AUDIT NEW ZEALAND
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International Public Sector Accounting Standards Board
International Federation of Accountants
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Submitted to: www.ipsasb.org

IPSASB Exposure Draft 84 – *Concessionary Leases and Right-of-Use Assets In-Kind (Amendments to IPSAS 43 and IPSAS 23)*

We appreciate the opportunity to provide comments to the International Public Sector Accounting Standards Board on ED 84.

We provide our responses to the specific questions asked by the IPSASB in the attached document.

If you would like to discuss our comments, please phone me on +64 21 222 6107 or email me at robert.cox@auditnz.parliament.nz

Yours sincerely

Robert Cox
Director and Head of Accounting

Our responses to the questions in the Specific Matters for Comment in IPSASB ED 84: *Concessionary Leases and Right-of-Use Assets In-Kind (Amendments to IPSAS 43 and IPSAS 23)*

1. The IPSASB decided to propose new accounting guidance for concessionary leases for lessees (see paragraphs IPSAS 43.BC124-BC137) and right-of-use assets in-kind (see paragraphs IPSAS 23.BC28-BC30). Do you agree with the proposed amendments to IPSAS 43 and IPSAS 23? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

We do not support the amendments proposed in ED 84. Although we consider it important to have clear and consistent financial reporting requirements for significant lease concessions provided by or received by public sector entities, we do not consider that the current proposals achieve this. Our main areas of concern are:

- Market rates based on current use, and
- Consideration of costs and benefits.

We discuss these and other matters further below.

Market rates based on current use

We find the requirement to measure right-of-use assets using market rates based on current use unclear and therefore we are not sure that this is the most appropriate measurement approach for public sector concessionary leases.

It could be argued that the market rate for the current use of some public sector assets is the amount paid under the concessionary lease.

For example, a public sector regional airport exists to provide air services to the region but is not profitable due to the small population in the region. The regional airport occupies land under a concessionary lease from the local authority. The market rate with use limited only to an airport is likely to be close to the concessionary amount being paid, as no commercial operator would lease the land for airport use and alternative uses cannot be taken into account in determining the market rate. In this interpretation of market rate for current use, the accounting does not convey information about the level of concession.

If market rate for current use is to be based on a hypothetical market that limits participants to particular uses, then we are unclear on how these market rates could be assessed.

For example, consider a public sector entity that is a lessee of land to be used for health or educational purposes. In this case, market rate information for leases of similar land with no restriction on use may be readily available from market transaction information. However, where there are limited or no alternative private sector providers to use the asset for the “same use”, there is unlikely to be a “market” for the current use and we are unclear how market rates for current use can be determined.

In summary, we consider market rates for current use are not clear in meaning and may be difficult to determine.

We recommend that the use of market rate for current use is reconsidered.

If market rate for current use is continued with, then more guidance should be provided about what it means and how it is determined.

Consideration of costs versus benefits

The New Zealand public sector has many concessionary lease (or similar) arrangements. There are a mix of current accounting approaches currently in use, but in many cases no accounting is done for the concession. We have concerns about the costs that may be incurred in determining market rates under the proposed accounting model. We do however consider that information about significant concessionary leases provided or received is important information for users of public sector financial statements (particularly where one party to the lease is a commercial entity).

We strongly support the proposal in the exposure draft to account at the amount of contractual payments when market rate information is not readily available. We consider it probable that market rate information will not be readily available in many cases (particularly for specialised public sector assets) and in these circumstances the proposals are a practical and cost effective solution.

We recommend that the IPSASB further consider the cost versus benefits of the proposals and whether there are opportunities to target the requirements only at those concessionary leases that are of significance to public sector accountability (such as those where one party to the lease is a commercial entity). We suggest that consideration is given to specific exceptions for small concessionary leases and also whether a scope exclusion (or accounting option) could be provided for concessionary leases (or similar) between entities within the same public sector group.

2. For lessors, the IPSASB decided to propose accounting for leases at below-market terms in the same way as for leases at market terms (see paragraphs IPSAS 43.BC138-BC149). Do you agree with the proposed amendments to IPSAS 43. If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

We do not agree with the proposed amendments to IPSAS 43 for lessors.

Public sector entities often choose to provide concessionary leases to other entities to achieve their service delivery or outcome objectives. We consider it important that public sector financial statements clearly and consistently across entities convey information about the significant concessionary leases provided. It is not clear that the proposed accounting and disclosures achieve this. For example, where a significant lease concession is provided to a commercial entity, we consider that information about the revenue foregone by the public sector lessor is important.

Also, it is not clear to us that the IPSASB has adequately considered the accounting for long term concessionary leases of public sector assets for service delivery or outcome objectives. If these are considered finance leases, then a loss arises on commencement (being the difference in carrying value of the underlying asset and the net investment in the lease). This contrasts with a slightly shorter lease assessed as an operating lease, where it can be argued the non-cash generating asset is not impaired as the service potential is unchanged because the service delivery objectives are achieved by services provided by the lessee. Therefore no loss arises on commencement of the operating lease. We consider this difference in accounting outcomes needs further consideration.

AG62(b) states that in a concessionary operating lease the entity **may** assess whether the underlying asset is impaired. BC145 states that the terms and conditions of the concessionary operating lease **might** help an entity assess whether there is an indication that the underlying asset **may** be impaired.

It would be useful if impairment in such cases was discussed in further detail and more clarity provided on when a concessionary operating lease is an impairment indicator.

3. The IPSASB decided to propose initially measuring right-of-use assets in concessionary leases (see paragraphs IPSAS 43.BC124-BC131) and right-of-use assets in-kind (see paragraphs IPSAS 23.BC28-BC30) at the present value of payments for the lease at market rates based on the current use of the underlying asset as at the commencement date of the lease. Do you agree with IPSASB's decision? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

We do not support these proposals for initial measurement as we consider market rates for current use are not clear in meaning and may be difficult to determine.

We repeat below our comments on specific matter 1 in relation to market rate based on current use. Also our comments on specific matter 1 about cost versus benefit are relevant.

We find the requirement to measure right-of-use assets using market rates based on current use unclear and therefore we are not sure that this is the most appropriate measurement approach for public sector concessionary leases.

It could be argued that the market rate for the current use of some public sector assets is the amount paid under the concessionary lease.

For example, a public sector regional airport exists to provide air services to the region but is not profitable due to the small population in the region. The regional airport occupies land under a concessionary lease from the local authority. The market rate with use limited only to an airport is likely to be close to the concessionary amount being paid, as no commercial operator would lease the land for airport use and alternative uses cannot be taken into account in determining the market rate. In this interpretation of market rate for current use, the accounting does not convey information about the level of concession.

If market rate for current use is to be based on a hypothetical market that limits participants to particular uses, then we are unclear on how these market rates could be assessed.

For example, consider a public sector entity that is a lessee of land to be used for health or educational purposes. In this case, market rate information for leases of similar land with no restriction on use may be readily available from market transaction information. However, where there are limited or no alternative private sector providers to use the asset for the "same use", there is unlikely to be a "market" for the current use and we are unclear how market rates for current use can be determined.

In summary, we consider market rates for current use are not clear in meaning and may be difficult to determine.

We recommend that the use of market rate for current use is reconsidered.

If market rate for current use is continued with, then more guidance should be provided about what it means and how it is determined.

4. When the payments for the lease at market rates based on the current use of the underlying asset are not readily available, the IPSASB decided to propose initially measuring right-of-use assets in concessionary leases (see paragraphs 43.BC132-BC133) at the present value of contractual payments for the lease. Do you agree with IPSASB's decision? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

We support the initial measurement of right-of-use assets in concessionary leases at the present value of contractual payments for the lease when market rates are not readily available. We consider it probable that market rate information will not be readily available in many cases (particularly for specialised public sector assets) and in these circumstances the proposals are a practical and cost effective solution.

We suggest that the disclosure requirements in paragraph 64A be expanded to include comment on the types of leased assets for which market rates are not readily available.

Other less significant matters for the IPSASB to consider:

Leases for nominal amounts

We note that leases for consideration are accounted for under IPSAS 43 whereas similar transactions without consideration are considered not to meet the definition of a lease. These no consideration transactions give rise to right-of-use assets in-kind that are accounted for under IPSAS 23 and give rise to disclosure requirements under IPSAS 23 paragraph 107A. We note that in New Zealand we see many leases at nominal amounts, such as "a peppercorn" or "one dollar if demanded". We presume these are considered to be for no consideration, although it would be useful if this was clarified in the proposed standard.

Non-exchange revenue under lessee accounting

We consider the proposed amended IPSAS 43 would be clearer if it explicitly stated that for a concessionary lease the difference between the right-of-use asset and the lease liability at initial recognition is accounted for following the non-exchange revenue requirements in IPSAS 23. We acknowledge this is covered by IPSAS 23 paragraph 105C, but it would be helpful to also have it is the leases standard.

Conditions or compliance obligations in concessionary leases

Conditions/compliance obligations are often not well expressed in concessionary lease documents. We consider further guidance should be incorporated into IPSAS 23 as to what may constitute a condition or compliance obligation in the context of a concessionary lease. For example is a restriction on the use of the asset a condition or compliance obligation.

Implementation example – revenue foregone disclosure

IE10A of IPSAS 43 provides an example of Lessor Measurement. In this example the lessor has foregone revenue of CU1,500,000 per month. The example states "The non-exchange component of CU1,500,000 per month is disclosed in accordance with IPSAS 23". We could find no clear requirement in IPSAS 23 to disclose foregone revenue. The example should be corrected or a clear disclosure requirement added.