their efforts to those challenging areas, consistent interpretation of the financial reporting framework is necessary.

Yours sincerely

Kevin Cantley

<u>EXECUTIVE DIRECTOR, ACCOUNTING SERVICES</u>