

7 December 2018

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West
Melbourne VIC 8007

via the AASB website

Dear Ms Peach

Right-of-Use Assets of Not-for-Profit Entities - Comments on ED 286

Crowe Horwath is pleased to respond to the Australian Accounting Standards Board's (the AASB's) exposure draft 286 (ED 286) and provide comments on the specific matters for comment.

We support the AASB's proposal to allow a temporary option for Not-for-Profit Entities to measure Right-of-Use Assets at cost rather than fair value as currently required by AASB 16. We broadly support the proposed additional disclosures and have provided some specific comments on the proposals.

We believe these proposals will be well received by Not-for-Profit entities and we note the ability for Not-for-Profit entities to continue to measure Right-of-Use Asset at fair value should they wish to do so.

We agree this option should be a temporary option until the other projects are finalised, at which time appropriate consideration should be given to the permanent accounting treatment of Right-of-Use Assets held by Not-for-Profit Entities.

Our responses to the specific questions posed in ED 286 are attached as Appendix 1 to this letter.

Crowe Horwath appreciates the opportunity to express our views and trust that you will find our comments useful in deciding the accounting for Right-of-Use Assets of Not-for-Profit Entities.

Yours sincerely



Christine Webb
IFRS Technical

Encl.

APPENDIX

Crowe Horwath's detailed responses to specific questions on ED 286

Question 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.

Yes. We agree with the proposed temporary option. We believe the option to measure at cost or fair value will provide Not-for-Profit Entities with a practical choice of which measurement method to take.

Furthermore, we agree that the project on Fair Value Measurements for Not-for-Profit Entities and the current legislative reviews should be finalised before the temporary option is removed. We also believe that the AASB's project on Special Purpose Financial Statements, as outlined in ITC 39 should also be taken into consideration.

Question 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.

We agree with the temporary option. Having this option exist on a permanent basis is a worthwhile consideration and we welcome the AASB in considering extending this as a permanent option. However, as mentioned above, we believe the other projects should be finalised before permanent decisions are made.

Question 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?

We broadly agree with the additional disclosure requirements proposed in ED 286. Below we have set out our expectations for the disclosures based on the proposed paragraphs Aus59.1 and Aus59.2 below. Should your expectations for the disclosures be different, we recommend an

amendment be made to the proposed wording, or additional guidance be provided to assist Not-for-Profit Entities in applying the requirements of the standard.

- In respect of the *entity's dependence on leases*, we expect an entity to disclose the impact to their operations if they were unable to maintain the peppercorn lease. For example, if they were to pay market rental for a premise currently under a peppercorn lease they would not be able to continue to provide the current level of services to the community. Whilst we don't believe it would be required, an entity could disclose an estimate of the market rent as part of this disclosure, so the user can quantify the impact.
- In respect of the *entity's dependence on leases*, we generally expect these disclosures to be at an entity level, however as necessary, this may include identification of the leases for which they could continue to operate, or those that would require a change to their operations.
- In respect of the *entity's dependence on leases*, we would not expect any quantitative disclosures.
- On the basis that an entity can aggregate right-of-use assets of a similar nature, we expect the following with respect to Aus59.1(b)
 - Lease payments would be disclosed as the annual payments to be made and may consist of a range for example from \$1 to \$100 per annum. However, because in most cases lease payments would be immaterial, no disclosure is expected.
 - Lease term would be disclosed as a range for similar nature assets. We interpret 'lease term' to have the meaning defined in AASB 16. On the basis that AASB 16.59(b)(ii) requires a lessee to disclose information about extension options and termination options as described in paragraph B50, we note that the lease term disclosures in respect of peppercorn leases at cost may include more than just the term as defined by AASB 16 to include those options not covered by the lease term
 - A description of the underlying asset would be akin to the class of underlying asset as required for AASB 16.53(a).
 - Restrictions would be disclosed as an explanation of the restrictions imposed on the group of right-of-use assets such as to provide affordable housing.
- We note that Aus59.2 allows material leases to be aggregated if the assets are of a similar nature. In our view, this is similar to the class of underlying asset, for example, land versus buildings. In certain circumstances, this may be broken down when considered relevant to a user. For example, an entity providing affordable housing may distinguish between premises used for administrative functions versus premises used to provide affordable housing.
- We note that Aus59.2 refers to a 'material lease'. In our view, a 'material lease' will be a qualitative judgement. This may require consideration of the entity's dependence on the lease.
- Aus59.2 requires the disclosures in Aus59.1 to be provided individually for each material lease or in aggregate for leases of a similar nature. Our interpretation is that the disclosures are required in aggregate for the remaining leases. For example, if an entity did not have any individually material leases, they would make disclosures in aggregate for all peppercorn leases. However, an overarching judgement may be made where all peppercorn leases are considered insignificant, no disclosure may be appropriate so as not to obscure more important information in the financial statements.
- We do not believe an entity would need to disclose specific assets, for example the address of a premises under a peppercorn lease. We do not believe this to be necessary information and such information may be considered sensitive for the entity.

In addition, in our work performed with clients to-date in respect of AASB 16, we have noted some implementation issues with respect to the following:

- When there is no formal lease agreement in place, is there a 'lease' in the scope of AASB 16? Often these arrangements are for peppercorn leases where no or nominal payments are made. An entity may consider that in the absence of a formal agreement, that there is no lease in the scope of AASB 16 and therefore may not consider the disclosures necessary. This may undermine the AASB's proposed additional disclosures.
- Some lease agreements include termination or extension options that bring into question the 'lease term' as defined by AASB 16. This may cause challenges to entities preparing the disclosure required by Aus59.1(b)(ii).

The AASB may like to consider providing additional guidance on the above items to improve the consistency of application of the standard to these matters.