

Bogotá, D.C. Colombia Enero 31 de 2018

Señores  
IPSASB  
Draft – 64  
Comment

Muchas gracias por la invitación a participar con comentarios sobre la NICSP 13 y IFRS 16 arrendamientos para arrendadores y arrendatarios, los cuales me parecen interesantes desde la parte en que tanto unos como los otros deben establecer unos criterios uniformes en la información que se maneje en los Estados financieros, y que estos deben ser conocidos para la correspondiente toma de decisiones.

Sin embargo, no veo en el documento Exposure Draft 64 January 2018, Comments... la forma de presentación en los reportes que se deben presentar o la información que se debe registrara, con el fin de fortalecer lo establecido en los IR International reporting y en los del GRI Global Reporting Intuitive, los cuales se presentan aspectos de sustentabilidad y se quiera o no estos también afectan a los social y al medio ambiente como aspectos fundamentales en la Responsabilidad Social empresarial y en la Sustentabilidad, aspectos que deben ser fundamentales en la toma de decisiones y en especial cuando son dados en arrendamiento a otros para que los administren y los usufructúen.

Estimaría que se debería dar una guía de su presentación en reporte, con el fin de orientar mejor estos manejos en propiedad de terceros y que afectan los costos y los gastos de las Propiedades Planta y Equipos.

Agradezco sus comentarios y gracias por recibir el presente.

Atentamente

CP Mg Álvaro Fonseca Vivas  
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**6<sup>th</sup> June, 2018*****To whom it may concern,******The Institute of Certified Public Accountants in Ireland welcomes the opportunity to comment on:*****“ED 64 Leases”****Overall comments**

The Institute of Certified Public Accountants in Ireland (CPA Ireland) welcomes the publication of this much needed exposure draft on accounting for leases and supports the broad thrust of the recommendations for lessee accounting but has some reservations on the changes to lessor accounting.

There is a need to ensure consistency in how leases should be accounted for in terms of their recognition, measurement, presentation and disclosure. CPA Ireland also agrees with the objective of the ED to ensure that the proposed amendments should provide relevant information in a manner that faithfully represents lease transactions.

**Specific comments****Comment 1**

*The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

CPA Ireland agrees with IPSASB’s reasons for adopting the right of use model. Clearly it makes sense to adopt the same model as per IFRS 16 and CPA Ireland agrees that not only does it fit the definition of an asset under the IPSASB’s *Conceptual Framework* but also there are no public sector issues that would suggest an alternative treatment. Undoubtedly there will be additional costs for lessees but these are outweighed by having consistent accounting treatment across all leases for lessees and thus the benefits outweigh the costs. The former artificial division of leases between finance and operating has led to similar leases being treated differently by different lessees and to ‘off balance sheet financing’ as most lessees would have treated the majority of their leases as operating and not finance.

**Comment 2**

*The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

CPA Ireland has practical issues with this approach. Clearly, in theory and under the *Conceptual Framework*, there should be a mirror accounting treatment by lessors to that applied by lessees and thus the approach proposed by IPSASB would be the ideal solution.

The reasons for adopting the ‘mirror’ or ‘control’ approach are logical i.e.

- The current risks and rewards division of finance and operating leases does not meet the definition of control under the conceptual framework
- The IFRS 16 approach does lead to inconsistent accounting by both parties with an asset effectively being reported on both the lessors’ and the lessees’ balance sheets, albeit at different values.

The Basis of Conclusions (BC10) argues that if public sector entities follow the IFRS 16 approach to lessor accounting there will be practical issues on consolidation, that leasing will become less understandable to users and that asymmetrical information will distort the analysis of the financial position of public sector entities.

These issues are not unique to the public sector and CPA Ireland questions whether the costs of implementing the ‘control’ model are really outweighed by the benefits. CPA Ireland would also question whether the public sector

should diverge from the private sector at this moment in time. It is likely that, at some stage in the future once the lessee model settles down, further changes may be adopted to IFRS 16 if it was felt that the financial statements of lessors were no longer providing a true and fair view. Should the IPSASB not wait until this emerges?

### Comment 3

*The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

Bearing in mind the comments above, if the IPSASB decides to adopt the 'control' model then Approach 1 would seem to be the easiest to apply which is not unimportant given the challenges of implementing IPSAS in many countries although, in theory, Approach 2 would seem to be more directly comparable with lessee accounting. Approach 1 will leave the underlying asset or part of it still being double-counted as it will be recorded in both sets of books but introducing a lease receivable (at present value of the future lease payments) and corresponding liability should reduce the costs of compliance considerably. CPA Ireland also agrees with the idea that the approach is consistent with the conceptual framework and is less complex than having to determine the component of the underlying asset to be derecognised and instead recognising a residual asset, as required in the second approach

### Comment 4

*For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

CPA Ireland supports this approach as concessionary leases appear frequently in the public sector and thus there is a case for special accounting treatment.

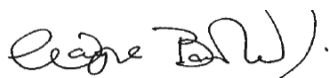
CPA Ireland supports the introduction of specific guidance on these leases and agrees with the approach adopted in the exposure draft, particularly the requirement to include them at fair value and recognize revenue in line with IPSAS 23 requirements.

### Conclusion

CPA Ireland welcomes the publication of ED 64 *Leases* and, in particular, the very useful application guidance and illustrative examples. However, it has concerns over the practical implementation of the proposals for lessors and, in particular, with the proposed divergence from the private sector's accounting treatment in IFRS 16 *Leases*. In the opinion of CPA Ireland there is not sufficient evidence to suggest that the public sector has unique issues to justify a different accounting treatment even though the IPSASB proposals are theoretically more correct than those of the IASB.

If you have any questions on the above, please do not hesitate to contact me.

Yours sincerely,



Wayne Bartlett  
Chair, CPA Ireland IPSAS Advisory Board





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11<sup>th</sup> June, 2018

The Technical Director

International Public Sector Accounting Standards Board (IPSASB)

New York

Dear Sir,

**Subject: Comments on the Exposure Draft 64 - Leases.**

We are grateful to the IPSASB for the opportunity given for us to comment on the Exposure Draft (ED) 64, Leases. We welcome the initiative of the IPSASB to propose improvements to lease accounting in order to ensure that lessees and lessors provide relevant information in a manner that faithfully represents leasing transactions.

We do concur with the ED and note that the various explanations in the Basis of Conclusions (BC) ensure consistency of the conceptual framework of IPSAS. Moreover, aligning IPSAS lease accounting to IFRS 16 leases ensures that accrual base information is adequately provided under a lease accounting.

We note the following on Specific matter for comment;

**Specific Matter for Comment 1:**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

ICAG is a member of:



Address all correspondences to: The Chief Executive Officer

#### **Comment**

While we do not disagree that the departure from IFRS 16 risk and rewards, we note that this should be stated in the body of the standard. We are of the view that making this clear statement would eliminate the danger of implementing the IFRS 16 rules.

We generally agree with the right of use approach adopted by the Board and specifically the selection of Approach 1. Approach 1 is easier to apply especially as it aligns with the treatment that will be applied in the books of the lessee. The other advantage of this approach is its alignment with the IPSAS conceptual framework and other IPSAS standards such as IPSAS 16, IPSAS 17, and IPSAS 32.

The major challenge we foresee with this approach though is its departure from the IFRS 16 principle which potentially creates an inconsistent basis for lessor accounting across the public and private sectors, making comparisons inappropriate if leases account for significant proportions of the balance sheets of the private and public sector entities being compared.

#### **Specific Matter for Comment 3**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

#### **Comment**

Yes we agree. Title is not transferred so this should still be reported as an asset on lessor's books. This model recognizes what has happened (transfer of use).

#### **Specific Matter for Comment 4**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons).

Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

#### **Comment**

We disagree with the recognition of the subsidy granted to lessees as a day-one expenses/revenue over the lease term. The reason given in BC81 is that this provides most useful information for accountability purposes. We believe that useful information can be disclosed in the note. Rather, we believe that the subsidy should mirror treatment that the lessee treats this gain over the life of the lease. That way there is reciprocal consistency in treatment. Useful information can always be disclosed without losing the symmetry in the



Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

**Comment**

We disagree with the recognition of the subsidy granted to lessees as a day-one expenses/revenue over the lease term. The reason given in BC81 is that this provides most useful information for accountability purposes. We believe that useful information can be disclosed in the note. Rather, we believe that the subsidy should mirror treatment that the lessee treats this gain over the life of the lease. That way there is reciprocal consistency in treatment. Useful information can always be disclosed without losing the symmetry in the accounting treatment between lessor and lessee. We however agree with the treatment recognizing revenues in accordance with IPSAS 23.


We think that the recognition of subsidy as day one expense is not appropriate for the following reasons:

- i. Given that the decision to lease will be over a period, the economic consequence of that decision should be spread over the period of the lease. Consequently, we believe a better approach will be to have these lease subsidies spread over the period of the lease.
- ii. Additionally, concessionary leases are a common occurrence in the public sector and the financial magnitude could be very significant. Consequently, day one recognition of lease subsidy could have extremely significant impact on the financial statements of the entities which in reality is a "book entry". We believe amortising this transaction over the period of the lease will more accurately reflect the impact of the concessionary lease decision on the entity.


We hope the IPSASB finds these comments helpful in further developing its consultations to issue a standard on the proposed Exposure draft on Leases for the Public Sector Accounting.

In turn, we are committed to helping the IPSASB in whatever way possible to build upon the results of this Exposure Draft. We look forward to strengthening the dialogue between us. Please do not hesitate to contact us should you wish to discuss any matters raised in this submission.

Yours Sincerely,



Paul Kwasi Agyemang  
(Chief Executive Officer)



Osei Adjaye-Gyamfi  
(Director, Technical and Research)

Ian Carruthers, Chair  
International Public Sector Accounting Standards Board

[www.ifac.org](http://www.ifac.org)

31 May 2018

Dear Ian

**Auckland Council submission to the IPSASB Exposure Draft 64: Accounting for Leases**

Thank you for the opportunity to comment on the consultation document of the International Public Sector Accounting Standards Board (IPSASB) Exposure Draft 64, *Leases*.

Auckland Council is Australasia's largest local government entity and is made up of the Council and six substantive council controlled organisations. We invest heavily in infrastructure and many of our decisions will have a fiscal impact on Auckland's future generations.

We have given our responses to the specific matters for comment for the respondents as an attachment to this letter.

Once again, thank you for the opportunity to comment.

Yours sincerely



Kevin Ramsay  
General Manager Corporate Finance  
and Property  
**AUCKLAND COUNCIL**



Gina Cruz  
Group Accountant – Policies & Standards  
**AUCKLAND COUNCIL**

cc: Warren Allen, Chief Executive  
External Reporting Board  
Email: [submissions@xrb.govt.nz](mailto:submissions@xrb.govt.nz)



## **Exposure Draft 64 – Accounting for Leases**

### **Attachment – Auckland Council’s Responses to Specific Matters for Comment**

#### **Specific Matter for Comment 1**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6-BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain your reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

#### Auckland Council Response:

We agree with IPSASB’s proposal to adopt IFRS 16 right-of-use model for lessees. For Auckland Council Group that is a mixed group (being a group that includes both public benefit entities and for-profit entities), better convergence of public benefit entity (PBE) Standards with IFRS means fewer differences or adjustments during consolidation and reporting.

Auckland Council is also a bond issuer in the New Zealand Stock Exchange (NZX), Swiss and Singapore Stock Exchanges. Part of the Group’s requirements of the international stock exchanges is to identify differences between the PBE standards adopted by Auckland Council Group and IFRS. Thus, it is helpful for Auckland Council’s bondholders that there are only minor differences between PBE standards and IFRS in our financial statements.

We understand that the rating agencies such as Standard & Poor’s and Moody’s have different views on operating leases. These rating agencies make an adjustment to bring operating leases onto the balance sheet based on the net present value. The net present value is calculated at high level based on the current lease standards’ required disclosures on operating lease commitments. We believe that with the right-of-use model, we can account for a more precise net present value of operating lease liability since the calculation is based on more granular data.

#### **Specific Matter for Comment 2**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9-BC13) for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

#### **Specific Matter for Comment 3**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34-BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

#### Auckland Council Response

We do not agree with IPSASB’s decision to depart from IFRS 16 risks and rewards model for lessor accounting and the proposal to use a single right-of-use for lessor and lessee accounting.

We believe that the rationale provided under the basis of conclusion does not strongly support the decision to depart from IFRS 16. We also do not believe that the three key practical issues summarised (consolidation and asymmetrical information) under BC10 are more prevalent in the public sector. The consolidation issues being prevalent in the public sector are not thoroughly discussed and supported by the IPSASB in the basis of conclusion. We believe that there is also a significant number of consolidated groups in the for-profit entities with an entity within the group undertaking property management as this is one of the ways to centralise and be cost effective within a group structure.



## Exposure Draft 64 – Accounting for Leases

### Qualitative characteristics

Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting (Chapter 3.6 of IPSASB's Conceptual Framework). We believe that the recognition of "right-of-use" asset and the corresponding lease liability by the lessee in its financial statements is relevant information. There has been a long history discussing the relevance of this information in the lessee's financial statements. As noted in our response to specific matter for comment 1 above, the rating agencies adjust the financial information in the financial statements by adding a right-of-use asset and a corresponding lease liability to reasonably account for all the obligations of the entity.

Whilst recognising a lease receivable by the lessor as proposed under ED 64 seems reasonable at first reading, we believe that recognising this asset does not provide relevant information to the users of the financial statements. As it is currently proposed, this requirement allows the entity to report overstated total assets in its financial statements. The carrying value of the underlying assets represent their future benefit potential. Adding a lease receivable asset overstates the total assets as it inflates the future benefit potential beyond what we expect to receive through use or ultimate sale.

There are notable differences between public sector and for-profit entities especially on revenue generating activities, however, public sector issuer entities such Auckland Council aim to prepare financial information for its users with minor differences between the two sets of accounting standards. One of the important users of Auckland Council's financial statements are the investors who also invest in listed for-profit entities. We believe that the difference in lessor accounting as presented in the financial statements of public sector and for-profit entities will deter comparability.

### Constraints on Information

Adopting new accounting standards always entails costs to ensure adherence to the new requirements, that information is properly gathered, and controls and processes are effectively in place.

Auckland Council Group is a lessor in some of our lease contracts and the proposed requirements of ED 64 will impact us. However, as noted above, we don't believe that changing the current requirements for lessors and departing from IFRS 16 gives the council group any benefits in preparing our financial reports. In this instance, we firmly believe that the cost of adopting ED 64's proposed lessor accounting requirements outweighs the benefits since we must ensure that 1) we've properly accounted for "the lease receivable" asset in our financial statements to meet the requirements of ED 64 and 2) we've identified this as a major adjustment to our financial statements for the investors to understand the difference between IPSAS and IFRS. Professional fees such as valuation fees and audit fees are expected to increase due to additional audit considerations.

### Double counting

We firmly believe that there is double counting on the recognition of the underlying asset and lease receivable on the balance sheet for lessors. An underlying asset is recognised in the financial statements of the entity since it is *"probable that the future economic benefits that are associated with the underlying asset will flow to entity and cost is measured reliably"*. The basis of economic benefits for the underlying assets is the lease contracts for which it is now proposed to be recognised as a separate asset on the balance sheet under ED 64.

We believe that the IPSASB has not thoroughly addressed the double counting in the basis of conclusion. We note that this was one of the overwhelming areas of feedback from practitioners when IFRS 16 was being finalised. The current IPSASB literature mentioned under the basis of conclusion, to avoid double counting is applicable to current requirement in the accounting standards which do not recognise another type of asset based on the "right-of-use" model for lessors. The double counting is



## Exposure Draft 64 – Accounting for Leases

not also explicit in IPSAS 17, *Property, Plant and Equipment*, in consideration of fixed assets at revalued amount. Auckland Council Group, for example, has asset classes such as operational land and buildings which are both subject to lease contracts and for Group's use. Auckland Council Group's operational land and buildings is a significant asset class which is carried at revalued amount.

### Transfer of risks and rewards

Classifying a lease as operating or finance for a lessor is sometimes an onerous exercise as it involves significant judgement based on the terms of the lease agreement, however, this practice has been working well for all entities, whether for-profit, public sector or not-for-profit. The current lease accounting standard and IFRS 16 have provided examples of situations/indicators that individually or in combination would suggest a lease be classified as finance lease. These indicators and examples which serve as guidance for classification, are no longer available in ED 64 since the classification requirement is removed. However, if these situations occur, a higher level of judgement is now involved for management to assess if the underlying asset should be derecognised because control over the underlying asset might be lost. We know that lawyers and project managers are often thinking of these kinds of characteristics such as lease term being for the major part of the economic life of the underlying asset, in negotiating and finalising contracts.

We note that under the basis of conclusion on lessor accounting (BC9 c.ii), transactions that transfer control of the assets are considered sales or purchases within the scope of the current standards such as IPSAS 9 and IPSAS 17, which requires derecognition of underlying asset. However, the current guidance of IPSAS 9 and IPSAS 17 for sale of assets does not include lease terms that may suggest loss or transfer of control. We believe that ED 64 does not provide enough guidance if there is indeed loss or transfer of control of the underlying asset when those indicators are individually or collectively evident in the lease contracts.

### Service concession arrangement principle

We note that the IPSASB has considered the principle behind the "grant of a right to the operator model" in IPSAS 32 *Service Concession Arrangements – Grantor* under ED 64 Basis of Conclusion BC40. However, it is difficult to understand that the principle of service concession's "grant of a right to the operator" model is consistent or applicable to the right-of-use model for lessor accounting.

Under the service concession arrangement, if the criteria are met under paragraph 9, the grantor will recognise a service concession asset since the economic substance of the transaction suggests that the grantor is able to control the service and the significant remaining useful life of the asset. Recognition of the service concession asset and unearned income will still result in an increase in the net assets of the grantor. This is due to the service concession asset being depreciated over the useful life of the asset while the unearned income is amortised over the term of the agreement, which is essentially shorter due to the criterion that the grantor gets significant remaining useful life.

Unlike in lease arrangements, the grantor in a service concession arrangement does not normally receive a cash consideration from the use of the asset. The grantor receives the asset or an upgrade to the asset, thus, an accumulated unearned income is recognised at initial recognition. For simplicity, we recognise unearned income as a liability because we receive an asset that is not yet recognised in the balance sheet. Under ED 64 lessor accounting, we would recognise a "lease receivable" asset that is based on a legal contract which has already been considered an economic benefit of an underlying asset recognised on the balance sheet.

Also, under the proposed lessor accounting, the recognition of both lease receivable and the unearned income do not essentially result in an increase in net assets, as these are collected and amortised over the same period of time.



## Exposure Draft 64 – Accounting for Leases

### Recommendation

We propose that the IPSASB retains the operating and finance lease classification for lessor accounting consistent with IFRS 16. While we understand the theoretical arguments for the single right-of-use model for both lessee and lessor, we believe that there are fundamental flaws to the right-of-use model proposed in ED 64. We encourage a collaboration between the standard setting bodies such as the IPSASB and the IASB in addressing issues around the accounting standards which are not specific to public sector to avoid significant differences.

### Specific Matter for Comment 4

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77-BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise revenue in accordance with IPSAS 23 (see paragraphs BC112-BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

### Auckland Council Response:

Although reasonable, we propose that concessionary leases should not be recognised at fair value. This view is largely based on consideration of the cost versus benefit for both preparers and users of the financial statements. The basis of conclusion discussed the importance of accountability to provide useful information in reporting of concessionary leases at fair value, as it shows the cost of the decision to grant the concession. We challenge this view of the IPSASB as we have observed that the decision makers within the council group do not require this information. Their focus is on providing facilities to deliver community services.

For Auckland Council Group, we are accountable to provide value for money to the ratepayers for every dollar of rates and user fees we collect. We believe that spending money to obtain a formal valuation for the thousands of concessionary leases of Auckland Council Group to comply with the proposed accounting standards is not a prudent use of ratepayers' funds and does not represent value for money. In addition, the elected members and the members of the committees are more interested in operating results, net of non-cash transactions, in order for them to make decisions over the prudent use of ratepayers' money.

### Concessionary lease – lessor

We do not agree with the proposed lessor accounting in relation to concessionary leases.

Within the council group, we believe that the ratepayers of Auckland do not want their money to be spent in completing fair value estimates of the concessionary leases to account for non-cash elements of services. As part of the initial evaluation exercise we have done, we've identified in excess one thousand three hundred concessionary leases entered into by Auckland Council and not-for profit entities, to operate from Auckland Council owned properties to provide community services such as pools, leisure, sporting events, etc.

### Concessionary lease – lessee

While we acknowledge the reasonableness of recognising the right-of-use asset at its fair value, we question the significant cost versus benefit particularly for smaller charitable entities. Obtaining the fair value of these concessionary leases that result in grossing up "non-cash" revenue and expenses does not represent value for money use of their sponsors or donors' funds. For those charitable entities supported by Auckland Council Group, we expect they will ask us to do the fair value assessment on their behalf or provide additional funding to them for this exercise. Either way, we will be spending additional ratepayers' money to comply with the required reporting with no improved service delivery benefit.



## Exposure Draft 64 – Accounting for Leases

### Standards that are included in IPSASB's work plan

We also noted issues in the proposed requirement for concessionary leases that are related to the standards that are currently in the IPSASB's work plan:

- 1) Fair value – the biggest issue for the concessionary leases is how to determine the fair value specific in the public sector. Unlike for-profit-entities who already have IFRS 13 *Fair value measurement*, entities in the public sector and not-for-profit currently do not have specific guidance on fair value. Determining fair value in the public sector remains a significant judgement. Specific to Auckland Council, we have an asset class of restricted land and buildings which by virtue of legislation, we are not allowed to sell or dispose. We have a number of concessionary leases in relation to these restricted assets and since these assets are restricted and are to be used to provide public service, the lease payments are always expected to be below market rates.

There are also significant number of lease arrangements between public sector entities at "peppercorn" consideration (nil or a dollar). We may conclude that the fair value of the lease arrangement is indeed a dollar or nil in the absence of specific guidance covering this kind of consideration.

- 2) Non-exchange revenue – during the last quarter of 2017, the IPSASB completed its consultation on Accounting for Revenue and Non-exchange Expenses. The current IPSASB literature does not include guidance on concessionary leases and yet ED64 has included a reference to IPSAS 23 for the accounting of the non-exchange component of concessionary leases. With this proposed requirement, management has to apply significant judgement in applying IPSAS 23, while noting that the standard is likely to change as a result of the consultation recently completed by the IPSASB. We suggest that the IPSASB consider including specific guidance on concessionary leases in the upcoming revenue standard.
- 3) Non-exchange expenses – as noted in above non-exchange revenue, we also note that the proposed requirements of ED64 refers to non-exchange component of expenses in a concessionary lease for lessors. We understand that the IPSASB has been working on accounting for non-exchange expenses for quite some time, thus, we recommend that the accounting for non-exchange expenses be finalised first ahead of guidance on concessionary leases.

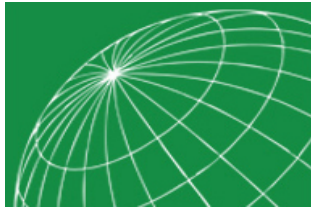
### Recommendation

We agree that it is necessary for the IPSASB to issue a new lease standard based on IFRS 16. We believe that it is relevant in New Zealand to use public benefit entity (PBE) standards with minimal differences when compared to IFRS, especially for mixed groups. Auckland Council Group is a mixed group and has the same responsibilities as listed for-profit entities to provide financial information to New Zealand and international stock exchanges.

We recommend completion of guidance on non-exchange expenses ahead of finalising a guidance on concessionary leases.

We also encourage the IPSASB to cover the specific issues on concessionary leases especially in relation to determining fair value relevant to public sector entities, when finalising the standards on public sector measurement and the accounting for revenue and non-exchange expenses.

Specific to concessionary leases, we believe that to inform the users of the financial statements, it is reasonable to provide appropriate note disclosure of the entity's concessionary leases, including "peppercorn" and nil value leases.



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June 25, 2018

The Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West, 6th Floor  
Toronto, Ontario M5V 3H2  
CANADA

Dear Sir

1. The International Consortium on Governmental Financial Management (ICGFM) welcomes the opportunity to respond to Exposure Draft 64 "Leases" issued January 2018.
2. We appreciate the opportunity to comment on this Exposure Draft and would be pleased to discuss this letter with you at your convenience. If you have questions concerning this letter, please contact Michael Parry at [Michael.parry@michaelparry.com](mailto:Michael.parry@michaelparry.com) or on +44 7525 763381.

Yours faithfully,

**Michael Parry**

Chair, ICGFM Accounting Standards Committee

**Members**

Michael Parry, Chair

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Jesse Hughes

Mark Silins

Nino Tchelishvili

Paul Waiswa

Cc: Jim Wright, President, ICGFM

# **International Consortium on Government Financial Management (ICGFM)**

## **Response to Exposure Draft 64 “Leases”**

### **Issued January 2018**

#### **Overview**

The proposed “right of use” approach to leases is both elegant and simple. The application of the right of use model to both lessor and lessee ensures symmetry between entities under common control. The right of use model removes the requirement to determine whether the lease is an operating or a financial lease by creating a right of use asset which separates the right of use from the underlying asset. The model also enables a logical solution to concessionary leases that enhances transparency.

Although as a general principle ICGFM advocates convergence with GFS, in this instance the right-of-use model is clearly superior to the GFS approach and it is the latter that should change.

However, the elegance of the solution is undermined by the fact that it is not universally applied:

- IMF (Government Finance Statistics (GFS) Manual 2014 continues to treat leases differently according to whether they are financial or operating
- Commercial public sector entities (public corporations) will report in accordance with IFRS 16, which has a different accounting treatment for lessors.
- Service concession arrangements (otherwise known as Public Private Partnerships (PPPs) or Public Finance Initiatives (PFIs)) often share many of the characteristics of leases, yet a different accounting treatment is applied under IPSAS 32.

These differences can potentially lead to complications in preparing financial reports:

- GFS and IPSAS reports on government - a decision will have to be made whether to base the valuations in the accounting system on the ED64 or GFS model. Assuming the accounting system is based on the ED64 requirements, sufficient information will then have to be recorded (e.g. continuing to have separate classification codes for finance and operating leases) to enable GFS reports to be prepared. The consequent IPSAS and GFS reports will show different values for assets and liabilities, reducing the credibility of both types of financial reports.
- When preparing whole of government accounts, it may be that a commercial public sector entity to be consolidated is a lessor to other public sector entities. The commercial public sector entity will report in accordance with IFRS 16. In consequence there will be asymmetry between the entities and balances that will not cancel out on consolidation.
- Assets acquired or provided under service concession arrangement (IPSAS 32) have many of the characteristics of leased assets, but will be treated differently to assets acquired or provided under leases.

For the reasons indicated above, the ICGFM also considers the right of use model should be considered for incorporation within an amended IPSAS 32. This would result in a consistent approach across different operational and funding models, and would minimise opportunities for “gaming” different valuation models.

## Specific matters for comment

Matter for comment	Response
<p><b>Specific Matter for Comment 1:</b></p> <p>The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6– BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions</p>	<p>We agree with the use of this model though we are concerned about the impact of different models for GFS and IPSAS and between different IPSAS (see comments above)</p>
<p><b>Specific Matter for Comment 2:</b></p> <p>The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.</p>	<p>We agree with the departure as it provides symmetry between lessors and lessees under common control. However, again we are concerned about the impact of having entities within common control using different standards and valuation models (see comments above)</p>
<p><b>Specific Matter for Comment 3:</b></p> <p>The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34– BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?</p>	<p>We agree with the single right of use model, subject to the comments above</p>

Matter for comment	Response
<p><b>Specific Matter for Comment 4:</b></p> <p>For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?</p>	<p>We agree with the approach in the ED. The proposed approach is logical and provides transparency</p>





Paris, July 3, 2018

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**Re: Response to Exposure Draft 64 *Leases***

Dear Mr Stanford,

The French Public Sector Accounting Standards Council (CNoCP) welcomes the opportunity to comment on the Exposure Draft 64 *Leases* published in January 2018 (ED64).

The CNoCP welcomes the efforts put in developing the proposals, essentially in ensuring the consistency between lessor and lessee accounting treatments, as well as in dealing with concessionary leases that are specific to the public sector.

The CNoCP understands the need to explore convergence with the principles set out for the private sector on leases. Because IFRS 16 was commented upon extensively as part of the IASB's process, we do not comment upon the merits or drawbacks of its application. However, we note that IFRS 16 is effective as of 1 January 2019 in the private sector; hence as of now, even if some entities chose to early adopt the new standard, no thorough feedback exists on its application. This makes it difficult to assess the impact and efficiency of its adaptation to the public sector.

In addition, we question the usefulness of a complex accounting solution. We are concerned that the cost of implementing the proposed accounting treatment might outweigh the benefits.

Therefore, we would appreciate if the Board could consider exempting public sector entities from applying the accounting requirements of the future standard for leases between entities from the public sector. The standard would then only apply mandatorily to lease arrangements between private and public entities.

For lessor accounting, we understand the objective of consistency between lessor and lessee accounting, but we would encourage the IPSAS *Board* to perform a thorough cost-benefit analysis as this section is specific to the public sector (IFRS 16 retains IAS 17 accounting requirements for the lessor). Moreover, we would recommend that the IPSAS *Board* should underline that arrangements that transfer control of the underlying asset are out of scope in the future standard, and not only in the Basis for Conclusions. Additional guidance on when arrangements transfer control would also be welcome.

Given the volume of issues that could possibly arise, we would recommend that the *Board* should carry out an effect analysis with a view to envisage all consequences of the proposed approach.

With respect to concessionary leases, we would like to call the Board's attention to a risk of inconsistency in the accounting treatments of transactions that might be in substance similar, only because they are covered by different standards.

Responses to the detailed questions set out in ED64 are presented in the following appendix.

Yours sincerely,

Michel Prada

## APPENDIX

### *Specific Matter for Comment 1 (SMC 1)*

*The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting. Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

From a conceptual perspective and a convergence standpoint, we understand the IPSASB's decision to adopt the IFRS 16 right-of-use model for lessee accounting. Conceptually, it seems sound to recognise the right to use an underlying asset distinctly from that asset as long as that right of use meets the definition of an identifiable asset (i.e. separable or arising from contractual or other legal rights). Similarly, recognising the corresponding liability, that is essential from the point of debt measurement, is in line with the IPSASB Conceptual framework.

From a practical viewpoint however, we believe that applying the proposed requirements to lease arrangements between public sector entities would entail costs that would outweigh the benefits of providing high quality financial information:

- IFRS 16 is effective as of 1<sup>st</sup> January 2019 and most entities in the private sector have not yet fully implemented the new requirements. This means that many application issues may surface in the coming years. Our understanding is that the application of IFRS 16 requires reviewing all contracts that may include a lease agreement and, as a first step, assessing them against the new definition of a lease. Adopting IFRS 16 is therefore highly demanding in terms of resources for certain entities and may require the development of new IT systems, processes and controls. This often proves challenging in the private sector, and would be even more challenging and burdensome for the public sector. With respect to the accounting treatment, determining the lease term, the discount rate and the relevant disclosures is of significant concern to our constituents.
- We also note that some constituents are concerned that additional liabilities in public sector entities' financial statements may impact reporting under national systems of accounts and may affect for instance the scope of the public debt.
- Another concern revolves around the effect of the new model on liability recognition: entering into lease agreements for entities that are restrained from borrowing would generate additional liabilities.

For the reasons above, we would appreciate if the Board could consider exempting public sector entities from applying the proposed accounting requirements for leases between entities of the public sector. The standard would then only apply mandatorily to lease arrangements between private and public entities. We believe that such an exemption would fit the cost-benefit constraint, while respecting an appropriate balance among the qualitative characteristics.

In addition, we are of the opinion that the future standard should discuss the recognition of a right-of-use asset in those cases where the underlying asset is not recognised. Such issues might arise from public sector arrangements that grant a right-of-use of the public domain.

Given the volume of issues that could possibly arise, we would recommend that the *Board* should carry out an effect analysis with a view to envisage all consequences of the proposed approach.

### ***Specific Matter for Comment 2***

*The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft. Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

We agree that the “risks and rewards” approach should no longer be retained to assess recognition of assets in the accounts of reporting entities party to a transaction. The definition of an asset in the Conceptual Framework makes it clear that control, as the power to direct the use of the asset, is the key factor to consider, while the risks and rewards of ownership is not of itself an indicator of the party that controls the asset.

We observe that the notion of control is well understood amongst our constituents when applied to property, plant and equipment or well-identified intangible assets. However, we note that it appears to be more difficult to apply in practice to a right-of-use, mainly because the asset seems to them to be recognised twice. We note that BC9(c)(ii) mentions that a lease conveys the right to use an underlying asset for a period of time and does not transfer control of the underlying asset. We would strongly recommend that the scope of the future standard should clearly state that where the arrangement leads in substance to transferring control of the underlying asset to another party it does not meet the definition of a lease; in other words, such arrangement should be out of the scope of this standard. Additional guidance on when arrangements transfer control would also be welcome.

Additionally, because the new lessor's model is a significant change from previous IPSAS requirements, we would recommend that further disclosures should be required in the financial statements to explain that lease arrangements in the scope of the future standard give rise to a right-of-use that meets the definition of an asset. Such additional disclosure could be only temporary, required during a transition period, and would state that the lease arrangement is considered a separate economic phenomenon from the underlying asset. We believe that this explanation would be in the public interest.

### ***Specific Matter for Comment 3***

*The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting. Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, please explain the reasons. If not, what changes would you make to those requirements?*

We acknowledge that a single model for lessors and lessees would ease communication: it is simpler than having to explain why a different accounting treatment should be retained, depending on whether the lease arrangement is analysed from the perspective of the lessor or of the lessee. Additionally, we firmly believe that, conceptually, the notion of control applies to the asset as a whole and that an accounting solution for the lessor that would have the asset partitioned would only raise complex implementation and measurement issues.

However, as for lessee accounting, in instances where lease arrangements are between public sector entities, we would question the need to introduce a complex accounting solution. In those cases, we would advocate that usefulness of information and the cost/benefit constraint should call for an exemption.

### ***Specific Matter for Comment 4***

*For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with the concessionary loans. For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise revenue in accordance with IPSAS 23. Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

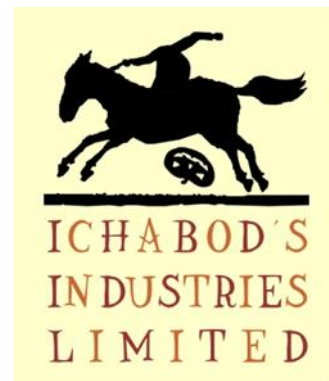
While we have sympathy for retaining an accounting treatment for concessionary leases that is consistent with that of concessionary loans, we would like to express reservations especially as

to the distinction between leases with below market term and zero consideration leases, the latter being excluded from the definition of a lease.

First of all, the accounting treatment for the non-exchange component would have to be consistent with the accounting treatment set out for non-exchange revenue and expenses. We note that the IPSASB is currently discussing the issue under the in-process revenue and non-exchange transactions project. As a matter of fact, issuing accounting requirements for the concessionary leases transactions might have repercussions on Board's decisions on a much wider area of transactions, for instance transactions such as universally accessible services.

Another difficulty we see is that in some instances in the public sector, fair valuing the liability as at the commencement date is impossible. This might be for instance because the underlying asset is a heritage asset or because it is so specific that there is no market lease payment available.

Lastly, we observe that, in the public sector, agreements that create enforceable rights and obligations and more specifically that convey a right to use an asset may take several forms. While ED64 addresses the issue of concessionary leases, we believe that there are many other forms of agreements specific to the public sector. To name a few, transfers of mission and competence and the use of the public domain may be considered similar to leases by our constituents, especially in that they contain an element of financing. We are concerned that leaving those topics aside may lead to different accounting treatments for similar transactions. We would therefore suggest that those other topics should be added to the IPSASB's agenda to ensure consistency.



## **Exposure Draft 64 - Leases**

### **Comments of Ichabod's Industries on the Consultation Paper**

Ichabod's Industries is an accountancy consulting firm that provides technical accounting support to a number of local government bodies in the United Kingdom. We have also been commissioned on a regular basis to draft guidance for the Chartered Institute of Public Finance and Accountancy, most recently on the application of IFRS 9 *Financial Instruments* and the Group Accounts standards by UK local authorities.

UK local authorities have not generally applied IPSASs, but a consultation on lease accounting has been opened by the relevant standard setter (the CIPFA/LASAAC Local Authority Accounting Code Board) which informs consultees about the IPSASB proposals for the lessor accounting model and asks for views.

We wish to contribute particularly to discussion on **Specific Matter for Comment 3**.

We are not convinced that the proposed right-of-use model is consistent with the IPSASB Conceptual Framework and properly reflects the substance of a lease transaction.

This arises fundamentally from our disagreement with the assertions in paragraph BC35 that the right-of-use asset is either a separate economic phenomena from the underlying asset or that it is a component of the underlying asset. In our view, the underlying asset is not intended by IFRS 16 to be an accounting concept but a descriptor of the physical item(s) that are the subject of the lease.

In this sense, the underlying asset is not something per se to be accounted for but a focus for the assessment of the resource represented by the leased property and how control is exercised over that property.

Applying the criteria for control in paragraph 5.12 of the Conceptual Framework, our view is that:

- the lessor retains legal ownership of the underlying asset
- the lessee acquires access to the resource represented by the underlying asset (or the ability to deny or restrict access to the resource) in its entirety on entry into the lease
- the lessee acquires the means to ensure that the resource is used to achieve its objectives
- the lessee has an enforceable right to service potential or the ability to generate economic benefits arising from the resource.



On the basis of past events, the lessor effectively transfers control of the entirety of the resource to the lessee, certainly in terms of the underlying asset. The lessee then determines through its use or misuse of the property whether it will be returned to the lessor in the expected state at the end of the lease. It is only the future event of the successful completion of the lease term that will actually return the underlying asset to the control of the lessor.

This can be seen with the example of a vehicle lease:

- at the commencement of the lease, the lessor hands over the keys and loses access to the vehicle
- the lessee then has access to the vehicle, the usage of which could lead to it being unable to deliver the identified vehicle back to the lessor at the end of the lease term – for example, it could be stolen or damaged beyond repair
- in these circumstances, it would be inappropriate for the lessor to account for the underlying vehicle asset as its Property, Plant and Equipment until control of the identified vehicle is returned to it at the end of the lease term and a past event then confirms the lessor's access

The appropriate model would then follow the existing lessor principles for finance leases in IFRS 16:

- on entry into the lease, the lessor derecognises the Property, Plant and Equipment asset in its entirety
- in its place, the lessor recognises its investment in the lease as an asset – the payments that the lessee will make for the right to use the vehicle, plus the value the lessee will return to the lessor at the end of the lease term (in the form of either the identified vehicle, a replacement vehicle and/or some other form of consideration to cover the lessee's inability to return the identified vehicle in the contracted state)
- the lessor recognises no liability, as it has satisfied its obligation to transfer the right-of-use asset when it put the vehicle into the physical care of the lessee
- at the end of the lease term, the lessor's investment is settled by the re-acquisition of a newly recognised Property, Plant and Equipment asset (or compensatory income)

This approach would more fairly represent the substance of the leasing transaction because:

- It does not require the lessor to assert during the lease term that it has a Property, Plant and Equipment asset that is available for use in the provision of goods and services at the end of each reporting period – its control over a PP+E asset will only be confirmed by the future event of the successful conclusion of the lease term.

The difficulties of continuing to carry a PP+E asset will be shown if the entity applies a revaluation model to its PP+E balances (as entities in the UK are required to do). To be consistent with the treatment in Approach 1, the valuation would presumably be based on the underlying asset in its entirety, ie, ignoring the fact that the property has been leased out on terms which might not currently reflect the fair value. To do otherwise would be to acknowledge that the underlying asset and the right-of-use asset are not separate economic phenomena.

- The lessor will not be accounting for a liability for an obligation that it is asserting it has yet to meet. It is difficult to see how the logic for setting up a lease receivable and recognition of a liability for unearned income would particularly for a contract for the supply of goods or services in return for specified periodic payments. The entity would have committed to transfer economic benefits to the receiver over the life of the contract in return for payment. Consistency with Approach 1 would require an asset and a liability to be recognised on entry into the contract, rather than as performance obligations arise and are met.

In summary, we consider that the role of the underlying asset is overplayed in the Exposure Draft and that a more appropriate lessor model would reflect that a lease passes control of the underlying property item to the lessee until such time as the future event of the termination of the lease confirms (or otherwise) the reacquisition of control over the identified underlying property.

A viable lessor model consistent with the Conceptual Framework would therefore be possible by extending the finance lease lessor model in IFRS 16 to operating leases.

**Stephen Sheen (Managing Director)**  
**25 June 2018**

John Stanford  
Technical Director  
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Lausanne, June 25, 2018

## Swiss Comment to

## Exposure Draft 64 Leases

Dear John,

With reference to the request for comments on the proposed Consultation Paper, we are pleased to present the Swiss Comments to Exposure Draft 64 Leases. We thank you for giving us the opportunity to put forward our views and suggestions. You will find our comments for the Consultation Paper in the attached document.

Should you have any questions, please do not hesitate to contact us.

Yours sincerely,

SRS-CSPCP



Prof Nils Soguel, President



Evelyn Munier, Secretary

Swiss Comment to Exposure Draft 64 Leases

**Swiss Comment to**

**Exposure Draft 64 Leases**

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## 1. Introduction

The Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP) was established in 2008 by the Swiss Federal Ministry of Finance together with the cantonal Ministers of Finance. One of its aims is to provide the IPSAS Board with a consolidated statement for all three Swiss levels of government (municipalities, cantons and Confederation).

The SRS-CSPCP has discussed the ED 64 Leases and comments as follows.

## 2. General Remarks

The SRS-CSPCP notes that in the proposed ED the symmetry between lessor and lessee in respect of booking is given. This symmetry is very important for consolidation purposes and also for financial statistics.

However, leasing agreements are already very difficult to reflect technically. This ED makes everything even more complicated. The SRS-CSPCP wonders why long-term rental agreements are to be treated differently from long-term insurance contracts (*executory contracts*). Liabilities under long term insurance contracts are not reflected in the statement of financial position sheet. In the Notes also there is no reference to these contracts. Furthermore, the SRS-CSPCP wonders whether the model for the lessor is suitable for long-term rental of land contracts (e.g. a leasehold agreement covering 70 years). Under certain circumstances two identical assets are reflected in the lessor (Property and Receivable from right of use). The SRS-CSPCP wonders whether this presentation is *true and fair* and serves as a better basis for decisions.

The SRS-CSPCP criticizes capitalization of the right of use: does one have the right to sell it? The SRS-CSPCP wonders what additional benefit the new model brings the public sector compared with the present model under IPSAS 13. It is of the opinion that the capitalization of all rental contracts as Rights-of-Use (RoU) achieves no additional benefit. Rather it unnecessarily blows up the statement of financial position. For example, in public entities with centralized property management, where all government units are tenants. Depending on the choice of accounts (stand-alone or consolidated accounts and calculation basis for key figures) a different picture is given, which is hardly comprehensible for the stakeholder.

In the statement of financial performance, instead of rental costs, amortization of the RoU and interest would be recorded. The informative value of the statement of financial performance is thereby diminished. The budget debate would also be made more difficult, because in public authorities it is carried out from a cash aspect. The fact that no cash flow is associated with traditional amortization, but that with the amortization of the RoU there is indirectly no cash outflow in the form of leasing instalments, would require explanation.

The proposed leasing model creates very high costs in the public sector, while compared with the present model the benefit is questionable. The *Conceptual Framework* talks of a favorable cost-benefit ratio. This is not considered in this proposal by the IPSASB.

The SRS-CSPCP would like the SRS-CSPCP to find a solution, which is more practical and less complicated.

## 3. Specific Matter for Comment 1

*The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

The SRS-CSPCP is not in agreement with the decision of the IPSASB. The reasons are the following:

- 1) This model is simpler in the use of rental contracts by decentralized properties (Australia, New Zealand). In the Swiss public sector, and also in other countries properties are in part managed centrally.
- 2) For the state from an operational standpoint it is important to know the individual types of cost (e.g. rental or occupation costs). In Switzerland this is very clear, when in the budget debate the various types of cost are analyzed. In the private sector on the other hand, frequently only the final result counts and therefore only the profit distribution. If now in the public sector amortization (of the RoU) is recorded instead of rental costs, the statement of financial performance loses informative value.
- 3) The SRS-CSPCP is of the opinion that the focus of the proposed model is concentrated too heavily on the statement of financial position. However, in the public sector the statement of financial performance is the central control instrument.
- 4) If the introduction of this model is too complicated and costly, there is a risk that the governments will try to deviate from this standard in some way or other or not to adopt it. It could possibly become another obstacle to adopting IPSAS accounting.
- 5) In small government units application difficulties have already been discovered; it can therefore be assumed that larger units will have to reckon with even greater difficulties in the implementation.
- 6) The current IPSAS 13 discloses the liability from operating leases in the Notes of the lessee. In the new standard this is no longer possible for most leasing liabilities. It is hardly comprehensible that in addition in the new standard the liability on unrealized income in the lessor must be carried among the liabilities in the statement of financial position.
- 7) The RoU model can result in valuation problems. For example, determination of the duration of the right of use can become a challenge, if grant of the rental contract is governed only by law. The accountant in the lessee and the accountant in the lessor must make estimates, which politically is extremely delicate. The power of decision lies with the legislator, i.e. the Parliament. Estimates are conceivable between one year (budget year, approval of expenditure), four years (legislative period) and 150 years (prior duration of use). Clear guidance would be necessary in the standard as a decision-making aid.

#### **4. Specific Matter for Comment 2**

*The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

As the SRS-CSPCP believes that symmetry between the recording in the lessor and the lessee is essential, it is in agreement with this decision. A synchronous accounting for such agreements in the lessor and the lessee is absolutely compulsory in the public sector, because different definitions for the same facts would not be comprehensible to the stakeholder. In the lessee and the lessor it is the same economic transaction and it should be reflected accordingly (purchase/sale or transfer of benefits and risks).

A combination of both alternatives, as implemented in IFRS 16, is rejected.

The SRS-CSPCP is not in agreement with the double recording of the assets in the lessor (once as an asset made available to the lessee (*underlying asset*) and once as receivable from sale of the right of use (*right to receive lease payments*)).

**5. Specific Matter for Comment 3**

*The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

The SRS-CSPCP regards the symmetry between recording in the lessor and lessee and the systematic classification of leasing agreements as essential.

However, the SRS-CSPCP rejects the present proposal of the IPSASB, because the lessor must report the asset twice in the statement of financial position. It is of the opinion that this does not represent the best implementation of the symmetric model. First it is reported as an asset made available to the lessee (*underlying asset*) and then as a receivable from the sale of the right of use (*right to receive lease payments*). In addition, the lessor carries in the liabilities a leasing liability (unrealized income). The SRS-CSPCP does not support that the lessor twice reports the same asset in the statement of financial position and thereby blows up its statement of financial position. The SRS-CSPCP wishes a review of this symmetric approach in the lessor, so that the expansion of the total of the statement of financial position (total assets) can be avoided. In addition, the carrying of the leasing liability (non-realized income) should be critically examined. As long as a convincing model for the lessor cannot be found, the present ISAS 13 should be retained, as it constitutes a proven symmetric model.

**6. Specific Matter for Comment 4**

*For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

The SRS-CSPCP welcomes that the existing gap in the treatment of such contracts on non-market terms in the accounts is to be closed. The SRS-CSPCP is of the opinion that *concessionary loans* and *concessionary leases* should be accorded equal treatment. In earlier consultations (e.g. *CP Revenue and non exchange expenses*) the SRS-CSPCP had already pointed out that the income and expense sides should be treated equally. A Day-one effect in the expenses with *conditions* is rejected. Possibly it is also a question under the topic "*Time Requirements*" that must be answered with new standards on "*Revenue and non exchange expenses*". We recommend close coordination in the projects. In this case too it is important that the recording is symmetrical between lessor and lessee.

Lausanne, June 11, 2018



# ***Proposed International Public Sector Accounting Standard***

## **“Leases”**

### **REQUEST FOR COMMENTS**

#### **Task force IRSPM A&A SIG, CIGAR Network, EGPA PSG XII**

*June 22, 2018*

The objective of the Exposure Draft is to develop a proposal for lease accounting, including both lessees and lessors, with the aim to provide relevant information in a manner that faithfully represents leasing transactions. The information included in the financial statements should be useful for users to assess the effect that leases have on the financial position, financial performance and cash flows of an entity for accountability and decision-making purposes

The Exposure Draft contains some questions in its REQUEST FOR COMMENTS. The responses prepared by the Task Force IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are presented hereafter.

The IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are three research networks that focus on Public Sector Accounting. The Task Force is made up of 16 researchers from these networks. The responses being presented are based on an analysis of the Consultation Paper, the IPSASB Conceptual Framework, relevant IPSAS, and various published research papers on the subject. Following various meetings and discussions, the members of the Task Force have reached the following common conclusions and suggestions.

The views expressed in this document represent those of the members of the Task Force and not those of the whole research community represented by the networks, nor the Institutions/Universities with which they are affiliated.

#### **Core assumptions**

*We are of the opinion that, in general, public sector entities require public sector specific principles and standards that properly accommodate public sector specificities. As such, when public sector transactions resemble those taking place in the private sector, then principles and standards may be kept as aligned as possible. However, for public-sector-specific transactions, we are in favour of standards that are not confined to those of the private sector, and we think there is a need to seek options that best fit the public sector. This core thesis underpins our proposals and recommendations herein.*

*In our view, when the public sector deals with leasing contracts with an economic objective the proposed IPSAS is generally acceptable. In those cases where public sector characteristics play a role, such as when lease payments are explicitly very low in comparison to the economic value of the right-of-use, then the proposed IPSAS disregards the public interest, social and cultural goals, and related governmental initiatives. We believe that the financial effects of such social objectives should be reported clearly and should be made transparent to the*

*stakeholders off-balance sheet.*

**Specific Matter for Comment 1:**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

**Comment**

We agree that the right-of-use asset satisfies the definition of, and recognition criteria for, an asset in the IPSASB’s Conceptual Framework.

The consideration of all leases as finance leases would result in the balance sheets of public administrations showing increased assets and liabilities. In the public sector, the control of debt and other liabilities are important issues. In this respect, the change to the proposed treatment will have an important effect. Nevertheless, it must be taken into account that public administrations often have many leases, and the application of the new requirements could sometimes prove difficult due to the lack of information on individual lease-type arrangements.<sup>1</sup> We would also highlight that the European System of Accounts 2010 (ESA10) retains the distinction between finance and operating leases, so that a difference between national accounting and financial reporting in the treatment of leasing transactions will be created. It would be useful to disclose the nature and extent of these differences in notes to the financial statements.

**Specific Matter for Comment 2:**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

**Comment:**

We agree

The risks and rewards model in IFRS 16 is an indirect approach to determine who controls the asset. According to the IPSASB conceptual framework, control of the asset should determine its recognition by the lessor, as well as by the lessee. In public administrations, it is very rare for the lessor to lose control of the underlying assets, so we consider the proposed treatment adequate.

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<sup>1</sup> This was evidenced, for example, in the paper from the UK Treasury to the Financial Reporting Advisory Board (2017), entitled “IFRS 16 Leases-Progress update and feedback from the initial impact assessment”.

**Specific Matter for Comment 3:**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

**Comment:**

We agree. We stated earlier, it is unusual for public administrations to lose control of the assets and therefore, the lessor should maintain the asset on its balance sheet. Furthermore, this model presents a coherent treatment for both lessee and lessor accounting.

**Specific Matter for Comment 4:**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

**Comment:**

We do not agree.

According to the IPSASB, a concessionary lease is an example of a financial arrangement, and should be recorded and reported as such by both the lessee and the lessor. In the concessionary situation, the contracted value of the right-of-use does not fit the market terms (often the payments are much lower than the market terms), so that the IPSASB proposed standard requires the recognition of non-earned amounts.

We believe that, in the public sector, the economic criteria and the fair value are not necessarily the main factors to determine about the recognition of transactions. A leasing contract with concessionary characteristics cannot be considered a pure financial arrangement because the reconstitution of all the amounts paid does not fit to the economic values of the rights-of-use. In profit-oriented enterprises, such a concessionary situation (perhaps between related parties) would indeed imply the expression of unearned amounts because enterprises think economically/financially; but in governments there are many other reasons why lease-type arrangements might not be based upon market values. For example, governments might enter a lease contract on concessionary terms to support common social or cultural goals of governmental organisations. In our view, concessionary leasing under these characteristics should not have balance sheet consequences, but only impact the statement of financial performance with additional disclosures describing the details of the concession in the notes to the financial statements.

A lease for zero or nominal consideration is a non-exchange transaction that could be considered as services in-kind. The services in-kind themselves are free and should not be accounted for in the general ledger. We believe that the quantification of the market value of

the right-of-use asset would add much subjectivity to the balance sheet. Services in-kind should still be reported: they can have important consequences and should be documented, explained and disclosed off-balance sheet.

The treatment of concessionary leases in the proposed IPSAS might, nevertheless, be maintained where the lease has initially been contracted using economic reasoning but then the conditions change and the lease is adjusted to concessionary terms. For example, the terms of a “normal” leasing contract that has been made with a value corresponding to market prices between a central government (lessor) and a local government (lessee) might be adjusted if the local government undergoes serious financial difficulties so that the central government agrees to a partial remission of the debt by adapting the original contract. In this case, the concessionary lease includes a non-exchange transaction that could be considered as a capital grant received or transferred, which leads to the following reasoning:

- (i) With respect to the lessor, we agree with the recognition of the subsidy granted to the lessee as an immediate expense, assuming that there are no further obligating events, and that there is a market value for the lease that can be identified so that the value of the concession can be measured reliably.
- (ii) With respect to the lessee, the recognition and measurement of a concessionary lease should consider the non-exchange revenue as a capital grant at the initial point of recognition (corresponding to the day-one expense of the lessor). The remaining liability should be measured at the present value of the future lease payments, discounted using the interest rate implicit in the lease, if that rate can be readily determined.

## **OTHER COMENTS**

### ***Scope***

#### ***Paragraph 3 and 4***

The proposed standard is not applicable to rights held by a lessee under licensing agreements within the scope of *IPSAS 31, Intangible Assets*, for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

A lessee may, but is not required to, apply this [draft] Standard to leases of intangible assets other than those described in paragraph 3

#### ***Comment:***

*The elimination of just some examples introduces uncertainty about the applicability of the standard. Due to the special characteristics of intangible assets, a specific section of the standard should deal with the leasing of intangibles.*

**Date: 22 June 2018**

**Signed:**

Aggestam Pontopiddan	Caroline	Associate Professor of Accounting	Copenhagen Business School
Anessi Pessina	Eugenio	Professor of Public Management	Università Cattolica del Sacro Cuore, Milan, Italy
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Bisogno	Marco	Associate Professor of Accounting	University of Salerno, Italy
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Caperchione	Eugenio	Professor of Public Management	Department of Economics "Marco Biagi", Modena and Reggio Emilia University, Italy
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Jorge	Susana	Assistant Professor with accreditation	Faculty of Economics, University of Coimbra, Portugal
Manes Rossi	Francesca	Associate Professor of Accounting, CPA, co-chair of EGPA PSGXII	University of Salerno, Italy
Reichard	Christoph	Professor Emeritus of Public Management	University of Postdam, Germany
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26 June 2018

Mr Ian Carruthers  
Chairman  
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Dear Ian

**Exposure Draft 64 - Leases**

CPA Australia represents the diverse interests of more than 163,000 members working in 125 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia supports IPSASB's standard-setting initiatives that seek to align, to the extent possible, International Public Sector Accounting Standards (IPSAS) with International Financial Reporting Standards (IFRS). Some of our high-level observations are provided below, with additional comments in response to the questions posed in the Consultation included in the **Attachment**.

We support the proposals to adopt the IFRS 16 right-of-use model for lessee accounting. However, for the reasons stated in the **Attachment** to this letter, we do not support the proposals to depart from the IFRS 16 model for lessor accounting. Our comments on the proposals on the accounting for concessionary leases are included in the **Attachment** to this letter.

If you require further information on our views expressed in this submission, please contact Ram Subramanian, Policy Adviser – Reporting, on +61 3 9606 9755 or at [ram.subramanian@cpaaustralia.com.au](mailto:ram.subramanian@cpaaustralia.com.au).

Yours sincerely

A handwritten signature in dark ink, appearing to read 'Paul Drum'.

Paul Drum FCPA  
Head of Policy

**Specific Matter for Comment 1**

**The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6– BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We agree with the proposals.

**Specific Matter for Comment 2**

**The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We do not agree with the proposals, and reasons for our disagreement include:

- The IASB conducted extensive consultation in developing IFRS 16, including the decision to leave lessor accounting largely unchanged from the previous standard, IAS 17 *Leases*. Reasons for this included a lack of evidence to indicate that user information needs required changes to existing lessor accounting under IAS 17. We do not believe user information needs in the public sector will significantly differ from those in the private sector.
- Misalignment with IFRS will cause additional and unnecessary complexity in jurisdictions that adopt IFRS for the private sector and IPSAS for the public sector. This will include complexities within mixed groups that include public sector and private sector entities, and further contribute to an increasing trend of non-transferable accounting skills between the private and public sectors.
- In the case of a lease that effectively transfers the entire economic benefits arising from a leased asset to a lessee (currently a finance lease), the lessor has, in substance, sold the asset to the lessee. We do not believe it is appropriate for the lessor to continue to recognise an underlying asset in such circumstances.
- In some cases, particularly where the underlying assets are carried at fair value, a double counting of assets can arise. The underlying asset can be revalued by reference to future cash-flows. Under the proposals, the same future cash-flows will also be recognised as a lease receivable.
- We acknowledge that the “risks and rewards” model for current lessor accounting is inconsistent with the “control” model in the IPSASB Conceptual Framework. Equally however, as acknowledged in paragraph BC53, the recognition of a liability (unearned revenue) under the proposals is also inconsistent with the IPSASB Conceptual Framework definition of a liability.

**Specific Matter for Comment 3**

**The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

As stated in response to SMC 2, we do not support the lessor accounting proposals in the ED.



#### **Specific Matter for Comment 4**

**For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

Since we do not support the proposals for lessor accounting in the ED, we also do not support the proposals for concessionary lease accounting by the lessor.

In principle, we support the proposals in the ED for concessionary lease accounting by the lessee. However, we do not consider it appropriate to exclude zero or nominal value leases from the scope of the proposed standard. In Australia, in accordance with AASB 1058 *Income of Not-for-profit Entities* (effective from 1 January 2019), the accounting requirements for all leases that have “significantly below-market terms and conditions” will be similar to the accounting proposed for concessionary leases in the ED. We believe this is a cost-effective approach as it does not require entities to differentiate below-market value leases from zero or nominal value leases. We suggest the IPSASB considers the approach adopted in AASB 1058 for the accounting for concessionary leases by lessees.



**The Japanese Institute of  
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June 27, 2018

Mr. John Stanford  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto, Ontario, Canada M5V 3H2

**Comments on Exposure Draft 64 “Leases”**

Dear Mr. Stanford,

The Japanese Institute of Certified Public Accountants (hereafter “JICPA”) highly respects the International Public Sector Accounting Standards Board (hereafter “IPSASB”) for its continuous effort to serve the public interest. We are also pleased to comment on the Exposure Draft 64 “Leases” (hereafter “ED”). Our comments to ED 64 are as follows.

We agree with the proposal of the ED’s regarding lessee accounting. On the other hand, we believe some improvement is needed regarding the accounting and proposal of the right-of-use model for lessor accounting as well.

The ED proposes for lessor accounting that at the commencement date, the lease receivables be recognized as an asset and unearned revenue as a liability, and that recognition of the underlying asset be continued. We are afraid that unearned revenue does not meet the definition of liability of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (hereinafter, the “IPSASB Conceptual Framework”). We also believe that the underlying asset should be derecognized because it causes a double-counting of assets (lease receivable and the underlying asset). Further, the proposed lessor accounting departs from IFRS 16 “Leases” (hereinafter “IFRS 16”) but we don’t think any reason for the public sector to justify such departure. For our more detailed opinion, please read below.

**Specific Matter for Comment 1 :**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

Comment:

We agree with the IPSASB decision. We agree from the standpoint of convergence with IASB and the fact that for operating leases, which have not been on balance sheets, recognizing them on the lessee’s financial statements will increase the usability of the information.

## **Specific Matter for Comment 2 :**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

Comment:

We do not agree with the IPSASB proposal. Lessors should use the risks and rewards model as prescribed in IFRS 16.

The IPSAS are required to use the same accounting as IFRS as long as there are not any public sector specific circumstances. We believe that there is no public sector specific circumstances which justify to divert from IFRS 16 lessor accounting. Accounting treatment consistent with IFRS 16 could increase the understandability of financial statement users. We also consider entities will not incur any additional costs in preparing financial statements. This view can be justified on cost and benefit standpoint.

BC9(a) argues against using the “risks and rewards incidental to ownership” model, saying it is not consistent with the definition for assets of the IPSASB Conceptual Framework’s “the underlying asset currently controlled by the reporting entity as a result of past events.” BC9(c)(ii) argues that the lessor should not derecognize the underlying asset in a lease transaction. We believe that the lessor has lost control over the use of the underlying asset at the commencement date, and therefore most of the “resources” of the underlying asset has transferred to the lessee. We propose that the IPSASB should consider whether the underlying asset, meets the definition of asset under the IPSASB Conceptual Framework.

BC9(d) argues that the “risks and rewards incidental to ownership” model does not provide complete information about the entity’s management of the resource. We think this argument is irrelevant. We believe the lessor continues to recognize the underlying asset in case of operating leases. We also believe that the lessor derecognizes the underlying asset while at the same time recognizing the lease receivables in case of finance leases. The lease receivables have control over the resources that can be obtained from the subject receivable in the future, so it meets the definition of asset, and the opposing argument of BC9(d) does not hold. If entities need to disclose assets for which ownership is held although not currently controlled, notes disclosure would be sufficient to provide information on the underlying asset.

BC(10)(a) criticizes applying a ‘risks and rewards’ model to lessor accounting that additional records will be required if lessor and lessee are part of the same economic entity and prepare consolidated financial statements. We think it is not necessarily true because additional records will be necessary even if the same accounting model is used.

That is because the discount rate and lease term used by the lessor and lessee may differ. That is, the discount rate used by the lessee in its initial measurement of the lease liability (the interest rate implicit in the lease or the lessee’s incremental borrowing rate; paragraph 75) and the discount rate used by the lessor in its initial measurement of the lease receivables (the interest rate implicit in the lease; paragraph 27) are not necessarily the same. Also, even if the lease transaction take place within the same economic entity, the lease term may differ between the lessor and lessee as well, and so there is a possibility that it may become a burden when preparing consolidated financial statements.

### **Specific Matter for Comment 3 :**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Comment:

We do not agree with the IPSASB’s proposal. Please refer to our comments to Specific Matter of Comment 2, considering qualitative characteristics under the IPSASB Conceptual Framework. In addition to our above comment on Specific Matter for Comment 2, we would like to point out the following four standpoints.

#### **(1) Double-counting of assets (resources)**

Under the right-of-use model, the lessee on the one hand recognizes the right-of-use asset, while the lessor does not derecognize the underlying asset. We believe that the “resource” obtained from the use of the underlying asset has transferred from the lessor to the lessee at the point where the lessee has recognized the right-of-use asset. Therefore, for the lessor to record both the underlying asset and the lease receivable on its financial statements constitutes a double-counting of assets (resources).

IPSASB should consider;

Whether it is appropriate for the lessor to account for the underlying assets same book value as the former asset on its statement of financial position; or

Whether the underlying assets are written down by the transfer of right-of-use asset.

#### **(2) Unearned revenue**

Unearned revenue that the lessor recognizes at the time of the lease agreement could be considered as an obligation to perform the duty of leasing the underlying asset to the lessee. However, in the case of operating leases, we consider that obligation as an executory contract and the lessor should consider whether it meets the definitions for liabilities and assets on the date of the contract. Also, in the case of finance leases, almost the entire risk accompanying the ownership of the underlying asset and its all economic value transfer to the lessee on the commencement date of the lease, there would be no performance obligation of outflow of economic benefit in the future. In both case, we consider unearned revenue would not meet the definition of liability defined in the IPSASB Conceptual Framework: “A present obligation of the entity for an outflow of resources”

#### **(3) From the standpoint of burden of preparing consolidated financial statements**

Where the lessor and lessee are the part of economic entity and prepare consolidated financial statements, the argument of that additional recordkeeping is not necessary due to the use of the same accounting model is not necessarily correct. The reason is set forth in our comment to Specific Matter for Comment 2.

#### **(4) The character of lessors in the public sector**

Furthermore, for the most part, the transactions of lessors in the public sector involve fixed term leases of land or the leasing of public housing, etc. where ownership does not transfer, and are currently classified as operating leases. With these kinds of leases, to recognize the

lease receivable by taking the unrecovered lease investment amount and dividing it by the interest rate implicit in the lease will be a large burden for public sector entities which does not manage lease business as their significant business, and it is questionable whether the benefit outweighs the cost.

**Specific Matter for Comment 4 :**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Comment:

We do not agree with the lessor’s accounting. The lessor’s accounting should use the risks and rewards model.

We agree with the lessee’s accounting. The lease should be measured at fair value and the revenue recognized pursuant to IPSAS 23 “Revenue from non-exchange transactions (taxes and transfers).”

Based on the reasons explained in our comments to Specific Matter for Comment 2 and 3, we think that the lessor’s accounting should use the risks and rewards model. Further, in the case of concessionary leases which are made for terms below market value, we consider it to be substantively equivalent to the granting of a subsidy. Therefore, the effect on the financial statements should be the same regardless whether an actual subsidy is granted or whether the form of a lease agreement is taken.

Accordingly for the lessor’s accounting for operating leases, the fair value of the lease earnings should be measured each accounting period, and a cost should be recognized each period to the extent actual earnings are less than fair value. In the case of finance leases, for the lessor’s accounting, the fair value of the lease should be measured, and for any variance from fair value, day-one cost should be recognized equal to the amount equivalent to a subsidy, and the underlying asset should be derecognized.

Yours sincerely,

Shuichiro Akiyama

Executive Board Member - Public Sector Accounting and Audit Practice

The Japanese Institute of Certified Public Accountants



27 June 2018

Mr John Stanford  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
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Submitted to: [www.ifac.org](http://www.ifac.org)

Dear John


**Exposure Draft 64 Leases**

We appreciate the opportunity to comment on the Exposure Draft 64 *Leases*.

Our responses to the IPSASB's Specific Matters for Comment are attached.

If you have any questions about our submission, please phone Sara Moonlight, Director, Accounting Policy on +64 21 244 0545 or email her at [Sara.Moonlight@oag.govt.nz](mailto:Sara.Moonlight@oag.govt.nz).

Yours sincerely



Greg Schollum  
Deputy Controller and Auditor-General

## Appendix 1: Responses to the Specific Matters for Comment in Exposure Draft 64:

- 1. The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We agree with the IPSASB’s decision to adopt the IFRS 16 right-of-use model for lessee accounting. We agree that the right-of-use asset and the lease liability meet the definition of, and the recognition criteria for, an asset and a liability respectively in the IPSASB’s Conceptual Framework.

- 2. The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

No, we do not agree with the IPSASB’s decision to depart from the IFRS 16 risks and rewards model for lessor accounting. We disagree with the IPSASB’s arguments regarding consistency with the Conceptual Framework, and we disagree that the proposals are an improvement on IFRS 16.

We believe there needs to be a persuasive reason to depart from IFRS 16, and, in our opinion, the IPSASB has not provided a persuasive reason. For example, the IPSASB presents arguments in paragraph BC10 surrounding consolidation issues. We do not consider the arguments to be that different in the public sector compared to the private sector, to warrant a departure from IFRS 16.

We are not convinced that consistency in accounting treatment between two parties to a lease is a reason for departing from IFRS 16. There should be no difference in the accounting treatment for the same lease entered into by a private sector lessor and public sector lessor.

Using a different lessor accounting model compared to the private sector is likely to be confusing to users of financial statements, particularly where users attempt to compare lease information between the public and private sectors.

Further, the right of use model does not necessarily resolve consolidation issues as the lease balances between the lessee and lessor in a mixed group context may not be the same. For example, the lessee and lessor may recognise different amounts for initial direct costs, different discount rates may be used in discounting the cash flows (lessor may use the rate implicit in the lease agreement as it has the information to do this, but lessee uses its incremental borrowing rate as it cannot determine the rate implicit in the lease), or different assumptions around lease terms, termination rights.

We also note that there is likely to be significant effort required by entities that are part of mixed groups if the ED 64 approach proceeds. We are aware of examples of airports that are profit oriented entities, which are majority owned by local government entities, and have significant numbers of leases. These airports would be required to maintain two sets of accounting records to be able to do the lease accounting required by ED 64.



- 3. The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

No, we do not agree with the IPSASB's decision to propose a single right-of-use model for lessor accounting consistent with lessee accounting. If the ED 64 approach was to be taken specific guidance needs to be provided to eliminate the possibility of a double-counting issue, i.e. plant, property & equipment asset plus a lease receivable right-of-use asset.

We are unclear how a lessor who has transferred the right to use the underlying asset to the lessee for the term of the lease controls the asset for accounting purposes during the term of the lease.

Currently it is unclear how the fair value of a leased asset is affected, if this is how the asset is valued in the financial statements. Fair value may be based on rental inflows but may also be based on comparable sales method (such as for residential properties that are leased). Specific guidance on dealing with this issue is needed, both for plant, property & equipment and investment property. There is some double counting guidance in IPSAS 16, there is none in IPSAS 17. The guidance in IPSAS 16 is not sufficient.

Conceptually, there are good arguments for the transaction to be accounted for by the deconsolidation method, where the value of the asset is split between a receivable and the asset itself. However, we note that this approach was not adopted in IFRS 16 or proposed in ED 64. In our view, the approach in IFRS 16 is closer to the conceptual position than the approach in ED 64.

- 4. For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons).**

**For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

We are pleased the IPSASB is looking to address the accounting for concessionary leases, as it is not covered by an existing IPSAS. Consequently, there is diversity in practice in this challenging area of accounting.

However, we do not agree with the IPSASB's proposal that lessors measure concessionary leases at fair value, and that lessors recognise the subsidy granted to lessees as a day-one expense and recognise an increased amount of revenue over the lease term consistent with concessionary loans.

We are strongly of the view that an accounting model for concessionary leases should focus on the financial performance of the lessor, rather than one that focuses on the balance sheet. We consider the most meaningful accounting is where the subsidy provided by the lessor is recognised over the term of the lease. If it is recognised on day one, the on-going subsidy is not reflected in subsequent reporting periods, and therefore the substance of the transaction is not reflected.

Further, we think the expense/revenue recognition for the subsidy component should be broadly comparable between the lessee and lessor. ED 64 does not achieve this.

We strongly disagree with the expense recognition accounting being based on that of concessionary loans in IPSAS 29 as they are different transactions. The up-front expense that arises on a concessionary loan is very much linked to the derecognition of cash.

It is likely to be complex to estimate a fair value for long-term concessionary leases where the lessee is fulfilling the lessor's purpose, and if the assets have restricted use. It would be more practicable to determine fair value each year, particularly in the case of an indefinite lease period. In either case, guidance needs to be provided on how to determine fair value, such as that provided by IPSAS 29 for concessionary loans and guarantees.

## 5. Other comments

1. We note that ED 64 defines leases in such a way that no or nominal leases are not within its scope. This could result in inconsistent accounting between no or nominal leases and other concessionary leases. The discussion in paragraphs BC 20-23 is not persuasive about why no or nominal leases have been scoped out. We recommend that all leases are dealt with within the scope of the leases standard.
2. Further, there is no definition of the terms **nominal** or **consideration**, which may lead to inconsistent interpretation.



Treasury Board of Canada  
Secrétariat

Secrétariat du Conseil du Trésor  
du Canada

Ottawa, Canada  
K1A 0R5

John Stanford  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street, 4th Floor  
Toronto, ONTARIO  
M5V 3H2

Dear Mr. Stanford:

SUBJECT: Exposure Draft: *Leases*

---

Thank you for the opportunity to comment on the Exposure Draft: *Leases* issued in January 2018.

The Government of Canada bases its accounting policies on the accounting standards issued by the Public Sector Accounting Board (PSAB) of the Chartered Professional Accountants of Canada (CPA Canada). The Government of Canada is not required to follow the International Public Sector Accounting Standards (IPSAS), however, IPSAS are regarded as an important secondary source of generally accepted accounting principles.

Our responses to the specific matters for comment in the Exposure Draft (ED) are included in the attached appendix.

We thank you again for providing the opportunity to comment on this Exposure Draft. If you require further information, please do not hesitate to contact either Blair Kennedy at [blair.kennedy@tbs-sct.gc.ca](mailto:blair.kennedy@tbs-sct.gc.ca) (613-404-2996) or myself at [diane.peressini@tbs-sct.gc.ca](mailto:diane.peressini@tbs-sct.gc.ca) (613-369-3107).

Yours sincerely,

for

Diane Peressini  
Executive Director,  
Government Accounting Policy and  
Reporting

c.c.: Janique Caron, Assistant Comptroller General of Canada  
Diane Peressini, Executive Director, Government Accounting Policy and  
Reporting

## **Responses to Specific Matters for Comment**

### **Specific Matter for Comment 1:**

*The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

We agree with the proposal to adopt the IFRS 16 right-of-use model for lessee accounting, as this better recognizes the rights and obligations arising from lease contracts compared to the requirements in IPSAS 13. We agree with the reasons stated in the Basis for Conclusions for adopting this approach.

### **Specific Matter for Comment 2:**

*The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

We agree that the lessor accounting model should be based on control, and should recognize the rights and obligations arising from the lease contract on the same basis as the lessee accounting model. We agree with the reasons stated in the Basis for Conclusions for developing this lessor model.

### **Specific Matter for Comment 3:**

*The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements??*

We agree with the proposed lessor model. We agree that the credit entry represents a liability, but believe that the Basis for Conclusions (BC 44-53) should provide a better explanation of how the credit entry satisfies the definition of a liability. In our opinion, the credit entry represents the obligation of the lessor for an outflow of the economic benefits or service potential embodied in the underlying asset, as a result of entering into the lease contract. Consequently, this obligation meets the definition of a liability. Since the lessor still controls the underlying asset, its performance obligation to provide the right to use the asset to the lessee is satisfied over the term of the lease.

**Specific Matter for Comment 4:**

*For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

We agree with the proposal for accounting for concessionary leases by the lessor.

**Other matters**

We have noted some additional issues for the IPSASB to consider in developing its guidance on leases.

*Service potential*

The Conceptual Framework defines an asset as “a resource controlled by an entity as a result of a past event”. A resource embodies either economic benefits or service potential. Throughout the ED, only economic benefits are referred to with respect to the right-of-use asset. However, we assume that there is an intent that a right-of-use asset embodying service potential be included within the scope of the proposals, and suggest that the guidance is updated accordingly.

*Presentation and disclosure*

We do not agree that the lessor should present the underlying asset with other items of property, plant and equipment according to their nature. As underlying assets that are the subject of a lease are not held by the entity in the provision of goods and services, we believe that they should be presented in a separate category.

*Transition provisions*

For concessionary leases, paragraphs 132(b) and 142(b) require that the value of the liability (unearned revenue) and the right-of-use asset are measured at the carrying amount as if the standard had been applied since the commencement date. These paragraphs require preparers to use hindsight to determine the fair value of the right-of-use asset/liability at inception. We do not believe this is appropriate unless the subsidy portion is explicitly stated in the lease contract. We suggest that the transition provision allows for the use of historical cost (based on the present value of the remaining lease payments) to determine a deemed carrying value of the right-of-use asset/liability in an existing concessionary lease.



**REPUBLIC OF KENYA**  
**PUBLIC SECTOR ACCOUNTING STANDARDS BOARD**

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**Ref: PSASB 1/1 Vol.1/ (103)**

**THE NATIONAL TREASURY**  
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**NAIROBI**

**Date: 28<sup>th</sup> June 2018**

John Stanford  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto  
Ontario M5V 3H2  
**CANADA**

**IPSASB EXPOSURE DRAFT 64 ON LEASES**

The Public Sector Accounting Standards Board (PSASB), Kenya was established by the Public Finance Management Act (PFM) No.18 of 24<sup>th</sup> July 2012. The Board was gazetted by the Cabinet Secretary, National Treasury on 28<sup>th</sup> February, 2014 and has been in operation since.

The Board is mandated to provide frameworks and set generally accepted standards for the development and management of accounting and financial systems by all state organs and Public entities in Kenya and to prescribe internal audit procedures which comply with the Public Finance Management Act, 2012.

The Public Sector Accounting Standards Board, Kenya is pleased to submit its comments on Exposure Draft 64 on Leases to the International Public Sector Accounting Standards Board. PSASB Kenya has considered the Exposure Draft and is in agreement with convergence of accounting for leases under IPSAS and the newly issued IFRS 16. The objective to develop a new IPSAS on Leases is welcome since it will resolve stakeholder criticisms on the current IPSAS 13.

PSASB Kenya responses on Specific Matters for Comment are documented in the attachment for your consideration.

With kind regards,

**BERNARD NDUNGU, MBS**  
**CHAIRMAN, PUBLIC SECTOR ACCOUNTING STANDARDS BOARD**



**ISO 9001:2008**  
**Certified.**

## **PSASB's Responses to Exposure Draft 64 on Leases**

### **Specific Matters for Comment 1**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC66BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

*PSASB agrees with IPSASB's decision to adopt the IFRS 16 right –of- use model for lessee accounting. In addition to the reasons outlined in BC6- BC8 of the Exposure Draft, adopting the right – of- use model for lessees allows the lessee to recognise an asset and liability arising from an operating lease and therefore resolves stakeholder criticism which necessitated a review on how leases are accounted for.*

### **Specific Matter for Comment 2**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC96BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

*PSASB agrees with IPSASB's decision to depart from the IFRS 16 risks and rewards model for lessor accounting for the public sector specific reasons outlined in the basis for conclusions.*

### **Specific Matter for Comment 3**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC346BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

*PSASB agrees with IPSASB's decision to propose a single right – of – use model for lessor accounting consistent with lessee accounting. This will resolve the public sector related issues noted by IPSASB in their basis for conclusions. This will also resolve asymmetry in accounting for leases which has not been resolved under IFRS 16. In addition, the lessor will continue to account for the underlying irrespective of whether the lease is operating or financing therefore providing a single criteria for accounting for similar leasing transactions in the public sector.*

*PSASB opines that more guidance should be provided on accounting for the underlying asset by lessor when the asset is expected to transfer to the lessee at the end of the lease term. Under IPSAS 13, where a lease is classified as financing, the lessor derecognises the underlying asset and the lessee recognises that asset in its statement of financial position.*



## **PSASB's Responses to Exposure Draft 64 on Leases**

*However, under the proposed ED, the lessor will no longer classify leases and will continue to recognise the underlying asset irrespective of the nature of the lease. Where the underlying asset is expected to transfer to the lessee at the end of the lease term, IPSASB needs to provide guidance on recognition and measurement of the transferred asset at the end of the lease term in both the lessee and lessors statement of financial position.*

### **Specific Matter for Comment 4**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC776BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC1126BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

*PSASB agrees with IPSASB's proposal on measurement of concessionary leases at fair value and the recognition of subsidy by both lessors and lessees. The treatment is consistent with underlying treatment for concessionary loans and in accordance with IPSAS 23 for lessors and lessees respectively.*

*PSASB notes that there is an on-going project on Revenue and Non- exchange Expenses which will address accounting for non- exchange expenses such as the subsidy as described under concessionary loans.*



**BUILDING A BRIDGE TO A BRIGHTER AFRICA**

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**The Chairperson**  
**International Public Sector Accounting Standards Board**  
*By email*

Presented below are the Pan-African Federation of Accountants' (PAFA) response to the specific matters raised in the Exposure Draft 64 issued by the International Public Sector Accounting Standards Board (IPSASB) titled *Leases*.

PAFA is the continental body representing Africa's Professional Accountants. Established in May 2011, PAFA is a non-profit organisation with 53 Professional Accounting Organisations (PAOs) from 43 countries. Our mission is to accelerate and strengthen the voice and capacity of the Accountancy profession to work in the public interest, facilitate trade, and enhance benefits and quality services to Africa's citizens. The responses detailed below, have been prepared in consultation with our members.

**Specific Matter for Comment 1:**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

**PAFA's Response**

Yes, PAFA agrees with the IPSASB's decision.

It is PAFA's view that shift to accounting for leases based on IFRS 16 will assist with reducing divergence in accounting treatment for lessees between public and private sector entities. Furthermore, PAFA believes that the proposed adoption of the right-of-use model for both lessees and lessors will contribute to enhanced transparency and consistency across the public sector.

**Specific Matter for Comment 2:**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this ED (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

**PAFA's Response**

While PAFA agrees with the IPSASB's decision to depart from the IFRS 16 risks and rewards model for lessor accounting, it is worth considering the impact this will have on the consolidation of group entities where an entity applying this IPSAS has a for-profit controlling entity that is a lessor (thus applying IFRS) as this might necessitate the inclusion of further guidance.

**Specific Matter for Comment 3:**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this ED? If not, what changes would you make to those requirements?

**PAFA's Response**

Yes, PAFA agrees with the IPSASB's decision.

**Specific Matter for Comment 4:**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this ED? If not, what changes would you make to those requirements?

**PAFA's Response**

Yes, PAFA agrees with the proposed accounting requirements for concessionary leases.

PAFA does however, wish to highlight that this requirement may prove to be an expensive exercise for smaller entities applying this IPSAS. Consequently, it is PAFA's recommendation that the IPSASB consider the inclusion of a minimum threshold as a means to provide flexibility to preparers where it is found that the cost exceeds the benefits of applying the proposed accounting requirements for concessionary leases.

Other concerns worth noting are in regards to scenarios where the proposed standard is applied to leases of properties that are intended to serve a particular purpose. In these cases, it may prove difficult to obtain the fair value of said property given their specialised nature. PAFA believes that the inclusion of additional detailed illustrative examples, from both the lessee and lessor perspective, would assist preparers with implementing the requirements of the proposed standard.

30 June 2018

Mr John Stanford  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto  
Ontario M5V 3H2  
CANADA

Submission via [www.ifac.org](http://www.ifac.org)

Dear John

### **Submission on Exposure Draft 64: Leases**

This submission is made jointly by Chartered Accountants Australia and New Zealand (CA ANZ) and the Association of Chartered Certified Accountants (ACCA) under our strategic alliance.

ACCA and CA ANZ created a strategic alliance in June 2016, forming one of the largest accounting alliances in the world. It represents 800,000 current and next generation accounting professionals across 180 countries and provides a full range of accounting qualifications to students and business. Together, ACCA and CA ANZ represent the voice of members and students, sharing a commitment to uphold the highest ethical, professional and technical standards. More information about ACCA and CA ANZ is contained in Appendix A.

We appreciate the opportunity to comment on the Exposure Draft ("the ED"). Our responses to the specific matters for comment raised in the ED follow in Appendix B.

Yours gratefully

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## Appendix A

### About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 117,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations. We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

### About ACCA

ACCA is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA supports its 200,000 members and over 486,000 students in 180 countries, helping them to develop successful careers in accounting and business, with the skills required by employers.

ACCA works through a network of 101 offices and centres and 7,291 Approved Employers worldwide, who provide high standards of employee learning and development. Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; audit; pensions; education; corporate governance and corporate social responsibility.

# Submission on Exposure Draft 64: Leases

## Appendix B

### Specific Matter for Comment 1

**The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We support replacing IPSAS 13 with an IPSAS primarily based on IFRS 16. Therefore we agree with the IPSASB’s proposal to adopt the IFRS 16 right-of-use model for lessee accounting.

### Specific Matter for Comment 2

**The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We do not agree with the IPSASB’s proposal to depart from IFRS 16 for lessor accounting. The IPSASB’s key reasons for departing from IFRS 16 appear to focus on consolidation issues where the lessor and the lessee are part of the same economic entity. However, it is likely that the proposals would still give rise to inconsistent accounting by the two parties to a lease, so consolidation issues would still arise. For example, the lease receivable and the lease liability would not necessarily be recorded at the same amount by the two parties due to different estimates being used, such as discount rates. In addition, the IPSASB is not proposing a recognition exemption for lessors for “low value” leases.

Of greater concern is the impact of different accounting requirements on “mixed groups” – economic entities that contain both public sector entities and private sector entities. Such structures are common within the public sector. Substantial differences between the IPSASB’s and IASB’s lessor model will, in our view, create even more consolidation issues.

Another reason for the departure that the IPSASB raises is the inconsistency with the Conceptual Framework. However we note that the deferred income balance proposed arguably does not meet the definition of a liability.

We therefore disagree with the IPSASB’s conclusion that there is a public sector issue that warrants a departure from the lessor accounting approach in IFRS 16.

### Specific Matter for Comment 3

**The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

As mentioned above, we do not support departure from IFRS 16. Furthermore, the proposed approach (“Approach 1”) results in a double counting of the one set of cash inflows in two assets – the whole underlying leased asset and the lease receivable. This appears to be because “control” of the underlying leased asset centres on legal ownership in the ED. We would argue that the



## Submission on Exposure Draft 64: Leases

concept of control needs to be considered in a broader context, for example; the entitlement to future service potential.

The existence of the two assets raises the issue of the need to consider their combined carrying value for impairment which is not currently specifically mentioned in the ED.

If the IPSASB does decide to adopt a right-of-use model for lessor accounting, our preference is the derecognition approach ("Approach 2") as outlined in paragraph BC35(b). We believe the lessor only recognising a residual underlying leased asset would provide a more faithful representation of the transaction, which in turn would result in information that is more relevant and understandable for users of the financial statements.

### Specific Matter for Comment 4

**For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

We are pleased the IPSASB is addressing the accounting treatment of concessionary leases as there are currently no requirements or guidance which has led to divergence in practice in accounting for such leases. However, we are concerned with the resulting revenue and expense recognition outcomes under these proposals. In particular, that the lessee and lessor recognise the subsidy in full as income and an expense respectively on the inception date of the lease. The benefits are provided over the lease term, therefore a model that results in the lessee and lessor both spreading the subsidy amount over the lease term would, in our view, be more appropriate and meaningful to users of the financial statements.

There are also concerns about the cost-benefit considerations of these proposals, such as determining the fair value of a concessionary lease. In particular, where the underlying leased asset has a restricted use (eg an entity can only undertake certain activities) and where the underlying leased asset is of a specialised nature (eg a school). This is a particular concern for NGOs that apply IPSAS, as well as public sector entities.

### Lessees

We consider it appropriate that a lessee reflects the benefits received from concessionary leases, and effectively recognises a donation. However, the benefits are provided over the lease term, not just on the inception date of the lease. So there would be more support for this approach if a lessee was permitted to recognise the subsidy over the lease term regardless of whether or not the lease included "conditions" as defined in IPSAS 23. We understand the IPSASB is currently considering feedback received on its *Consultation Paper: Revenue and Non-Exchange Expenses*, including that IPSAS 23 is too restrictive in only allowing non-exchange revenue to be recognised over time where there is a condition. Under the public sector performance obligation approach that was proposed, there may be more flexibility for the subsidy to be recognised over the lease term. We recommend the IPSASB consider these two projects in tandem.

## Submission on Exposure Draft 64: Leases

### *Lessors*

Since the proposed accounting for concessionary leases by lessors is also based on the right-of-use model, it follows that we do not support this approach. If a concessionary lease and a concessionary loan are the same or similar in substance, then it follows that the accounting treatment should be consistent. With a concessionary loan, once the grantor has paid out the cash, the cash is derecognised. Therefore with a concessionary lease the subsidy should be credited to the underlying leased asset to reflect the transfer of future service potential.

If the IPSASB decides that lessors should recognise the subsidy of a concessionary lease, then we support this derecognition approach which is consistent with our view in SMC 3. If the IPSASB proceeds with recognition of the subsidy as an expense then, as previously mentioned, there is support for spreading this over the lease term.

### *Leases for zero or nominal consideration*

The definition of a lease includes “in exchange for consideration” which excludes leases for zero or nominal consideration. Leases for zero or nominal consideration are considered to be grants and are, therefore, outside the scope of ED 64 and accounted for as a non-exchange transaction (paragraph BC21).

A lessee would account for leases for zero or nominal consideration in accordance with IPSAS 23 (paragraph AG60(a)). ED 64 also proposes amendments to IPSAS 23 to require right-of-use assets acquired by a lessee through non-exchange transactions to be measured at fair value as at the date of acquisition, and the fair value of right-of-use assets to be measured in accordance with ED 64. This circuitousness is unnecessarily complex.

A lessor would account for leases for zero or nominal consideration in accordance with the “relevant international or national accounting standard” (paragraph AG60(b)). This is unhelpful when there is no relevant international standard, and most countries are unlikely to have a national standard dealing with non-exchange expenses. In our view, the IPSASB should provide some specific requirements or guidance for lessors to account for leases for zero or nominal consideration.

29 June 2018

The Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
529 Fifth Avenue, 6th Floor  
New York, NY 10017  
United States of America

Attention: Mr John Stanford

**Consultation Paper: Recognition and Measurement of Leases**

The New Zealand Treasury welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board on the ED 64: Leases.

We have attached our responses to the specified matters for comment.

Yours sincerely



Jayne Winfield  
Manager, Fiscal Reporting

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**Specific Matter for Comment 1:**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons).

Do you agree with the IPSASB’s decision?

If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

The New Zealand Treasury considers the right-of-use model for lessee accounting by itself is inadequate for public sector reporting.

We believe the IPSASB has missed an important opportunity to consider more deeply the allocations of rights, which pertain to physical and intangible assets, which are prevalent in the public sector. A fuller consideration would make it more likely all such rights, not just right-of-use, are accorded appropriate and transparent accounting treatment. That would ensure that different decisions over the assets (including right-of-use) are better informed by accounting, and that accounting enables those decisions to be better assessed.

To illustrate our concerns, consider the schema of property rights identified by Edella Schlager and Nobel Prize winning economist Elinor Ostrom<sup>1</sup>:

- Access        the right to enter a defined physical property
- Withdrawal   the right to obtain the “products” of a resource
- Management   the right to regulate internal use patterns and transform the resource by making improvements
- Exclusion       the right to determine who will have an access right, and how that right may be transferred
- Alienation     the right to sell or lease the above rights

This is a property rights framework characterized by nested, cumulative attributes. It has become arguably the most ubiquitous framework for analysis of natural resources and property rights.<sup>2</sup> Discriminating between these rights is particularly important for assets providing non-private goods, where aspects of non-rivalry and non-excludability require collective management structures. Such structures are in fact often separate public sector reporting entities themselves. The framework can be summarised in the following chart from their paper.

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<sup>1</sup> Schlager E, Ostrom E. Property-Rights Regimes and Natural Resources: A Conceptual Analysis. Land Economics [serial online]. August 1992;68(3):249-262. Available from: EconLit with Full Text,

<sup>2</sup> Galik C, Jagger P. Bundles, Duties, and Rights: A Revised Framework for Analysis of Natural Resource Property Rights Regimes. Land Economics [serial online]. February 2015;91(1):76-90



<b>Bundles of Rights Associated with Persons</b>				
	<i>Owner</i>	<i>Proprietor</i>	<i>Claimant</i>	<i>Authorised User</i>
Access and withdrawal	X	X	X	X
Management	X	X	X	
Exclusion	X	X		
Alienation	X			

In this framework, an owner may transfer rights of direction-of-use and rights-of-use to a proprietor or claimant, and rights-of-use, but not rights-to-direct-use to an authorised user. Lease contracts are just one way to reflect a transfer of rights of use from an owner (lessor) to a claimant (lessee). Not only may other arrangements than lease contracts be used, but if financial reports are to fairly reflect the rights of a public sector entity, and then other bundles of rights than access, withdrawal and management should be provided for.

A holistic approach that fully reflects the attributes of rules and rights that apply over the use of assets in the public sector is likely to be a much better fit for purpose than an accounting approach derived simply from private sector lease contracts. We briefly highlight some benefits below.

Authorised users, and not the reporting entity managing many infrastructure and natural resource assets controlled by the state, have access and withdrawal rights, (e.g. road users in fact use the roads of a road authority managing state-owned roads). The property rights framework thus copes better than the contractual leasing approach for the awkward fact that many lessees in the public sector are not in fact users of the asset.

The framework helps clarify the distinction between operators of concession arrangements and lessees. The concept of authorised users that do not have the right to regulate use patterns is also likely to be useful when the IPSASB comes to consider natural resource rights, such as access to the radio spectrum. Some so called 'concessional leases' where the lease is conditional on a prescribed use of the asset, may in fact be better reflected as 'authorised use' agreements and accounted for differently than leases,

Claimants appear similar to lessees, in that they have both a "right-of-use" and a "right to direct" the use but notably without sub-leasing rights. The private sector standard setter's analysis of rights to direct however seems limited to shipping containers and assets requiring specialised skills to operate. The public sector standard setter must consider more deeply the common situation where assets that are provided for the use only of another entity, whose objective the 'lessor' supports. We submit that more thinking that is refined is required here.

For example, the accommodation lease that a school makes available to a health operator on school premises so that health care can be provided to pupils, is different in substance to an accommodation lease that the same health provider might receive from a property management company. A judgement is required as to whether the health provider is an authorised user or a claimant. The proposed guidance in AG19 -22 is not up to this task. In another example, a better accounting outcome is likely to be achieved if the IPSASB seeks to best reflect a rail operating company paying a rail access charge as a claimant on the rail asset rather than as a lessee, and the infrastructure owner as an asset provider than a lessor.

Finally, the differentiation between proprietors and owners may be useful when considering the assets that the reporting entity is charged for maintaining and preserving for future generations. Are heritage assets effectively on 'lease' to public sector entities to look after them on behalf of the public?

Another possible use for this concept is the common practice of governments providing property rights to other governments for embassy and consulate purposes, but where if the embassy were to be withdrawn the property would revert to the host government. The IPSAS conceptual framework has stated that service recipients and resource providers will need information that supports the assessment of the capacity of the entity to adapt to changing circumstances.

The adaptive capacity of an entity with alienation rights is quite different to an entity without those rights. In New Zealand, both our Public Works Act, and arrangements with Māori who have provided property for public purposes, provide residual rights back to the original owners if the property is no longer required for those public purposes.

Those examples illustrate that the allocation of withdrawal rights in the public sector is not such a simple matter as the public sector where leases are ubiquitous and simply a type of contract law and property can be described as either freehold or leasehold. The Treasury is not contesting the assertions made in paragraphs BC 7, nor indeed that the right-of-use approach may be appropriate for many lease arrangements, but rather is arguing that they omit critical public sector differences that should affect the development of the standard.

The Treasury would therefore propose that the IPSASB withdraw the exposure draft, and prepare a consultation paper that makes use of the property rights literature that has developed in the twenty-five years since the Schlager and Ostrom paper, in an effort to ensure that allocations for bundles of rights over assets are most appropriately accounted for in the correct context. We would particularly urge this, should the IPSASB get significant pushback on other proposals in this standard.



**Specific Matter for Comment 2:**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons).

Do you agree with the IPSASB’s decision?

If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

**Specific Matter for Comment 3:**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons).

Do you agree with the requirements for lessor accounting proposed in this Exposure Draft?

If not, what changes would you make to those requirements?

The Treasury shares the Board’s dissatisfaction with the current IFRS 16 risk and rewards approach and it’s disconnect with both the IFRS and IPSAS Conceptual Frameworks, and we share the Board’s concern with a derecognition approach that seems to ignore the alienation rights remaining with the owner. However, there are significant problems with the proposed approach to the lessor accounting:

- There is no justification for the “credit entry in the statement of financial position”. The lessor has no obligation to report.
- The recognition of both the underlying asset and the lease receivable in the statement of financial position means the lessor is double counting the economic benefits it expects to receive from the asset.

The proposals would therefore distort the statement of financial position, so that it no longer fairly reflects the rights and obligations of the lessor.

The proposals are derived from the idea that the right-of-use asset is a separate economic phenomenon to the underlying asset, and that assets cannot be derecognised and derecognised as portions (slices) of individually controlled rights.

Yet as noted above the property rights literature recognises the nested, cumulative attributes of rights over assets. If accounting fails to recognise this, it fails to reflect economic substance. The solution requires the Board to go back to that literature and reflect how it can best make those nested cumulative rights transparent to users of financial statements.

The Treasury also has some concern with the logic for the different accounting approach for the public sector expressed in BC 10 and BC 1. In particular, the IPSASB view that “In many jurisdictions, a centralised entity will undertake most or all of the property management for a government. The entity will own all the government’s property assets, and lease them to other government entities. As a consequence the prevalence of consolidation issues may be greater in the public sector than in the private sector”

If such an arrangement is in place, that centralised entity’s financial performance is likely to be assessed against those of profit-oriented property management companies. It is therefore more than possible they will be required to follow IFRS rather than IPSAS, particularly if the government has leveraged their ownership by enabling that entity to trade some of its shares on a listed exchange. The table below compares the consolidation difficulties if the IFRS 16 lessor accounting approach was retained, or if the ED 64 proposals were adopted, under a number of possible scenarios.

	<b>If IPSAS takes the ED 64 Approach</b> (right-of-use for lessees, lease receivable and separate credit entry)	<b>If IPSAS takes the IFRS 16 Approach</b> (right of use for lessees, no changes for lessors from IAS 17 / IPSAS 13)
Both Lessor and Lessee apply IPSAS  e.g. Both entities in General Govt. Sector	Lessees incur transition cost of change,  Lessors incur transition cost of change  Consolidation unit eliminates lease receivables and lease payables.  Consolidation unit eliminates right of use asset with lessor "credit entry"	Lessees incur transition cost of change, need to identify whether lessor reports the lease as operating or finance.  Lessors incur no transition cost of change  Consolidation unit eliminates "finance lease" receivables and "finance lease" payables  Consolidation unit eliminates "operating lease" receivables with right of use assets  Consolidation unit eliminates remaining right of use asset with "operating lease" liabilities
Lessor Applies IFRS and Lessee applies IPSAS  e.g. Property Mgmt Co a Public Corporation, and Lessee in General Govt Sector	Lessees incur transition cost of change  Lessors must keep two books, one for consolidation purposes, and one for their own accounts.  Consolidation unit eliminates lease receivables and lease payables.  Consolidation unit eliminates right of use asset with lessor "credit entry"	Lessees incur transition cost of change, need to identify whether lessor reports the lease as operating or finance.  Lessors incur no transition cost of change  Consolidation unit eliminates "finance lease" receivables and "finance lease" payables  Consolidation unit eliminates "operating lease" receivables with right of use assets  Consolidation unit eliminates remaining right of use asset with "operating lease" liabilities
Lessor Applies IPSAS and Lessee applies IFRS  e.g. Rail Owning Co in General Govt Sector leases track to Rail Operating Co, a Public Corporation at a concessionary rate	Lessees incur transition cost of change,  Lessors incur transition cost of change  Consolidation unit eliminates lease receivables and lease payables.  Consolidation unit eliminates right of use asset with lessor "credit entry"	Lessees incur transition cost of change,  Lessors incur transition cost of change  Consolidation unit eliminates lease receivables and lease payables.  Consolidation unit eliminates right of use asset with lessor "credit entry"



What this table reveals is that the proposed ED 64 approach eases the consolidation load when both the lessor and lessee adopt IPSAS, as different elimination entries are not required for leases in the finance and operating categories. However, the proposed ED64 approach makes the consolidation approach much more onerous when the consolidated group has lessors that account under IFRS.

If lessors adopt IFRS but have a public sector parent, they will be required to keep two sets of books under the current proposal. However, if the public sector standard were to take the approach of the private sector standard, then what is required is the identification or tagging of leases to either a finance or operating lease category, so the necessary consolidation entries can be made. The Treasury submits that this is a far less onerous accounting process. We submit therefore that the current proposals could have the unintended consequence of making typical consolidations in the public sector more onerous rather than less onerous.

**Specific Matter for Comment 4:**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons).

For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft?

If not, what changes would you make to those requirements?

The Treasury understands from the Basis of Conclusions that the IPSASB regards leases as the financings of the right to use an underlying asset, and because an outstanding loan and a lease receivable have the same economic nature, the financing component of loans and leases are comparable transactions.

The Treasury considers this conclusion incorrect. The great majority of concessionary or 'peppercorn' leases do not attract any lease receivable or payable. The lessee does not have to finance their right to use the asset, and the statement of financial position should not reflect such a fiction. Entities receiving a concessionary loan do not have a liability

Consequently, the Treasury considers that a concessionary lease is not comparable to a loan, nor that accounting requirements should be derived from the financial instruments guidance. Rather, the Treasury considers that concessional leases are comparable to grants, and the accounting guidance should be derived from the non-exchange revenue guidance.

As we noted under Specific Matter for Comment 1, the Treasury considers also that a differentiation is necessary when a 'leasing' entity has limited right to direct the use of an asset. Many concessionary leases would fall into this category.

Consider for example a local council wishing to promote sport, providing land for a tennis club, so long as the club maintains tennis courts on it. It is firstly not clear whether this is a lease as the club may not have the right-to-direct use, and secondly it is not clear that there is in fact a concession, given the maintenance obligations the club accepts for use of the owner's property. Given the ubiquity of such arrangements in the public sector, clarity is needed from this proposed standard.

The Treasury is also concerned about the measurement of a concession. The standard describes concessionary leases as leases below market terms, and a non-exchange component of concessionary loans. The difficulty is that in the public sector concessionary leases are generally concessional for a reason. Often the leased asset will be a non-cash generating asset and there will be little or no 'market' for it. In the previous example of land leased only for tennis courts, the market value of nearby unencumbered land leases cannot be used as a market value for such encumbered rights.

Where the service potential the asset provides is better realised if it is used by the lessee than the lessor, and that service potential is in the nature of a public good, then we submit the 'market' is an unreliable basis for any concession to be determined.

An illustration of measurement difficulty in applying the proposed standard is demonstrated in the current 'market' of European cities seeking to host regulatory agencies that have been located in the United Kingdom as a consequence of Brexit. A lease that is won in this competition would thus appear to be at market terms, even if significantly concessional compared to similar other accommodations in the same city. Paragraph 15 of the proposed ED does not provide sufficient guidance to provide consistent, comparable accounting judgements for such leases.

As a consequence of these concerns, the Treasury proposes that concessionary leases be removed from this standard, and incorporated in the forthcoming guidance on non-exchange expenses and (exchange and non-exchange) revenue.

29 June 2018

Ian Carruthers, Chair  
International Public Sector Accounting Standards Board

[www.ifac.org](http://www.ifac.org)

Dear Ian

### **SUBMISSION ON IPSASB ED 64 *LEASES***

Thank you for the opportunity to comment on the exposure draft relating to accounting for leases and disclosing them in the financial statements. Wellington City Council (the Council) is pleased to provide comments on this exposure draft.

The proposals have significant potential impacts for the Council, in particular the sections on concessionary leases. Our specific comments are outlined in the attached appendix 1.

If you would like further clarification on the issues raised in our submissions please don't hesitate to contact me.

Yours sincerely



Richard Marshall  
Manager Financial Accounting & Transactional Services  
Wellington City Council





## **Appendix 1. Wellington City Council's comments on IPSASB ED 64 leases**

### **Specific Matter for Comment 1:**

*The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6-BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

#### **Accounting for leases – right of use asset for lessees**

In principle the concept of having a right of use asset from a lessee point of view makes sense. By entering into the lease arrangement the lessee has the right to use an asset over a period of time in return for lease payments. The liability represents the present value of the lease payments and in our opinion presents the readers of the accounts with useful information.

We are of the opinion that the right to use assets should be presented separately to other assets in the notes to the financial statements to distinguish them from normal purchased assets.

### **Specific Matter for Comment 2:**

*The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9-BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

#### **Accounting for leases – right of use asset for lessors**

We are supportive of using the right of use model for lessor accounting so it is consistent with the treatment for lessees.

**Specific Matter for Comment 3:**

*The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34-BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

**Accounting for leases – departure from IFRS 16 for lessor accounting**

We support the departure from IFRS 16 which means that the lessor and lessee accounting are done on a consistent basis using the right of use model. We believe that it would be confusing for readers of the accounts to have two entities accounting for the lease in different ways and it would also make consolidation between groups of public sector entities unnecessarily complicated.

**Specific Matter for Comment 4:**

*For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77-BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise revenue in accordance with IPSASB 23 (see paragraphs BC112-BC114 for IPSASB's reasons). Do you agree with the requirements for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

**Accounting for leases – concessionary leases**

The accounting for concessionary lease in the ED requires the lease to be measured at market value in order to separate out the exchange and non-exchange portions of the lease. While in principle this would seem like a good idea, in practice it could be a complicated and expensive process, especially if there are lots of leases involved, as it would likely require the expertise of external valuers. For the Council in particular we have many of these types of leases to community groups and not for profit organisations but the values of the lease payments are usually small. These leases often involve heritage assets, limited or restricted use assets or restricted land and are often to non-commercial organisations. We will certainly be looking to work with our auditors to determine whether any of these leases are material enough (individually or in aggregate) to warrant the additional time and cost of calculating the market value.

We also feel that any non-exchange portion i.e. the subsidy should be spread over the term of the lease and not recognised on the commencement of the lease. This is because in substance by entering into a lease at below market terms the Council is agreeing to provide an annual “subsidy” to the lessee. This means that we can recognise, on an annual basis, the value that we provide to these community organisations. Recognition on commencement of the lease results in the potential for large year on year fluctuations in the statement of financial performance which are non-cash in nature and we believe this would be difficult for readers of the accounts to understand.

It is also noted that there is no clarification between what is nominal and what is below market value to trigger whether the lease would be recognised under this proposed standard.

### ***General comment***

While Council agrees with the proposed direction of this standard in regards to Accounting for leases – right of use asset, it has concerns with the proposed accounting treatment for concessionary leases. Apart from the difficulty of obtaining the market valuations for such leases, the impact of recognising the non-cash difference between market value of the lease and actual lease value which may result in potentially inflating the expenditure of public sector entities such as Councils. This may have an unintended consequence on the social outcomes that they are trying to achieve. For instance local authorities in New Zealand are governed by the Local Government Act 2002, which under section 100 “Balanced Budget” requirement states:

“A local authority must ensure that each year’s projected operating revenues are set at a level sufficient to meet that year’s projected operating expenses.”

While local authorities can resolve to operate outside of that requirement, over time they may come under pressure to adhere to it. Thus loading an additional cash burden on local communities through increases in rates or other revenues to fund the shortfall created by a non cash theoretical recognition of the difference and thereby potentially undermine the social outcomes they are trying to achieve. For example, a sporting club that isn’t being charged a “peppercorn” rental but an amount below market value to help achieve a social outcome of “healthier communities” would incur for that Council an increase in expenditure whereas a Council that doesn’t have the same social outcome, charges market rates to the same type of sporting club will result in higher revenue.



IPSASB Exposure Draft 64

*Leases*

## ***Comments on ED 64, Leases***

June 29, 2018

June 29, 2018

John Stanford  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto, ON M5V 3H2 Canada

**Re: The comments on the Exposure Draft 64,**  
***Leases***

Dear Mr. Stanford,

The Government Accounting and Finance Statistics Center (GAFSC) at Korea Institute of Public Finance (KIPF) is pleased to provide comments on the Exposure 64, *Leases* issued by the International Public Sector Accounting Standards Board (IPSASB).

The comments have been prepared and reviewed by the staff of the GAFSC, and they are available in the following pages. Please feel free to contact us if you have any questions regarding our comments. You may direct your inquiries to the technical staff of GAFSC, Stella Kim ([sjkim@kipf.re.kr](mailto:sjkim@kipf.re.kr)).

Sincerely,



---

Do-Jin Jung  
Director (GAFSC at KIPF)



### **Specific Matter for Comment 1**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons.

If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

[GAFSC comments] The adoption of the IFRS 16 right-of-use model for lessee accounting not only converges with IFRS 16, but also enhances the usefulness of information on an operating lease. Accordingly, we are of a view that we agree to the IPSASB’s decision to adopt the right-of-use model for lessee accounting as proposed in the Exposure Draft.

### **Specific Matter for Comment 2**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision?

If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

[GAFSC comments] We do not agree with the IPSASB’s decision to diverge from the ‘risks and rewards incidental to ownership model’ for lessor accounting. Although we agree that the underlying asset and the right-of-use asset are separate items, it is still questionable that the two items are treated as different economic phenomena.

In addition, when the right-of-use asset is transferred to a lessee, the cash flows derived from the underlying asset are also transferred to the lessee. Because the lessor in current right-of-use model recognizes both the underlying asset and the lease receivables, we consider that it is double-counting.

### **Specific Matter for Comment 3**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

[GAFSC comments] We disagree to the IPSASB's decision, which is in line with our comments for SMC 2. In this light, we encourage the IPSASB to conduct a detailed review on the plan to adopt the right-of-use model for lessor accounting based on definitions of assets and resources given under the *Conceptual Framework*.

#### **Specific Matter for Comment 4**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft?

If not, what changes would you make to those requirements?

[GAFSC comments] We generally agree to the IPSASB's proposal, but the IPSASB needs to take into consideration that compared to concessionary loans, the current system is not sufficient to measure the FV of concessionary leases (i.e. lack of a market to determine FV).

29 June 2018

Mr. John Stanford  
International Public Sector Accounting  
Standards Board  
529 Fifth Avenue, 6<sup>th</sup> Floor  
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submitted electronically through the IPSASB website

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**Re.: ED 64, Proposed International Public Sector Accounting Standard - Leases**

Dear Mr. Stanford,

We would like to thank you for the opportunity to provide the IPSASB with our comments on the draft proposed International Public Sector Accounting Standard – Leases (referred to hereinafter as “ED 64”).

The IDW supports the approach taken developing ED 64 and, subject to points raised in our response to Specific Matter for Comment 3, specifically agrees with the proposed departure from IFRS 16 in respect to lessor accounting.

We respond to each of the Specific Matters for Comment as follows:

**Specific Matter for Comment 1**

**The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6-BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We agree with the IPSASB’s decision to adopt the IFRS 16 right of use model for lessee accounting. In our view the reasoning provided in the BCs is comprehensive.

We have one comment on the wording of BC7.(b): “The right of use asset is recognized when the lessee controls the asset”. We would like to point out that

GESCHÄFTSFÜHRENDER VORSTAND:  
Prof. Dr. Klaus-Peter Naumann,  
WP StB, Sprecher des Vorstands;  
Dr. Klaus-Peter Feld, WP StB;  
Dr. Daniela Kelm, RA LL.M.;  
Melanie Sack, WP StB

**Page 2 of 5** to the comment letter to the IPSASB dated 29 June 2018

control of the underlying asset itself is only passed from the lessor to the lessee in the event of a sale, or a sale and leaseback arrangement. In our opinion this text should be amended to read: “The right of use asset is recognized when the lessee controls the use of the underlying lease asset as conveyed by the lease contract) .....”.

### **Specific Matter for Comment 2**

**The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9-BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We agree with the IPSASB’s decision to depart from the IFRS 16 risks and rewards model for lessor accounting. In our view the reasoning provided in the BCs is comprehensive.

### **Specific Matter for Comment 3**

**The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34-BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

In its letter to the IASB dated 13 September 2013, the IDW clearly stated its disagreement with the IASB’s then proposed dual model in respect of lessee and lessor accounting. In addition to the IDW’s technical reservations that led it to take this stance, we agree that public sector specifics justify this difference in lessor accounting in the public sector, for the reasons explained in BCs 9-13.

We support the proposed single right-of-use model for lessor accounting consistent with lessee accounting. We specifically agree that a lease is the sale of an unrecognized “right-of-use asset” and agree that the lessor shall recognize the lease receivable as an asset, as a separate economic phenomenon from the underlying asset.

However, we note some confusion and inconsistency in ED 64 surrounding the nature of the corresponding credit entry recognized by the lessor. Specifically, AG 39 and BCs 44-53 are highly confusing in explaining the IPSASB’s

**Page 3 of 5** to the comment letter to the IPSASB dated 29 June 2018

deliberations regarding the nature of this credit entry, as well as being inconsistent with the explanation in the first sentence of BC 91.

BC 53 states: “ ... recognizing the credit entry as a liability until revenue recognition criteria are met may not be consistent with the *Conceptual Framework* definition of a liability.” and also “ ... recognizing revenue directly in the statement of financial position, while consistent with the *Conceptual Framework*, would not be consistent with the current requirements in IPSAS.”. BC 53 further states: “The IPSASB ... decided these inconsistencies should be addressed in a future IPSASB project to revise existing IPSASs for consistency with the *Conceptual Framework*”. This unresolved situation is less than satisfactory for the finalization of ED 64.

The IDW does not support the explanation that the lessor’s liability should be denoted as an unearned revenue liability. However, we do agree with the IPSASB’s explanation (in the first sentence of BC 91) that the credit entry represents a performance obligation to provide access to the underlying asset throughout the lease period. The lessor is contractually bound to forego any alternative use, i.e., to forego service potential. In our view this represents a commitment to an outflow of resources because the lessor cannot benefit from the service potential (i.e., use the underlying asset for its own purposes, including leasing it to another party to receive cash) but has committed to provide this service potential to the lessee. From the lessor’s viewpoint this foregoing of a right of use thus equates to a continuative outflow of service potential throughout the lease period. On this basis the credit entry constitutes a liability for the lessor to perform; i.e., a performance obligation. It follows that it is only over the ongoing “delivery” throughout this performance period that the liability for performance is reduced as revenue is earned and recognized in the statement of performance.

Since we contend that the credit entry represents the lessor’s performance obligation, we disagree that the liability will, in every case, need to be adjusted by the same amount as the change resulting from the measurement of the lease receivable (paragraph 44). Not all factors impacting the measurement of the lease receivable have an equivalent impact on the measurement of the performance obligation.

In conclusion, in finalizing ED 64, the IPSASB will need to address the inconsistency we outline above. Should the IPSASB decide on the interpretation given in the first sentence of BC 91, i.e., that the credit entry is a performance obligation, there would be no unresolved issue concerning consistency with the *Conceptual Framework* as discussed in BC 53. However, appropriate revision to

**Page 4 of 5** to the comment letter to the IPSASB dated 29 June 2018

ED 64 would need to be made, especially to paragraph 44 in respect of subsequent measurement of the liability.

#### **Specific Matter for Comment 4**

**For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77-BC96 for IPSASB's reasons). For lessees, the IPSSB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112-BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

We agree that a lease contract at below-market terms includes a non-exchange component (concessionary lease) and will generally not constitute a lease agreed at a "bargain price" for the lessee. Unless there are clear indications to the contrary (e.g., the arrangements constitute a financing transaction), the non-exchange part of a lease represents a grant or subsidy from a lessor to a lessee. We agree that to meet the needs of financial statement users, under the IPSASB's Conceptual Framework, such grants or subsidies should be transparent.

However, we also appreciate that there may be some degree of discomfort as to ED 64's proposed treatment of concessionary leases as explained in BCs 94-96. In our view, the IPSASB could require an appropriate note disclosure, to both explain the nature of the respective asset and liability and value of the concession. Alternatively, differentiated presentation on the face of the financial statement might address the discomfort with the notion of recognizing lease income in excess of cash received, as the fact that an entity elects to lease an asset at a price below market value (assuming there would be a market) means it is "giving away" service potential of that asset for a specific purpose, which needs to be sufficiently transparent.

In addition, factors such as the lessor's intention in agreeing to concessionary terms, or either party's ability to withdraw from the contract may need to be reflected in the accounting treatment, i.e., in certain circumstances there may be valid arguments for recognizing the expense and income over the lease period, rather than as a day-one transaction.



**Page 5 of 5** to the comment letter to the IPSASB dated 29 June 2018

A specific disclosure support provided by lessors and received by lessees by way of concessionary leases is in the public interest and essential in terms of accountability. Without such information and disclosures support measures provided and received would not be transparent. In our view, appropriate application guidance to support para. 61 of ED 64 might be helpful in this respect.

We would be pleased to provide you with further information if you have any additional questions about our response and would be pleased to be able to discuss our views with you.

Yours truly,

Klaus-Peter Naumann  
Chief Executive Director

Gillian G. Waldbauer  
Head of International Affairs

**anan**



Founded in 1979 and chartered by Act No. 76 of 1993

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**Our Ref:**

**Your Ref:**

**June, 2018**

Dear Sir,

## **RESPONSE TO THE EXPOSURE DRAFT 64 - LEASES**

The Association of National Accountants of Nigeria is pleased to comment on the Exposure Draft 64 - Leases.

**Our response to Questions for respondents are set out below:**

### **Specific Matter for Comment 1**

The Association of National Accountants of Nigeria (ANAN) agrees with IPSASB on the decision to adopt IFRS 16 Right-of-Use model for Lessee Accounting because the reasons adduced in BC7 are comprehensive coupled with the fact that they equally bringing to prominence the concept of the "Right-of-Use" to override the right of control.

### **Specific Matter for Comment 2**

ANAN agrees with IPSASB to depart from the IFRS 16 "Risks and Rewards Model" for Lessor Accounting in the Exposure Draft. The reason for the conclusion is fundamentally based on the Conceptual framework of recognizing and derecognizing criteria of assets.

### **Specific Matter for Comment 3**

ANAN agrees with the proposed single Right-of-Use model for Lessor Accounting consistent with lessee accounting. This is based on the fact that it is in tandem with what obtained in practice within the leasing industry.

#### **Specific Matter for Comment 4**

ANAN agrees with IPSASB position to measure concessionary leases at fair value and recognize the subsidy granted to lessees as day-one expense and revenue over the lease term consistent with concessionary loans for lessors. Also, the IPSASB proposal to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23. The reason is that BC112 - BC114 clear the doubts in the minds of those that are not familiar with the norms of accounting.

#### **ABOUT ANAN**

The Association of National Accountants of Nigeria (ANAN) is a statutorily recognized Professional Accountancy body in Nigeria. The body is charged among others, with the responsibility of advancing the science of accountancy.

The Association was founded on 1<sup>st</sup> January, 1979 and operates under the ANAN Act 76 of 1993(Cap A26 LFN 2004), working in the public interest. The Association regulates its practising and non-practising members, and is overseen by the Financial Reporting Council of Nigeria.

Active ANAN members are 20,049, who are either FCNA or CNA and are found in Business, Practice, Academic and Public Sector in all the States of Nigeria and Overseas. The members provide professional services to various users of accountancy services.

ANAN is a member of the International Federation of Accountants (IFAC), International Association for Accounting Education & Research (IAAER), The Pan African Federation of Accountants (PAFA), and Associate of Accountancy Bodies in West Africa (ABWA).

Yours faithfully,

***ASSOCIATION OF NATIONAL ACCOUNTANTS OF NIGERIA***

**DR. Nuruddeen Abba Abdullahi, mni, FCNA**  
Registrar/Chief Executive

## IPSASB Exposure Draft 64 *Leases*

### **Response from the Chartered Institute of Public Finance and Accountancy (CIPFA)**

29 June 2018

**CIPFA, the Chartered Institute of Public Finance and Accountancy**, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at [www.cipfa.org](http://www.cipfa.org)

Any questions arising from this submission should be directed to:

**Don Peebles**

Head of CIPFA Policy & Technical UK  
CIPFA  
Level 3 Suite D  
160 Dundee Street  
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Tel: +44 (0)131 221 8653  
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**Steven Cain**

Technical Manager  
CIPFA  
77 Mansell Street  
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Tel: +44 (0)20 543 5794  
Email: [steven.cain@cipfa.org](mailto:steven.cain@cipfa.org)

CIPFA is pleased to present its comments on this Exposure Draft which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

As noted in our response to IPSASB's consultation on its strategy and workplan, CIPFA strongly supports the approach which IPSASB has taken to maintaining alignment with international frameworks.

IFRS 16, *Leases* introduces a new accounting treatment for lessees, which is aligned with more recent thinking in the IASB's current Conceptual Framework, moving away from the risks and rewards model developed under older frameworks. However, despite substantial efforts the IASB could not develop and agree an aligned accounting treatment for lessor accounting which was acceptable to stakeholders. IFRS 16 therefore largely retains the lessor requirements of IAS 17, *Leases*, and justifies this asymmetric approach on cost-benefit grounds rather than conceptual ones.

CIPFA agrees with the IPSASB's analysis of IFRS 16, including that

- there are no public sector specific reasons for departing from the well founded improvements to lessee accounting set out in IFRS 16; and
- the cost benefit arguments for the public sector are different to those of the private sector, and the decision not to pursue symmetrical and conceptually consistent reporting for lessors should be reconsidered.

### **Response to Specific Matters for Comment**

Against this background, we strongly agree with the Board's decision that a revised IPSAS should include

- An IFRS 16 aligned treatment for lessee interests in standard commercial leases and other leases where there is no public sector specific dimension, consistent with the IASB and IPSASB conceptual frameworks.
- A lessor treatment which is not aligned with the IFRS 16 lessor treatment, but is consistent with the IFRS 16 lessee treatment

We also agree that the thinking which informed IPSAS 29 material on concessionary loans is relevant to concessionary leases. However, as explained in our detailed response, it is not clear that the Option 2 model will provide the most useful presentation of the economic reality of leases made for social purposes.

Detailed responses to the SMCs are attached as an Annex.



**Specific Matter for Comment 1:**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons).

Do you agree with the IPSASB’s decision?

If not, please explain the reasons.

If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

CIPFA agrees with the decision to adopt the IFRS 16 right-of-use model for lessee accounting, for the reasons set out in BC6 to BC8.

**Specific Matter for Comment 2:**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons).

Do you agree with the IPSASB’s decision?

If not, please explain the reasons.

If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

CIPFA agrees with the decision to depart from the IFRS 16 risks and rewards model for lessor accounting, for the reasons set out in BC9 to BC13.

**Specific Matter for Comment 3:**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons).

Do you agree with the requirements for lessor accounting proposed in this Exposure Draft?

If not, what changes would you make to those requirements?

CIPFA agrees with the proposed requirements for lessor accounting.

**Specific Matter for Comment 4:**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons).

For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons).

Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft?

If not, what changes would you make to those requirements?

CIPFA agrees with the ED proposals for lessee accounting.

CIPFA partially disagrees with the ED proposals for lessor accounting.

While CIPFA agrees with the IPSASB proposal to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense, we have concerns over the specific proposals to mirror the treatment of concessionary loans, as explained below.

In particular, CIPFA considers that there should be more measured consideration of whether to apply Option 2 or Option 3 to the credit entry for the non-exchange component as discussed at BC84-85.

We also consider that the reasoning provided for discounting Option 3 is faulty.

BC85 refers to discussion at BC45 and BC46 which imply that this credit entry is not of a type allowed by IPSAS 1. However, in considering the four types of entry allowed by IPSAS 1, BC 46 (c) merely notes that reserves are defined in specific IPSAS, and those reserves which have already been defined in existing IPSAS are not of this type. CIPFA considers that as a standard setter, IPSASB is specifically empowered to decide whether items should be considered to be reserves.

We therefore suggest that the determination of whether to adopt Option 2 or Option 3 should reflect the merits of the information presented under each approach, and the extent to which these provide useful information and support the objectives of general purpose financial information.

A key aspect of this determination is what the ‘liability’ in respect of ‘unearned’ items should represent. We suggest that applying this to IPSASB’s extension of the right of use model to lessors is not completely straightforward.

In an exchange transaction, we would expect the values of the underlying asset and the lease liability to roughly balance out at the inception of the lease, except in respect of residual value. The ongoing value to the lessor is mainly through the lease receivable.

However, it is less clear whether this is the appropriate presentation in a public sector non-exchange transaction. The underlying asset is providing value to the lessor both through the lease receivable, and through service potential which it is providing to the lessee, in line with the service objectives of the lessor. This additional value would generally equate to at least the non-market component of the lease.

We can therefore see arguments for the measurement of the 'liability' having regard to contractual flows in line with Option 3 and this would have a number of advantages. It would for example address concerns over the presentation of an ongoing liability which will be in excess of the receivable for the duration of the lease. It would also actually equate to 'unearned revenue'.

It is of course important that the subsidy is recognised, and Option 3 achieves this by recognising an expense in the same way as Option 2, and by an adjustment to net assets/equity.

In the event that the Board does choose to pursue Option 2 as outlined in the Exposure Draft, we suggest that some changes to the terminology should be made. In particular, we suggest that if the liability is measured at market value, it should not be articulated purely in terms of unearned revenue. Option 2 extinguishes the liability through a combination of revenue cash flows in future periods, taken together with the unwinding of the subsidy in future periods. Using the term 'revenue' for this internal lessor transaction seems both unnatural and confusing.



# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

(Set up by an Act of Parliament)

CASLB/G/10

June 29, 2018

Mr. Ian Carruthers  
Chairman,  
International Public Sector Accounting Standards Board,  
The International Federation of Accountants,  
277 Wellington Street West,  
Toronto, Ontario M5V 3H2 CANADA

Dear Ian Carruthers,

**Sub: Comment on 'IPSAS Exposure Draft 64, 'Leases''**

We are pleased to provide comments on the Exposure Draft 64, 'Leases' issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC). Our views on the each of the specific questions for comments are enclosed with this letter.

Please feel free to contact us, in case any further clarification in this regard is required.

Thanking you,

Yours sincerely,

(CA. Vidhyadhar Kulkarni)  
Head, Technical Directorate  
The Institute of Chartered Accountants of India  
Ph: 011-30110449 (CASLB Secretariat)  
E-mail Id: [caslb@icai.in](mailto:caslb@icai.in); [vidhyadhar.kulkarni@icai.in](mailto:vidhyadhar.kulkarni@icai.in);

Encl.: As above



# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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## Comments on Exposure Draft 64, 'Leases'

### Specific Matters for Comment 1

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6 – BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

#### ICAI's View:

We agree with the approach of IPSASB to adopt IFRS 16 right-of-use model for lessee accounting.

It is understood that the lease contracts, whether classified as operating leases or as financing leases, always create rights and obligations for lessee that meets the definitions of assets and liabilities. However, existing IPSAS 13 does not provide to recognize the assets and liabilities in the books of lessee in case of operating lease. In reality, the operating lease also gives rise to assets and liabilities that are not being recorded on the face of the financial statements of lessee under the "Risk and Reward Model". In other words, the said assets and liabilities remain off-balance sheet in the books of lessee under operating leases which provide incomplete financial information to the users (investors and other stakeholders) and also provide opportunities to structure transactions to achieve a particular accounting outcome.

Under the new proposed model, i.e., right-of-use model, ED 64 proposes to recognize the right-of-use the asset (as lessee controls the right to use the underlying asset for the lease term) and a lease liability (as lessee has a present obligation to pay lease rentals over the lease term) in the books of lessee that would significantly increase the transparency and the comparability of the financial statement and would better address the needs of users of financial statements.

### Specific Matters for Comment 2

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9 – BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.



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## ICAI's View:

We do not agree with the IPSASB's proposal to depart from IFRS 16 "Risks and Rewards" model for lessor accounting for reasons stated in our response to the SMC 3.

## Specific Matters for Comment 3

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34 - BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

## ICAI's View:

We are not in favor of IPSASB's decision to propose a single right-of-use model for lessor accounting due to following reasons:

ED 64 prescribes that the underlying asset and the right-of-use asset are separate economic phenomena. Accordingly, ED 64 prescribes to recognise in the books of lessor, the underlying asset as well as a lease receivable and a liability (unearned revenue) at the commencement date. In our view, this would artificially inflate a lessor's assets and liabilities since both the underlying asset as well as the right-to-use asset would get reflected in the lessor's balance sheet.

It is not understood, how the two separate assets, i.e., underlying asset and right to use the same can be recorded/recognized in lessor's financial statements when lessor has already given up the right of use of that asset to the lessee. In other words, future economic benefits associated with the asset being leased out would flow to the lessor in the form of lease receivables and retained interest in the underlying asset (residual value), therefore, it does not seem appropriate to recognize the underlying asset in the financial statements of the lessor in its entirety (at the carrying amount of the commencement date) in addition to the right-to-use (lease receivables) from that underlying asset.

In view of the above, it is mentioned that the model proposed in the ED does not seem appropriate to be applied to at least to those assets with limited useful life. Though, in case of assets with unlimited useful life such as land, the aforesaid model can be applied but still it is felt that some more research is required for applying this model appropriately to all types of assets in financial statements of lessor.





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It may be mentioned that IASB had also considered a similar model for lessor accounting while developing IFRS 16. However, the IASB decided not to pursue it for various reasons. The IPSASB should discuss in its Basis for Conclusions why it feels that the reasons of IASB abandoning that model are not sufficient for IPSASB to desist it from following an approach that is abandoned by IASB even though IASB's Conceptual Framework follows the control model similar to that of IPSASB.

We are further of the view that "risks and rewards" approach is a sub-set of control model. Accordingly, we are of the view that the two approaches do not necessarily result in different consequences in all cases, e.g., in transfer of control of a right-to-use asset. In our view, therefore, the application of control model being the difference in IASB's approach and the IPSASB's approach does not seem to be sufficient reason for departure from IFRS 16.

Further, we are of the view that the information provided in financial statements should meet the needs of the users and should be transparent. However, to achieve this objective it is not an emphasizing consideration to have a symmetrical model of accounting for both lessor and lessee. Accordingly, we are of the view that either the lessor's accounting model should be retained on the same lines as that in IFRS 16 or the IPSASB develops a model that is appropriate for all types of assets.

## Specific Matters for Comment 4

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77 - BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112 - BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

## ICAI's View:

While we agree with the proposed requirements prescribed by the IPSASB to account for concessionary lease, we have one observation that this ED has prescribed to measure these concessionary leases at 'fair value'. However, it is felt that prescribing fair value is not in concordance with the IPSASB's Conceptual



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Framework which explains the term “market value” as one of the measurement base for assets/liabilities.

Though BC 26 of this ED while recognizing the above fact explains the reason of using the term “fair value” in line with other existing IPSASs, we feel that prescribing “market value” would be more appropriate as “market value” is considered to be entity specific and, therefore, may be more appropriate as compared to “fair value” which is market specific.

*Okulkarni*



International Public Sector Accounting Standards Board  
Mr Ian Carruthers, IPSASB Chair  
and Mr John Stanford, IPSASB Deputy Director  
277 Wellington Street West  
Toronto, Ontario M5V 3H2  
Canada

E-mail: [Ian.Carruthers@cipfa.org](mailto:Ian.Carruthers@cipfa.org), [JohnStanford@ipsasb.org](mailto:JohnStanford@ipsasb.org)

30 June 2018

Dear Mr Carruthers, dear Mr Stanford,

**Exposure Draft on Leases**

We are pleased to respond to the invitation from the International Public Sector Accounting Standards Board (IPSASB) to comment on Exposure Draft 64 Leases on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of those firms that commented on the Exposure Draft. "PricewaterhouseCoopers" or 'PwC' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We support the work the IPSASB undertakes to develop high-quality accounting standards for use by governments and other public sector entities around the world with the aim of enhancing the quality, consistency and transparency of public sector financial reporting worldwide.

- We agree with the conclusion to adopt the IFRS 16 right-of-use model for lessee accounting.

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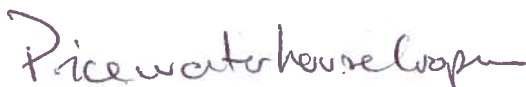
PricewaterhouseCoopers International Limited is registered in England number 3590073.  
Registered Office: 1 Embankment Place, London WC2N 6RH.

- We also agree with the proposed model to depart from the IFRS 16 risks and rewards model for lessor accounting and to apply a “symmetrical approach” to lessee accounting with some caveats and proposed amendments.
- With respect to lessor accounting we prefer approach 2 (as per ED 64.BC35) for conceptual reasons, but could concur with approach 1 for practical reasons. If the IPSASB would follow approach 1 we believe some refinement or clarification to the ED 64 version is necessary.
- We agree with the proposal for concessionary lease and also have some suggestions for changes or clarification.
- Furthermore we give feedback on some aspects that have not been identified as “specific matter for comment” by the IPSASB.

Our detailed responses are in the Appendix to this letter.

If you would like to discuss any of these points in more detail, please contact Henry Daubeney ((+44) 20 7804 2160), Patrice Schumesch ((+32) 2 710 40 28) or Sebastian Heintges ((+49) 69 9585 3220).

Yours sincerely,

A handwritten signature in dark ink, appearing to read "PricewaterhouseCoopers", written in a cursive, flowing style.

PricewaterhouseCoopers

<b>Appendix: Responses to the questions in IPSASB's Exposure Draft on Leases</b>
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**1. Specific Matter for Comment 1**

**The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6– BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons.**

**If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We agree with the conclusion to adopt the IFRS 16 right-of-use model for lessee accounting.

As an additional reason, we would like to point out that the IFRS 16 right-of-use model also recognizes a lease liability related to future lease payments that meet the definition of a financial liability for all leases as compared to the risk-and-reward based model where the liability for operating leases is off-balance sheet. We note that financial analysts tend to adjust financial statements for this off-balance sheet liability.

**2. Specific Matter for Comment 2**

**The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision?**

**If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We agree with the proposed model to depart from the IFRS 16 risks and rewards model for lessor accounting and to apply a "symmetrical approach" to lessee accounting with some caveats and proposed amendments.

We note that the conceptual framework establishes the concepts that are to be applied in developing IPSAS (CF para 1). In the proposed strategy and work plan 2019-2023 the IPSASB also confirmed its objective "to continue to work to maintain convergence with IFRS". We concur with the IPSASB that a "symmetrical approach" is more in accordance with the conceptual framework, whereas the "risk-and-reward" model is not. Therefore, we appreciate that the IPSASB is in a dilemma as to which objective it should follow.

We note that the IASB decided to keep the lessor accounting model as in IAS 17 for cost-benefit reasons and because of established past practice in the private sector. So, any reason to keep the IPSAS lessor model would not primarily be based on sound conceptual reasons, but rather on the desire to keep alignment with IFRS (which, in itself has merits). The IPSASB, however, believes that different cost-benefit considerations apply in the public sector and wants to align lessor accounting for the receivable with lessee accounting for the payable (see ED 64.BC11). We also note that the past practice of using IPSAS 13 is much less than was the case with IAS 17 in the private sector (many public sector entities still need to make the move to IPSAS). Along with the assumption that consolidation issues for leases are more prevalent in the public sector as compared to the private sector and that it is important to develop a consistent set of financial reporting standards, we understand that the IPSASB has not followed IFRS 16 for lessor accounting and instead, introduced the "symmetrical approach". It might also be beneficial that for the IPSASB to evaluate whether the cost of making a one-time change from current lessor accounting for those already applying IPSAS to the "symmetrical approach" is outweighed by cost-savings in following the "symmetrical approach" going forward, which might be easier to apply than following the operate/finance lease model and in accounting for intra-group leases. We invite the IPSASB to double-check that the cost-benefit justification is robust enough to justify this accounting treatment, thus respecting the IPSASB due process for departing from IFRS .

### **3. Specific Matter for Comment 3**

**The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft?**

**If not, what changes would you make to those requirements?**

We agree that a lease is the sale of an unrecognized "right-of-use asset" and agree that the lessor shall recognize the lease receivable as an asset, which, as a separate economic phenomenon, is distinct from the underlying asset.

#### ***Preference for approach 2 for conceptual reasons***

We generally concur with the analysis of approaches 1 and 2 (ED 64.BC 35). We note that the IASB also discussed a "gross" and a "net" approach in discussing lease accounting before it reverted to the "risk-and-reward model". We also note that the disadvantage of approach 1 is that it is difficult to substantiate the credit entry (lease liability), respectively unearned revenue. We note that the IPSASB itself had difficulties in justifying that aspect of approach 1 (ED 64.BC 53) and that this difficulty does not arise in relation to approach 2.



We agree that the lease receivable in the lessor's books should mirror the lease payable in the lessee's books. However, we do not agree with having the full asset recognised in the balance sheet, as it would imply double counting of the economic benefits that can be derived from that asset (so in this sense would not meet the definition of an asset). We believe it is wrong to compare this with a concession asset under IPSAS 32, as a grantor has control of a concession asset (including the way it should be used), whereas a lessor relinquishes control of the use of the asset for the duration of the lease term. The measurement of the underlying asset should therefore be reduced proportionately for the portion corresponding to the right-of-use granted. A receivable should be recognised (counterpart to the lessee's liability) and possibly a gain or loss is recorded in the lessor's books as the difference between the reduction in the carrying amount of the underlying asset and the lease receivable. Applying this treatment, no payable would be recognised in the lessor's books; which would also best reflect economic reality and reconcile with the definition of a liability in the framework. In fact, there is no liability: The credit entry does not represent a performance obligation of the lessor (to make the leased asset available) over the term of the lease, as the right of use asset has been delivered to the lessee at the commencement of the lease.

Proposed approach 1 is also inconsistent with the control concept. The lessor has transferred the right to use the underlying asset to the lessee for the term of the lease, and so it is unclear how the lessor retains control of the underlying leased asset during the term of the lease. We think that the rights of the lessor under a lease agreement consist of (i) the lease receivable, and (ii) the rights retained (residual rights) in the underlying leased asset, rather than the underlying asset itself. We agree that the right-of-use asset and the underlying leased asset are different economic phenomena. However, it does not follow that the economic benefits/service potential embodied in the right-of-use asset are additional to the economic benefits/service potential embodied in the underlying leased asset.

#### ***Could concur with approach 1 for practical reasons***

We note that approach 2 is more difficult to apply in practise. The question arises what portion of the underlying assets should be derecognized at inception of the lease, is it a proportion in relation of the lease term in comparison of the useful life of the asset, is it based on a present value calculation or is it simply the same amount as the lease receivable. For this detriment we can also concur with approach 1 as proposed in ED 64.

The current IPSAS guidance on offsetting can also be a reason why this would be appropriate. IPSAS 1.48 points out that assets and liabilities shall not be offset unless required or permitted by any IPSAS. Offsetting should only be allowed if that reflects the economic substance of the transaction. We concur with the IPSASB that there are three different economic phenomenon being

- underlying asset
- lease receivable, and
- unearned lease revenue

and that based on their substance the liability should not be offset with any of the two assets:

- Though the entity might be restricted in the use of the underlying asset through the lease contract it is free to sell that asset to a third party as it has not sold but leased the asset. Therefore, it controls the underlying asset.
- The entity is entitled to the lease receivable as stipulated in the lease contract.
- The entity has to provide access to the leased asset during the lease term.

***If approach 1 would be followed, further refinement necessary***

We would like to point out the following:

- As pointed out in ED 64.BC 40 "a lease under the right-of-use model is in substance a sale of an unrecognized right-of-use asset." The lessor has transferred this right-of-use asset and therefore recognizes a lease receivable as financial asset. As we believe the nature of the credit entry can only be the lessor's obligation to continually allow the lessee full access to the underlying asset, the liability is a **counterbalance to the underlying asset** and not to the lease receivable, as the lessor is restricted in using the leased asset. The lease receivable is initially measured based on the payment terms of the lease contract and subsequently reduced using the effective interest method depending on when contractual lease payments are made, whereas, in contrast, the access to the asset is granted on a continual basis. Therefore, we do not agree with the provision in ED 64.44 of subsequent measurement of the liability: "A lessor shall adjust the liability (unearned revenue) by the same amount as the change resulting from the remeasurement of the lease receivable." Payment terms of leases (e.g. up-front payments, key-money or lease free periods) may be, and often are, unrelated to access granted on a continual basis.
- For the same reason we propose consequential amendments to IPSAS 26 – Impairment of cash-generating assets to avoid double counting. The lease receivable is subsequently measured according to IPSAS 29. The underlying asset is subsequently tested for impairment according to IPSAS 26. As the cash flows during the lease period are reflected in the lease receivable (IPSAS 29), in order to avoid double-counting they may not be considered in the cash flows in determining the fair value less cost to sell (if a discounted cash flow model is used) or the value in use.. The IPSASB should explore whether it is more appropriate to

- either require an impairment test for the cash-generating-potential of the underlying asset and lease receivable together and consider the cash flows from the lease contract in the estimate of future cash flows or
- require an impairment test for the underlying asset excluding the cash flows from the lease contract, but deducting the unearned lease revenue as a liability based on IPSAS 26.87 (b).

#### **4. Specific Matter for Comment 4**

**For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft?**

**If not, what changes would you make to those requirements?**

We agree that a lease contract at below-market terms includes a non-exchange component (concessionary lease) and will generally not constitute a lease agreed at a "bargain price" for the lessee. The non-exchange portion of the lease represents a grant or subsidy from a lessor to a lessee and a phenomenon that is specific to the public sector. It should be accounted for in accordance with similar phenomena already dealt with in IPSASB's literature.

We agree that the below-market component should be treated as a subsidy. This is consistent with other IPSAS requirements dealt with in other standards or projects. Specifically, we refer to the CP and upcoming ED on Revenue and Non-Exchange Expenses, which deal with donations, goods in kind and services in kind. These kinds of transactions are frequent in the public sector and should be made transparent in the financial statements. For example, some public sector entities sometimes receive large real estate properties at below-market conditions (even for free) for use throughout long periods; not recognising anything in the balance sheet would make financial statements less transparent and would not meet the accountability objective of financial statements. Public sector entities should show the resources entrusted to them. A simple disclosure would, in our view, not be enough.

We note that the following changes or considerations should be made with respect to concessionary leases:

- According to ED 64.AG61 (b) the lessor considers whether the concessionary component is a transaction with owners, in their capacity as owners (e.g. representing a capital contribution). We do not understand why accounting requirements for the lessee – receiving the capital contribution - are not consistent with lessor accounting (refer to ED 64.61 (a)). We would expect that the concessionary component, representing a capital contribution, is treated as such by the lessor and by the lessee.
- If a concessionary component is not a transaction with owners, it is treated as an expense at initial recognition by the lessor (ED 64.AG61 (b)). The entity receiving the concessionary lease recognizes revenue at initial recognition, except if a present obligation exists, in which case, it recognizes a liability (IPSAS 23.105C-105D). From a consistency perspective, we question why the lessor would not also consider whether to recognize an asset if the lessee recognizes a liability.

We would like to draw the IPASB's attention to its current Revenue and Non-Exchange Expenses project. In example 10 (June 2018 Paper 9.2.3, Appendix A) a Central Government provides funds to a University for the construction of teaching space. The University is required to provide teaching for 30 years. In this example the non-exchange component (forgiveness of the loan) is recognized as an asset at initial recognition and expensed over time by the Central Government. We would expect that, had the Central Government not provided funds, but a concessionary lease, the concessionary component would equally not be recognized as an expense immediately, but deferred and recognized as expense over time.

In our opinion, outcome of the Revenue and Non-Exchange Expenses Project for the non-exchange component and accounting for a concessionary lease component by the lessor as well as by the lessee should be consistent. This should be considered when finalizing the Leasing standard and the Revenue and Non-Exchange Project.

- We would assume that a concessionary lease might create some incentive at least for the lessee to continue the lease. We note that ED 64.16-19 and ED 64.AG29-37 on lease term have not been changed as compared to IFRS 16. We think the IPSASB should explore what effect a concessionary lease has on the lease term and include appropriate guidance.

## **5. Additional comments**

In addition to our comments to the SMC above we would like to point out the following:

- ED 64.28: This is the definition of lease payments included in the **lessor's** lease receivable. ED 64.28(a) should state "...less any lease incentives **payable**", instead of "...**receivable**".
- ED 64.41: This paragraph addresses the remeasurement of the lease receivables of the lessor. 41(a) does not fit the definition of lease payments in ED 64.28. "...amounts expected to be payable under a residual value guarantee" in referring to the definition of lease payments for the lessee (see ED 64.76). Residual value guarantees are included in the lessor's lease receivable as "any residual value guarantees", not "amounts expected to be payable". Also, as it is from the lessor's view, it should state "receivable", instead of "payable".
- What is the difference between ED 64.54(a) and (c)? "Variable lease payments that do not depend on an index or a rate", as stated in .54(a), are "variable lease payments not included in the measurement of the lease receivable", as stated in .54(c). Thus, both (a) and (c) refer to the same type of variable lease payments.
- ED 64.78: Why is the fair value of the lease liability calculated using the lessee's incremental borrowing rate? Shouldn't, in any case, a market interest rate be used to determine a fair value?
- ED.AG60 states: "An entity firstly assesses whether the substance of the concessionary lease is in fact a financing transaction, a grant or a combination thereof." We note a contradiction in this sentence. We understand that leasing is a kind of financing. ED 64.15 states a concessionary lease is at below market terms. Therefore, in our understanding a concessionary lease can only be a grant or a combination of a financing and a grant. If it were a financing transaction without a grant, it would not be concessionary.
- In the public sector, the form of the arrangements in respect of concessionary leases may vary a lot, ranging from clear contractual arrangements to public promises or declarations of intent. Examples include buildings put freely or at below-market conditions by governments at the disposal of international organisations or other public sector organisations to attract them in their country or region. What constitutes an **enforceable right and determination of the lease term** in such circumstances might be judgmental and have a big impact on the amounts to be recognised in the balance sheet. Reflecting the impact of these arrangements in the balance sheet would meet the accountability objectives of financial statements and make the resources that are entrusted to the public sector entity transparent. We would welcome the IPSASB to provide more guidance on this matter to ensure consistency in the accounting of such arrangements.







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The Technical Director  
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Per electronic submission  
30 June 2018

Dear John

## **COMMENTS ON ED 64 *LEASES***

We welcome the opportunity to comment on the proposed IPSAS on *Leases*.

The views expressed in this letter are those of the Secretariat and not the Accounting Standards Board (Board). In formulating its comments, the Secretariat consulted a range of stakeholders including auditors, preparers and professional bodies.

As this is a converged project with IFRS 16, we agree with the IPSASB's proposal to adopt the right-of-use model in IFRS 16 for lessees. However, we do not support the decision to depart from the IFRS 16 model for lessors. In our view, the proposed accounting to continue to recognise and measure the underlying asset does not reflect that the lessor's right to service potential and future economic benefits in the underlying assets have diminished. We believe that the IPSASB should either consider (a) modifying its current proposal to reflect a change in measurement of the underlying asset, or (b) retaining the IASB's model for lessors. By retaining the IASB's model, it means that the same transactions are accounted for in the same way in the public and private sectors.

Furthermore, while we agree in principle with the concept of concessionary leases from the perspective of lessees, we disagree with the proposed accounting for lessors. We have concerns about recognising revenue for a transaction that has no economic substance at the outset.

Board Members: Ms F Abba, Ms L Bodewig, Mr C Braxton, Mr K Hoosain, Ms I Lubbe, Mr K Makwetu,  
Ms P Moalusi, Ms Z Mxunyelwa, Mr V Ndzimande, Ms N Themba,  
Alternate: Ms M Sedikela  
Chief Executive Officer: Ms E Swart, Technical Director: Ms J Poggiolini

Our detailed responses to the specific matters for comment are outlined in Annexure A to this letter. Other matters, which mostly indicate areas where additional guidance should be considered, are outlined in Annexure B.

Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Poggiolini', with a stylized, cursive script.

Jeanine Poggiolini  
Technical Director

## ANNEXURE A – RESPONSES TO SPECIFIC MATTERS FOR COMMENTS

### Specific matter for comment 1

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6 to BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

We support the IPSASB's decision to adopt the IFRS 16 right-of-use model for lessee accounting. We believe that the right-of-use model for lessees is easily understandable and its conceptual basis is reflective of the existing principles established by the IPSASB in its literature.

### Potential implementation issues

#### *Resource implications for first time adoption*

We note that in paragraph BC7(e) the IPSASB considered the costs associated with adopting the right-of-use model, and concluded that these costs would not outweigh the benefits if the IPSASB also adopted the practical expedients in IFRS 16. Our stakeholders indicated that the cost of implementation in the private sector has been significant, particularly where changes to systems are required to ensure that relevant information is gathered on a timely basis to recognise right-of-use assets and lease liabilities. As most leasing arrangements in the public sector are currently classified as operating leases, the costs involved to make the necessary system changes and obtain the relevant skills to undertake the implementation are likely to be significant. Although the practical expedients or recognition exemptions made available to lessees will be helpful and alleviate some cost issues, not all leases will meet the criteria to apply the practical expedients or other recognition exemptions.

#### *Impact on debt and other financial ratios*

For lessees, the effect of the proposed accounting is that entities will be reporting financial liabilities for those leases. While the proposed accounting is expected to provide more transparent information about the lessee's existing financial commitment, we are concerned that the impact of recognising additional financial liabilities on financial ratios such as net and gross debt has not been considered. There is a possibility that applying the proposed lessee accounting may result in some entities no longer complying with debt covenants on existing financing facilities or other regulatory requirements as a result of the potential change in debt ratios.

### Recommendation

Since leases are pervasive in public sector and likely to affect most public sector entities, we recommend that the IPSASB reconsiders the transitional provisions and/or effective date of the Standard to allow entities sufficient time to obtain the relevant information to apply the right-of-use model. In addition, we believe that the IPSASB, when determining the effective date of the Standard, should consider which other IPSASs will become effective in the same period so that entities do not deal with too many reporting changes at once.

Furthermore, we believe the IPSASB should take cognisance of the consequences of the changes to the accounting for lessees, and similar to the IASB, consider conducting extensive outreach activities with users of financial statements (such as rating agencies, analysts and lenders) to raise awareness of the changes, and manage the likely effects.

## Specific matter for comment 2

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9 to BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

We do not support the IPSASB's decision to depart from the IFRS 16 risks and rewards model for lessor accounting. We note the IPSASB's reasons for departing from the IFRS 16 model in BC9 to BC13, and we do not believe the reasons provided are sufficient grounds for departure.

Our stakeholders were not in favour of the IPSASB's decision and indicated that while IFRS 16 may not be consistent with the lessee model, they would support retaining the dual model in IFRS 16 for lessors.

### **Lessors should not derecognise the underlying asset in a lease**

Paragraphs BC9 and BC35(a) explain that the lease does not transfer control of the underlying asset to the lessee as no sale has occurred, and the lessor should not derecognise the underlying asset. We question whether the conclusions reached are appropriate in relation to the principles of control in the Conceptual Framework.

In particular, paragraph AG4. in the Exposure Draft explains that a lessee should assess whether a lease conveys the right to control the use of the leased asset based on whether it has the a) right to obtain substantially all of the economic benefits from use and b) right to direct the use of the underlying asset. To direct the use, the lessee should consider whether it has the right to direct how and for what purpose the asset will be used or whether the decisions about how and for what purpose are predetermined. In accordance with the determinants of control in the Conceptual Framework, the lessee accounting demonstrates that the substance of the lease is that the lessor has transferred the following to the lessee:

- *access to the resource, or ability to deny or restrict access to the resource;*
- *the means to ensure that the resource is used to achieve its objectives; and*
- *the existence of an enforceable right to service potential or the ability to generate economic benefits.*

Based on the above principles, we believe that the IPSASB's proposals seemingly apply substance over form only when assessing the lease from the lessee's perspective. However, from the lessor's perspective, the proposal has ignored that in substance the lessor's rights in the underlying asset have diminished. Therefore, we have concerns that the lessor model allows the continued recognition of the underlying asset even though the lessor's rights to service potential or the ability to generate economic benefits from using the asset are limited for the duration of the lease.

### **Applicability of the control based approach in IPSAS 32, Service Concession Arrangements: Grantor**

The IPSASB explains in paragraphs BC9 to BC13 that the risks and rewards model in IFRS 16 is not based on control, and is inconsistent with existing literature (i.e. IPSAS 32). While we understand that there may be similarities in the control based approach in IPSAS 32 and the proposed lease accounting, we have our reservations about the arguments made that the proposed lessor accounting is consistent with the grant of a right to the operator model, in all respects.

For instance, the principles of control in IPSAS 32 are on the premise that the grantor has control over the service concession asset when the grantor controls or regulates the services that the operator must

provide, to whom the operator must provide them and at what price. In the case of the lessor, the IPSASB concludes that the lessor has control over the underlying asset, even though it is explicitly clear in the lessee model that the lessor does not have the right to obtain substantially all of the economic benefits from use or the right to direct the use of the underlying asset for the duration of the lease. As such, the right to direct the use, how and for what purpose the underlying asset will be used or whether the decisions about how and for what purpose are predetermined rests with the lessee rather than the lessor in this case. Therefore, we do not believe that the arguments made in paragraphs BC9 and BC36 can be supported based on IPSAS 32.

## **Practical issues in the public sector**

### *Consolidation issues*

The IPSASB also decided to depart to address consolidation issues and to make leasing transactions more understandable by the lessor and lessee applying the same accounting model. The IPSASB was concerned that under the risks and rewards model, if the lessor classifies the lease as a finance lease, the underlying asset would not be recognised by either party, and separate records would be required to report the underlying asset. A similar observation is made for operating leases and the recognition of lease receivables.

The IPSASB's arguments to address the consolidation issues are only relevant where all public sector entities apply IPSASs. However, in some jurisdictions, including our own, the consolidation issues discussed in paragraph BC10 will remain a challenge for mixed groups, i.e. where entities apply IFRS Standards and IPSASs (or equivalent reporting framework). In such cases, lessors applying IFRS Standards will be required to account for their leases based on the risks and rewards model in IFRS 16 in their own financial statements, and produce information that applies the right-of-use model for use in the consolidated financial statements. For the economic entity, the implications may be limited for leases within the group as these would be eliminated, however the cost implications may be significant for leases external to the economic entity as the lessor will be required to apply different principles, and maintain separate records.

In our view, we believe that departing from the IFRS 16 model will result in understandability issues for users in the public sector and private sector, as the same transaction is accounted differently in the public sector and private sector.

## **Recommendation**

We suggest that the IPSASB re-evaluates its reasons for departing from IFRS 16 in an effort to achieve symmetry. In our view, a symmetrical approach was intended to resolve consolidation issues where the lessee and lessor apply IPSASs and are both part of the same economic entity. In such cases, symmetry allows for the same transaction to be accounted for in the same way by both parties in their individual entity (or separate) financial statements. From an economic entity level, symmetry is unachievable if the counterparty is external to the economic entity and does not apply IPSASs.

We have examined the IASB's developments in its lease project. The IASB proposed similar approaches in its Exposure Drafts but concluded that it would retain the existing dual model in IAS 17 as most constituents indicated that the existing accounting worked well in practice. We suggest that the IPSASB considers the feedback provided to the IASB's by its constituents, when it considers feedback from respondents as this may assist the IPSASB to either (a) conclude that the economics of leases in the public and private sector are the same and that there is no reason to depart from the IFRS 16 model, or (b) provide guidance on how to resolve the measurement of the underlying asset as discussed in our response to SMC 3.

Therefore, depending on the feedback received by the IPSASB, we would propose that either the IPSASB retains the IFRS 16 model or modifies Approach 1 to address the measurement issues discussed in our response to SMC 3.

### **Specific matter for comment 3**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34 to BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

We do not support the IPSASB's proposal for lessors to apply the right-of-use model consistent with the lessee accounting as we do not agree with the IPSASB's reasons for adopting Approach 1 rather than Approach 2.

### **IPSASB approaches to the right-of-use model**

Our comments below should be read in the light of our response to SMC 2.

Paragraph BC35 notes that the IPSASB considered two mutually exclusive approaches to the right-of-use model for lessors. The IASB considered several possible approaches for lessor accounting in its project on leases. In 2010, the IASB proposed that both lessees and lessors should apply the right-of-use model when accounting for leases. The IASB model considered whether the lessor retained exposure to the risks or benefits associated with the underlying asset during the lease term. The extent of exposure determined whether the lessor would either recognise a lease liability while continuing to recognise the underlying asset (i.e. performance obligation approach) or derecognise the rights in the underlying asset that the lessor transferred to the lessee and continue to recognise a residual asset of its rights to the underlying asset at the end of the lease term (i.e. derecognition approach). Approach 1 of the IPSASB is the right-of-use model proposed in the Exposure Draft, and is similar to the IASB's performance obligation approach while Approach 2 is similar to the derecognition approach. The IASB received mixed views on those approaches but decided to retain the existing lessor accounting.

We question whether it is appropriate for the lessor to continue to recognise and measure the underlying asset without considering that its rights to service potential or the ability to generate economic benefits from using the asset are limited for the duration of the lease. We considered the IPSASB's reasons for favouring Approach 1 to Approach 2, and note the following concerns about the Approaches.

#### *Approach 1: right-of-use asset is a separate economic phenomenon to the underlying asset*

We agree that the right-of-use asset is a separate economic phenomenon to the underlying asset but question whether the continued recognition of the underlying asset is appropriate.

#### Continued recognition of the underlying asset

This approach assumes that the lessor retains control of all the future economic benefits and service potential of the underlying asset and should continue to be recognised in its entirety in the statement of financial position. We do not believe that the accounting of the underlying asset is a faithful representation of the substance of the transaction, as noted in our response to SMC 2.

#### Recognition of the lease receivable

We agree with the IPSASB's conclusion that the lease receivable should be recognised as the lessor has an unconditional right to receive the lease payments. However, some of our stakeholders generally

disagreed with Approach 1, as it requires the recognition of a lease receivable as well the underlying asset which results in double counting and “grossing up” of the lessor’s financial position.

#### Recognition of a credit entry

The IPSASB decided in paragraph BC35 that the lessor should recognise a credit entry and refer to it as a lease liability (unearned revenue) that will be reduced subsequently over the lease term as revenue is recognised in the statement of financial performance. The IPSASB acknowledges that the treatment would not be consistent with the Conceptual Framework and existing IPSASs on revenue recognition. Since there is no outflow of resources, we do not believe that the credit entry is a liability. Additionally, it is unclear how the credit entry represents revenue, when the lessor has not earned any revenue and the credit entry is just a consequence of the recognition of the lease receivable.

Some of our stakeholders also questioned what is meant by the phrase in paragraph 43 that the lessor should recognise revenue according to the substance of the lease contract. They indicated that since most leases are time-based, it is unclear what is meant by “the substance of the lease”. Some indicated that this means revenue should be recognised on a straight line basis over the term of the lease. We suggest that the IPSASB considers providing additional guidance to clarify that revenue may be recognised on a straight line basis, or another systematic basis to ensure that consistent principles are applied when determining what is meant by “the substance of the lease contract”.

#### *Approach 2: right-of-use asset is a component of the underlying asset*

Similar to the IASB’s proposed derecognition model, in Approach 2 the right-of-use asset is a component of the underlying asset and the lessor would derecognise the component of the underlying asset that is transferred to the lessee and recognise a residual asset. The IPSASB’s reason that the derecognition approach is not consistent with the Conceptual Framework is debatable. In our view, IPSASs allow for the derecognition of parts of or components of assets (for example, property, plant and equipment and financial instruments) and this principle would apply in the same way under Approach 2. As such we disagree that the Approach 2 is not consistent with the Conceptual Framework. In addition, we also disagree with the IPSASB’s arguments that Approach 2 is not consistent with the control based approach in IPSAS 32. As noted earlier in our response, we do not believe that the approach in IPSAS 32 is entirely consistent with the control approach discussed in the Exposure Draft.

#### **Recommendations**

Given the similarities between the IPSASB’s approaches and the IASB’s proposed performance obligation and derecognition approach, we question whether the IPSASB fully explored the IASB’s reasons to not pursue its earlier proposals in the Exposure Draft in 2010. The IASB undertook extensive consultation on its proposals, with users and preparers, and based on the feedback decided that the risks and rewards model is not conceptually flawed and should continue to be applied for lessors. We therefore recommend that the IPSASB re-evaluate whether the same concerns raised in response to the IASB’s proposals in the private sector do not also exist in the public sector.

Furthermore, the IPSASB seems to have concluded that Approach 2 is more costly and complex. In our view, cost considerations and the complexity of the proposed accounting are applicable to both approaches and if cost and undue effort was the only consideration, we would support consistency with the IFRS 16 model in this regard.

If Approach 1 is retained in the final IPSAS, we suggest that the IPSASB considers modifying this Approach to deal with the concerns raised that the measurement of the underlying asset cannot be the same as that of similar assets that are not the subject of a lease.



Our proposed modified Approach is a hybrid approach that combines some aspects of the two approaches. This would mean that:

- The lessor would continue to recognise the underlying asset but re-measure it in such a way that the value of the underlying asset reflects the lessor's residual rights to service potential or the ability to generate future economic benefits. The re-measurement would require the underlying asset to be measured at the fair value (similar to the fair value model in IPSAS 16), irrespective of whether the IPSAS relevant to that underlying asset allows the use of the revaluation, fair value or cost model.
- In determining the fair value of the underlying asset, the entity would need to consider the possibility of double counting when measuring the underlying asset and the lease receivable. Existing guidance in IPSAS 16 indicates that in determining the fair value of the underlying asset, the value of the other assets recognised should be excluded. In this case, the value of the lease receivable would be excluded from the fair value of the underlying asset to resolve the issue about double counting in the statement of financial position.
- If however, the IPSASB believes that prescribing the use of fair value for all leased assets is inappropriate, and retains the proposed requirement to continue to allow entities to use either the revaluation, fair value or cost model, then similar measurement consideration would be required where the cost model is applied. The carrying amount of the underlying asset would also reflect the lessor's residual rights to service potential or the ability to generate future economic benefits by either proportionately reducing the cost of the underlying asset or impairing the underlying asset.

#### **Specific matter for comment 4**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Some of our stakeholders welcomed the introduction of the concept of concessionary leases in ED 64 as concessionary leases are prevalent in the public sector. Generally, support was expressed for the guidance on concessionary leases for lessees, however many disagreed with the proposed lessor accounting. In particular, our stakeholders found it difficult to understand the conceptual basis of the proposed lessor accounting.

In other cases, stakeholders did not agree with the introduction of concessionary leases as they did not believe it provides useful information to the users of financial statements.

Some stakeholders also indicated disagreement with the proposals for concessionary leases for lessees as the use of assets in these arrangements is similar to services in-kind, and that the IPSASB is not being consistent by allowing lessees to recognise concessionary leases, when services in-kind are not required to be recognised in the financial statements under IPSAS 23.

#### **Recognition of concessionary leases**

We do not support the recognition of concessionary leases by lessors. While we understand that the IPSASB aims to reflect the substance of the transaction on day one (i.e. an expense is recognised for the economic benefits given away through reduced lease payments), we have concerns about recognising revenue for a transaction that has no economic substance at the outset.

Our stakeholders also questioned how entities should account for a cancellation to a concessionary lease as it was unclear whether the lease would be derecognised upon cancellation. We suggest that the IPSASB considers providing additional guidance to address cancellation of concessionary leases.

In mixed groups, entities preparing financial statements based on IFRS Standards would need to identify concessionary leases and report on them differently when preparing the information for the consolidation. Therefore, there would be cost implications as concessionary leases need to be measured at fair value.

## **Measurement of concessionary leases**

### *Determining market-related payments*

Concerns about the measurement of concessionary leases were raised by preparers. It was noted that it would be difficult to determine a market-related rental as the types of lease arrangements undertaken in the public sector often do not exist in the broader property market in a jurisdiction. In our local government environment, we identified leases where municipalities lease social housing to citizens, lease land used in road reserves, lease sidewalks to residents to be used as gardens, and leases of land for sporting facilities, at no or nominal consideration or below market terms. While these leases may appear to be either at no or nominal consideration or below market terms, it was unclear whether the market envisaged in the Exposure Draft would be the government-specific market or the broader property market in a jurisdiction.

Some of our stakeholders indicated that if the classification of leases is made based on the government-specific market, entities may find that the lease is in fact at market terms and not a concessionary lease. Some of our stakeholders also noted that lessees may experience further difficulties in obtaining information about market lease payments when the lessor is not another public sector entity. Furthermore, we noted that in some cases the lease payments charged may be regulated by government. For example, in our environment some entities are centralised lessors established to lease property to other public sector entities, and the lease payments are capped and regulated by the treasury/ministry of finance. In such cases, it is questionable whether those capped lease payments in fact represent a market-related lease. We suggest that the IPSASB considers clarifying which market is used in determining the appropriate classification of leases.

If the IPSASB envisaged a broader property market in a jurisdiction in the Exposure Draft, we suggest that the IPSASB considers introducing a practical expedient that concessionary leases are measured based on the contractual lease payments.

### *Measuring the unearned revenue*

The IPSASB proposes recognising a day 1 expense resulting in a lease liability (unearned revenue) that is higher than the contractual lease receivable. Conceptually, the proposed accounting is inconsistent with existing revenue principles. For example, initially the unearned revenue is based on the benefits the entity has given away in the lease rather than the benefits it expects to receive. This is inconsistent with the principles in the revenue standards which indicate revenue is measured based on the value of the consideration received or to be received.

Furthermore, it was unclear what the nature of the credit entry is in a concessionary lease. From our understanding, the unearned revenue represents foregone revenue. In our view, the lessor has not earned the revenue relating to the concession, and therefore it should not be recognised in the financial statements. We also had difficulty understanding the conceptual difference between this type of concession and subsidised goods and services. For example, in the case of subsidised goods and

services, an entity would recognise revenue based on what it expects to receive from service recipients, and not what was given away as proposed in this Exposure Draft.

Our stakeholders also noted that the proposed accounting results in double counting of expenditure. For example, on initial recognition, the lessor recognises the subsidy as an expense and the entity will also incur costs such as depreciation, maintenance, etc. to make the underlying asset available to the lessee. The recognition of additional expenditure may overstate the cost of providing the subsidised lease.

### **Recommendation**

In our view, the proposed accounting is not conceptually sound and is also difficult to understand. It is important that the IPSASB considers the objective of recognising this information, and the relevance of providing the information to the users of financial statements. We believe that the benefits of recognising concessionary leases may be outweighed by the costs involved to recognise and measure the concessionary leases. Instead, it may be more appropriate to provide disclosures about the concession in the financial statements.

Some of our stakeholders noted that if the IPSASB concludes that the market is the government-specific market, then there may not be as many concessionary leases to be reported in the public sector. Similarly, where there are concessionary leases, it may be more appropriate to provide disclosures rather than recognise and measure those leases as proposed in this Exposure Draft.

It was also suggested that if the IPSASB concludes that recognising the subsidy implies grossing up revenue, then the subsidy and revenue should be offset over time or should be offset against each other in the same reporting period.

## Annexure B – Other matters

Reference	Comments
Paragraph 4	The definition of a lease indicates that the right to control the use of the asset is in exchange for consideration. Our interpretation of “in exchange for consideration” led us to conclude that barter transactions are not considered to be leases as no consideration has been exchanged. Our stakeholders indicated several instances where, for example, an entity would enter into an arrangement to lease undeveloped land to another entity, in return for a developed building. The entity providing the land waives the right to collect taxes, the obligation to undertake routine maintenance, etc. We believe that guidance on how to treat these types of arrangements may be useful.
Paragraph 10	This paragraph notes that the allocation of consideration should be in relation to IPSAS 9. In IFRS 16, this reference would be to IFRS 15 <i>Revenue from Contracts with Customers</i> . The guidance in IFRS 15 is more specific than that in IPSAS 9. We question whether the guidance in IPSAS 9 is sufficient, and if the specific guidance needed should be aligned to IFRS 15 in the interim, in the absence of an IPSAS that is converged with IFRS 15. It may also be useful for the IPSASB to explain in the basis for conclusions the reasons it believes the IPSAS 9 guidance is sufficient for entities to allocate the consideration, as intended in IFRS 15.
Paragraph 15	<p>Paragraph 15 requires that a lessor and lessee should determine whether the lease is at market terms or at below market terms. Some of our stakeholders indicated that the IPSASB should clarify the treatment of discounts and other reductions when making the assessment. It was noted that guidance similar to IPSAS 23.11 should be considered for inclusion to clarify whether the classification of leases subject to discounts will be at below market terms.</p> <p>Our stakeholders noted that it may be difficult in practice to distinguish between concessionary leases and leases at no or nominal consideration. The distinction requires judgement to be exercised, and it may be useful for the IPSASB to provide additional guidance, particularly where it is not immediately clear whether the arrangement is concessionary or at no or nominal consideration. We also suggest that the exclusion of leases at no or nominal consideration should be more prominent, as it is unclear from the diagram in paragraph 22 and the application guidance that these leases are effectively scoped out and accounted for using other Standards.</p>
Paragraphs 98 to 112	Paragraph BC 110 notes that the IPSASB decided to adopt the Conceptual Framework’s approach on presentation that distinguishes between information selected for display or disclosure. We note that the presentation requirements for lessors reflect this approach while the lessee presentation requirements do not. We suggest that this section is amended to be consistent with the presentation approach in the Conceptual Framework.
AG3	This paragraph provides guidance on whether an arrangement is a contract. We question whether arrangements would include those that are not in writing.
AG 4 to AG26	The application guidance provides guidance on how to assess whether a lease conveys the right to control the use of an identified asset. It requires that the customer

	<p>should assess whether it has the right to obtain <i>substantially all of the economic benefits</i> from use of the identified asset. It is unclear why the IPSASB decided to exclude from the discussion the service potential embodied in the underlying assets. If this was deliberate, it would be useful for the IPSASB to provide reasons in the basis for conclusions why the lease accounting does not recognise that leased assets are resources embodying service potential.</p> <p>The guidance does not deal with how an entity would identify whether a contract is a lease or a sale under IPSAS 9. For example, it is not clear how entities should account for an arrangement that conveys the right to control the use of the asset for substantially all of its economic life. Such guidance would be useful to clarify at what point a lessor would lose control of an underlying asset.</p>
AG27 to 28	<p>While this application guidance deals with separating components of a contract, we questioned whether the existing principles of separating a lease of land and buildings in IPSAS 13 may be of relevance in the IPSAS on leases. For example, when accounting for a lease of land and buildings IPSAS 13 required the separation of the lease between the two elements. It was unclear whether such a principle would apply under the proposed accounting, particularly if the lessee is required to apply the depreciation requirements in IPSASs when subsequently measuring the right-of-use asset. As land typically does not have a finite life, it may be useful to provide guidance on how the measurement requirements in the Exposure Draft should be applied, or indicate that the land and buildings may be treated as a single unit for the purpose of the proposed accounting. In addition, we believe the principle may be useful to include when considering whether an entity has conveyed the right to use an asset for substantially its economic life. It is important to make the distinction as the considerations will be different for land and buildings.</p>
AG 29 to 37	<p>The application guidance provides guidance on determining the lease term of a contract. Our stakeholders indicated that it is common for a lessee to lease a custom-built property (for example, military base, police stations and correctional facilities) on a month-to-month basis, with the option to renew each month. In such cases, it was unclear how entities would account for such a lease, as the underlying asset is of such a specialised nature that, in substance, it can be argued that the lease arrangement is indefinite. Therefore the IPSASB should consider providing additional guidance for these types of leases.</p>
AG56 to 57	<p>The application guidance indicates how entities should account for subleases. While we agree with the guidance, we note that in our jurisdiction, some entities are centralised lessors established to lease property to other public sector entities. In some cases, the property to be leased may be of such specifications that the lessor does not have the property available in its portfolio of assets, and enters into a lease contract as an intermediary with a third party on behalf of the lessee. The lease contract between the centralised lessor and the lessee would be under the same terms as the original lease contract with the third party. It is unclear from the guidance whether the lessor would be required to account for the lease as both lessee and lessor, or whether the lease arrangements can be offset, and a back-to-back arrangement is disclosed in the financial statements.</p>
AG60	<p>Paragraph AG60 notes that where a concessionary lease (grant) is granted by the</p>

	lessor, the grant should be accounted for according to the relevant international or national accounting standard. We suggest that the IPSASB acknowledges that currently no such guidance exists for accounting for non-exchange expenses and, a consequential amendment can be made in the final IPSAS when the IPSASB approves the guidance on non-exchange expense in 2020.
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## **THE NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS**

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Our Ref: NBAA/ CF/TSC.1/VII/147

Date: 27<sup>th</sup> December, 2017

Chief Executive Officer,  
International Federation of Accountants,  
International Public Sector Accounting Standard Board,  
529 5th Avenue  
New York, New York 10017.

Dear Sir/Madam

#### **RE: COMMENTS ON EXPOSURE DRAFT 64 - LEASES.**

Refer to the heading above.

NBAA as the PAO responsible for the professional training, development and regulation of the accountancy profession in Tanzania and as the member board of the International Federation of Accountants welcomes the opportunity to provide you with our comments on the Exposure Draft no. 64 on Leases.

In principle, we are supportive of all the requirements in the Exposure Draft. However, after going through it we came up with the following critical insights which we think can add value and consequently ensure wider coverage when it comes to issues related to lease accounting in the public sector.

#### **Concessionary leases issued at no consideration**

##### **Paragraph 20 of ED 64:**

Agreeing with proposal regarding Paragraph 20 that “At the commencement date, a lessor shall not derecognize the existing underlying asset” **except for concessionary leases issued at no consideration.**

#### **Rationale**

Not derecognizing leases issued for no consideration in the books of a lessor is not in line with the conceptual framework. Under the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities para 5.6 an asset is defined as “a resource presently controlled by the entity as a result of a past event”. Further, para 5.7 defines a resource as “**an item with service potential or the ability to generate economic benefits**”. Physical form is



not a necessary condition of a resource. The service potential or ability to generate economic benefits can arise directly from the **resource itself or from the rights to use the resource**".

The lessor under a concessionary lease issued for no consideration loses control of the underlying asset. Recognition of the underlying asset implies retention of only the physical form (which as indicated in the conceptual framework "is not a necessary condition of a resource"). In these cases the ability to use the asset to obtain service potential/economic benefits is transferred to the lessee. No service potential or ability to generate economic benefits is retained by the lessor.

The statement on the basis of conclusion BC9 (c) (ii) that ..... "a lease conveys the right to use an underlying asset for a period of time and does not transfer control of the underlying asset to an entity" does not apply to leases issued at no consideration as no economic benefits or service potential are obtained by the lessor thus the underlying asset is in substance transferred to the lessee.

**Suggestion:** An exception to allow derecognition of the underlying asset in the books of accounts of the lessor should be introduced in Para 20 for leases issued at no consideration. The emphasis on recognition of assets should strictly follow the definition of control as defined in the conceptual framework.

We trust that our comments are of assistance to you. If you require any clarification on our comments, please contact the undersigned.

Thank you in advance for your cooperation.

Yours sincerely,



P. A. Maneno  
**EXECUTIVE DIRECTOR**

30 June 2018

Mr John Stanford  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto  
Ontario M5V 3H2  
**CANADA**

Submitted to: [www.ifac.org](http://www.ifac.org)

Dear John

**ED 64 Leases**

Thank you for the opportunity to comment on ED 64 *Leases* (ED 64). The ED has been exposed in New Zealand and some New Zealand constituents may comment directly to you.

We are pleased that the IPSASB has undertaken this project to update the accounting for leases in IPSAS. This is a significant project which is also impacted by other ongoing IPSASB projects (for example, revenue and non-exchange transactions, and public sector measurement). In addition to commenting on the proposals in ED 64 we have highlighted areas where we consider that further work on those other projects may be required before aspects of this project can be progressed (in particular, concessionary leases).

While we agree with the accounting model proposed for lessees in ED 64, we disagree with the accounting model proposed for lessors and with the proposed accounting for concessionary leases by both the lessee and the lessor.

In our view, the IPSASB should:

- (a) proceed with the proposals in ED 64 for lessee accounting, except for concessionary leases;
- (b) not proceed with the proposals in ED 64 for lessor accounting and instead develop proposals based on IFRS 16 *Leases* (which would need to be exposed for comment); and
- (c) not proceed at present with the proposals in ED 64 for concessionary leases. This topic should be reconsidered at a later date after the IPSASB has made further progress on related on-

going projects (such as the IPSASB's projects on Revenue, Non-Exchange Expenses and Measurement).

The IPSASB initiated this project following the completion of IFRS 16 *Leases* by the International Accounting Standards Board (IASB). We support this strategy as it puts the IPSASB in a position to benefit from the detailed analysis and lengthy debates that occurred during the development of IFRS 16. The IASB's project considered a number of approaches for both lessors and lessees and involved a number of exposure drafts. The final requirements in IFRS 16 were determined after due consideration of both the conceptual and practical arguments identified by the IASB's constituents.

We acknowledge that public sector specific circumstances may lead the IPSASB to form different views about the merits of various lessor accounting approaches in contrast to the IASB. However, we do not think that the arguments for and against various lessor accounting approaches have been sufficiently explored in the Basis for Conclusions on ED 64 (BC). Where the IPSASB has departed from IFRS 16 the public sector specific reasons for doing so should be clearly articulated, including the conceptual, practical and user information considerations.

We consider that the BC is incomplete and, as a result, does not provide adequate information for constituents to make an informed decision regarding the lessor accounting proposals, particularly for those constituents that are not fully familiar with the IASB's deliberations during its project to develop IFRS 16. The BC does not include the counter-arguments against Approach 1 (right-of-use model proposed in ED 64) nor the counter-arguments in favour of Approach 2 (derecognition approach). In developing IFRS 16 the IASB proposed approaches which are similar to Approach 1 and Approach 2 considered by the IPSASB. Inclusion in the BC of the IASB's reasons for rejecting both of these approaches and instead choosing the lessor accounting approach in IFRS 16 would have provided a more balanced view of the advantages and disadvantages of both approaches.

In our view the omission of these counter-arguments from the BC may be interpreted as giving a biased view of the conceptual arguments for and against each approach, and means that constituents have not been provided with some key information that is necessary to make an informed evaluation of the lessor accounting proposals in ED 64. This could result in constituents supporting the proposals in ED 64 based on incomplete information, and the IPSASB then making inappropriate decisions based on the feedback received from constituents who were not fully informed about the arguments for and against each approach. In our opinion, the BC is an important document for explaining the IPSASB's deliberations and should, therefore, include a comprehensive and balanced view of the proposals in ED 64.

In view of these omissions from the BC and the potential consequences, we believe that the IPSASB should consider whether the content of ED 64 relating to lessor accounting was sufficient from a due process perspective. However, this point depends on whether or not the IPSASB decides to proceed with the proposals in ED 64 on lessor accounting – as explained earlier, we believe that it should not do so, and should instead develop an ED based on IFRS 16.

Our recommendations and responses to the Specific Matters for Comment are set out in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Vanessa Sealy-Fisher ([Vanessa.Sealy-Fisher@xrb.govt.nz](mailto:Vanessa.Sealy-Fisher@xrb.govt.nz)) or me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Kimberley Crook'. The signature is fluid and cursive, with the first name 'Kimberley' written in a larger, more prominent script than the last name 'Crook'.

Kimberley Crook

**Chair – New Zealand Accounting Standards Board**

## APPENDIX

### Response to Specific Matters for Comment

#### Specific Matter for Comment 1:

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusion.

The NZASB agrees with the IPSASB’s decision to adopt the IFRS 16 right-of-use model for lessee accounting. We agree that the right-of-use asset and the lease liability meet the definition of, and the recognition criteria for, an asset and a liability respectively in the IPSASB’s *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework).

We agree that for lease accounting it is important that IPSAS be updated to reflect the latest thinking of the IASB in IFRS 16. Where transactions are the same for the public and private sector it is important that convergence with IFRS® Standards is maintained. This process ultimately contributes to the IPSASB developing high-quality IPSAS.

From outreach activities conducted in New Zealand, we did not identify any public sector specific reasons to depart from the IFRS 16 right-of-use model for lessee accounting.

#### Specific Matter for Comment 2:

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusion.

The NZASB does not agree with the IPSASB’s decision to depart from the model for lessor accounting in IFRS 16. See also our response to SMC 3 below for further comments.

We acknowledge that the lessor accounting in IFRS 16 (based on risks and rewards incidental to ownership) is not consistent with the lessee accounting (based on control), and that a control-based approach would be more consistent with the Conceptual Framework. However, after having debated the options considered over the course of IFRS 16’s development and the matters that led the IASB to largely retain its previous lessor accounting requirements, we do not believe that the case put forward by the IPSASB for departing from IFRS 16 is strong enough. Our reasons for this are as follows.

- (a) In our view the IPSASB appears to have ignored some factors, such as user information needs, that would support the retention of the IFRS 16 approach.
- (b) The IPSASB has argued that the approach proposed in ED 64 is consistent with its Conceptual Framework and is an improvement on the IFRS 16 approach. We think that both arguments are debatable.

In preparing our response to this SMC we have carefully considered the IPSASB's reasons for departing from IFRS 16. The IPSASB's key reasons for departing from IFRS 16 appear to be those outlined in paragraph BC10. We are not convinced that the arguments in paragraph BC10(a) surrounding consolidation are sufficiently different in the public sector to warrant a departure from IFRS 16. There will always be adjustments needed for consolidation purposes, for example, to eliminate inter-entity transactions and align accounting policies.

We have some specific comments on paragraph BC10 as follows.

- (a) Paragraph BC10(a) states that if the lessor classifies the lease as a finance lease the underlying asset would not be recognised by either the lessee or the lessor, and that separate records would need to be maintained for consolidation purposes. We doubt that this situation would arise often in practice for the following reasons.
  - (i) The types of leasing arrangements discussed in paragraph BC11 (where a centralised entity undertakes the property management for a government) are unlikely to involve finance leases. Feedback from New Zealand constituents indicated that these types of leases are classified as operating leases, in which case the underlying asset remains on the lessor's statement of financial position.
  - (ii) The types of finance lease arrangements commonly seen in the corporate sector (such as manufacturers or dealers providing finance to customers, or banks providing financing to companies) are unlikely to occur between public sector entities.
- (b) Paragraph BC10(a) also states that additional records would be needed if the lessor classifies the lease as an operating lease (because the lessor will not recognise a lease receivable but the lessee will recognise a lease liability). We question this statement on the following grounds.
  - (i) From the perspective of the consolidated reporting entity there would be no lease, and therefore no lease receivable. The lease accounting would need to be eliminated, and the underlying leased asset would be accounted for in accordance with the relevant standard. The creation of a lease receivable is not necessary to report assets in the consolidated financial statements.
  - (ii) Paragraph BC10 seems to assume that the non-recognition of a lease receivable by the lessor would make it more difficult to eliminate the lease liability of the lessee during the consolidation process. However, even if the lessor recognised a lease receivable, the lease receivable and the lease liability would not necessarily be the same amount (for example, because of different discount rates). Also, for consolidation purposes, there are other ways of eliminating lease accounting by the lessee and lessor that might be more efficient, irrespective of how the lessor accounts for the lease.
- (c) According to paragraph BC10(b), using different accounting models in the financial statements of the lessee and the lessor might make leasing transactions less understandable to some

users. However, there are some counter-arguments that have not been explored in the Basis for Conclusions.

- (i) There appears to be no discussion of whether applying a different lessor accounting model in the public sector to the lessor accounting model in the private sector would make the financial statements of public sector entities less understandable to users.
- (ii) One of the key reasons for the IASB retaining the existing lessor accounting model was that users of the financial statements preferred the existing approach to other approaches considered by the IASB. Other approaches considered by the IASB included an approach similar to the lessor model proposed in ED 64. This suggests that users of the financial statements would be better served by maintaining the current approach to lessor accounting. As explained in our response to SMC 3, there are valid reasons why the IASB retained the requirement for a lessor to classify a lease as either an operating lease or a finance lease.

In addition to the concerns we have raised about the arguments in paragraph BC10, we are concerned about the impact of different accounting requirements for lessors where a public sector controlling entity prepares consolidated financial statements that include for-profit controlled entities. A significant amount of work will be required on consolidation where the controlled for-profit entity is a lessor that applies IFRS 16 and the public sector controlling entity applies the model proposed in ED 64. We are aware that New Zealand is not the only country that would be impacted by having a different accounting model under IPSAS to the lessor model under IFRS 16.

**Specific Matter for Comment 3:**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

The NZASB does not agree with the lessor accounting model proposed in ED 64 and is of the view that the IPSASB should develop proposals for lessor accounting based on IFRS 16 rather than proceed with the proposals in ED 64.

During the development of IFRS 16 the IASB proposed a similar lessor model, the performance obligation approach, set out in IASB ED/2010/9 *Leases*. Many of the IASB’s respondents were of the view that the performance obligation approach would result in an entity double counting its assets in the statement of financial position, and questioned how one set of cash flows (those received from the lessee) could relate to both the lease receivable and the underlying asset. Many also questioned how the obligation to permit the lessee to use the asset would meet the definition of a liability. We agree with these views and consider the reasons for not supporting the performance obligation approach for lessor accounting in the private sector are also applicable to the public sector.

Our views on the two approaches discussed in the Basis for Conclusions in ED 64 are explained below.



### *Concerns with Approach 1 and the IPSASB's reasons given for supporting Approach 1*

Paragraph BC36 sets out the IPSASB's conclusions for proposing the lessor accounting model in ED 64 (Approach 1). Under Approach 1 the right-of-use asset is considered to be a separate economic phenomenon to the underlying asset. Under this approach the lessor recognises both the underlying asset (in its entirety) and a lease receivable. We have the following concerns with the conclusions reached in relation to Approach 1.

- (a) The IPSASB has concluded that the lessor has retained control of the entire underlying asset, but the Basis for Conclusions does not provide any explanation of how the IPSASB reached that conclusion. In considering whether the lessor has control of the asset, we raise the following matters.
  - (i) Paragraph 5.11 of the Conceptual Framework states that "...control of the resource entails the ability of the entity to use the resource (or direct other parties on its use)...". However, as the lessor has transferred the right to use the underlying asset to the lessee for the term of the lease, it is unclear to us how the lessor can have the ability to use the underlying asset or direct other parties on its use during the term of the lease. The lessor may still have some residual rights to the asset but, in our view, these rights are not equivalent to the lessor having control over the originally recognised resource.
  - (ii) Paragraph BC36(d) draws parallels between the thinking underlying IPSAS 32 *Service Concession Arrangements: Grantor* and the proposed lease accounting in ED 64. In our view, a comparison of the requirements in IPSAS 32 with the proposed lessor accounting is not appropriate because the control that the grantor has over the service concession asset is not the same as the control that the lessor has over the underlying asset in a lease. A grantor controls or regulates the services that the operator must provide, to whom the operator must provide them and at what price (IPSAS 32, paragraph 9(a)). A lessor grants the lessee a right to use the lease asset but has no say in how the lessee operates the asset, what services are provided and what price the lessee charges for those services. Because of the significant differences in the rights of the grantor versus the rights of the lessor relating to the use of the asset during the terms of the arrangement, it is not valid to use the conclusion in IPSAS 32 (that the grantor has control over the service concession asset in a service concession arrangement) as the basis for concluding that the lessor has control over the entire leased asset in a lease arrangement. In addition, this is an example of where the proposals in ED 64 are being based on standards-level requirements that have not yet been assessed for consistency with the Conceptual Framework.
  - (iii) The definition of an asset in the IASB's *Conceptual Framework for Financial Reporting* is similar to the definition of an asset in the IPSASB's Conceptual Framework. However, the IASB has concluded that the rights of the lessor under a lease agreement consist of two sets of rights, being (i) the lease receivable, and (ii) the rights retained in the underlying leased asset (see paragraphs BC35–BC40 of IFRS 16), rather than the underlying asset itself. Furthermore, in March 2018 the IASB published a revised *Conceptual Framework for Financial Reporting* which has a revised asset definition and more discussion of the unit of account and derecognition than the 2010 version. This

revised pronouncement sets out the IASB's view that (i) an asset comprises several rights which are often treated as a single unit of account, and (ii) that derecognition is the removal of all or part of a recognised asset. We think that these ideas could be particularly useful when thinking about accounting for leases and encourage the IPSASB to consider these ideas when the IPSASB undertakes the limited review of its Conceptual Framework.<sup>1</sup>

- (b) We also have the following concerns with the proposals in ED 64 for the recognition of a liability (unearned revenue) by the lessor.
  - (i) Paragraph BC53 acknowledges that (i) recognising the credit entry as a liability until the revenue recognition criteria are met may not be consistent with the Conceptual Framework, and (ii) recognising revenue directly in the statement of financial position would not be consistent with existing IPSAS. We are of the view that the credit entry does not meet the definition of a liability because there is no outflow of resources by the lessor.
  - (ii) One of the IPSASB's reasons for not adopting the IFRS 16 lessor model is that the "risks and rewards incidental to ownership" model in IFRS 16 is not consistent with the lessee accounting control-based model. However, ED 64 includes several references to IPSAS 9 *Revenue from Exchange Transactions* which is also based on risks and rewards. We think it is inconsistent to argue against a risks and rewards approach and then refer a lessor to a standard that is based on that approach. We acknowledge that the IPSASB is working on proposals to update its revenue standards, but this could be one example of where another project needs to be further advanced before significant changes to lessor accounting can be fully considered.
  - (iii) We question how a lessor can continue to have a performance obligation (to make the underlying asset available) over the term of the lease when the lessee accounting model is based on the premise that the right to use the asset has been delivered to the lessee at the commencement of the lease.
- (c) We agree with the conclusion in paragraph BC9(b) that the right-of-use asset and the underlying leased asset are different economic phenomena. However, it does not follow that the economic benefits/service potential embodied in the right-of-use asset are additional to the economic benefits/service potential embodied in the underlying leased asset.

#### *Rejection of Approach 2 by the IPSASB*

The IPSASB considered and rejected Approach 2. Under Approach 2 the right-of use asset is considered to be a component of the underlying asset. The lessor would derecognise the component of the underlying asset that is transferred to the lessee and would recognise a residual asset (as well as a lease receivable). Paragraph BC38 states that Approach 2 is not consistent with IPSASB literature and provides reasons to support this statement. We disagree with those reasons as follows.

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<sup>1</sup> This project is identified as a priority project for 2019–2023 in the IPSASB's Proposed Strategy and Work Plan 2019–2023.

Paragraph BC38(a) states that Approach 2 is not consistent with the principles in other IPSAS because it requires the derecognition of a portion of the underlying asset. As explained below, we do not think that derecognition of a portion of an asset is inconsistent with the Conceptual Framework and note that partial derecognition is already required by some standards.

- (a) Paragraph 6.10 of the Conceptual Framework refers to the derecognition of an element, which in this case is an asset. An asset is defined in paragraph 5.6 of the Conceptual Framework as “A resource...”. Paragraph 5.7 of the Conceptual Framework explains that “A resource is an item with service potential or the ability to generate economic benefits. Physical form is not a necessary condition of a resource. ...”. Nowhere in the discussion of assets does it suggest that resources, once recognised as an asset, are not divisible. Simple examples such as cash and inventory are clearly divisible, and portions of the carrying amount of certain assets are derecognised when assets are consumed or sold.
- (b) A number of existing IPSAS require the derecognition of portions of recognised assets. Some examples follow.
- IPSAS 29 *Financial Instruments: Recognition and Measurement* requires the derecognition of a portion of a financial asset when it is transferred to another party (and certain criteria are met).
  - IPSAS 17 *Property, Plant and Equipment* requires the derecognition of parts of the property, plant and equipment (PP&E), for example, when replacing parts of the PP&E item or if part of a building is demolished. Although the division of the asset, and the derecognition of those parts of the asset that have been disposed of, is based on physical components, the basic point is that parts of the asset are derecognised.
  - IPSAS 37 *Joint Arrangements* requires a party to a joint operation to recognise and derecognise parts of PP&E. For example, if a party to a joint operation transfers an item of PP&E into the joint operation, it must derecognise the share of the PP&E item now held by other parties to the joint operation while continuing to recognise the retained portion (its share of the asset now held jointly).
- (c) A similar outcome to Approach 2 could be achieved using a full derecognition approach. The execution of the lease could be regarded as resulting in the entity derecognising the underlying leased asset in its entirety and recognising two new assets – the lease receivable and the residual ownership interest in the PP&E. So, in the same way that the right-of-use asset under a lease is a different economic phenomenon to the underlying asset (the PP&E), the residual ownership interest of the lessor in the underlying asset can be viewed as a different economic phenomenon from the underlying leased asset.

We also disagree with the other reasons in paragraph BC38.

- (a) Paragraph BC38(b) states that Approach 2 is not consistent with the IPSASB literature because it is more complex and costly than Approach 1. Both Approach 1 and Approach 2 are more complex and costly than the existing lessor accounting – so complexity and cost would be an argument for retaining the existing lessor accounting, rather than for preferring one new approach over another new approach.

- (b) Paragraph BC38(c) appears to be included in error, as it is discussing the ‘risks and rewards’ lessor accounting model in which leases are classified as operating or finance leases, not Approach 2 (which is a derecognition approach).
- (c) Paragraph BC38(d) states that Approach 2 is not consistent with IPSAS 32’s requirements. We have outlined our concerns with basing lessor accounting on the grantor accounting requirements in IPSAS 32 earlier in this letter. We are also of the view that at some point the requirements in IPSAS 32 should be assessed against the Conceptual Framework for consistency, and this could result in changes to the requirements in IPSAS 32 and different conclusions than those reached when IPSAS 32 was first developed.

### **Next steps for lessor accounting**

In our opinion, the IPSASB should not pursue the performance obligation approach (Approach 1) for lessor accounting. In our view, it is conceptually flawed and, in particular, it results in the overstatement of the lessor’s total assets, which is misleading.

Although we support the conceptual reasoning underlying the derecognition approach (Approach 2), we consider that there are strong practical reasons to support the IFRS 16 lessor accounting model.

- The IFRS 16 model avoids introducing *unnecessary* differences between IFRS and IPSAS requirements by having a consistent approach to lessor accounting across the public sector and the corporate sector. This is beneficial for groups which comprise both public sector and for-profit entities and is less confusing for users of the financial statements.
- The derecognition approach is complex to apply in practice, as evidenced by responses to the IASB’s exposure draft in which this approach was proposed.

Therefore, the IPSASB should not proceed with the proposals in ED 64 for lessor accounting and should instead develop proposals based on IFRS 16 (which would need to be exposed for comment).

#### **Specific Matter for Comment 4:**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

The NZASB agrees conceptually with the proposals for lessee accounting for concessionary leases. However, we do not support the recognition of the concession at this time, for the reasons outlined below.

The NZASB disagrees with the proposals for lessor accounting for concessionary leases, in particular, the recognition of the credit entry for the concession as unearned revenue. We are also of the view that the IPSASB should progress its project on non-exchange expenses before considering the lessor

accounting for concessionary leases rather than referring lessors to the relevant international or national standard.

We are aware that, over the years, entities applying IPSAS have requested the IPSASB to develop requirements for the accounting for concessionary leases, for example, international agencies that are provided with office space in cities around the world. The proposals in ED 64 for lessees would likely be appropriate in such circumstances because the fair value of the lease can be determined and, therefore, the assets and liabilities can be reliably measured.

However, we are of the view that there are many circumstances where the proposals in ED 64 for concessionary leases may not be appropriate for both lessees and lessors because of the challenges with measuring the fair value of the lease and other reasons, as discussed further below.

#### *Accounting for concessionary leases by lessees*

Conceptually we agree with the proposals for the recognition of the concession by the lessee, but we do have some concerns regarding the proposals.

Some of the IPSASB's decisions regarding the proposals in ED 64 are linked to other active IPSASB projects, for example, the *revenue and non-exchange expenses* project and the *public sector measurement* project. We are of the view that the IPSASB should first make progress on these projects, in particular, amendments to IPSAS 23 and developing guidance on what is meant by fair value in the public sector (especially for assets with restricted use), before progressing the proposals in ED 64. This would avoid unnecessary changes in the short to medium-term to the accounting for the concessionary portion of the lease. Although some New Zealand constituents supported the IPSASB's proposals for the recognition of the concession by the lessee, they raised questions about how to measure fair value (as discussed further below) and raised similar issues about when revenue should be recognised (e.g. on commencement of the lease or over the lease term) as have been raised in the revenue and non-exchange expenses project.

We also have concerns about whether the benefits of recognising and reporting the concession would exceed the costs of determining the fair value of the lease. For example, where the leased asset is of a specialised nature (for example, a school) or there are restrictions in the lease agreement (for example, an entity is permitted to undertake only certain activities from the leased property), the market value of the lease may be difficult to determine because of a lack of information about such leases. In some cases, the contractual lease payments could represent the fair value of the lease because of the specialised nature of the asset or the restrictions in the lease. ED 64 does not appear to cater for these types of circumstances. A further concern is that the valuation costs that lessees would incur in applying the proposals in ED 64 could be better utilised by the lessee (bearing in mind that concessionary leases are generally intended to support entities with complementary objectives to the lessor).

#### **Next steps on accounting for concessionary leases by lessees**

Although we agree conceptually with the proposals for lessees, at present we do not agree that lessees should be required to recognise the subsidy component of a concessionary lease for cost-benefit reasons (as explained above). We think that disclosure about the existence of the lease, the fact that it is on concessionary terms and any key conditions of the lease would provide useful

information for users. Disclosure would also provide flexibility for a lessee to provide more contextual information about its concessionary leases, for example, where specialised activities are undertaken from prime properties, or the lessee undertakes activities that complement the objectives of the grantor.

We are also of the view that the IPSASB should further progress both its revenue project and its public sector measurement project and then reconsider the accounting for concessionary leases by lessees. This would avoid unnecessary changes to accounting requirements that depend on decisions made by the IPSASB during the development of other projects that have an impact on the proposals in ED 64. In undertaking this further work, we recommend that the IPSASB also considers the guidance developed by the Australian Accounting Standards Board on accounting for concessionary leases by the lessee.

#### *Accounting for concessionary leases by lessors*

We do not agree with the proposals for accounting for concessionary leases by lessors. In particular, we do not agree that the proposed accounting by the lessor for a concessionary lease is similar to the existing accounting treatment by the grantor for a concessionary loan. In other words, although the IPSASB has justified its proposals on the grounds of consistency with the accounting treatment of concessionary loans, we consider that the proposed lessor accounting for a concessionary lease is *not* consistent with the accounting treatment of concessionary loans. As explained below:

- The proposals in ED 64 would result in the grossing up of lease revenue, whereas there is no grossing up of interest revenue when accounting for a concessionary loan.
- The proposals in ED 64 do not adjust the carrying amount of the asset to reflect the concession granted, whereas the accounting for a concessionary loan requires the loan balance to be reduced to reflect the concession granted.

More generally, we do not agree with the proposed accounting for the concessionary portion by lessors.

In our view, the IPSASB has mischaracterised the current accounting treatment by the grantor for a concessionary loan. Our understanding of the accounting treatment by the grantor of a concessionary loan is illustrated by means of an example.

#### **Example**

A loan of \$100 (principal) with zero interest is granted (the transaction is not a transaction with owners). Market interest rates are 10% and the net present value of the future cash inflows (calculated at market rates) is \$80. As per paragraphs AG88 and AG89 of IPSAS 29, the \$100 paid to the borrower is divided into two components.

#### **New loan granted**

Dr Loan	80	
Dr Grant expense	20	
Cr Bank		100

(Payment of the loan)

The future cash flows to be received over the term of the loan (\$100 principal and zero interest per the loan documentation) are equivalent to a loan of \$80 at normal market rates.

Although the loan is documented as \$100 at zero interest, in economic terms, it is the same as a loan of \$80 at 10% interest. The accounting reflects the economics, not the legal form (loan documentation) of the transaction.

**Example**

A loan of \$100 (principal) with zero interest is granted (the transaction is not a transaction with owners). Market interest rates are 10% and the net present value of the future cash inflows (calculated at market rates) is \$80.

As per paragraphs AG88 and AG89 of IPSAS 29, the \$100 paid to the borrower is divided into two components.

Over the term of the loan the \$100 cash inflows are treated as representing repayment of \$80 principal and payment of \$20 interest (under the effective interest rate method of measuring financial assets at amortised cost).

Some people refer to the interest recognised under the effective interest rate method as “reversing” the original \$20 expense, but this is not reflective of the economics that the accounting is intended to show. The \$20 is the interest revenue received on the \$80 loan, and this is reflective of the actual cash flows received.

The mechanics of the effective interest rate method result in the expense and the interest revenue being the same amount (that is, \$20), which is likely causing some confusion.

**Existing loan and then concession granted**

Dr Loan	100	
Cr Bank		100
(Loan at normal market rates)		
Dr Expense	20	
Cr Loan		20

(Concession granted – no interest to be paid)

In this case, the loan is granted at \$100 at normal market rates. The existing loan is subsequently written down to reflect the concession granted, that is, the loan is now interest free. The balance on the loan now represents principal of \$80 with interest at normal market rates of \$20, which is reflective of the actual cash flow subsequently received.

Accounting for concessionary loans does not result in the grossing up of the interest revenue, as the interest revenue recognised for a concessionary loan is supported by cash inflows (as illustrated in our example). In contrast, the proposals in ED 64 result in the grossing up and reporting of revenue that is not supported by cash inflows.

In addition, the balance sheet amounts under the proposals in ED 64 are not consistent with the accounting for concessionary loans. When accounting for a concessionary loan, the loan is reported at a reduced amount (being \$80 in our example), not the nominal amount of the loan (being \$100 in our example). This reduced amount reflects the fact that the concession reduces the future economic benefits (present value of the future cash inflows) to be derived from the loan below the nominal amount of the loan. In contrast, the proposals in ED 64 do not reduce the carrying amount of the leased asset to reflect the reduction in economic benefits/service potential to be derived from the leased asset as a consequence of transferring economic benefits/service potential to the lessee without equivalent consideration in return.

Therefore, we do not agree with either (i) the IPSASB’s characterisation of the accounting treatment of concessionary loans or (ii) the accounting treatment for concessionary leases that involves the grossing up of lease revenue, resulting in the reporting of lease revenue that is not supported by cash inflows. Instead, if the concession is recognised, we consider it should result in the reduction of the carrying amount of the leased asset to reflect the concession granted.

We also have some concerns regarding the costs of the proposals where a lessor grants hundreds of concessionary leases and leases for zero or nominal consideration. For example, local governments in New Zealand grant many concessionary leases to public sector and not-for-profit entities. The concessions are a way of providing support to such entities and acknowledging the complementary nature of their objectives and the goods and services they deliver. If those entities did not provide those goods and services, local governments would have to undertake some of those activities



themselves. In some circumstances the value of the concessions granted may be immaterial to the lessor, but the lessor would still incur costs in determining the value of those concessions and forming a judgement on the materiality of the concessions.

### **Next steps on accounting for concessionary leases by lessors**

As explained in SMC 3, we disagree with the lessor accounting proposed in ED 64. This means that we also disagree with the proposed accounting for concessionary leases by lessors and, in particular, recognition of the credit entry for the concession as revenue. And even under the lessor accounting model proposed in ED 64, we are of the view that the credit entry for the concession should be against the leased asset if the lessor is to recognise the concession as an expense, as explained above. Hence, irrespective of whether the IPSASB proceeds with its proposed lessor accounting model or reverts to the IFRS 16 lessor accounting model (discussed below), in our view the IPSASB should not proceed with an approach that results in the grossing up of lease revenue when accounting for a concessionary lease.

Under the IFRS 16 lessor accounting model, if a lessor classifies a lease as a finance lease, the concession would be recognised as part of the 'sale' of the asset. This could also be further explained in the notes to the financial statements. If a lessor classifies a lease as an operating lease, the credit entry would be against the leased asset.

We also believe that further consideration should be given to the measurement of the concession granted in situations in which the leased asset is measured using the cost model under IPSAS 17 *Property, Plant and Equipment*, as it is likely to be more appropriate to measure the concession as an allocation of the carrying amount of the leased asset rather than at fair value.

In addition, we also think the IPSASB should progress its non-exchange expenses project before considering the lessor accounting for concessionary leases rather than referring the lessor to the relevant international or national standard.

### *Leases for zero or nominal consideration*

Leases for zero or nominal consideration are effectively scoped out of ED 64 per the diagrams following paragraphs 22 and 62, and paragraph AG60 of ED 64. However, proposed new paragraph 43A of IPSAS 23 requires the lessee to measure the right-of-use asset held by a lessee in accordance with ED 64. We question the reason for this scope exclusion if the fair value of a right-of-use asset acquired under a lease for zero or nominal consideration is measured in exactly the same way as a right-of-use asset acquired under a concessionary lease. Drawing an artificial boundary between concessionary leases and leases for zero or nominal consideration creates challenges for preparers of financial statements.

We would prefer that ED 64 apply to all leases. We acknowledge that the definition of a lease under both IFRS 16 and ED 64 requires "exchange for consideration" and that the IPSASB has wanted to keep this definition. We also note that paragraphs BC112 and proposed new paragraph 123A of IPSAS 23 refer to "concessionary leases for zero or nominal consideration", and proposed new paragraph 105C of IPSAS 23 refers to "at below market terms, including leases for zero or nominal consideration.". We recommend that the Scope section of ED 64 be amended to specifically include leases for zero or nominal consideration. This can be achieved by adding guidance to explain that if a

transaction meets the definition of a lease other than “exchange for consideration”, then the transaction is within the scope of ED 64. It could be argued that leases for *nominal consideration* are within scope of ED 64 because there is some consideration paid.

If the IPSASB decides to continue with ED 64 and effectively exclude leases for zero or nominal consideration, it is not helpful to refer lessors to the “relevant international or national standard” to account for the concessionary portion of the lease (see diagram following paragraph 22, and paragraph AG06(b)). It is not clear which standard the IPSASB would expect lessors to refer to. As noted earlier, we are of the view that the non-exchange expenses project should be progressed further if the IPSASB continues with the proposals for concessionary leases in ED 64.

### **Other matters**

We have received feedback that it is unclear whether the scope of ED 64 includes leases with perpetual rights of renewal (for example, leases of land that provide the lessee with a perpetual right of renewal, subject to rent reviews undertaken on a regular basis (such as every 27 years)) and leases with long terms (which could effectively be a sale rather than a lease). The forthcoming IPSAS dealing with lease accounting should include guidance that clarifies its scope.



## LEASES

Issued 30 June 2018

ICAEW welcomes the opportunity to comment on International Public Sector Financial Reporting Board's (IPSASB) Exposure Draft 64 *Leases* published by IPSASB in January 2018, a copy of which is available from this [link](#).

This response of 30 June 2018 has been prepared on behalf of ICAEW by its Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. Comments on public sector financial reporting are prepared with the assistance of the Faculty's Public Sector Financial Reporting Committee. The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

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## MAJOR POINTS

### Support for the exposure draft

1. We welcome the opportunity to comment on IPSASB's exposure draft (ED) on Leases. We support the proposals which align IPSASs with IFRSs but disagree with the approach to lessor accounting.

### Lessor Accounting

2. IPSASB are proposing a right-of-use model for lessor accounting where the lessor would continue to recognise the entire underlying asset as well as creating a new lease receivable. We do not agree with this approach since we believe that this would inflate the lessors gross assets. We question how one set of cash flows (received from the lessee) could relate to both the lease receivable and the underlying asset.
3. In our view the leased asset is double counted by the lessor under the current proposals. The ED attempts to explain why it is not a double count in BC66 but this explanation is not clear or convincing. In our view, since the underlying asset would continue to be subsequently measured using IPSAS 16 Property, Plant and Equipment, the cash flows from the lessee would only be available to support the lease receivable and the residual interest in the underlying asset; they cannot also be used to support the whole carrying value of the asset. Thus the underlying asset would be impaired and the assets would no longer be grossed up. The ED does not discuss this point, which is in our view regrettable as it is not clear how the impairment of the asset would be calculated and whether amendment of the impairment standard would be necessary.
4. The IASB proposed a similar approach in their 2010 consultation on IFRS 16 Leases and received little support from respondents, mainly for the above reasons. We cannot see why this approach would be acceptable for the public sector yet not for the private. The IASB also proposed the de-recognition of the proportion of the underlying asset that is being leased. This was rejected primarily on cost/benefit grounds (especially in relation to multi-occupancy office buildings). In our view the IPSASB has not produced a convincing case why the public sector should not face the same issues.
5. We believe that more confusion would be caused by having a different accounting treatment compared to IFRS than by having two different models for lessors and lessees. Our strong preference is for IPSASB to follow IFRS and only make adjustments were necessary, such as for concessionary leases. It is worth noting that the UK government is looking to adopt IFRS 16 with only minor amendments.

## RESPONSES TO SPECIFIC QUESTIONS FOR COMMENT

### Specific Matter for Comment 1:

***The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6 - BC8 for IPSASB's reasons).***

***Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.***

6. Adopting the IFRS 16 right-of-use model will lead to more accountability and transparency as more lease arrangements go on balance sheet. Recognition of these assets and liabilities should, among other things, provide users with a better picture of an entity's gearing. We therefore agree with the adoption of the IFRS 16 right-of-use model for lessee accounting.
7. Furthermore, adopting the IFRS 16 right-of-use model for lessee accounting will also align the accounting treatment between central government entities and Government Business Enterprises, which tend to apply private sector accounting standards such as IFRS. This should benefit users, who will only need to understand one set of lessee accounting rules.

### Specific Matter for Comment 2:

***The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9 - BC13 for IPSASB's reasons).***

***Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.***

8. SMC 2 cannot be answered without considering SMC 3, since a departure from the risks and rewards based lessor model would imply the availability of a more appropriate alternative. We do not believe that the proposed single right-of-use model for lessor accounting is an appropriate alternative. See our response to SMC 3 for more detail.
9. We do not believe that the arguments put forward to depart from IFRS for lessor accounting, as detailed in BC9 to BC13, are persuasive enough to warrant a departure for reasons listed below.
10. BC9 puts forward arguments against continued application of a risks and rewards model. We believe that the level of economic consumption of the underlying asset by the lessee plays an important role in the accounting treatment of the lease by the lessor, yet there is no evidence that this has been considered. For example, BC9 (c) (ii) argues against the derecognition of the underlying asset since the lessor maintains control. However, if the lessee uses up all or most of the economic benefits of the underlying asset, the asset would have little economic value to the lessor. It is difficult to imagine how the lessor could reasonably justify the continued recognition of the underlying asset if the lessee uses up most of its economic benefits during the lease term as the substance of the transaction is more akin to a sale. See paragraph 15 for more detail.
11. BC10 argues that practical issues may arise from the application of inconsistent accounting models by lessors and lessees. Whilst we do not dispute this, we believe that the arguments put forward are somewhat overstated. BC10 (a) highlights some consolidation issues and the need to maintain additional records. However, many public sector entities need to maintain additional records such as cash transactions/balances, accruals-based information, budgeting information and statistical information for GFS requirements. Furthermore, a

lessee and a lessor that are part of the same group would simply reverse intra-group transactions as part of normal consolidation adjustments rather than trying to match these off.

12. Additionally, BC10 (b) states that the use of two different accounting models may make leasing transactions less understandable. We believe that diverging from IFRS could lead to more confusion than having two different accounting models for leases. The same paragraph also states that it may be difficult to distinguish between a lease and the sale of an asset in the lessor's financial statements. We do not agree with this assertion.
13. We agree with BC11 in that it is common for a centralised entity to undertake most or all of the property management for a government. As described above, the entities that have internal leases and are part of the same group would be required to put through consolidation adjustments to reverse out their positions. At the whole of government level for example, one would expect these types of adjustments to be common and whilst they are consolidation issues, we do not think they are insoluble and rely on normal good practices of record-keeping.

### **Specific Matter for Comment 3:**

***The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34 - BC40 for IPSASB's reasons).***

***Do you agree with the requirements for lessor accounting proposed in this Exposures Draft? If not, what changes would you make to those requirements?***

14. Whilst we sympathise with the idea of having symmetrical accounting between lessor and lessees, we do not agree with the single right-of-use model proposed by the ED for lessor accounting. We believe that IPSASB should follow IFRS 16 for both lessor and lessee accounting because we are not convinced that the arguments put forward in the ED are sufficient to warrant divergence from IFRS and we do not believe that the proposals for lessor accounting are a conceptually sound alternative.
15. We believe that the recognition of the underlying asset in its entirety, as well as a lease receivable, inappropriately inflates the lessor's assets and as such is imprudent. We do not believe that a single cash flow from the lessee can support both the underlying asset as well as the lease receivable. Consequently the recoverable amount of the underlying asset could be less than the carrying amount, potentially leading to impairments to be recognised. Should the underlying asset be impaired (cost model) or revalued to its reversionary interest (valuation model) then there would no longer be a double count. The ED fails to debate this point and the explanations provided in BC66 to suggest that there is no double-counting are difficult to follow, should be clarified and are unconvincing.
16. In the basis for conclusions for lessor accounting (BC20-61) there are two sub-headings that review the recognition of the lease receivable (BC41-43) and liability (BC44-53). However, the ED does not discuss the continued recognition of the underlying asset. It would be useful to understand IPSASB's application of the Conceptual Framework to the underlying asset.
17. BC35 describes two approaches for lessor accounting. We prefer Approach 2 over Approach 1 since the second approach derecognises the component of the underlying asset that is being transferred. However, we do not believe that requiring a lessor to recognise a lease receivable for all leases, as is currently being proposed, would improve financial reporting to the extent that the benefits would outweigh the costs associated with such a change.

Furthermore, Approach 2 would be complicated to apply when one asset is leased to multiple parties concurrently.

18. In addition to cost/benefit considerations, users of the accounts may find it difficult to understand the differences between private and public sector accounting treatment for leases. This may be exacerbated by Government Business Enterprises that could be applying IFRS yet are still within the public sector boundary.
19. For the reasons outlined above we do not agree with IPSASB's proposed lessor accounting model and recommend that IFRS 16 be adopted with minor changes where necessary. It is worth noting that the UK government is currently going through the process of adopting IFRS 16 with only minor adaptations.

#### **Specific Matter for Comment 4:**

***For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77 - BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise revenue in accordance with IPSAS 23 (see paragraphs BC112 - BC114 for IPSASB's reasons).***

***Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?***

20. We support IPSASB's proposals to show the subsidy component in both the lessor's and lessee's financial statements. Given the prevalence of concessionary leases in the public sector, we welcome the additional guidance in the ED.
21. For lessors, we share the concerns raised in BC94 that recognising lease revenue in excess of the lease receivable may seem counter-intuitive. Alternative options outlined in the ED are either not to show the subsidy element at all (option 1 in BC84 (a)) or to recognise the credit entry directly in net assets/equity (option 3 in BC84 (c)). We believe that users will find the information on the subsidy element useful and therefore do not agree with option 1. We agree with IPSASB that the non-exchange component of the credit entry does not meet the definition of net assets/equity and therefore reject option 3 in BC84. We have not identified any other possible options to account for the credit entry and therefore agree with the proposed approach in the ED (option 2 in BC84 (b)).
22. We agree with the proposed treatment of concessionary leases for lessees.

#### **Further observations**

23. The definition of a concessionary lease states that it is a lease at below market terms. BC21 makes it clear that leases for zero or nominal consideration are in substance grants in kind and therefore out of scope of the draft standard. We recommend that the definition of a concessionary lease should also include the exclusion of leases for zero or nominal consideration and that BC21 should say that grants in kind are in scope of IPSAS 23 Revenue from non-exchange transactions.

2 July 2018

Ian Carruthers  
Chair  
International Public Sector Accounting Standards Board  
277 Wellington Street West  
Toronto, ON M5V 3H2

Dear Mr. Carruthers

**Exposure Draft ED 64 *Leases***

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the IPSASB Exposure Draft ED64 *Leases*.

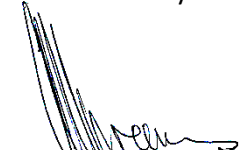
The views expressed in this submission represent those of all Australian members of ACAG.

ACAG agrees with the decision to adopt IFRS 16 *Leases* accounting for lessees. However, ACAG disagrees with the current proposals for lessor accounting and supports the use of IFRS 16 accounting for lessors, based on the finance and operating lease classification.

We have also raised concerns regarding the accounting for concessionary leases for both lessees and lessors. The attachment to this letter addresses the specific matters for comment outlined in the Exposure Draft.

ACAG appreciates the opportunity to comment and trust that you will find the attached comments useful.

Yours sincerely



Andrew Greaves  
**Chairman**  
**ACAG Financial Reporting and Accounting Committee**



**IPSASB Exposure Draft ED 64 Leases****Specific Matter for Comment 1**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions

ACAG agrees with the decision to adopt IFRS 16 accounting for lessees.

**Specific Matter for Comment 2**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

ACAG disagrees with the decision. ACAG supports the use of IFRS 16 accounting for lessors, based on the finance and operating lease classification. Our reasons are similar to IASB’s reasons for rejecting similar proposals to those contained in ED 64 (refer IASB Exposure Draft ED/2010/9) including:

- the lack of support for derecognising components of non-monetary assets based on rights
- existing lessor accounting requirements work well in practice.

ACAG disagrees that keeping the current finance and operating lease distinctions for lessors would involve more issues on consolidation (refer paragraphs BC10 and BC11). ACAG expects that most intra-government accounting will be operating leases. ACAG believes that the ED 64 proposals would require greater consolidation processes.

**Specific Matter for Comment 3**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

ACAG disagrees with the proposed lessor accounting for numerous reasons, including:

***Assets effectively sold remaining on balance sheet***

In Australia, there have been numerous government entity privatisations that have involved “selling” infrastructure assets on 99-year leases. Under these leases, the government lessor has transferred to the operator substantially all the risks and rewards of the underlying assets, with the infrastructure required to be returned in a suitable condition at the end of the lease. Infrastructure assets privatised have included airports, electricity distribution and transmission assets, and ports. Also, in some instances, Crown land has been leased out on 99-year terms.

Under the ED 64 proposals, recognition of the underlying asset would be subject to IPSASB 9 *Revenue from Exchange Transactions*, which is currently based on a risk and return assessment. It is unclear whether assets that are effectively sold (per the current definition of a finance lease) would be required to remain on balance sheet under the ED 64 proposals as the assets would be subject to a lease.

***The lease receivable is not a financial asset***

The proposals state that the lease receivable meets the definition of a financial asset (refer for example BC9, BC41, and BC58). However, ACAG believes that the lease receivable is not a financial asset, as the lessor does not have the unconditional right to receive cash. Leases are often subject to termination clauses because of the failure of the lessee or lessor to meet their contracted responsibilities.

ACAG agrees that a lease receivable has the characteristics of a financial asset, and that some financial instrument accounting (such as impairment and de-recognition) is applicable. However, given that the definition of a financial asset is not met, ACAG questions whether the IPSASB's reasoning for recognition of lease receivable as a financial asset is appropriate.

***Double counting of certain types of assets***

ACAG believes that some assets may be double counted under these proposals. For example, an investment property will often be valued by reference to future cash flows. However, under the proposals, the future cash flows represented by existing leases of these properties will require the recognition of an additional asset. Therefore, the same cash flows will be recognised in two assets.

This would also be the case where an asset is subleased. The right-of-use leased asset (lessee accounting) will represent future use of cash flows from the asset. Under the ED 64 proposals, the lessee will not use the asset for any of that time, and instead receive future cash flows from the sublease. Yet, the ED 64 proposals suggest the lessee will recognise a right-of-use asset, as well as a future rentals receivable asset.

***Financing effect on results of lessors***

ACAG disagrees with lessors' results being impacted by the financing effect of imputed interest on the lease receivable and straight-line revenue recognition for the amortisation of the credit.

***Fair value of underlying asset***

It is not clear how the revaluation of public sector property, plant and equipment will operate under the ED 64 proposals. Fair valuing such assets (particularly land, buildings, and infrastructure) is common in Australia. Under the ED 64 proposals, would the underlying asset (e.g. PPE) be revalued in full, but the portion "monetised" as a lease receivable and remain at historical value?

***The proposed unearned revenue is not a liability***

ACAG disagrees that the proposed unearned revenue is a liability, as there is no expected outflow of resources to another entity.

***Recognising the credit against the asset would result in confusing valuation of public sector assets***

When considering the ED 64 proposals, ACAG considered the consequences of having to recognise the credit for the lease receivable against the underlying asset i.e. derecognising the underlying asset into the lease receivable and residual components (where residual is the asset to be returned at the end of the lease). A concern was in relation to fair valuing the residual of the underlying asset. ACAG is unclear from the proposals how revaluing that portion of the underlying asset would be performed and whether it would provide useful information to users.

**Specific Matter for Comment 4(a) (Lessors)**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

ACAG disagrees with requiring an upfront recognition of a grant expense (representing the discounted amount “lost” for future lease payments) and the recognition as revenue of this discounted amount on a straight-line basis over the lease term.

ACAG believes that if IFRS 16 accounting is followed, there should be no upfront grant expense, or impairment of the underlying asset, as the underlying asset is being used for its intended purpose.

Our main reasons for disagreeing are:

- The requirement to recognising an upfront opportunity cost and recognising the benefit over time
- the proposed accounting (of an upfront expense) is counter intuitive for a public sector entity providing public services
- the total revenues recognised do not equate to the undiscounted imputed market rentals.

As noted above, the total revenues recognised under the ED 64 proposals do not equate to the undiscounted imputed market rentals. Below is a calculation of the revenue and expenses based on ED 64 illustrative example 23:

Interest revenue	\$2,493,471
Revenue (unearned over time)	<u>\$23,000,000</u>
Total	\$25,493,471

This amount differs to the total “market rent” of  $5 \times \$5,312,420 = \$26,562,100$ . The difference appears to relate to interest not being imputed on the upfront subsidy.

**Specific Matter for Comment 4(b) (Lessees)**

For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

ACAG agrees with the proposals to recognise upfront grant revenue for a concessionary lease, and a corresponding right-of-use asset (and subsequent depreciation). However, ACAG is unsure of the proposals to distinguish concessionary leases between those with zero or nominal consideration and the remainder. ACAG believes that different outcomes may arise as different standards are applied.

ED 64 proposes that concessional leases (for lessees) should be accounted for under IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. We don’t consider it is clear that all concessional leases would be recognised under IPSAS 23. In relation to lessors, ACAG requests clarification on which accounting standard(s) the IPSASB is referring to, given the absence of an IPSAS standard for expenses. Further, ACAG believes that all concessionary leases should be accounted for within one standard.

ACAG also have identified the following issues relating to concessionary leases by lessees:

***Excessive compliance cost on lessees***

ACAG believes that the proposals are likely to cause excessive costs for lessees. ED 64 defines a concessionary lease as a lease at below market terms. This would require all leases to be checked for whether any rentals are, or are not, at market rates – potentially a significant cost burden for lessees.

In Australia, concessionary leases accounting is dealt with an Australian specific accounting standard, AASB 1058 *Income for Not-for-Profit Entities*. This standard's concessionary lease provisions only apply to those leases that have "*significantly below-market terms and conditions principally to enable the entity to further its objectives*". This ensures there is a threshold where lessees will not be unnecessarily burdened by having to search for situations to determine if the lease terms and conditions are at any amount below market rates.

ACAG believes that without such a suitable threshold in ED 64 that entities will have to incur significant costs on transition in identifying concessionary leases.

***Accounting effects on lessees***

ACAG notes that many public sector lessees disagree with the proposed accounting and the effect on their results (i.e. large upfront revenue recognition and increased subsequent depreciation expense) arguing that it is not representative of their underlying activities. They suggest either not recognising the subsidy at all, or recognising the subsidy over time (and matching the depreciation of the right-of-use asset).

While the proposed illustrative example to be included in amendments to IPSAS 23 (paragraph IG55) refers to upfront and deferral, ACAG considers that depending on conditions, this would likely change to only upfront if the IPSASB adopts the performance obligation approach for revenue recognition.

***Valuation issues***

While the equivalent requirements are not yet operational in Australia, ACAG have encountered a number of issues in the valuation of concessionary leases. These include:

**Market Participant**

1. What / who is the market participant for a concessionary lease to a not-for-profit entity?
2. Should valuations be based on commercial market rates that would be paid by a for-profit entity, even though the arrangements would not actually be made available to a for-profit entity?  
Should valuations be based on the rent that a not-for-profit entity could afford to pay? How would this be determined?
3. Should a deprival value notion be considered, i.e. that if a not-for-profit had to pay commercial lease rates, would it continue to operate?

**Fair Value**

4. How should any legal restrictions and conditions on concessionary leases of a specialised nature be accounted for?

5. What is the fair value of a right-to-use asset under a 99 year lease when the lessor has the right to terminate the lease with no penalty on shorter notice (for example two years)? A market participant (i.e., not a related party) would ordinarily not contain a 99 year lease term. They would only value the right as being for two years use, or potentially some risk adjusted premium on the understanding that the lessor would not terminate the lease early.

**Contingent Rent option**

6. What is the fair value of a concessionary lease with contingent rent? If the fair value is based on fixed rent, and then the lease liability for the minimum payments (possibly nil) are deducted, large upfront revenue for a 'notional' subsidy would be recognised. Such accounting would not reflect substance of the actual lease agreement (i.e., arbitrary), as the subsidy would have to be measured against a comparable (contingent) rent for an applicable market participant.

<b>Other Matters</b>
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ACAG provides the following specific paragraph comments for consideration:

*Paragraph 27*—While ACAG notes the paragraph 27 requirement for the lessee in a sublease to use the head lease discount rate, ACAG believes that in some situations there may be differences in the head lease rate and what would otherwise be used. For example, the lessor has a lease for a considerably different term than that leased to the lessee, or where the sublessee is not a controlled entity. ACAG notes that paragraph 29 (concessionary leases) overrides the requirement for subleases, requiring a market interest rate to be used.

*Paragraph 58*—ED 64 proposes a maturing analysis disclosures for each of next 5 years, and then for the remaining years of the lease. ACAG suggests that disclosure requirements be consistent with lessees and IFRS 7 *Financial Instruments: Disclosures* and equivalent IPSAS 30.

*Paragraph 73*—ACAG questions if paragraphs 69(c) (initial direct costs) and paragraph 69(d) (dismantling and rehabilitation costs) are included within the fair value, or added to the fair value?

*Paragraph 74*—ACAG suggests that the paragraph be re-drafted to clarify that such that cost should be fair value (possibly with items in paragraphs 69(c) and 69(d) added), rather than that fair value is equal to cost.

*Paragraph 128*—ACAG seeks clarification on what is the residual value in relation to the transition provisions for leases previously classified as finance leases.

*Paragraph 129*—ACAG questions, in relation to the simplified transition method, should a similar choice (as for lessees) be given to recalculate unearned revenue from the start of the lease?

*Paragraph AG37*—ACAG questions why this differs to IFRS 16 (refer paragraph BC127) in relation to the assessment of lease term?

*Paragraph AG41*—(underlying asset with a low value) ACAG considers this guidance appears too generous as it ensures any lease would be low-valued if assessed within confines of how material it is the lessee's financial statements.



MALAYSIAN INSTITUTE  
OF ACCOUNTANTS

30 June 2018

Mr John Stanford  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto, Ontario M5V 3H2  
CANADA

Dear John,

**EXPOSURE DRAFT 64 LEASES**

The Malaysian Institute of Accountants ("MIA") is pleased to provide comments on the International Public Sector Accounting Standards Board ("IPSASB") Exposure Draft 64 *Leases* as attached in Appendix 1 to this letter.

We hope our comments would contribute to the IPSASB's deliberation in finalising the matter. If you have any queries or require clarification of this submission, please contact Rasmimi Ramli at +603 2722 9277 or by email at [rasmimi@mia.org.my](mailto:rasmimi@mia.org.my).

Yours sincerely,

**MALAYSIAN INSTITUTE OF ACCOUNTANTS**

**DR NURMAZILAH DATO' MAHZAN**  
Chief Executive Officer



**Specific Matter for Comment****Specific Matter for Comment 1**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

We agree with the decision of IPSASB in adopting the right-of-use model for lessee accounting for reasons provided in BC6-BC8.

**Specific Matter for Comment 2**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

We agree with IPSASB’s decision to depart from the application of risks and rewards model for lessor accounting for reasons described in paragraphs BC9-BC13.

**Specific Matter for Comment 3**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

We agree with the proposed single right-of-use model for lessor accounting for reasons stated in paragraphs BC34-BC40. However, we noted that the initial and subsequent measurement of the unearned revenue for lessors and the right-of-use asset for lessees would result in different carrying amounts in lessors’ and lessees’ books. We are not sure how these will be dealt with during a consolidation exercise.

**Specific Matter for Comment 4**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons).

Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make



## to those requirements?

### Fair value measurement of concessionary leases

For lessors, paragraph 32 of the ED states that “the fair value of the right-of-use asset transferred to the lessee shall be measured by discounting market lease payments using a market interest rate”. While for lessees, paragraph 78 of the ED provides that if the lessee’s incremental borrowing rate cannot be readily determined, the lessee shall use market interest rates. Generally, in the public sector, the right-of-use asset being transferred to the lessee is unique to the public sector where it will be difficult to obtain the market interest rate to finance such an asset. We believe that guidance on how a market interest rate or an incremental borrowing rate can be determined in practice should be provided.

### Recognition of subsidy granted to lessees as a day-one expense

The IPSASB Consultation Paper on *Accounting for Revenue and Non-Exchange Transactions*, among others, addresses non-exchange expenses comprising grants, contributions and other transfers. In the Consultation Paper, the IPSASB proposes that where grants, contributions and other transfers contain either performance obligations or stipulations, they should be accounted for using the Public Sector Performance Obligation Approach (PSPOA).

We believe the subsidy granted to lessees falls under grants, contributions and other transfers that were addressed in the Consultation Paper. Accordingly, we propose for the IPSASB to consider PSPOA in determining the accounting for the subsidy.



PO Box 1411  
Beenleigh QLD 4207  
4 July 2018

Ian Carruthers  
Chair  
International Public Sector Accounting Standards Board  
277 Wellington Street West  
Toronto, ON M5V 3H2

Lodged via website

Dear Mr. Carruthers

**Exposure Draft ED 64 Leases**

I am currently involved in applying IFRS 16 in the public sector in Australia (through AASB 16).

I was involved in contributing to the Australasian Council of Auditors-General (ACAG) submission, as part of my role as Technical Director at Queensland Audit Office.

I support that submission and submit the attached comments covering:

- Specific Matter for Comment 2 – Additional consolidation processes under ED 64
- Specific Matter for Comment 3 – The lessor lease receivable is not a financial asset
- Other Matters
  - Definition of lease – expansion to agreements
  - Definition of lease – statutory leases
  - Improvement in lessor finance lease accounting.

I provide expert, authoritative leadership on public sector financial reporting and the audit response in the not-for-profit and for-profit sectors.

I have extensive experience in accounting advisory functions of large accounting firms providing advice, insights and explanations on Australian accounting and International Financial Reporting Standards (IFRS and AIFRS) and external financial reporting requirements for the public and private sectors.

Yours sincerely,

David Hardidge

## IPSASB Exposure Draft ED 64 Leases

## Specific Matter for Comment 2

As stated in the ACAG submission, ACAG believes that the ED 64 proposals would require greater consolidation processes.

The following illustrative entries demonstrate this:

<b>Operating lease to controlled entity</b>	
IFRS 16	ED 64
<p>Lessee - Reverse lessee accounting in controlled entity</p> <p>Right-of-use asset</p> <p>Lease liability</p> <p>Right-of-use asset depreciation</p> <p>Lease liability interest</p> <p>Intra-group cash flows (offset)</p> <p>Lessor</p> <p>Nil balance sheet and income statement entries – underlying PPE still on balance sheet</p> <p>Intra-group cash flows (offset)</p>	<p>Lessee – Reverse lessee accounting in controlled entity</p> <p>Right-of-use asset</p> <p>Lease liability (offset*)</p> <p>Right-of-use asset depreciation</p> <p>Lease liability interest (offset*)</p> <p>Intra-group cash flows (offset)</p> <p>Lessor - Reverse ED64 lease accounting</p> <p>Lessor lease receivable (offset*)</p> <p>Unearned revenue / credit</p> <p>Lease receivable interest (offset*)</p> <p>Unearned revenue / credit amortisation</p> <p>Intra-group cash flows (offset)</p> <p>offset* - offset is equal if underlying assumption on lease term and discount rate are the same</p>
<b>Finance lease (e.g. back-to-back sublease) to controlled entity</b>	
IFRS 16	ED64
<p>Lessee – Reversal some of the lessee accounting in controlled entity</p> <p>Right-of-use asset - Do not need to reverse right-of-use asset as it would flow through on consolidation to group - assuming that finance lease would mean carrying value of right-to-use asset in controlled entity would be substantially the same as</p>	<p>Lessee – Reverse lessee accounting in controlled entity</p> <p>Right-of-use asset</p> <p>Lease liability (offset*)</p> <p>Right-of-use asset depreciation (not needed)</p> <p>Lease liability interest (offset*)</p>

carrying value of the parent (if reinstated)  Lease liability (offset*)  Right-of-use asset depreciation (not needed – see above) Lease liability interest (offset*)  Intra-group cash flows (offset)	Intra-group cash flows (offset)
Lessor – Reverse lessor accounting Lessor lease receivable (offset*)  Lease receivable interest (offset*)  Intra-group cash flows (offset)	Lessor - Reverse ED64 lease accounting Lessor lease receivable (offset*) Unearned revenue / credit  Lease receivable interest (offset*) Unearned revenue / credit amortisation  Intra-group cash flows (offset)

### Specific Matter for Comment 3

As noted in the ACAG submission, ACAG does not believe that the lease receivable meets the definition of a financial asset. ACAG noted that leases are often subject to termination because of the failure of the lessee or lessor to meet their contracted responsibilities.

Examples of situations where the lessee can terminate a lease agreement is when the lessor fails to meet its contractual obligations to:

- pay local council rates, land tax etc.
- pay for structural repairs and capital improvements
- pay property insurance (building structure).

This situation differs from a financial asset as the lessor is not unconditionally entitled to future rental payments. Further, the lessor will forfeit the future rental payments if it fails to meet the contractual obligations.

Also, the lessor can recover the underlying property if the lessee fails to meet its contracted obligations (for example to):

- pay and maintain insurance (e.g. public liability, loss of profits insurance / business continuity)
- pay all services (e.g. utilities)
- provide financial information (as required under the lease agreement)
- maintain premises to defined standards, including lighting, plate glass, gardens and lawns, and fire prevention and safety equipment.

This situation differs from a basic lending arrangement where lenders usually only have a right to the underlying property if the borrower fails to make loan repayments.

## **Other Matters**

### Definition of lease – expansion to agreements

I note that ED 64 proposes to expand the definition of contract to include agreements. I believe that this will be particularly useful for the public sector. For example, where state government departmental financial statements are prepared and one department enters into a lease with another department. In this situation, both are the same legal entity, and (in Australia) there is no legal contract between them.

### Definition of lease – statutory leases

I am still assessing situations where a statutory lease may exist. For example, land under roads in Queensland, where the roads are recognised by the Department of Transport and Main Roads and the land under roads is administered by a different department, being the Department of Natural Resources, Mines and Energy. This might be regarded as being the statutory right to use an identified asset. As there is no payment for this arrangement, the definition of concessionary lease may also be met.

I am yet to assess other rights to use land (often for no or nominal value) through statutory arrangements.

### Improvement in lessor finance lease accounting

An area of diversity in Australia for lessor accounting is for the subsequent residual for a finance lease. For example, the return of the infrastructure assets under “99 year” leases / “government entity privatisations” mentioned in ACAG’s submission. At least one state, New South Wales<sup>1</sup>, recognises the accrual for a residual, while at least one state, Queensland, does not on the basis the estimate is not reliable.

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<sup>1</sup> New South Wales TPP 06-08  
[https://www.treasury.nsw.gov.au/sites/default/files/pdf/TPP06-8\\_Accounting\\_Policy\\_-\\_Accounting\\_for\\_Privately\\_Financed\\_Projects.pdf](https://www.treasury.nsw.gov.au/sites/default/files/pdf/TPP06-8_Accounting_Policy_-_Accounting_for_Privately_Financed_Projects.pdf)

Mr. Ian Carruthers  
Chairman  
International Public Sector Accounting Stand-  
ards Board

Submitted via website

30 June 2018

## Comments to the Exposure Draft 64 - Proposed International Public Sector Accounting Standard Leases

Dear Mr. Carruthers:

We would like to thank you for the opportunity to provide our comments to the Exposure Draft 64 on the Proposed International Public Sector Accounting Standard Leases. We are pleased to contribute to the improvement of this draft responding to each specific matter for comment.

### Specific Matter for Comment 1

*The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6-BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

We agree with the IPSASB's decision to adopt the IFRS 16 right-of-use model for lessee accounting. The right-of-use model would facilitate the identification of lease arrangements in the balance sheet of the lessee when recognizing among the entity's other assets the right-of-use of the underlying asset. The paragraph BC7 addresses the compatibility of the right-of-use of the asset definition with the Conceptual Framework, therefore, we would suggest to also addressing the IPSASB's view concerning the compatibility of the recognition of the liability (i.e. unearned revenue) at the lessor side with the Conceptual Framework.

## Specific Matter for Comment 2

*The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9-BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

We agree with the IPSASB decision to depart from the IFRS 16 risks and rewards model for lessor accounting. The reasons explained are comprehensive in our view, especially the inconsistencies issues that the risks and rewards model could produce when the lessor and lessee are part of the same accounting entity. As some constituents are concerned about a potential "accounting duplicity" with the approach taken by the IPSASB, we suggest to include in the BCs an explanation in regards to this matter.

## Specific Matter for Comment 3

*The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34-BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

We support the IPSASB decision to develop a single right-of-use model for lessor accounting that is consistent with lessee accounting criteria. The approach suggested by the IPSASB might be difficult and costly for the lessor to apply in practice. A lessor would have to analyse and start accounting for all the former operating lease contracts. It is worth to dedicate a few more lines in explaining the reasoning of including in the lessors' accounting not only a lease receivable but also a liability representing the unearned revenue. It is important to also evaluate the consistency of this liability definition with the Conceptual Framework.

## Specific Matter for Comment 4

*For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77-BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112-BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and*



*lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

We agree with the IPSASB's proposition to measure concessionary leases at fair value and to recognize the subsidy granted to lessees as an expense in the lessor accounting and as a revenue in the lessee accounting and thereby ensuring consistency with the approach to concessionary loans. The Exposure Draft requires the lessor to measure the liability (unearned revenue) recognized through a concessionary lease at fair value. The fair value of the right-of-use asset transferred to the lessee shall be measured by discounting market lease payments using a market interest rate. Conceptually, the accounting treatment seems sound, this may however be complex to apply in practice. The IPSASB should consider providing some additional guidance to aid entities determining what would constitute a market lease payment. For example:

If an entity has a 10 years lease, which market lease payments should be used to determine the concessionary amount? One possibility might be to use the market lease payments as at day one (inception of the lease), another possibility might be to estimate the market lease payments over the lease term. If the market lease payments over the lease term must be estimated, this may be a very complex calculation for entities to perform. On the other hand, should entities only refer to the market lease payments as at inception of the lease, a significant portion of the concession could potentially not be taken into account.

E.g. (simplified example with no market interest rate)

	Year 1	Year 2	Year 3	Total
Market lease payments	10	12 (estimated)	14 (estimated)	36
Contractual payment	5	6	7	18

Using the simplified example above, if you determine the concession amount using the day one market rental, the concession total will be CU12 (10\*3 years [assuming market lease payments at inception for the entire lease term] - CU18 contractual rental). Using the market lease payments estimated over the term, the concession would be CU 18 (36 market lease payments - 18 contractual rental). The concession could thus potentially be understated if the day one market lease



payments is used. In contrast to that, an entity may not be able to accurately determine the estimated market lease payments over the lease term.

This calculation may also be more complex in situations where entities enter into long term leases (e.g. 99 year leases or even 999 year leases). Some guidance on how an entity should approach the measurement of the concessionary element in these instances would be helpful.

Guidance should in our view be provided on the process an entity should follow in the absence of market lease payments. This can be in instances where the market does not lease similar assets (e.g. specialised assets or equipment such as military assets). In absence of market lease payments, it might be argued that the “market lease payments” could be equal to the rent that the government entity is charging, given the fact that there is no comparable market transaction. Another alternative would be to follow the three step approach of IFRS 13 to identify a fair value in cases where no open market with observable transactions exists. Therefore, some guidance and clarification in this regard would be helpful.

A further question may also arise on the market interest rate. Is the market interest rate the interest rate available to any party in the market, or the rate available to a similar party in the market (similar type of entity, similar term, similar size, similar risk profile etc.)? If the market rate refers to a similar entity in the market, this could be difficult to determine in certain instances as there may not be a comparable entity or where the market may not be willing to provide financing to an entity of a similar nature. In certain jurisdictions there are instances where the only party willing to transact with the counter party is a government entity due to the mandate of said government entity. A commercial institution may not be willing to finance the counter party. The Board might want to consider giving some guidance on how to determine a market interest rate under these circumstances.

We hope our comments are useful for the IPSASB. Should you need any further information, please do not hesitate to contact us.

Best Regards,



Thomas Müller-Marqués Berger  
Partner and Global Leader of International Public Sector Accounting

Ernst & Young GmbH  
Wirtschaftsprüfungsgesellschaft



EUROPEAN COMMISSION  
Budget

Budget execution (general budget and EDF)  
**Accounting**

Brussels,  
BUDG.DGA.C02/MK/BG

Mr Ian Carruthers  
Chairman  
International Public Sector Accounting  
Standards Board (IPSASB)

## **Comment letter on Exposure Draft 64 *Leases***

Dear Mr Carruthers,

We welcome the opportunity to comment on the above mentioned Exposure Draft 64 *Leases* ('the ED'). The following comments are made in my capacity as Accounting Officer of the European Commission responsible for, amongst other tasks, the preparation of the consolidated annual accounts of the European Union, which comprise more than 50 European Agencies, Institutions and other European Bodies with an annual budget of more than EUR 140 billion<sup>1</sup>.

We would like to thank the International Public Sector Accounting Standard Board (the 'IPSASB') for this opportunity to contribute to the due process and we are pleased to provide you with our comments with the aim of improving the transparency, relevance and comparability of the financial statements across jurisdictions.

We generally support the IPSASB's approach to the convergence of public sector accounting standards with International Financial Reporting Standards ('the IFRS') applied in the private sector, whenever the nature of the transaction is economically similar, and any public sector specific issue is addressed separately.

In particular, we welcome the IPSASB proposal to adopt the lessee accounting model based on IFRS 16 *Leases*, which is effective for periods beginning on or after 1 January 2019, while adding public sector specific guidance and illustrative examples.

Nevertheless, we disagree with the decision to depart from IFRS 16's model for the lessor, due that we do not consider there are public sector reasons to do so. Furthermore, we consider that a dual accounting model should apply for the lessor so as to appropriately reflect their business model.

Moreover, while we consider the new guidance on concessionary leases very useful, we think it could be potentially streamlined.

<sup>1</sup> For the sake of clarity, the views presented in this comment letter do not represent the views of the EU Member States, or the views of the European Public Sector Accounting Standards ('EPSAS') Task Force, and are without prejudice to future decisions which may be taken in the context of the EPSAS project.

Overall we agree with the proposals included in the ED, except for the lessor accounting as mentioned in the previous paragraph. Please find in annex our detailed comments and responses to the questions included in the ED.

If you would like to discuss our comments further, please do not hesitate to contact me or my accounting team in DG Budget.

Yours sincerely,



Rosa ALDEA BUSQUETS

cc: Derek Dunphy, Martin Koehler, Bruno Gomes, Magdalena Zogala (DG.BUDG.C2), Alexandre Makaronidis (ESTAT.C.TF.EPSAS)

## **Appendix – Response to the questions raised in the ED**

### **Question (Specific Matter for Comment 1) – Lessee Accounting: Right-of-use model (based on IFRS 16 Leases)**

*The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6 – BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons.*

*If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

#### **Response**

As a principle, we consider IPSAS standards should be as close as possible to IFRS standards, provided that there is no public sector specific reason to do otherwise. In this regard we fully support IPSASB's decision to adopt the right-of-use model for the lessee based in IFRS 16.

This model is, in our view, a better representation of the economics of the transaction. In particular, we agree that under a lease agreement, the lessee obtains the right to use an underlying asset for a period of time, and during that period the lessee has the ability to determine how to use the underlying asset and how it generates future economic benefits from the right of use.

Furthermore, we understand that a lease agreement transaction is economically similar in both the private and public sector, thus, we agree with IPSASB to take advantage of the mature stage of the private sector discussion.

Likewise, we agree to provide additional guidance for leases below market rates (Concessionary Leases), as the guidance is useful and consistent with the guidance for concessionary loans.

### **Question (Specific Matter for Comment 2) – Lessor Accounting: IPSASB departure from IFRS 16 risk and rewards model**

*The IPSASB decided to depart from the IFRS 16 risk and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9 – BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons.*

*If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

#### **Response**

We do not support the decision to depart from the IFRS 16 model for the lessor. We do not reach the same conclusions as to the public sector reason for this departure and we are therefore not in favour of creating an accounting gap between the private and a public sector as leasing operations are similar in both sectors.

*Economics of a lease transaction is the same as in the private sector*

In our view, as concluded by IPSASB in paragraph ED64.BC2, the economics of a lease transaction is the same in both public and private sector. Accordingly we understand they should not have different accounting treatments.

Furthermore, IPSASB acknowledged that the reasons that led to a departure from the IFRS model are not unique to the public sector (ED 64.BC11), however IPSASB imply that the issues may be more prevalent in the public sector, due to the fact that public sector entities usually create centralised agencies for the management of their properties. In our view, the way an entity (private or public) organises and/or manages their property should not affect the accounting treatment applied.

#### *Asymmetry between lessee and lessor accounting*

We understand the leases project in the IASB was triggered by the following criticisms, which demonstrated that the previous model failed to meet the needs of users of financial statements, in particular on the lessee side:

- (a) Information reported by lessees about operating leases lacked transparency and did not meet the needs of users of financial statements;
- (b) The existence of two different lessee accounting models meant that transactions that were economically similar could be accounted for in very different ways. These differences reduced comparability for users of financial statements and provided opportunities to structure transactions to achieve a particular accounting treatment; and
- (c) Users had inadequate information about lessor's exposure to credit risk (arising from a lease) and exposure to asset risk (arising from the lessor's retained interest in the underlying asset), particularly for leases of equipment and vehicles that were classified as operating leases.

The first two issues – lessee accounting – were addressed by the IASB through the establishment of a new accounting model ('single accounting model') based on the right-of-use model which they concluded it would result in a more faithful representation of the lessee's assets and liabilities, and also greater transparency.

On the lessor side, the IASB addressed the issue by enhancing the disclosure requirements for the lessors but kept the previous accounting model ('dual accounting model'). The decision was based on the fact that the majority of the constituents supported the dual accounting model; they suggested classification should be based on the transfer of risks and rewards, transfer of control, or sale of the underlying asset, in a manner similar or identical to the existing lessor lease classification guidance as it appropriately reflects the lessor's business model.

In line with that view, we do not agree with the IPSASB conclusion in paragraph BC9 (c)(ii)<sup>2</sup>, that the *lessor should not derecognise the underlying asset in a lease transaction*. In practical terms, we understand the paragraph implies that the new IPSAS would mainly be applicable for operating leases, while part of the finance leasing (using the old terminology) would be accounted for as acquisitions according to other IPSAS. In particular, in the cases mentioned in paragraph 63 of IFRS 16, we understand the lessor, according to the ED, only has 2 options: (i) the transaction is a sale and it derecognises the underlying asset and recognises a Loan/trade receivable (out of scope of the lease standard); or (ii) the transaction meets a definition of a lease and the underlying asset is not derecognised.

In our view, under a finance lease it might happen that the lessor provides the rights and rewards to the lessee, but retains rights associated with ownership of the underlying asset despite having provided the control of the right of use, and

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<sup>2</sup> ED 64.BC9 (c)(ii): "As a finance lease would derecognize the underlying asset. The IPSASB is of the view that a lease conveys the right to use an underlying asset for a period of time and does not transfer control of the underlying asset to an entity—transactions that do transfer control are sales or purchases within the scope of other Standards (for example, IPSAS 9, Revenue from Exchange Transactions or IPSAS 17, Property, Plant, and Equipment). Therefore, the IPSASB considered that the lessor should not derecognize the underlying asset in a lease transaction"

therefore the lessor should not account for the transaction as a sale (in accordance with other standards) but also not keep the underlying asset in its balance sheet.

Due to the fact that we consider the dual accounting model more appropriate for the lessors accounting and ED 64 narrows the scope (only including operating leases), we support the asymmetry between the two models. In summary, we see no valid reasons to depart from IFRS 16's model.

In addition, we think that a dual accounting model should apply for the lessor accounting, i.e. a lease should be first classified as finance or operating, with the underlying asset derecognised only for a finance lease.

Considering the above, we suggest that IPSASB review the conclusion, or preferably explain the reasons for departure from IFRS 16's model.

#### *Lack of guidance for the Lessor accounting in the ED*

As explained, we understand that the IPSASB proposed model may in fact scope-out finance leases. In any case, a lessor must at the inception of each contract assess, based on all facts and circumstances, whether it provides the lessee with the use for a period of time, or in substance sells the underlying asset to the lessee. This exercise involves judgement of the future lessee's behaviour in line with the terms of the contract.

For that reason, IPSASB should consider providing additional guidance for situations where the initial judgement of the lessee's behaviour does not correspond to the actual behaviour. For example, if the lessee is likely to exercise an acquisition option, but in the end decides not to, it is unclear for us how the lessor should then account for the underlying asset.

Additional guidance in this regard would avoid diversity in practice.

#### *Consolidation issues*

As mentioned before we do not consider that the consolidation issues would be more prevalent in the public sector than in the private sector. In fact, we do not consider them to be issues but challenges arising from the complexity of the transaction that obliges the transaction between entities within the same consolidation scope to be completely eliminated so as to present a single economic entity (IPSAS 35.14).

According to IPSAS 35.40(c) an entity shall eliminate in full intra-economic entity assets, liabilities, net assets/equity, revenue, expenses and cash flows relating to transactions between entities of the economic entity (surpluses or deficits resulting from intra-economic entity transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full).

Paragraph BC10 identifies the consolidation issues considered by IPSASB:

- (i) *Consolidation issue 1: Where the lessor and the lessee are part of the same economic entity, and the lessor classifies a finance lease, the underlying asset is not recognised by either party.*

Applying IFRS 16's guidance at the individual financial statements level, neither the lessor nor the lessee recognise an asset in their financial statements, as they would recognise a lease receivable and a right to use the underlying asset, respectively.

However, in the consolidated financial statements the underlying asset is recognised based on its nature, since the entire lease transaction is



eliminated in full, this entire (intercompany) transaction is eliminated and the asset is reclassified to the category where was booked before it was leased to the other entity of the group.

We agree that it adds complexity but we do not believe this is an issue or a reason to depart from the IFRS model.

In our view, the current requirement to keep the underlying asset in the lessor's books in all cases, aiming to avoid *the underlying asset is not recognised anywhere*, will undermine the relevance and reliability of the individual over the consolidated financial statements.

- (ii) Consolidation issue 2: *separate records will need to be maintained to report the underlying asset.*

We agree that separate records of the underlying assets will have to be kept, however this is a consequence of having intercompany transactions. Consolidation adjustments are needed for other similar types of transaction, such as an acquisition of an asset by an entity of the same group, in particular if it includes a margin, separate records are already needed for consolidated financial statements.

Therefore, although we agree it increases complexity we do not see it as a reason for concluding that the IFRS model is not appropriate for the public sector.

- (iii) *The use of different accounting models may make leasing transactions less understandable to some users of the financial statements. It may also be difficult for users to distinguish between a lease and the sale of an asset in a lessor's financial statements.*

Our understanding is that these arguments are actually valid for the IPSASB's proposed model, as users will not be able to understand the substance of the transaction. Even if the lessee will consume the asset during its entire useful life it is still shown in the lessor's balance sheet.

#### *Risk and rewards incidental model ownership*

We would also like to comment on the risk and rewards incidental model which, we do not consider to be inconsistent with the notion of control included in the conceptual framework for the recognition of an asset.

We note that paragraphs CF.5.11-5.12 state that an entity must have control of the resource, demonstrated by the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist: (i) Legal ownership; (ii) Access to the resource, or the ability to deny or restrict access to the resource; (iii) The means to ensure that the resource is used to achieve its objectives; and (iv) The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.

As a consequence of this guidance, in particular the second and third criteria, we disagree with IPSASB that the risk and rewards model is inconsistent with the notion of control.

### *Stated-owned enterprises*

We note that the consolidation scope of a public sector entity might include also entities operating in the private sector, for which the proposed guidance (keeping the underlying assets) would be even more inappropriate, since they could not compare their financial statements with the other players of the market.

### **Question (Specific Matter for Comment 3) – Lessor Accounting: Proposal for a single right-of-use model**

*The IPSASB's decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34 – BC 40 for IPSASB's reasons).*

*Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

### **Response**

As previously mentioned in our reply to SMC 2, we disagree with the proposed departure from IFRS 16's model since we do not agree there is a public sector specific reason and the private and public sector transactions have the same economics and features, therefore they should have the same accounting treatment.

Moreover, we consider that it would be more appropriate and beneficial for the understandability of the financial statements to have a dual accounting model for the lessor.

In this sense, on top of the current model proposed by IPSASB, we suggest to create an additional step, similar to the IFRS proposal, classifying the lease as finance or operating, based on whether it transfers substantially all the risks and rewards of the underlying asset. Examples and indicators of whether a lease would classify as finance or operating should be provided on a principle basis.

However, unlike the IFRS 16's model, we support IPSASB on the view that for the operating lease a lessor should recognise the underlying asset and the lease receivable, as this presentation provides more complete information for the users of the financial statements.

We understand that this is a dual accounting model for lessor, in contrast to a single model for the lessee; however we believe that it would better depict the business model of a lessor, in line with the user's views.

Finally, we noted that in paragraph 82 of the ED 64 it is assumed that there are cases where the lease agreement transfers the ownership of the underlying assets to the lessee, which should depreciate the right-of-use on the basis of the useful life.

Despite the fact that we agree with the text of the paragraph we consider it is inconsistent with the accounting model for the lessor as it envisages that the lessor should never derecognise the underlying asset.

#### **Question (Specific Matter for Comment 4) – Additional guidance for Concessionary Leases**

*For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise the subsidy granted to lessees as a day one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC 77 – BC96 for IPSASB's reasons).*

*For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise revenue in accordance with IPSAS 23 (see paragraphs BC112 – BC 114 for IPSASB's reasons).*

*Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

#### **Response**

We support IPSASB proposal to add additional guidance on concessionary leases.

##### *Concessionary lease – for lessor*

The ED includes guidance on concessionary leases in paragraphs 15, 22 and AG60.

Overall we agree with the guidance provided and we think it is useful, however, we believe that if a transaction meets the definition of a lease, the ED should apply, even if the lease is for no consideration instead of referring to different frameworks such as national standards.

As it might lead to diversity in practice we suggest to treat all the non-exchange component included in the lease in the same way, this is by using paragraph 23 and AG61(b) of the ED also for leases for no consideration or nominal amount.

##### *Concessionary lease – for lessee*

In line with our previous comment, we consider that the flowchart in paragraph 62 should not include the last step that relates to leases for no consideration or nominal amounts. The same accounting treatment should apply for all non-exchange part of the lease, regardless of the amount.

##### *Distinguish among financing transactions, grant or combined (paragraph AG60)*

We would like to suggest to IPSASB to reconsider whether distinguishing among financing transactions, grants or both is needed in this regard. As we previously mentioned, we consider that if a lease agreement meets the definition of a *lease*, and it contains a non-exchange part, the treatment should be the same, regardless of whether is just below the market value or for zero. We agree that the assessment if the lease is below market rate is necessary, however further assessment of whether the consideration is 'nominal' will be very judgemental and may lead to unnecessary divergence in practice.

##### *Leases for no consideration*

The ED defines in paragraph 5 a lease as "a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time **in exchange for consideration**" and Concessionary leases as "a lease at below market terms".

Accordingly, a lease agreement for no consideration does not fit with the definitions and therefore it seems that leases at no consideration – that are likely to occur in the public sector – are out of scope (despite paragraph 22 includes a flowchart that foresees leases for zero or nominal amount).

For consistency purposes, we suggest to change the definition of a concessionary lease and/or lease in order to encompass leases for no consideration.

### **Additional comments for IPSASBs consideration:**

#### *Recognition exemption for lessor*

The guidance for lessees includes two recognition exemptions: short-term and low value; however for the lessors only one exemption is provided: short-term.

According to the explanation, IPSASB decided not to provide the recognition exemption for the lessor as this relief is already given by IPSAS 1 based on materiality threshold.

Although we agree with IPSASB reasoning that such guidance is already available, on the other hand, we consider it might raise doubts amongst preparers about what was the intention of the Board to explicitly provide the exemption for lessees and not for lessors.

Consequently, for the avoidance of doubt and to give clarity on the application of the standard, we strongly suggest explicitly providing the exemption for the lessor in the body of the standard (or otherwise exclude the exemption for the lessees from the standard as well).



**ACT**  
Government

Chief Minister, Treasury and  
Economic Development

Mr John Stanford  
The Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
529 Fifth Avenue, 6th Floor  
New York, NY 10017  
United States of America

Dear Mr Stanford

**Exposure Draft 64 *Leases***

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board (IPSASB) on IPSASB Exposure Draft (ED) 64 – *Leases*.

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee comprises the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

HoTARAC broadly agrees with the approach outlined in this ED as being appropriate for the not-for-profit public sector. However, HoTARAC does not agree with the approach proposed for lessors preferring the derecognition approach over the performance obligation approach.

The attachment to this letter sets out HoTARAC's response to the specific matters for comment, as well as some additional comments on other aspects of the ED. If you have any queries regarding our comments, please contact Peter Gibson from the Commonwealth Department of Finance on: +61 2 6215 3551 or by email to [peter.gibson@finance.gov.au](mailto:peter.gibson@finance.gov.au).

Yours sincerely

David Nicol  
Chair

Heads of Treasuries Accounting and Reporting Advisory Committee  
5 July 2018

## Specific Matters for Comments

### Specific Matters for Comment 1

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

HoTARAC agrees.

The right-of-use model in IFRS 16 has a number of flaws, and IASB adopted it after exposing, and then rejecting, a number of other models, however, the right-of-use model has now been accepted. It will be beneficial for the accounting by lessees to be consistent across private and public sectors, both in user understanding and in ease of accounting and consolidation in “mixed groups” of for-profit and not-for-profit public sector entities.

HoTARAC supports use of the incremental borrowing rate in all lease calculations, for the reasons given in the Basis for Conclusions.

### Specific Matter for Comment 2

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

If the right-of-use model is adopted for lessees, a majority of HoTARAC agrees with applying the same model to lessors.

- The economic substance of a lease is broadly the same for lessors and lessees. Further, IPSASB recognises in the Basis for Conclusions that in the public sector, it is much more common for entities to be lessors as well as lessees for the same assets, and a single model does make consolidation easier.
- Conceptually, it is difficult to reconcile a risks and rewards approach to both the IASB and IPSASB Conceptual Frameworks, which favour a control approach to definition and recognition of assets and liabilities.

A HoTARAC minority disagrees with the proposal to diverge from the risks and rewards approach of IFRS 16. The HoTARAC minority is of the view that lessor accounting should be consistent with IFRS.

### Specific Matters for Comment 3

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

HoTARAC does not agree with the model proposed.

Our view is that the derecognition model is more conceptually sound. A derecognition model should not greatly affect the ability to consolidate, if good accounting records are maintained.

An asset embodies a number of rights, derived from the legal system, physical possession, and the physical nature of the asset. The right to use is one of these rights. Others include the right to sell the asset and the right to pledge the asset as security. In our view, a lease transfers the right to use the asset to the lessee, and the lessor retains only the remaining rights. The right-of-use asset is not a new asset created at the time of the lease.

### **Specific Matters for Comment 3 - Continued**

HoTARAC suggests that IPSASB should reconsider the model for lessors, noting that the derecognition approach has at least two practical flaws:

- It may potentially still lead to confusion among some users with regards to the nature of the asset and its value; and
- It may be practically difficult if the underlying asset is measured at cost, yet the derecognised right-of-use is measured at fair value. The derecognised amount may of itself exceed the cost of the whole underlying asset.

### **Specific Matters for Comment 4**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

HoTARAC agrees in principle with measuring concessionary leases at fair value. This is consistent with recognition of donated assets at fair value under IPSAS 23, and provides the economically soundest measure of the value of the subsidy provided by the lessor to the lessee. HoTARAC agrees that the revenue for the lessee should be measured in accordance with IPSAS 23, because in some circumstances there may be conditions within the lease having the effect that the subsidy is not all earned at the commencement of the lease.

HoTARAC also agrees that leases for no or nominal consideration are in substance grants, and should be accounted for as grants.

However, HoTARAC does not agree that concessionary leases are conceptually equivalent to concessionary loans in all respects. This could result in an argument that the subsidy expense of the lessor should be recognised progressively rather than all on day-one, under conditions existing for some leases. HoTARAC notes that this could be covered by the non-exchange expense standard that is currently work in progress.

## **Other Comments**

### ***Practicality***

While HoTARAC broadly supports the approach to accounting for leases, as discussed above, we note that the proposed approach considerably complicates accounting for leases. Practical experience with adopting IFRS 16 indicates a considerable administrative burden for entities with many leases.

Furthermore, determination of fair value for some transactions (particularly concessionary leases) may not be straightforward and thus requiring professional valuation services. This could result in considerable cost for some entities, as acknowledged in the Basis for Conclusions (e.g. BC95).

Cost and effort may be a burden for countries with limited resources, including in situations where they are considering a transition to accrual accounting.

Given that cost/benefit is a standard-setting consideration in the IPSASB Conceptual Framework, HoTARAC asks that IPSASB carefully consider the costs imposed by the various features of the proposed approach, and the benefits derived by users.



### ***Mismatch***

HoTARAC's view is that where an entity acts as both lessee and lessor, the proposed standard should allow the entity to adopt an approach that matches the accounting by the lessee and lessor. This would overcome a situation where there otherwise would be an accounting mismatch. A similar option is provided for some financial instruments. This could apply, for example to:

- low value assets (which may be excluded by lessees but not lessors);
- the assumptions about matters such as lease terms and interest rates where the terms; and to conditions of the two leases are different; and
- concessionary leases (where the revenue/expense recognition pattern may be different for lessors and lessees).

In HoTARAC's view this approach would not seriously impair information for users of financial reports.

### ***Sale and Leaseback***

HoTARAC agrees with the IPSASB approach to sale and leaseback transactions, subject to our other comments.

### ***Distinguishing Leases***

HoTARAC supports the guidance to distinguish leases from asset sales, service agreements and service concessions. In particular, the distinction between leases and service concessions may otherwise be difficult to determine for marginal cases, based on IASB literature.

JULY 4, 2018

# IPSASB EXPOSURE DRAFT 64: LEASES

CONSULTATION RESPONSE



KALAR CONSULTING

MANJ KALAR



KALAR CONSULTING



Manj has over 20 years' experience working in public sector, focusing on implementation of accrual accounting across UK central Govt departments and the Whole of Government Accounts consolidation. She has advised a number of jurisdictions on implementing accrual accounting.

Manj has particular interest in supporting governments to address the practicalities of implementing IPSASs.



International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street, 4th Floor  
Toronto  
Ontario M5V 3H2  
CANADA

Submitted electronically

4<sup>th</sup> July 2018

Dear IPSASB secretariat

### **ED 64: Leases**

I am delighted to share my comments on the proposed Exposure Draft standard on leases (ED 64) consultation.

### **Leases**

Accounting for leases has long been a challenging area for standard setters to best reflect the economic reality of transactions.

### **Lessee Accounting**

I agree with the approach recommended by IPSASB as it is consistent with the approach set out in IFRS 16 (to adopt a right of use model.) I believe this better reflects the substance of the transaction rather than the risk and reward approach (IPSAS 13). This is in line with IPSASB's strategy to converge (or align<sup>1</sup>) with the development of IFRSs.

### **Lessor Accounting**

I agree with the Board's recommended approach to adopt the right of use model for lessors. This is different to the approach set out in IFRS 16. IPSASB's approach promotes greater accountability, transparency and consistency between the lessor and lessee. For instance, the dynamic may be quite different in the public sector where having lessors and lessee in the same group is more common, for example where a property agency owns all of a government's properties and leases them to departments/ministries. A different approach to accounting for leases would result in a distorted view to the user of the accounts.

Detailed responses to the specific matters for comment are provided in the Annex.

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<sup>1</sup> Alignment with IFRSs better reflects the position as recommended in the previous submission to the 2019-2023 IPSASB Strategy and Work Plan



Thank you for the opportunity to comment on the draft standard on leases. If there are any questions, please do not hesitate to contact me.

Yours sincerely,

Manj Kalar

Principal consultant

## Annex: Detailed response to the Consultation ED 64: Leases

### Specific Matter for Comment 1

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting.

Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

I agree with IPSASB's decision to adopt the IFRS 16 right of use model.

This approach allows for continued alignment with IFRSs, which is better for mixed groups (therefore ensures consistency in approach to lessees) and better reflects the economic reality of the transaction rather than looking at risks and rewards (although this was a marked improvement on previous leasing standards).

The key (practical) challenge will be to review all lease arrangements to obtain the required information and adopting the exclusions (leases less than one year/low value) as per IFRS 16 will help to reduce the burden.

### Specific Matter for Comment 2

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft

Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

I agree with IPSASB's decision.

Although the right of use model approach does not achieve the aim of maintaining alignment with the IFRSs, the proposed approach better reflects the economic reality (substance) of the transaction. It is logical and consistent with the approach proposed for lessees. As there is greater likelihood of mixed groups including lessors and lessees in the public sector, the right of use model aids comparability (hence greater transparency and accountability to the citizen).



KALAR CONSULTING

### Specific matter for comment 3

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting.

Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

I agree with the requirements for lessor accounting proposed in this Exposure Draft.

It is helpful to have the rationale (i.e. the two different approaches considered and option 1 being adopted).

### Specific matter for comment 4

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans. For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23.

Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

I agree with the proposals.

The approach is logical, consistent with other IPSASs. For greater transparency the disclosure of the value of the concession is required.

Thank you for the opportunity to comment.





June 28, 2018

Cliff: 369750

E-mail: [johnstanford@ipsasb.org](mailto:johnstanford@ipsasb.org)  
John Stanford  
Technical Director, IPSASB  
International Public Sector Accounting Standards Board  
277 Wellington St. West  
Toronto, ON M5V 3H2

Dear John Stanford:

**RE: IPSASB Exposure Draft 64: Leases**

Thank you for the opportunity to provide comments on the exposure draft titled "Leases". The views expressed in this letter reflect the views of the Government of the Province of British Columbia, including central agencies, ministries and entities consolidated into the British Columbia Summary Financial Statements.

The Summary Financial Statements of the Province are prepared in accordance with Canadian Public Sector Accounting Board (PSAB) standards. We have a particular interest in the development of IPSASB's guidance as it may influence future PSAB standards.

*Consideration of users of financial statements*

We are encouraged by the proposed right-of-use model as it provides users with useful information. Our government is committed to transparency and accountability in our reporting and recognition of the right-of-use asset and associated liability is consistent with this requirement. Reporting certain operating leases on the statement of financial position may give users a better understanding of the financial impacts of leasing arrangements for the lessee. A right-of-use model has the potential for better understandability in distinguishing between a lease and the sale of an asset in the lessor's financial statements. A consistent treatment for lessors and lessees as proposed by this model could lead to simplified consolidation within the Government Reporting Entity (GRE).

However, we are concerned that right-of use assets may introduce ambiguity in the definition of assets. The usefulness of the information provided from this model is dependent on whether the creation of a right-of-use asset clearly meets the definition of an asset under generally accepted accounting standards. We are also concerned that from a cost-benefit perspective, the administrative costs associated with this added reporting requirement may exceed the benefits to our users, specifically, the exercise of analysing and updating existing leases if the standard requires retroactive adoption.

*Accountability for substance of the transaction*

Moving away from the current accounting of operating lease financing will be a significant change for the entities within our GRE. Despite these challenges, our government is committed to transparency in our financial reporting and clarifying financing obligations and accountability for the associated assets under lease will meet this mandate. We continue to believe the best representation of the substance of a transaction will come from consistent application of the definition of assets and liabilities.

Responses to specific questions posed in the consultation paper are attached. Should IPSASB have any comments or questions, please contact me at: 250 387-6692 or via e-mail: [Carl.Fischer@gov.bc.ca](mailto:Carl.Fischer@gov.bc.ca), or Diane Lianga, A/Executive Director, Financial Reporting and Advisory Services Branch, at 778 698-5428 or by e-mail: [Diane.Lianga@gov.bc.ca](mailto:Diane.Lianga@gov.bc.ca).

On behalf of the Government of British Columbia,

Sincerely,



Carl Fischer, CPA, CGA  
Comptroller General  
Province of British Columbia

Encl.

cc: Diane Lianga, A/Executive Director  
Financial Reporting and Advisory Services  
Office of the Comptroller General

## Specific Matters for Comment

### Specific Matter for Comment 1:

**The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We agree with the adoption of the right-of-use model for lessee accounting when the right-of-use assets and corresponding liabilities meet the definitions of assets and liabilities in currently accepted standards. Many organizations within the Province of BC’s reporting entity have no intention on retaining and holding the underlying leased asset, so clarity in the standard may be useful to avoid ambiguity.

The right-of-use model suggests that the current accounting treatment is failing to report the substance of the transaction for leasing arrangements; however, there is no evidence of this in the basis for conclusions. Both capital and operating models could be valid, and the choice of which to use should best reflect the substance of the transaction.

### Specific Matter for Comment 2:

**The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.**

We do not agree with the departure from IFRS 16 risks and rewards model for lessor accounting. IFRS has demonstrated that the existing lessor accounting was “generally accepted,” so they retained it. There is no evidence that suggests that the preparer and user communities of government financial statements believe that lessor accounting is not currently meeting their reporting needs. Symmetrical accounting between the lessor and lessee within the government does streamline financial reporting, but should only be appropriate as long as the substance of the transaction is reflected.

### Specific Matter for Comment 3:

**The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

We do not agree with the proposed single right-of-use model for lessor accounting. The basis for conclusions states that the existing “risk and rewards ownership model” (in IPSAS 13 and in IFRS 16 lessor accounting) is not based on control; however, the IPSAS conceptual framework 5.6 defines control as “the ability to use the resource so as to derive the benefit of the service potential or economic benefit”. We do not see any significant difference between the existing risk and rewards model and the IPSAS conceptual framework 5.6. As the substance of the transaction has not changed, it is difficult to agree with the decision for the lessor to not derecognize the underlying asset because it is easier for

## Specific Matters for Comment

users to understand that when a government leases assets to external entities, those assets are no longer available to the government, therefore reducing the tangible capital assets in the financial statements.

The proposed guidance is not clear on where control over the asset lies. We highlight the following statements regarding the control aspect:

- AG48 states, “Obtaining legal title does not in itself determine how to account for the transaction.”
- BC9 states, “Transactions that do transfer control are sales or purchases within the scope of other standards (for example IPSAS 9).”
- IPSAS 9 says that revenue should be recognized when the entity has transferred the “significant risks and rewards of ownership.”
- BC88 states that a lease is “in substance a sale of an unrecognized right-of-use asset,” implying that control does change hands.

If legal title does not define control, and the characteristics of finance leases or sales transactions do not define control, further guidance is required to identify the control point in a transaction. One of the key qualitative characteristics of the financial statements is that the statements are reliable by representing the substance of the transaction rather than its legal form. Our concern with the right-of-use model is that it represents the transaction based on its legal form (ownership of asset) rather than the substance of transaction (leasing).

### Specific Matter for Comment 4:

**For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?**

We agree that a concessionary lease receivable is similar in nature to a concessionary loan receivable.

## Other Matters

### *Consideration of users of financial statements*

We are encouraged by the proposed right-of-use model as it provides users with useful information. Our government is committed to transparency and accountability in our reporting and recognition of the right-of-use asset and associated liability is consistent with this requirement. Reporting certain operating leases on the statement of financial position may give users a better understanding of the financial impacts of leasing arrangements for the lessee. A right-of-use model has the potential for better understandability in distinguishing between a lease and the sale of an asset in the lessor's financial statements. A consistent treatment for lessors and lessees as proposed by this model could lead to simplified consolidation within the Government Reporting Entity (GRE).

However, we are concerned that right-of use assets may introduce ambiguity in the definition of assets. The usefulness of the information provided from this model is dependent on whether the creation of a right-of-use asset clearly meets the definition of an asset under generally accepted accounting standards. We are also concerned that from a cost-benefit perspective, the administrative costs associated with this added reporting requirement may exceed the benefits to our users, specifically, the exercise of analysing and updating existing leases if the standard requires retroactive adoption.

### *Accountability for substance of the transaction*

Moving away from the current accounting of operating lease financing will be a significant change for the entities within our GRE. Despite these challenges, our government is committed to transparency in our financial reporting and clarifying financing obligations and accountability for the associated assets under lease will meet this mandate. We continue to believe the best representation of the substance of a transaction will come from consistent application of the definition of assets and liabilities.

In addition to our replies to the Specific Matters for Comment, we have the following other comments:

- AG24, which appears to contradict AG19 (b) (i). You can consider predetermined decisions in either of AG19(b)(i) or (ii), but AG24 then restricts it:
  - AG24: “unless the conditions in paragraph AG19 (b) (ii) exist, an entity shall not consider decisions that are predetermined before the period of use.”
- AG32 is unclear about whether the entity making the assessment about the lessee is the lessor or the lessee. If it refers to the lessor we do not see how the lessor could reasonably obtain all of this knowledge about the lessee, particularly in a third party lessee. For example, determination by the lessor as to the underlying assets importance to the lessee's operations.
- We do not agree that a cancellation clause (AG37) related to appropriations should only be considered if there is reasonable uncertainty that the appropriation will not be made. Governments retain the discretion to authorize appropriations in future years. As long as this discretion exists, no assets or liabilities should be recorded.

July 9, 2018

International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto, ON M5V 3H2 Canada

**Re: PSAB Staff Comments on Exposure Draft 64 (ED 64), “Leases”**

Thank you for the opportunity to provide input on the proposed International Public Sector Accounting Standard – Leases.

PSAB staff fully supports the proposed improvements to lease accounting in ED 64. This standard would ensure that lessees and lessors provide relevant information in a manner that faithfully represents leasing transactions. This standard will ensure that better information about leases is provided in the financial statements for accountability and decision-making purposes, consistent with the objective of financial reporting in the IPSAS conceptual framework. This is an excellent, thoroughly researched and well explained proposed standard that has been appropriately adapted to the public sector, and we would support its adoption as a new IPSAS.

We are particularly supportive of the proposal to apply the same right of use model to both lessee and lessor accounting for leases. The articulated reasons for this decision in the Basis for Conclusions are compelling and this accounting will promote greater accountability for leasing transactions in the financial statements of public sector entities. Further, the proposals for concessionary leases are important additions to public sector accounting theory. Together these proposals ensure internal consistency within the IPSAS for items of similar substance.

We have provided responses to each of the specific matters for comment, which we hope you will find useful.

Kind regards,

Ali Ahmed  
Principal,  
Public Sector Accounting Board.  
[aahmed@psabcanada.ca](mailto:aahmed@psabcanada.ca)

Martha Jones Denning,  
Principal,  
Public Sector Accounting Board.  
[mjonesdenning@psabcanada.ca](mailto:mjonesdenning@psabcanada.ca)

**Specific Matter for Comment 1**

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6– BC8 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

We agree with the IPSASB’s decision to adopt the IFRS 16 right of use model for lessee accounting. The reasons explained under BC6-BC8 are comprehensive.

However, we believe that the users will benefit further if clarification is provided under BC7 with respect to what is controlled (identified asset, control of the right to use an identified asset or control of the right to access to operate an identified asset) how is it controlled and for how long (lease term).

**Specific Matter for Comment 2**

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB’s reasons). Do you agree with the IPSASB’s decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

We agree with the IPSASB’s decision to depart from the IFRS 16 risk and rewards model for lessor accounting. The reasons mentioned under BC9 – BC13 are comprehensive.

**Specific Matter for Comment 3**

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB’s reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

We agree with the IPSASB’s proposal for a single right-of-use model for lessor accounting consistent with lessee accounting. We agree that Approach 1 is appropriate for the reasons stated in paragraphs BC34–BC40.

However, we believe that the readers would benefit if BC37 were consistent with the information suggested under specific matter for comment 1.

Also, the explanation provided under BC56 to not propose all recognition exemptions for lessors is not compelling because BC56(a) and BC56(b) would apply to lessee also, perhaps the argument could be further strengthened.

**Specific Matter for Comment 4**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB’s reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize

revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB’s reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

We agree with the overall requirement to account for concessionary leases for lessors and lessees proposed in the exposure draft and the specific requirements on how such leases should be accounted for in public sector financial statements. The proposed approach is consistent with that for items of similar substance in other IPSAS, and also consistent with the underlying theory in Canadian accounting standards for accounting for loans provided with concessionary terms (Public Sector Accounting (PSA) Handbook, Section PS 3050.20-.25) and portfolio investments with concessionary terms (PSA Handbook, Section PS 3041.17-.26).



Responses to IPSASB Consultation Paper: Leases  
(January, 2018; Comments due: June 30, 2018)

## **CONSULTATION PAPER (CP)**

### **ACCOUNTING FOR LEASES**

*The Technical Director*

*International Public Sector Accounting Standards Board (IPSASB)*

*International Federation of Accountants*

*277 Wellington Street West, 6<sup>th</sup> floor*

*Toronto, Ontario M5V 3H2 CANADA*

Brasília, Brazil

June 30, 2018

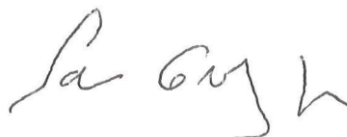
Dear Mr. John Stanford,

The Conselho Federal de Contabilidade (CFC) of Brazil welcomes the opportunity to collaborate with the consultation on *Leases*. CFC, along with its regional arms - Regional Accounting Councils or Conselhos Regionais da Contabilidade (CRCs), is the Professional Accountancy Organization that carries out regulatory activities for overseeing the accountancy profession throughout the country.

Our points of view and comments can be found on the Appendix of this document that was prepared by the Advisory Board for Public Sector Accounting Standards (GA/NBC TSP) of the CFC.

If you have any questions or require clarification of any matters in this submission, please contact: [tecnica@cfc.org.br](mailto:tecnica@cfc.org.br).

Regards,



**Idésio S. Coelho**  
*Technical Vice-President*  
Conselho Federal de Contabilidade

## APPENDIX

### 1. Context and General Comments

The Brazilian Federation is composed by central, 26 states, one federal district and 5,569 municipalities. These levels of governments are responsible for formulating, implementing and evaluating public policies in cooperative and/or competitive arrangements.

The proposed approach requires a “right-of-use” model to all leases. Under this model, lessees would record a right-of-use asset and a lease liability in the statement of financial position and lessor would record a lease receivable and a liability (unearned revenue).

In this document, we present the contributions for the consultation paper based on a practical approach applicable to our jurisdiction. In general, we believe that the IPSASB propositions are appropriated, however, the proposed approach to concessionary leases may be excessively onerous due the requirement to assess if all leases contracts are at market value.

In the next section, we present our comments and answers on the preliminary views and specific matters for comment of the consultation paper on an international level.

In addition, we included in the other comments section of this letter the following topic:

#### (a) Low value assets

One aspect of the proposal is that a lessee may elect not to apply the requirements in paragraphs 63 and 68–100 to leases for which the underlying asset is of low value. This election, however, has not been allowed to lessors. In order to maintain consistency between the accounting of both the lessor and lessee, we believe that such election should also be allowed to lessors.



## 2. Responses to the Specific Matters for Comment and Preliminary Views

### Specific Matter for Comment 1:

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

We are not aware of any other alternative that would comply more with the current version of the framework and with what would be expected of financial statements prepared according to IPSAS.

The proposed approach would nearly eliminate off-balance sheet financing through operating leases.

**GA/CFC agrees with the right-of-use model for lessee accounting.**

### Specific Matter for Comment 2:

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

An approach for lessor (risk and reward) different from the approach for lessee (right-of-use) will cause an asymmetrical accounting making leasing transaction less understandable to some user of the financial statements. Also, there are lease agreements between government entities in our jurisdiction and an asymmetrical accounting will cause consolidation issues.

GA/CFC agrees with IPSASB approach to depart from IFRS 16 risk and rewards model and the adoption of the right-of-use model for lessor.

### Specific Matter for Comment 3:

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

GA/CFC agrees with the Board view in adopting approach 1 of BC 35 where the right-of-use is considered a separate phenomenon to the underlying asset and, therefore, the lessor continue to recognize the underlying asset in its entirety.

GA/CFC agrees that it maintains consistency with the lessee accounting and does not conflict with other principles derecognizing "slices" of assets.



**Pre Specific Matter for Comment 3:**

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons).

For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

GA/CFC agrees with the Board proposal for lessors to measure concessionary lease at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term.

GA/CFC also agrees with the Board proposal for lessees to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23.

GA/CFC also believe that additional guidance should be provided in order to help lessor and lessees evaluate when a lease contract is at market value as it may be excessively onerous to assess every single contract in order to check if it is at market value.

**Other comments**

*Low value assets*

One aspect of the proposal is that a lessee may elect not to apply the requirements in paragraphs 63 and 68–100 to leases for which the underlying asset is of low value. This election, however, has not been allowed to lessors.

As per the paragraph 54 of the basis for conclusion, the IPSASB decided not to propose a recognition exemption for lessors for leases for which the underlying asset is of low value for the following reasons:

- (a) IPSAS 13 does not provide recognition exemptions in lessor accounting;
- (b) IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors already provides sufficient guidance on materiality in applying IPSASs to specific transactions; and
- (c) It is consistent with a head lease not qualifying as a lease of a low-value asset if the lessee subleases an asset, or expects to sublease an asset.

We believe that the reasons set up in (a) and (b) above would also be applicable for lessee and would not justify a different approach for lessors and lessee.

In order to maintain consistency between the accounting of both the lessor and lessee, we believe that such election should also be allowed for lessors.



Paris, le 13/07/18

**DIRECTION GÉNÉRALE DES FINANCES PUBLIQUES**

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Référence : 2018/07/3315

**Subject :** Response to Exposure Draft 64 "Leases".

I am writing you on behalf of the French Directorate of Public Finances (hereinafter mentioned as DGFIP) to express our views on the mentioned above exposure draft (hereinafter mentioned as ED).

Head of Central Government Accounting Department

François Tanguy





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RÉPUBLIQUE FRANÇAISE

Paris, le 13/07/18

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This consultation relates to



the complex issue of Leases.

The DGFIP contributed to the drafting of the reply and accordingly shares the position expressed by the Public Sector Accounting Standard Concil (CNoCP or The Concil) annexed to this dossier.

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## **Version française**

Cette consultation est relative à la question complexe des contrats de location.

La DGFIP a contribué à la rédaction de la réponse et partage en conséquence la position exprimée par le Conseil de normalisation des comptes publics (CNoCP ou le Conseil) jointe en annexe au présent dossier.

\*\*\*\*



Paris, July 3, 2018

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**Re: Response to Exposure Draft 64 *Leases***

Dear Mr Stanford,

The French Public Sector Accounting Standards Council (CNoCP) welcomes the opportunity to comment on the Exposure Draft 64 *Leases* published in January 2018 (ED64).

The CNoCP welcomes the efforts put in developing the proposals, essentially in ensuring the consistency between lessor and lessee accounting treatments, as well as in dealing with concessionary leases that are specific to the public sector.

The CNoCP understands the need to explore convergence with the principles set out for the private sector on leases. Because IFRS 16 was commented upon extensively as part of the IASB's process, we do not comment upon the merits or drawbacks of its application. However, we note that IFRS 16 is effective as of 1 January 2019 in the private sector; hence as of now, even if some entities chose to early adopt the new standard, no thorough feedback exists on its application. This makes it difficult to assess the impact and efficiency of its adaptation to the public sector.

In addition, we question the usefulness of a complex accounting solution. We are concerned that the cost of implementing the proposed accounting treatment might outweigh the benefits.

Therefore, we would appreciate if the Board could consider exempting public sector entities from applying the accounting requirements of the future standard for leases between entities from the public sector. The standard would then only apply mandatorily to lease arrangements between private and public entities.

For lessor accounting, we understand the objective of consistency between lessor and lessee accounting, but we would encourage the IPSAS *Board* to perform a thorough cost-benefit analysis as this section is specific to the public sector (IFRS 16 retains IAS 17 accounting requirements for the lessor). Moreover, we would recommend that the IPSAS *Board* should underline that arrangements that transfer control of the underlying asset are out of scope in the future standard, and not only in the Basis for Conclusions. Additional guidance on when arrangements transfer control would also be welcome.

Given the volume of issues that could possibly arise, we would recommend that the *Board* should carry out an effect analysis with a view to envisage all consequences of the proposed approach.

With respect to concessionary leases, we would like to call the Board's attention to a risk of inconsistency in the accounting treatments of transactions that might be in substance similar, only because they are covered by different standards.

Responses to the detailed questions set out in ED64 are presented in the following appendix.

Yours sincerely,

Michel Prada

## APPENDIX

### *Specific Matter for Comment 1 (SMC 1)*

*The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting. Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

From a conceptual perspective and a convergence standpoint, we understand the IPSASB's decision to adopt the IFRS 16 right-of-use model for lessee accounting. Conceptually, it seems sound to recognise the right to use an underlying asset distinctly from that asset as long as that right of use meets the definition of an identifiable asset (i.e. separable or arising from contractual or other legal rights). Similarly, recognising the corresponding liability, that is essential from the point of debt measurement, is in line with the IPSASB Conceptual framework.

From a practical viewpoint however, we believe that applying the proposed requirements to lease arrangements between public sector entities would entail costs that would outweigh the benefits of providing high quality financial information:

- IFRS 16 is effective as of 1<sup>st</sup> January 2019 and most entities in the private sector have not yet fully implemented the new requirements. This means that many application issues may surface in the coming years. Our understanding is that the application of IFRS 16 requires reviewing all contracts that may include a lease agreement and, as a first step, assessing them against the new definition of a lease. Adopting IFRS 16 is therefore highly demanding in terms of resources for certain entities and may require the development of new IT systems, processes and controls. This often proves challenging in the private sector, and would be even more challenging and burdensome for the public sector. With respect to the accounting treatment, determining the lease term, the discount rate and the relevant disclosures is of significant concern to our constituents.
- We also note that some constituents are concerned that additional liabilities in public sector entities' financial statements may impact reporting under national systems of accounts and may affect for instance the scope of the public debt.
- Another concern revolves around the effect of the new model on liability recognition: entering into lease agreements for entities that are restrained from borrowing would generate additional liabilities.

For the reasons above, we would appreciate if the Board could consider exempting public sector entities from applying the proposed accounting requirements for leases between entities of the public sector. The standard would then only apply mandatorily to lease arrangements between private and public entities. We believe that such an exemption would fit the cost-benefit constraint, while respecting an appropriate balance among the qualitative characteristics.

In addition, we are of the opinion that the future standard should discuss the recognition of a right-of-use asset in those cases where the underlying asset is not recognised. Such issues might arise from public sector arrangements that grant a right-of-use of the public domain.

Given the volume of issues that could possibly arise, we would recommend that the *Board* should carry out an effect analysis with a view to envisage all consequences of the proposed approach.

### ***Specific Matter for Comment 2***

*The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft. Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.*

We agree that the “risks and rewards” approach should no longer be retained to assess recognition of assets in the accounts of reporting entities party to a transaction. The definition of an asset in the Conceptual Framework makes it clear that control, as the power to direct the use of the asset, is the key factor to consider, while the risks and rewards of ownership is not of itself an indicator of the party that controls the asset.

We observe that the notion of control is well understood amongst our constituents when applied to property, plant and equipment or well-identified intangible assets. However, we note that it appears to be more difficult to apply in practice to a right-of-use, mainly because the asset seems to them to be recognised twice. We note that BC9(c)(ii) mentions that a lease conveys the right to use an underlying asset for a period of time and does not transfer control of the underlying asset. We would strongly recommend that the scope of the future standard should clearly state that where the arrangement leads in substance to transferring control of the underlying asset to another party it does not meet the definition of a lease; in other words, such arrangement should be out of the scope of this standard. Additional guidance on when arrangements transfer control would also be welcome.

Additionally, because the new lessor's model is a significant change from previous IPSAS requirements, we would recommend that further disclosures should be required in the financial statements to explain that lease arrangements in the scope of the future standard give rise to a right-of-use that meets the definition of an asset. Such additional disclosure could be only temporary, required during a transition period, and would state that the lease arrangement is considered a separate economic phenomenon from the underlying asset. We believe that this explanation would be in the public interest.

### ***Specific Matter for Comment 3***

*The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting. Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, please explain the reasons. If not, what changes would you make to those requirements?*

We acknowledge that a single model for lessors and lessees would ease communication: it is simpler than having to explain why a different accounting treatment should be retained, depending on whether the lease arrangement is analysed from the perspective of the lessor or of the lessee. Additionally, we firmly believe that, conceptually, the notion of control applies to the asset as a whole and that an accounting solution for the lessor that would have the asset partitioned would only raise complex implementation and measurement issues.

However, as for lessee accounting, in instances where lease arrangements are between public sector entities, we would question the need to introduce a complex accounting solution. In those cases, we would advocate that usefulness of information and the cost/benefit constraint should call for an exemption.

### ***Specific Matter for Comment 4***

*For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with the concessionary loans. For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise revenue in accordance with IPSAS 23. Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?*

While we have sympathy for retaining an accounting treatment for concessionary leases that is consistent with that of concessionary loans, we would like to express reservations especially as

to the distinction between leases with below market term and zero consideration leases, the latter being excluded from the definition of a lease.

First of all, the accounting treatment for the non-exchange component would have to be consistent with the accounting treatment set out for non-exchange revenue and expenses. We note that the IPSASB is currently discussing the issue under the in-process revenue and non-exchange transactions project. As a matter of fact, issuing accounting requirements for the concessionary leases transactions might have repercussions on Board's decisions on a much wider area of transactions, for instance transactions such as universally accessible services.

Another difficulty we see is that in some instances in the public sector, fair valuing the liability as at the commencement date is impossible. This might be for instance because the underlying asset is a heritage asset or because it is so specific that there is no market lease payment available.

Lastly, we observe that, in the public sector, agreements that create enforceable rights and obligations and more specifically that convey a right to use an asset may take several forms. While ED64 addresses the issue of concessionary leases, we believe that there are many other forms of agreements specific to the public sector. To name a few, transfers of mission and competence and the use of the public domain may be considered similar to leases by our constituents, especially in that they contain an element of financing. We are concerned that leaving those topics aside may lead to different accounting treatments for similar transactions. We would therefore suggest that those other topics should be added to the IPSASB's agenda to ensure consistency.