May 10, 2023

IPSASB
International Public Sector Accounting Standards Board
529 Fifth Avenue, New York, NY 10017

By “Submit a Comment” link

Re: Comments on Exposure Draft 84, *Concessionary Leases and Right-of-Use Assets In-kind* (Amendments to IPSAS 43 and IPSAS 23)

Dear Sirs/Madams,

The WFP submits the following comments to you regarding the above captioned Exposure Draft 84, *Concessionary Leases and Right-of-Use Assets In-kind* (Amendments to IPSAS 43 and IPSAS 23). WFP thanks the IPSASB for the opportunity to comment.

Sincerely
Maryna Mananikova
Deputy Director Financial reporting

Attachment

WFP

Comments on Exposure Draft 84, *Concessionary Leases and Right-of-Use Assets In-kind* (Amendments to IPSAS 43 and IPSAS 23)

May 10, 2023

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GENERAL COMMENTS

The WFP welcomes this opportunity to comment on the Exposure Draft 84, *Concessionary Leases and Right-of-Use Assets In-kind* (Amendments to IPSAS 43 and IPSAS 23). This section summarizes our primary comments. Answers to specific questions raised in the Request for Comments are presented in a separate section below.

We appreciate the IPSASB's effort to clarify the accounting and financial reporting in this area. However, our detailed answers cover the following categories:

- <u>Definitions of terms and consistency with IPSAS 23</u>. We find that the work arounds not to define a "concession" and a "right-of-use asset in-kind" may add conceptual and terminological confusion, as well as the language about using IPSAS 23 principles in conjunction with IPSAS 43 accounting.
- <u>Consistency with other standards</u>. In addition to the previous point, we find potential misalignments
    - o Between revenue recognition for right-of-use assets in-kind or the concession element of a concessionary lease and IPSAS 47, especially with reference to situations contemplated in IPSAS 47, but not in ED 84, of a right-of-use asset that arises as part of either an arrangement that a) is a binding arrangement but not an in-substance contract, or b) that is not a binding arrangement.
    - o Between the decision to use but not to define the expression "current use" and the direction of a single concept of fair value, either as currently in IFRS 13, or as it would be defined as part of the Measurement Project with ED 76 and ED 77.
- <u>Inconsistency with IPSAS 43 and IFRS 16</u> when the Basis for Conclusions discusses the right-of-use asset versus the underlying asset and versus a service agreement. We explain why such a discussion on one hand presents conceptual conflicts with IPSAS 43

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and IFRS 16 and, on the other hand, diverges from the Basis for Conclusions in IPSAS 43. In addition, the introduction of a notion of "cost of concession" also has definition issues.

- Specific accounting clarifications.
- Editorial corrections.

MATTERS ON WHICH SPECIFIC COMMENTS WERE REQUESTED

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.

Response:
We have the following observations on specific aspects of the proposed amendments to IPSAS 43:

Definition of terms

- IPSAS 43, para. 18D states: "an entity firstly assesses whether the substance of the concessionary lease is in fact a lease transaction, a concession or a combination thereof, by applying the principles in this Standard and paragraphs 39-58 of IPSAS 23 …" IPSAS 23 does not use the term "concession", but it uses the expression "non-exchange component". ED84 does not define a concession either and IPSAS 43 paras. BC113-115 explain the rationale. However, even in the absence of a definition there should be consistent terminology, or IPSAS 23 should be amended accordingly. Furthermore, this is also to avoid confusion with "service concession" under IPSAS 32.

Scope

- IPSAS 43, paras. BC106-BC113 explain the rationale for applying the amendments only to arrangements that are contracts. Clarification would be needed to understand the treatment of a right to use an asset as part of either an arrangement that a) is a binding arrangement but not an in-substance contract, or b) that is not a binding arrangement. This should be clarified with reference both to amended IPSAS 23 and to IPSAS 47 and IPSAS 48.

Measurement

- IPSAS 43, para. 26B explicitly requires that "the carrying value of the right-of-use asset shall also include the items identified in paragraphs 25(c) and 25(d)". A question arises as to whether the absence of a refence to IPSAS 43, paras. 25(a) and 25(b) should be read in the sense that they do not apply. This is important because para. 25(a) refers to para. 27, which is about the initial measurement of the lease liability, and paras. 27-28 exclude variable payments that do not depend on an index or rate from the measurement of the lease liability. While for the purpose of measuring the lease liability of a concessionary lease para. 29A refers to paras. 27-29, we suggest clarifying whether the silence on referring to para. 27 for the purpose of a right-of-use asset is intentional so that its measurement for a concessionary lease would also diverge on this point.
- IPSAS 43, para. AG62b: "In an operating lease, the entity recognizes lease revenue in accordance with this Standard and may assess whether the underlying asset is impaired" would better read "and shall assess …".

Application guidance

- IPSAS 43, para. AG60: "Examples of concessionary leases include leases to international organizations or to other public sector entities with public policy objectives" should read "Examples of concessionary leases include leases to international organizations or to other public sector entities with public policy objectives <u>granted to or received by the lessee at below-market terms</u>".

Illustrative Examples

- IPSAS 43, para. IE11 Example 25: "CU 340,801 (CU 1,800,000-CU1,259,204)" should read "CU 340,801 (CU 1,800,000-CU1,459,200)"

We have the following observations on specific aspects of the proposed amendments to IPSAS 23:

Right-of-use assets in-kind

- IPSAS 23, BC29 states that "… the right to use an underlying asset for zero consideration … does not meet the definition of a lease because they lack consideration …". IPSAS 43, para. BC116 states: "… the IPSASB is of the view that transactions that convey the right to use an underlying asset without consideration do not meet the definition of a lease as defined in IPSAS 43". IPSAS 43, para. BC117 states that "a transaction that conveys a right-of-use asset in-kind is in substance a non-exchange transaction and, therefore, the principles in IPSAS 23 … are applicable to this type of transaction". On the other hand, IPSAS 43, para. BC115(c) states that "the accounting for arrangements that convey the right to use an underlying asset without consideration is the same as arrangements that convey the right to use an underlying asset with consideration at below-market terms". This reasoning appears lacking logical consistency. If something does not meet a certain definition and instead reflects certain other principles, it should be accounted for under those principles, i.e., IPSAS 23. The fact that the principles in both IPSAS 43 and IPSAS 23 apply to the exchange and non-exchange components of a concessionary lease, respectively, does not mean that IPSAS 43 applies to the non-exchange component, on the contrary it means that IPSAS 23 does apply to the non-exchange component of a concessionary lease. So, if a right-of-use asset in-kind does not meet the definition of a lease, IPSAS 43 should not apply; conversely, IPSAS 23 should apply. In practice, applying IPSAS 43 to a right-of-use asset in-kind means measuring the asset at present value and the liability at nil value, i.e., recognizing revenue (assuming no condition exists). This means that IPSAS 23 applies, not IPSAS 43.

Editorial corrections on referencing a liability

- IPSAS 23, para. 105D states: "where a lessee determines that the difference between the value of the right-to-use asset on initial recognition and the present value of contractual payments is non-exchange revenue, a lessee recognizes the difference as revenue, except if a present obligation exists, e.g., where specific conditions imposed on the transferred asset (the right-of-use asset) by the lessee result in a present obligation. Where a present obligation exists, it is recognized as a liability"
  would better read

  "where a lessee determines that the difference between the value of the right-to-use asset on initial recognition and the present value of contractual payments is non-exchange revenue, a lessee recognizes the difference as revenue, except if a present obligation exists that meets the definition and recognition criteria as a liability, e.g., where specific conditions imposed on the transferred asset (the right-of-use asset) by the lessee result in a present obligation that meets the definition and recognition criteria as a liability. ~~Where a present obligation exists, it is recognized as a liability~~". In fact, IPSAS 23.50 states: "a present obligation arising from a non-exchange transaction that meets the definition of a liability shall be recognized as a liability when, and only when … [recognition criteria stated]".

Consistency with IPSAS 47

- ED 84 would amend IPSAS 23, including that the recipient would recognize revenue immediately when such assets do not have any conditions attached. As this is not necessarily where IPSAS 47 is heading to for contribution agreements (e.g., timing stipulations), it would be appropriate to explain the interaction with it.

Disclosures

- IPSAS 43, para. BC147 notes that "foregone revenue is not recognized under IPSAS 9". IPSAS 43, para. IE10A states: "… a non-exchange component – Representing the portion of the foregone revenue, which is not accounted for as revenue. The non-exchange component … is disclosed in accordance with IPSAS 23, and the lease payments are accounted for in accordance with this IPSAS". However, the proposed amended IPSAS 23 and IPSAS 9 do not have any disclosure requirements for foregone revenue. So, either IE10A or IPSAS 23/IPSAS 9 should be amended.

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.

Response:
We have the following observations on IPSAS 43:

Rationale for using the cost model for concessionary finance leases

- IPSAS 43, para. BC139 states: "In a finance lease, the substance or the main issue of the lease is the underlying asset being transferred with the attached financing (net investment in the lease) ..." IPSAS 43, para. BC141 states: "… in a … concessionary finance lease, the concession component is related to the price of the asset transferred to the lessee…". IPSAS 43, para. BC142 states: "… concessionary finance leases – which can be equivalent to transferring of a non-cash asset (the underlying asset) at below-market terms attached with financing for a portion of the value of the asset transferred…".

  We think that this discussion on one hand does not correctly reflect the principles in IPSAS 43 and is potentially confusing and, on the other hand, it is not necessary to support the conclusion it intends to support, as explained in IPSAS 43, para. BC143, i.e., that "the IPSASB decided to continue measuring the transfer of the underlying asset to the lessee at its carrying amount because it is: a) the cost of the concession incurred by the lessee, being the economic benefit or service potential given up measured by the carrying amount of the underlying asset, and b) consistent with the derecognition principles in IPSAS 16, *Investment Property*, IPSAS 17, *Property, Plant and Equipment*, and IPSAS 31, *Intangible Assets for Disposals*".

Our conclusion is based on the following:

- Although in practice the economics of a lease is similar to that of a purchase of an asset with a loan, IPSAS 43, para. 5 defines 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". IPSAS 43, para. BC9 explains that a "lessor has only transferred the right to use an underlying asset, not the underlying asset itself".
- The same principle is in IFRS 16. As known, IPSAS 43 is modelled after IFRS 16, and the IPSASB does not repeat the Basis for Conclusions of IFRS 16, so we need to look at them directly. IFRS 16, para. BC140 states that "IFRS 16 applies to contracts that convey the right to use an underlying asset for a period of time and does not apply to transactions that transfer control of the underlying asset to an entity—such transactions are sales or purchases within the scope of other Standards (for example, IFRS 15 or IAS 16)". IFRS 16, para. BC118 states: "IFRS 16 clarifies that only the economic benefits arising from use of an asset, rather than the economic benefits arising from ownership of that asset, should be considered when assessing whether a customer has the right to obtain the benefits from use of an asset. A lease does not convey ownership of an underlying asset; it conveys only the right to use that underlying asset. Accordingly, the IASB concluded that, when considering whether a contract contains a lease, a customer should not consider economic benefits relating to ownership of an asset (for example, tax benefits as a result of owning an asset). However, a customer should consider benefits relating to the use of the asset (for example, renewable energy credits received from the use of an asset or by-products resulting from the use of an asset)". IFRS 16, para. BC37 states: "although the lessor transfers the right to use the underlying asset to the lessee at the commencement date, the lessor has the right to the underlying asset at the end of the lease term (and retains some rights to the underlying asset during the lease term; for example, the lessor retains title to the asset). Consequently, the lessor retains some of the potential economic benefits embedded in the underlying asset". IFRS 16, para. BC38 states: "the lessor controls

the rights that it retains in the underlying asset. A lessor can often, for example, sell the underlying asset (with the lease attached) or agree at any time during the initial lease term to sell or re-lease the underlying asset at the end of the lease term. The lessor's rights to the underlying asset arise from a past event—the purchase of the underlying asset or commitment to a head lease, if the lessor subleases the asset. Future economic benefits from the lessor's retained rights in the underlying asset are expected to flow to the lessor, assuming that the lease is for anything other than the full economic life of the underlying asset. The lessor would expect to obtain economic benefits either from the sale, re-lease or use of the underlying asset at the end of the lease term".

  - However, as explained in the Basis for Conclusions of IPSAS 43, IPSASB engaged in a very long discussion as to whether to adopt the lessor model of IFRS 16. The point was that although IFRS 16 also distinguishes between the right to use the asset and the underlying asset, its lessor model does not clearly make such a distinction. In the end, IPSASB decided to align with IFRS 16, but this is due to governance and cost/benefit considerations, not the rationales expressed in paras. BC141-143 above.

<u>Rationale for concessionary operating leases</u>

- IPSAS 43, para. BC141 states: "… concessionary operating leases, the concession component is related to the price of lease payments received from the lessee." IPSAS 43, BC142 states: "this means that the lessor can have two types of transactions: … b) concessionary operating leases – which can be equivalent to services partially in kind, as the lessor continues to recognize the underlying asset".
  We find this discussion misleading, as the definition of a lease rules out service contracts. IFRS 16, para. BC32 states: "the IASB concluded that leases create rights and obligations that are different from those that arise from service contracts. This is because, as described in paragraph BC22, the lessee obtains and controls the right-of-use asset at the time that the underlying asset is made available for use by the lessee". IFRS 16, para. BC34 states: "in contrast, in a typical service contract, the customer does not obtain an asset that it controls at commencement of the contract. Instead, the customer obtains the service only at the time that the service is performed. Consequently, the customer typically has an unconditional obligation to pay only for the services provided to date. In addition, although fulfilment of a service contract will often require the use of assets, fulfilment typically does not require making those assets available for use by the customer throughout the contractual term".

- Finally, we find that this discussion in ED 84 is not instrumental to justifying any new requirements. Therefore, both on this ground and in consideration of the contrast with the fundamental tenets in IFRS 16 and IPSAS 43, we suggest deleting that sentence in IPSAS 43, para. BC142.

Cost of the concession

- There is some inconsistency between IPSAS 43 paras. BC147 and BC148 about the "cost of the concession" for a concessionary operating lease. IPSAS 43, para. BC147 states that "for concessionary operating leases, the IPSASB noted that lessors continue recognizing as revenue the cash received in the form of lease payments made by lessees and there would be no separate recognition of the concession. This situation occurs because the concession is related to the foregone revenue related to the lease payments…." IPSAS 43, para. BC148 states that "the IPSASB concluded that the cost of the concession will be the difference between the a) depreciation of the underlying asset, other expenses related to the underlying asset, and the impairment charges related to the underlying asset, if any; and b) revenue obtained in the lease payments received from the lessee." So, while BC147 refers to decrease in revenue due to the concession, BC148 refers to a notion of net surplus/deficit. The latter, however, is the net surplus/deficit from the lease, neither the cost, nor the net surplus/deficit of the concession. Second, unlike the discussion on the cost of the concession for a concessionary finance lease (which was intended to support the notion of derecognition of the carrying amount of the asset), such a discussion on the cost of the concession for a concessionary operating lease does not seem to be instrumental to any aim, as there is no requirement for accounting for the cost of a concession. We suggest deleting this discussion, as potentially misleading.

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 decisions? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

Response:
We have the following observations:

- IPSAS 43, para. 18C: "… concessionary leases … the present value of contractual payments (consideration) on initial recognition of the lease will be lower than the present value of payments for the lease at market rates based on current use of the underlying asset". However, the term "current" is still undefined: current when? Before or after the lease? By use by the future lessee, lessor, or by market participants?
- IPSAS 43, para. BC128 states that "the IPSASB also noted that the current definition of fair value in IPSAS 9, *Revenue from Exchange Transactions* will be replaced by a new fair value definition from IFRS 13, *Fair Value Measurement*". IPSAS 43, para. BC130 explains that the IPSASB decided not to refer to the highest and best use under IFRS 13. We think that it would be better to include specific consideration for concessionary leases by way of application guidance as opposed to diverging from a single definition of fair value, which is why a fair value standard was issued. This is both in relation to IFRS 13 and in consideration of the fact that the concept of fair value would be part of the Measurement Project, including the Chapter 7 of the Conceptual Framework, in ED 76 and ED 77.

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 decisions? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

Response:
As a related issue, we have the following observations:

- IPSAS 43, para. 42 requires using the initial discount rate, not a revised discount rate as for other leases, when reassessing the lease liability of a concessionary lease because of a change in the lease term or in the assessment of a purchase option. The rationale of the amendment is not explained in the Basis for Conclusions.