



ACT
Government

Chief Minister, Treasury and
Economic Development

Ms K Peach
Chair
Australian Accounting Standards Board
PO Box 204
COLLINS ST WEST
VIC 8007

Dear Ms Peach ^{KMS}

Exposure Draft 286 Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on its Exposure Draft 286 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities*.

The attachment to this letter sets out HOTARAC's responses on the specific and general matters for comments. We have unanimous views from the members on most aspects of the Exposure Draft.

If you have any queries regarding our comments, please contact Steve Mitsas from Victoria Treasury and Finance on 03 9651 2645 or by email at steve.mitsas@dtf.vic.gov.au.

Yours sincerely,

David Nicol

CHAIR

Heads of Treasuries Accounting and Reporting Advisory Committee

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Overall Comments

HoTARAC agrees with the objective of the Exposure Draft to provide Not-For-Profit entities that are lessees, with the temporary option to record below market leases at cost as opposed to fair value, on initial recognition, until further guidance is provided in AASB 13: *Fair Value Measurement* (AASB 13).

Specific Matters

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.

HoTARAC agrees with the proposed temporary option to measure below market leases initially at cost, but notes that application will also likely need to be extended to the public sector through amendment of AASB 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049), to avoid any ambiguity in connection with application of fair value principles in Whole of Government (consolidated) financial reports, in compliance with the Government Finance Statistics (GFS) Manual. HoTARAC expands on this issue in the response to Specific Matter 5.

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.

Although HoTARAC agrees with the proposals within the Exposure Draft, granting permanent relief from the requirement to recognise below market leases at fair value when those have been entered into prior to the initial application date, would be welcome.

Many below market/peppercorn leases have been entered into many years ago and the contractual arrangements supporting these arrangements vary in their formality, with many very difficult, if not impossible to source, making the transition exercise highly onerous. Furthermore, if lessees are required to record significant amounts on their balance sheets as right-of-use assets and depreciate/amortise these over their remaining lease terms, it could arguably skew the operating results of the lessees as peppercorn leases are often used to facilitate access for service requirements, detracting from meaningful financial reporting.

In certain jurisdictions the reported output costs for general government entities could potentially significantly increase and it could be argued that the increase is not a true reflection of what they are or should be funded for (acknowledging that jurisdictions have different budgetary reporting frameworks and funding policies).

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?

HoTARAC agrees that providing additional disclosure will assist the users to understand the effects of below market/peppercorn leases. However, HoTARAC requests further guidance or clarification in connection with the requirements stipulated in paragraph Aus59.2 regarding the definition of a “material lease” requiring individual disclosure, considering that the payments are usually/generally nominal and such leases are a very small percentage of the resources controlled by reporting entities.

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?

HoTARAC agrees that the Not-For-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in the Exposure Draft. As per our response to Question 5, further consideration is needed for public sector application.

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?

HoTARAC notes that the requirement to record the fair value of below market/peppercorn leases would likely have given rise to convergence differences in themselves, because it is the current view of the Australian Bureau of Statistics (ABS) that arrangements that would have been classified as operating leases under the existing AASB 117 Accounting Standard, would not be recognised under GFS requirements.

HoTARAC continues to engage with the ABS in connection with the application of AASB 16 and the apparent convergence differences with the GFS requirements, caused by recording operating leases (classified as such under the existing AASB 17 *Leases*), on the balance sheet.

In considering the requirements of AASB 1049, some might argue that the requirements of paragraph 13 of AASB 1049 would require the measurement of the right-of-use asset at fair value, which will largely eliminate the effect of the intended relief for the public sector through the specific issue standards. To secure the same relief to the public sector as for the private sector not-for-profit entities, HoTARAC suggests that the AASB also amends AASB 1049 to allow the right-of-use asset for peppercorn leases to be carried at cost, aligned with the temporary and/or permanent relief proposed.

6. Whether, overall, the proposals would result in financial statements that would be useful to users?

HoTARAC agrees that providing a guidance that would promote consistency in reporting across the not-for-profit public sector would be useful to users.

7. Whether the proposals are in the best interests of the Australian economy?

HoTARAC agrees that the proposals are in the best interests of users of financial statements. Some members have expressed a view that the disclosure requirements proposed may potentially result in the disclosure of some commercially sensitive information that may result in the lessee being exposed to higher cash expenditures in the future.

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. Comments included above where appropriate.

HoTARAC agrees that the proposals in the Exposure Draft will likely avoid undue cost and effort being incurred by preparers in applying AASB 13 in the absence of additional guidance, specific to below market/peppercorn leases, providing the AASB accepts HoTARAC's proposal on the grandfathering option on peppercorn leases entered into prior to the application date of AASB 16, as noted in our response in Question 2. Applying fair value measurement to historical peppercorn leases could involve considerable cost and effort.

To put these comments into context, jurisdictions have individually identified several hundreds of peppercorn leases that will need to be fair valued. The benefit of this exercise is questioned, considering that most of these arise in the public sector from directions to use existing public sector assets to mutually fulfil service delivery requirements.