CONSELHO FEDERAL DE CONTABILIDADE

EXPOSURE DRAFT 75,

LEASES

The Technical Director

International Public Sector Accounting Standards Board (IPSASB)

International Federation of Accountants

277 Wellington Street West, 6th floor

Toronto, Ontario M5V 3H2 CANADA

Brasília, Brazil

May 17, 2021

Dear Mr. Ross Smith,

The Conselho Federal de Contabilidade (CFC) of Brazil welcomes the opportunity to collaborate with the consultation on Exposure Draft 75 - 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.

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 city governments. 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 leases for lessees. Under this model, lessees would record a right-of-use asset and a lease liability in the statement of financial position. This may cause a significant impact in the governments’ financial position.

In this document, we present the contributions for the consultation paper and request for information applicable to our jurisdiction. As detailed in our response to the Specific Matter for Comment 2, we do not agree with the proposition to retain the fair value definition consistent with IFRS 16 and IPSAS 13.

2. Responses to the Specific Matters for Comment and Preliminary Views

Specific Matter for Comment 1:

The IPSASB decided to propose an IFRS 16-aligned Standard in ED 75 (see paragraphs BC21–BC36). Do you agree with how the IPSASB has modified IFRS 16 for the public sector (see paragraphs BC37–BC60)? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

GA/CFC agrees with the IPSASB's proposition to align the IPSAS accounting requirements for leases with IFRS 16.

In addition, we have the following comment:

ED 75 requires that at commencement date, the lease payments included in the measurement of the lease liability should comprise, among other items: "Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date".

In summary, the projected cash flow used to measure the lease liability should be calculated based on the prevailing index as at the commencement date not including any estimated projection as, for instance, inflation. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

While there is a negligible difference between real interest rates and nominal interest rates in developed economies, with extremely low inflation expectations (sometimes negative), the difference between real and nominal interest rates in non-developed countries with high inflation can be significant and, therefore, inflation expectation may be implicit in the borrowing rate.

Based on the above, projecting cash flow not considering an estimation of inflation index and discounting it using the lessee's incremental borrowing rate that usually includes an estimation for inflation may cause distortion in the present value of the lease liability.

Therefore, GA/CFC believes that additional guidance should be provided in determining the borrowing rate, specifically mentioning if the borrowing rate should consider the real interest rate (not considering inflation) or nominal interest rate (considering inflation).

Specific Matter for Comment 2:

The IPSASB decided to propose the retention of the fair value definition from IFRS 16 and IPSAS 13, Leases, which differs from the definition proposed in ED 77, Measurement (see paragraphs BC43–BC45). Do you agree with the 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.

GA/CFC does not agree with the IPSASB's view to retain the fair value definition consistent with IFRS 16 and IPSAS 13. We believe that the proposed definition of fair value in ED 77 should be used. Our disagreement with the proposition of the IPSASB is due to following:

- ✓ should not be two different definitions of fair value used in IPSASB's literature.
- ✓ the change in the fair value definition would cause impact only in limited circumstances, mainly in the lease classification for lessors and the timing of recognizing gains or losses for sale and leaseback transactions. We recommend the inclusion of additional implementation guidance related to the use of the new definition of fair value in the context of the lease classification and of the timing of recognizing gains or losses for sale and leaseback transactions.
- ✓ most countries are still in the process of implementing IPSAS and, therefore, this would not cause significant change for their accounting system.

Specific Matter for Comment 3:

The IPSASB decided to propose to refer to both "economic benefits" and "service potential", where appropriate, in the application guidance section of ED 75 on identifying a lease (see paragraphs BC46–BC48). Do you agree with the 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.

GA/CFC agrees with IPSASB proposition to refer to both "economic benefits" and "service potential" in the application guidance.

However, we believe that implementation guidance and illustrative examples showing hypothetical situations of how an entity should consider service potential on identifying a lease are necessary.

Responses to IPSASB Exposure Draft 75: Leases
(January 2021; Comments due: May 17, 2021)

Request for Information (RFI), Concessionary Leases and Other Arrangements Similar to Leases

In addition to the responses to the consultation on Exposure Draft 75 – Leases, we included below our comments to the questions included in Request for Information (RFI), Concessionary Leases and Other Arrangements Similar to Leases.

Question 1: In your jurisdiction, do you have concessionary leases (or similar arrangements) as described in this RFI? If yes, please: (a) Describe the nature of these leases (or similar arrangements) and their concessionary characteristics; and (b) Describe the accounting treatment applied by both parties to the arrangement to these types of leases (or similar arrangements), including whether the value of the concession is reflected in the financial statements.

Properties of the Union can be granted free of charge or under special conditions (i.e. below at market rates) to States, Federal District, Municipalities and non-profit entities in the areas of education, culture, social assistance or health.

These arrangements are common between the Union and States and Municipalities, where the aforementioned entities receive the right to use properties for the provision of certain public services. These arrangements can be free of charge or for a symbolic amount. The aforementioned entities may also assume an obligation to build, renovate or provide engineering services in Union real estate.

The accounting guidance is to derecognize the asset by the Union (lessor) and recognize it by the aforementioned entities since the economic or potential benefits services, as well as the costs of maintaining these assets, are transferred to the aforementioned entities.

The Union maintains in the Financial Statements the responsibility for the custody of the property transferred, carried out by control accounts (clearing accounts), which are mandatory in the bookkeeping of public sector entities and which must be evidenced in the Balance Sheet by force of art. 105, item VI, combined with its Paragraph 5, of Law No. 4,320, of March 17, 1964.

It is also important to emphasize that similar situations occur in different levels of the Federation such as States and Municipalities and the accounting practices describe above may also be applied.

Question 2: In your jurisdiction, do you have leases for zero or nominal consideration as described in this RFI? If yes, please: (a) Describe the nature and characteristics of this type of lease (or similar arrangement); and (b) Describe if and how the value of the concession is reflected in the financial statements of both parties to the arrangement.

Properties of the Union can be granted free of charge or under special conditions (i.e. below at market rates) to States, Federal District, Municipalities and non-profit entities in the areas of education, culture, social assistance or health.

These arrangements are common between the Union and States and Municipalities, where the aforementioned entities receive the right to use properties for the provision of certain public services. These arrangements can be free of charge or for a symbolic amount. The aforementioned entities may also assume an obligation to build, renovate or provide engineering services in Union real estate.

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It is also important to emphasize that similar situations occur in different levels of the Federation such as States and Municipalities and the accounting practices describe above may also be applied.

Another identified examples of leases for zero consideration are:

- ✓ student accommodations granted by Public Universities where the costs of maintaining the property and related depreciation still been booked by the Universities with no other consideration analyzed or accounting entry recorded.

- ✓ Housing granted to Public Servants allocated to provide services in location different from the where the Public Servant lives. The housing is granted specifically for the period of when the service is provided and there are circumstances where such period is indeterminable.

Question 3: Does your jurisdiction have arrangements that provide access rights for a period of time in exchange for consideration? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.

The temporary occupation of a private property, where a Hospital operated, for the use in the treatment of patients infected by the coronavirus, was authorized in March 2020 by the Federal Justice. It is important to emphasize that the Hospital was abandoned and not used by the private sector.

Refurbishment expenses have been recorded as Improvements in Goods of Third Parties

Question 4: In your jurisdiction, do you have arrangements with the same or similar characteristics to the one identified above? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.

No arrangements like this have been identified in our jurisdiction.

Question 5: In your jurisdiction, do you have arrangements involving social housing with lease-type clauses or other types of lease-like arrangements with no end terms? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of the social housing provider.

No arrangements like this have been identified in our jurisdiction.

Question 6: In your jurisdiction, do you have arrangements involving the sharing of properties without a formal lease contract? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.

In order to make a better use of properties, it is a common practice for the Federal Government to provide it free of charge to different entities that are part of the Government to share the use of it without a formal lease contract. The maintenance expenses related to such properties are split between the occupants.

Question 7: In your jurisdiction, do you have other types of arrangements similar to leases not mentioned in this RFI? If so, please describe the characteristics of these arrangements and how they are presently being reflected in the financial statements of both parties to the arrangement.

a) Arrangement type 1

Law No. 6,776/2016 linked the real estate assets of the Secretary of Education from the State of Piaui to the Financial Fund of the Social Security System ("RPPS Funds") through the Piaui Pension Foundation, attributing it the possibility of collecting rents and the obligation to pass them on to the RPPS Funds.

In other words, the Secretary of Education would remain using the real estate paying rentals to the Piaui Pension Foundation that in turn would pass it to the RPPS Funds.

There were no accounting records related to transference of the assets to the Piaui Pension Foundation.

b) Arrangement type 2

The Union granted a land to a private entity in turn of building a laboratory that would be used by a Foundation attached to the Health Ministry. In turn, the Foundation pays rental to the private entity for the use of the laboratory.