



## ED 84 CONCESSIONARY LEASES AND RIGHT-OF-USE ASSETS IN-KIND (AMENDMENTS TO IPSAS 43 AND IPSAS 23)

Issued 17 May 2023

ICAEW welcomes the opportunity to comment on ED 84 *Concessionary Leases and Right-of-Use Assets In-kind (Amendments to IPSAS 43 and IPSAS 23)* published by International Public Sector Accounting Standards Board on 17 January, a copy of which is available from this [link](#)

### Inconsistency across IPSASs

- The current draft measurement standard makes it very clear that assets held for their operational capacity are to be valued at Current Operational Value (COV) and assets held for their financial capacity at fair value. Leases, including concessionary leases, will in the main be held for their operational capacity yet will not be able to apply the COV measurement basis because it does not permit the application of the income approach.
- An inconsistent definition of fair value is applied in the leasing standard compared with the measurement standard. The latter applies the IFRS 13 definition which includes highest and best use, which is not applicable for leased assets. If COV were to be applied to leases, then IPSAS would only require the one definition of a lease.

### Post implementation review

- We acknowledge the difficulties in measuring right of use assets when there is no active market and agree with the ED that this could often be the case.
- Leases are quite frequently provided on a concessionary basis within government and if users of this standard would rarely account for the concessionary element it would not fulfil the purpose of the standard.
- We therefore ask IPSASB to monitor how this standard is applied in practice and to revisit alternative applications of fair value to make it easier to account for the concessionary element of leases.

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As a regulator of the accountancy and audit profession, ICAEW is currently the largest Recognised Supervisory Body (RSB) for local audit in England. We have ten firms and over 85 Key Audit Partners registered under the Local Audit and Accountability Act 2014.

This response has been prepared by ICAEW's Public Sector team in consultation with ICAEW's Public Sector Advisory Group. ICAEW's Public Sector team supports members working in and with the public sector to deliver public priorities and sustainable public finances, including over 11,000 in ICAEW's Public Sector Community. ICAEW engages with policy makers, public servants, and others to promote the need for effective financial management, audit and assurance, financial reporting and governance and ethics across the public sector to ensure public money is spent wisely.

For questions on this response please contact our Public Sector team at [representations@icaew.com](mailto:representations@icaew.com) quoting REP 43/23.

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## ANSWERS TO SPECIFIC QUESTIONS

### Specific Matter for Comment 1

***The IPSASB decided to propose new accounting guidance for concessionary leases for lessees (see paragraphs IPSAS 43.BC124-137) and right-of-use assets in-kind (see paragraphs IPSAS 23.BC28-30). Do you agree with the proposed amendments to IPSAS 43 and IPSAS 23? If not, please explain your reasons. If you agree, provide any additional reasons not already discussed in the Basis for Conclusions.***

1. We agree with the proposed accounting to initially recognise the right of use asset at the present value of payments for the lease at market rates and the liability to be measured at the present value of the lease payments. However, there are several inconsistencies that need to be addressed.
2. Throughout IPSASB's literature, concessionary assets are valued at fair value and BC126 confirms that this principle is to be maintained for concessionary leases. Please see SMC 3 below for further comments regarding the fair value measurement technique.
3. There are several issues with applying fair value to a right of use asset. Firstly, IPSAS 43 *Leases* will have the same inconsistent application of fair value as the IFRS leasing standard. The fair value definition in IPSAS 43 will not be the same as IPSAS 46 *Measurement* yet IPSASB decided that if the term 'fair value' is used in IPSAS, the same meaning as that in IFRS 13 should apply (BC54 draft measurement standard). IPSASB should review the application of fair value in the leasing standard as it could cause confusion.
4. Secondly, the draft measurement standard explicitly states that assets held for their operational capacity should be valued using Current Operational Value (COV) and assets used for their financial capacity should be valued using the fair value measurement basis. However, many leased assets will be used for their operational capacity which is then incompatible with a fair value measurement basis.
5. This inconsistency could have been avoided if COV had permitted the income approach as a measurement technique. Both COV and fair value permit the market and cost approach yet only the latter also permits the income approach. COV, in our view, could be applicable for right of use asset since it provides an entity specific measurement that reflects the amount an entity would pay for the remaining service potential. That could be represented by the cash flows of the lease at market rate.
6. We are fully aware that applying a current value measurement model for operational assets that have no market data is challenging. In our experience of applying Depreciated Replacement Cost (DRC) in the UK, we have found that it can lead to significant over-valuation of assets, primarily driven by the requirement to apply a modern equivalent asset value and inconsistent application of obsolescence adjustments, which are very judgemental.
7. By contrast, assets that generate cash flows, such as leisure centres, libraries, social housing etc, are most likely to generate below market rate income. Applying an income approach to valuing these assets is most likely to lead to an under-valuation of assets compared to market or cost approach.
8. We acknowledge that IPSASB added a phase II of the measurement project which is to review the application of COV across the suite of IPSASs. We believe this work to be extremely important to ensure COV achieves what IPASB originally intended, which was to create a viable alternative to fair value for all assets measured at current value. We urge

IPSASB to approach this project with an open mind and to re-visit previously agreed positions should the need arise.

### Specific Matter for Comment 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. BC138-149). Do you agree with the proposed amendments to IPSAS 43?***

9. We agree with the proposed amendments to IPSAS 43.

### Specific Matter for Comment 3

***The IPSASB decided to propose initially measuring right-of-use assets in concessionary leases (see paragraphs IPSAS 43.124-131) and right-of-use assets in-kind (see paragraphs IPSAS 23.BC28-30) 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, provide any additional reasons not already discussed in the Basis for Conclusions.***

10. Whilst we agree with the principle that the fair value of a right of use asset can be determined using the present value of payments of the lease at market rates based on the current use of the underlying asset, there are two problems with this approach:
- As already mentioned, this is not in line with the new definition of fair value as applied in IPSASB's measurement standard since it focuses on the current use of the asset and does not consider the highest and best use; and
  - It will be costly for the lessee to comply with because they are having to calculate what the present value of future payments would have been had the asset been obtained on an arm's length basis. These cash flows are then compared with the concessionary cash flows to determine the concession.
11. We agree with BC124 that for non-exchange transactions a cost measurement basis does not reflect the economics of the transaction, because it does not capture the embedded concession. Currently, the IPSAS suite of literature requires assets acquired through non-exchange transactions to be measured at their fair value. We welcome IPSASB's review of the appropriateness of this and whether this should be expanded to also include COV.
12. IPSAS 43 states that the right of use asset is measured at cost unless the leased asset belongs to an asset class of PPE to which the lessee applies a revaluation model. In that case a current value model is to be applied to the leased asset. As already noted above, we believe that COV could be applicable to the leasing standard if the income approach were permissible.

### Specific Matter for Comment 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 IPSAS 43.132-133) 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.***

13. We agree that measuring contractual payments for leases could be a useful approach when market rates are not readily available.
14. Measuring leases using present value of contractual payments is the application of the income method. However, contractual payments for concessionary leases are, by definition,

below market rate and therefore do not represent a fair value (sales price). If the concessionary lease is to be valued at current value in line with the asset class it belongs to, what measurement basis would be available? Currently there is only a choice between fair value and COV. In our view, in these circumstances, neither fair value or COV would strictly be applicable. However, allowing the income approach for COV could help solve this problem.

15. We acknowledge the difficulties in measuring right of use assets when there is no active market, and we agree with BC130 (c) that leases are frequently granted on a concessionary basis within government. If users of this standard would rarely account for the concessionary element this standard would not fulfil its purpose. We therefore ask IPSASB to monitor how this standard is applied in practice and to revisit alternative applications of fair value to make it easier to account for the concessionary element.