



TE TAI ŌHANGA  
THE TREASURY

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Mr Ross Smith  
Program and Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
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CANADA

Dear Ross

**EXPOSURE DRAFT 84 CONCESSIONARY LEASES AND RIGHT-OF-USE ASSETS  
IN-KIND (AMENDMENTS TO IPSAS 43 AND IPSAS 23)**

Thank you for the opportunity to respond to the Exposure Draft 84 (ED 84).

The New Zealand Treasury is responsible for the New Zealand Government's accounting policies that comply with NZ GAAP for the public sector, which is mainly based on IPSAS.

The New Zealand Treasury disagrees with the proposals in ED 84 for the reasons set out in the attachment.

We trust you will find this response useful in your further deliberations. If you have any queries regarding Treasury's comments, please contact Ken Warren or Angela Ryan by email to [ken.warren@treasury.govt.nz](mailto:ken.warren@treasury.govt.nz) or [angela.ryan@treasury.govt.nz](mailto:angela.ryan@treasury.govt.nz)

Yours sincerely

A handwritten signature in blue ink that reads 'Jayne Winfield'.

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## Responses on Exposure Draft 84

### Specific Matter for Comment 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.

The Treasury does not agree with the new lessee accounting guidance for concessionary leases and the right-of-use (ROU) assets in-kind for the following reasons:

1. In our view ED 84 provides an insufficient and inappropriate conceptual basis to justify the proposals.
2. We disagree with the IPSASB's conceptual analogy between concessionary loans and concessionary leases which appears to be one of the main reasons for the accounting proposals for the concession component in ED 84.
3. We think the proposals in ED 84 will not improve understandability for readers of financial statements but rather there is a risk that the proposals lead to more complexity for users. In addition, we believe the proposals would be costly to implement and may not be practicable. There are high costs for negative benefit.
4. We think there are alternative ways to ensure that users have necessary information in respect of public sector concessionary leases and ROU assets in-kind, mainly through enhanced disclosures.

We expand on these four points below.

#### ***Insufficient conceptual basis***

Most 'concessionary leases' are not in fact financing arrangements. Put simply, the rationale used by the IASB to determine that commercial leases are a form of financing cannot be applied when there is little substantive financial liability. Rather, most concessionary leases are a form of operating support to the lessee that does not involve financing.

In addition, the conceptual principle underpinning the ROU model, and its transferability to the public sector, has not been analysed satisfactorily so far in the scope of PBE IPSAS 43, nor in IPSASB's concessionary lease project culminating in ED 84.

Rights-to-use in the public sector are inextricably bound up with property rights in a manner that can be disregarded by the profit-oriented entities, that operate within a more limited property rights framework. As we have noted previously, a broad representation of these rights can be summarised as:

- 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. 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, and to recognise indigenous world views.

The framework can be summarised in the following chart.

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

Concessionary lease contracts are just one way to reflect a transfer of rights of use from an owner to a lessee. Many other arrangements besides lease contracts may be used to transfer similar rights in the public sector. Some examples are provided below.

- A reporting entity managing infrastructure and natural resource assets controlled by the state, may have access and withdrawal rights as an authorised users but not as a lessee
- There is a 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 considering 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 in the public sector 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. 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 (lessee)

- The differentiation between 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?

ED 84 has not connected with these generally accepted conceptualisation of property rights in the public sector context, differentiating between them and thus fairly reflecting the economic substance of various public sector "concessionary leases". As a result, ED 84 provides an insufficient and inappropriate conceptual basis to justify the proposals.

### ***Wrong conceptual analogy***

Where the lessor primarily benefits from specified complementary activities being delivered by the lessee, rather than the consideration for the lease, and the lease arrangements enable the lessor to enforce those complementary activities<sup>1</sup> (e.g. through withdrawing from the arrangement) then accounting should fairly represent that transaction for what it is rather than attempt to shoehorn it into an inappropriate standard.

Financing through a 'debt-like liability' was the primary factor behind the original IASB decision to adopt the right-of-use model for lessees (treating it as a financing activity), but this is not the case for concessionary leases. Treasury would therefore suggest that characterising most concessional leases as operating subsidies would be a more fair reflection of their economic substance than reporting it as a financial obligation.

We also do not agree with the rationale in BC134 that the concession component in a concessionary lease is similar to the concession component in a concessionary loan. The concession in a concessionary loan is imputed interest on a FV loan (financing) and in a concessionary lease, the initial concession is a revaluation of a ROU asset (non-cash), which leads to higher depreciation (non-cash) of the ROU asset as the asset is "used". As a result, the concession in a concessionary lease is more akin to services in-kind, rather than financing.

### **Poor cost / benefit**

We doubt the grossing up of a ROU asset in a concessionary lease, or ROU asset in-kind, to reflect the present value (PV) of payments for the "lease" at market rates (if such prices are readily available) will provide useful information on the balance sheet, when the liability will reflect the PV of actual "lease" payments to be made.

Users expecting that revenue recognised (upfront or amortised) for the concession presented in the operating statement of the lessee (as a result of grossing up of a ROU

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<sup>1</sup> Note we consider that a "complementary activities as consideration" test is a useful criteria that could be developed in an accounting standard to differentiate the underlying economic substance of the transaction,

asset) may be misled into thinking the revenue will be confirmed by a matching cash inflow, perhaps when the underlying asset is returned to the lessor. This does not happen.

Rather, the concession in a concessionary lease unwinds generally through depreciation of the ROU asset. These accounting entries of non-cash revenue, with a matching non-cash expense will not be useful to readers of the financial statements, both because they do not reflect economic substance, and also because they add unwarranted clutter and complexity to the operating statement.

We generally support the IPSASB view that assets received in a non-exchange transaction should be recognised at fair value (e.g. property, plant and equipment), but only where an entity receives the underlying asset as owners. Because of the challenges in unpacking different bundle of rights in respect of an underlying asset in the public sector, and attributing separate values to those rights, we think the IPSASB should be able to depart from this general principle for recognising a ROU asset at current market value. We also note that the IPSASB has departed from this general fair value principle before in similar circumstances with similar reasoning e.g. services-in-kind received, which are also assets received in a non-exchange transaction.

We believe the costs associated with implementing IPSAS 43 and ED 84 will be significant for the following reasons:

- Adopting IPSAS 43 for exchange leases will be an enormous task for the New Zealand public sector and will be a costly exercise based on our observations of the for-profit sector adopting the standard
- There are a myriad of concessionary lease type arrangements in the public sector with some type of right to use or right to access an asset and determining whether they are in scope of IPSAS 43 will required significant judgement
- The majority of concessionary lease type arrangements would likely be operating subsidies in the New Zealand public sector, rather than finance leases
- There are numerous lease-type arrangements between related entities in New Zealand, where the entities are consolidated, either into the whole of government accounts or into local government group accounts. On consolidation these transactions are eliminated.
- An extensive search in the public sector would be required to identify ROU asset in-kind, and then a further search to determine whether there are readily available market lease payments for equivalent assets.

Therefore, our judgement is that the costs of implementation will be large, and the benefits to the users of public sector financial statements will be negative. Further the BCs of ED 84 do not provide any analysis refuting such judgements regarding the costs and benefits of the proposals.

### ***Alternative approaches available***

Users are likely to better understand the concessional lease transactions if they are simply explained in a narrative, with elements of that narrative being required to be disclosed in the standard. Information proposed to be required on the ROU asset is

only useful in a “what if” sense of deprival risk and the IPSASB would do better to consider reporting on this risk through developing its requirements in IPSAS 1.140-148.

Taking that approach, user needs would be better served through note disclosures about the risks and benefits associated with a concessionary lease type arrangement, particularly disclosing the relationship between the lessor and lessee, the motive of the lessor and the obligation of the lessee in relation to any right granted in respect to an underlying asset, and the implications of that arrangement being terminated.

## Specific Matter for Comment 2

### 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–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.

Treasury disagrees with the proposed amendments.

We note the IPSASB has stated in the BC to the ED that:

- “In a finance lease, the substance or main issue of the lease is the underlying asset being transferred **with the attached financing** (emphasis added)”
- “In an operating lease, the substance or main issue of the lease is **the stream of cash flows received by the lessor in the form of lease payments**” (emphasis added).

Despite this acknowledgement, that the attached financing or the stream of cash flows to the lessor is critical to its substance, the ED appears to treat the leasing standard as somehow appropriate for use by lessors providing concessional leases when these elements are not there.

This leads to some strange results; for example a public sector lessor providing a “concessional operating lease” to a related public sector lessee to enable shared public objectives to be achieved, may be the highest and best use of the asset, with its recoverable amount not impacted. Nevertheless, the lessor appears to be asked to consider an impairment of the asset. This should not be contemplated.

**Specific Matter for Comment 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.

The Treasury disagrees. Refer to previous comments.

**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.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.

The Treasury disagrees. Refer to previous comments.