AASB-1058

Accounting standard change
Peppercorn Leases

Updated 6 September 2019
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Definition

The ACNC describes peppercorn leases as:

Where a charity enters into a significantly below-market value lease, it is sometimes referred to as a peppercorn lease. To account for such leases, AASB 1058 amends AASB16 Leases to require charities to measure the right-of-use asset at fair value and the lease liability of future lease payments at present value. The difference would be income under AASB 1058 if there are no other obligations on the lease, but is not considered to form part of revenue for ACNC purposes.

Update

On December 31 2018 the ACNC advised:

The AASB has issued AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-use Assets of Not-for-Profit Entities* to provide a temporary option for not-for-profit lessees to elect to measure a class (or classes) of right-of-use assets arising under 'concessionary leases' at initial recognition at cost, rather than at fair value.

A permanent option will be considered at a later time.

The AASB has determined that establishing the fair value of the right-of-use asset is problematic, particularly where there are restrictions on the use of the asset that may impact fair-use-value.

What it actually means

- The standard introduced on 1 January 2019 is based on changes to the way that leases are accounted for.

- After the amendment, organisations need to determine whether to account for peppercorn leases at fair-value or at cost. NHVic auditors recommend the at cost method.

- The title of an agreement for use of a property does not remove the obligation to report. So licence agreements, leases, rental agreements are all caught under the change.

What is happening?

- Peppercorn Leases are now being referred to as 'concessionary leases' and they are agreements where the owner provides a premises to a NFP for a reduced amount in order to help that NFP to carry on its business.
- They are almost universally in place in the sector.
- The claim was that the standard aimed to establish the velue between what was paid and what the actual value of the lease is, however, it now claims to determine the reliance of a NFP on peppercorn leases.

What is happening?

- The December 2018 amendment permits Not-for-profit organisations to opt out of the fair-use-rule and to account for leases at cost, or, to continue with the new rule and establish the Right of Use (ROU) Value

- If the option is exercised additional disclosures must appear on financial statements.

- The option to not report fair-use-value is temporary, however, NHVic Auditors have argued for the change to become permanent. We have not had an update on this since January 2019.

How to account for the Fair-value method.

- If using the ROU Value, there are a few methods for starting to calculate the opening journal for this.

- It is beyond the scope of this session to review the methods, however, the easiest way seems to be the Modified Retrospective Approach #1.

- This approach can be taken up at 1 January 2019 and it accounts for the remaining period of the lease from that date.

The Entry

- Ideally a new Retained Earnings Line could be used to report the amount to ensure that any interested party, including the Board, can see that the amount is not ordinary Retained Earnings.

- A suggestion is Equity Account ‘AASB1058 – Peppercorn Retained Earnings’

- There will need to be a corresponding asset account ‘Right of Use Asset Value – AASB1058’

- And a Current Liability Account ‘Lease Liability – AASB1058’

The Entry cont.

- The journal will be:

- Debit Right of Use Asset (Fair estimate of the value of the lease)

- Credit Lease Liability (The actual amount that is paid for the duration of the contract)

- Credit new Retained Earning account the difference.

Full Lease Value

- The full remaining term of the lease is accounted for and depreciated over the term of the lease.

- Options to extend contained within an agreement may need to be included in the calculation. If there are extensions you should refer to your accountant for advice on whether the value for the extension should be included in the amount.

How to account for the at-cost method.

- A liability account that would list the total payable over the term of the lease.

- A corresponding Asset account equal to the liability, for example $150 where a 3 year lease term remains and the annual payment amount is $50.

- If this method is adopted, financial reports must include in the notes the following information:
  - The lease term/remaining term.
  - The amount of the lease payments if any.
  - A description of any underlying assets (significant fixtures).
  - Any restrictions on the use of the asset/property.

More info

- At present there is no requirement to provide a formal valuation of the lease, and this is where the problem for the AASB came about as it is very difficult to create a straight forward method of valuation.

- Some councils already record the amount they value the lease at so if you are in a council owned building they may be able to tell you the commercial right of use value.

- Short-term leases less than 12 months can be excluded, however, this includes any extension options. So just having a constantly renewable 11 month lease will not create an exemption.

Some more

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- There could be an exemption where the lease is considered to be a Service Concession Arrangement.

- These occur where a council/government contracts to the tenant to operate and develop the Right of Use Asset.

- If you think you fall into this category you should provide your lease document to your accountant for comment.

Some more

- The Australian Charities and Not-for-profits Commission (ACNC) has undergone its 5 year Legislative Review which may result in further exemptions for the lower reporting level thresholds (under $1m).

- Best practice would be to record the notes information as per the amendment issued by the AASB in December 2018. NHVic's Auditor has advised that the consulting panel see no value in NFPs taking up the right-of-use value at this point.

- This has the dual impact of prioritising your lease agreement to the board and preparing your accounts in the event the right-of-use rules become enforceable to your organisation.

Discussion

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