AASB Staff Response to Submissions on the Fatal-Flaw Review Draft *Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary Leases* (October 2019)

Submissions on the Fatal-Flaw Review Draft

The Fatal-Flaw Review Draft of the proposed amending Standard *Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary Leases* was released on 31 October 2019, with a 30-day comment period that closed on 29 November 2019.

Three submissions were received. The respondents were:

- The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)
- The Australasian Council of Auditors-General (ACAG)
- Mr David Hardidge

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HoTARAC supported the proposals without any additional comments.

ACAG and Mr David Hardidge provided some suggested changes to the proposals and additional comments. The table below summarises these comments and staff's analysis and response to the matters raised.

Submission	Summary of suggestions/comments	Staff's analysis and response
ACAG and Mr David Hardidge	**Issue 1: Disclosure requirements** Paragraphs Aus59.1 and Aus59.2 of AASB 16 set out additional disclosures when an entity elects to measure a class of concessionary right-of-use (ROU) assets at cost at initial recognition. ACAG and David requested that the Board clarify that these disclosure requirements are also required at subsequent measurement.	Staff note that AASB 16 disclosure requirements are applicable to an entity when preparing financials statements, which would include subsequent measurements. Paragraphs Aus59.1-Aus59.2 require additional disclosures when an entity elects to measure concessionary ROU assets at cost. **Staff response:** Added paragraph BC13 to clarify that the additional disclosure requirements are also required at subsequent measurement.
ACAG and Mr David Hardidge	**Issue 2: Reference to 'other entities' in BC12** ACAG noted the reference to "other entities" and "local government" could cause confusion and recommend deleting this reference. Mr Hardidge commented that the proposed temporary option to measure concessionary ROU assets at cost at subsequent measurement should be permitted for all not-for-profit (NFP) public sector entities and not only restricted to Whole of Government (WoG) and General	As noted in paragraph BC12, Accounting Standards do not require any other entities, other than WoG and GGS, to align with Government Finance Statistics (GFS) requirements (which requires assets to be measured at fair value). It is Treasury Departments that instruct their government entities to fair value their assets. Therefore, as echoed by ACAG, this is not a matter for the AASB. Treasury Departments could resolve this issue by changing their instructions to their respective government entities.

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	Government Sector (GGS). For example, universities and local governments that are not consolidated into WoG and GGS should be allowed to apply the temporary relief.	**Staff response:** Amended paragraph BC11 to clearly state that the amendment was to AASB 1049, and amended paragraph BC12 to better explain why the AASB 1049 amendment is not relevant to public sector entities other than WoG and GGS.
Mr David Hardidge	**Issue 3: Interpretation of AASB 1049's requirement to fair value ROU assets** Mr Hardidge disagrees with staff and other constituents' interpretation that AASB 1049 requires ROU assets to be measured at fair value. His interpretation is that AASB 1049 does not require 'non-GFS assets' to be measured at fair value, and that ROU assets are not GFS assets as operating leases are generally not recognised for GFS purposes; and therefore, there is no requirement to fair value such ROU assets. Mr Hardidge recommends amending BC5 and BC7 to reject that interpretation of AASB 1049 requirements.	Staff consider that AASB 1049 is not entirely clear on the measurement requirements of ROU assets since GFS only recognises the underlying leased assets and not ROU assets. However, if a class of ROU assets includes some assets that GFS would recognise (under a finance lease as identified under GFS), then that would require those ROU assets to be measured at fair value per para 13 of AASB 1049. Standards then require all assets in a class to be measured on the same basis, which would therefore require the remaining ROU assets also to be measured at fair value. Staff observe that ACAG is of the view that concessionary ROU assets would need to be fair valued at subsequent measurement if the revaluation model is applied to the related class of property, plant and equipment (PPE). Staff also consider that paragraph 13D of AASB 1049 indicates that fair value could be required for a class of ROU assets, and therefore should be amended as proposed. **Staff response:** No further action is required, given the proposed amendment to paragraph 13D of AASB 1049.
Mr David Hardidge	**Issue 4: Using the former finance lease and operating lease definitions as definition of a 'class of ROU asset'** Mr Hardidge disagrees with paragraphs BC17–BC18 that the former finance and operating leases definitions cannot be used to distinguish classes of ROU assets. Mr Hardidge is of the view that the operating lease and finance lease distinction can meet the definition of class of asset in Accounting Standards as the nature and risks of assets in these leases are often different in an entity's operations.	From a standard-setting perspective, staff consider, as noted in paragraph BC19 of the Standard, that identifying a class of ROU assets based on superseded definitions of operating lease and finance lease would conflict with the accounting measurement basis for leases, given the removal of the operating and finance lease distinction for lessees. Paragraph BC15 states that the assessment of a 'class of ROU asset' is based on whether the ROU assets arise under concessionary or non-concessionary leases <u>in addition to</u> the requirement for a

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	Mr Hardidge commented that since the operating vs finance lease distinction will continue to operate for lessors and the current ABS manual, distinguishing class of ROU assets based on these definitions should be permitted.	similar asset nature and use. It is up to each entity to determine the basis on which it appropriately distinguishes the nature and use of its assets, but the Standard cannot refer to operating and finance leases as a basis for lessees. **Staff response:** No action is required.
Mr David Hardidge	**Issue 5: Apply the same 'class of asset' concept to owned assets** Mr Hardidge noted that if the reasoning for the Board to allow the distinction for leases is based on interpreting the general description of 'similar nature and use', then the concessionary distinction should also apply to owned PPE and how those assets were funded.	At the September 2019 AASB meeting, when the Board decided to temporarily permit concessionary ROU assets to be treated as a separate class of ROU asset, it was noted that distinguishing a class of ROU assets based on whether the lease is a concessionary lease or market lease (as well as nature and use of the asset) is not consistent with the concept of a 'class of assets' in other Standards, which looks only at the nature and use of the assets in an entity's operations. However, the Board considered that this would be a pragmatic response to the issue given the option to measure concessionary ROU assets at cost is only a temporary one. At that meeting, the Board decided that distinguishing classes of assets based on whether the transaction was at market terms and conditions or at concessionary terms is not to be applied in any other context. Consequently, paragraph Aus25.2 of AASB 16 specifically says that this "approach shall not be applied by analogy to distinguish sub-classes of other assets as separate classes of assets". **Staff response:** No action is required.
Mr David Hardidge	**Issue 6: Application of the proposals** Mr Hardidge requested the Board clarifies how the 'class of ROU assets' should be applied in practice and provided specific examples in his submission. He also requested clarification whether the concessionary/non-concessionary distinction applies within a type (class) of asset.	Staff do not think that examples are necessary. Staff consider that paragraph BC15 which states "… distinguished a class of right of use assets based on whether the right of use assets arise under concessionary or non-concessionary leases, in addition to the requirement for a similar asset nature and use" is sufficient in explaining how classes of ROU assets can be distinguished within what would otherwise be a class of assets. **Staff response:** No action is required.

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Mr David Hardidge	**Issue 7: Consider granting permanent relief from fair valuing concessionary ROU assets** Mr Hardidge is of the opinion that many respondents to Exposure Draft ED 286 (which became AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities*) specifically requested the option to not measure concessionary ROU assets at fair value to be provided on a permanent basis. Mr Hardidge believes that the relief to not fair value concessionary ROU assets granted through AASB 2018-8, and the proposals in this proposed Standard, as amended, should be made permanent.	When issuing AASB 2018-8, the Board decided it will consider whether the temporary option should be made permanent at a later time, when the fair value measurement guidance has been developed and the NFP private sector financial reporting requirements have been finalised (AASB 2018-8 paragraph BC10). **Staff response:** No action is required.
Mr David Hardidge	**Issue 8: A longer exposure period** Mr Hardidge is of the view that a longer exposure period on the Fatal-Flaw Review Draft should have been given as the proposed changes are not perfunctory.	Exposing the Fatal-Flaw Review Draft for public comment for 30 days is in line with the AASB Due Process Framework. Staff did not receive feedback from any other constituents that a longer exposure period was required. AASB 16 is effective for periods beginning on or after 1 January 2019; therefore, an amending Standard that changes the requirements of AASB 16 would need to be issued prior to an entity applying AASB 16 to the 2019 calendar financial year (ie before 31 December 2019). **Staff response:** No action is required.