CIPFA The Chartered Institute of Public Finance & Accountancy

IPSASB Exposure Draft 64
Leases

Response from the Chartered Institute of Public Finance and Accountancy (CIPFA)

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the people in public finance

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IPSASB Exposure Draft 64, *Leases*

CIPFA is pleased to present its comments on this Exposure Draft which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

As noted in our response to IPSASB's consultation on its strategy and workplan, CIPFA strongly supports the approach which IPSASB has taken to maintaining alignment with international frameworks.

IFRS 16, *Leases* introduces a new accounting treatment for lessees, which is aligned with more recent thinking in the IASB's current Conceptual Framework, moving away from the risks and rewards model developed under older frameworks. However, despite substantial efforts the IASB could not develop and agree an aligned accounting treatment for lessor accounting which was acceptable to stakeholders. IFRS 16 therefore largely retains the lessor requirements of IAS 17, *Leases*, and justifies this asymmetric approach on cost-benefit grounds rather than conceptual ones.

CIPFA agrees with the IPSASB's analysis of IFRS 16, including that

- there are no public sector specific reasons for departing from the well founded improvements to lessee accounting set out in IFRS 16; and
- the cost benefit arguments for the public sector are different to those of the private sector, and the decision not to pursue symmetrical and conceptually consistent reporting for lessors should be reconsidered.

Response to Specific Matters for Comment

Against this background, we strongly agree with the Board's decision that a revised IPSAS should include

- An IFRS 16 aligned treatment for lessee interests in standard commercial leases and other leases where there is no public sector specific dimension, consistent with the IASB and IPSASB conceptual frameworks.
- A lessor treatment which is not aligned with the IFRS 16 lessor treatment, but is consistent with the IFRS 16 lessee treatment

We also agree that the thinking which informed IPSAS 29 material on concessionary loans is relevant to concessionary leases. However, as explained in our detailed response, it is not clear that the Option 2 model will provide the most useful presentation of the economic reality of leases made for social purposes.

Detailed responses to the SMCs are attached as an Annex.

Specific Matter for Comment 1: The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.
CIPFA agrees with the decision to adopt the IFRS 16 right-of-use model for lessee accounting, for the reasons set out in BC6 to BC8.
Specific Matter for Comment 2: The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.
CIPFA agrees with the decision to depart from the IFRS 16 risks and rewards model for lessor accounting, for the reasons set out in BC9 to BC13.
Specific Matter for Comment 3: The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?
CIPFA agrees with the proposed requirements for lessor accounting.

Specific Matter for Comment 4:

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons).

For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons).

Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft?

If not, what changes would you make to those requirements?

CIPFA agrees with the ED proposals for lessee accounting.

CIPFA partially disagrees with the ED proposals for lessor accounting.

While CIPFA agrees with the IPSASB proposal to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense, we have concerns over the specific proposals to mirror the treatment of concessionary loans, as explained below.

In particular, CIPFA considers that there should be more measured consideration of whether to apply Option 2 or Option 3 to the credit entry for the non-exchange component as discussed at BC84-85.

We also consider that the reasoning provided for discounting Option 3 is faulty.

BC85 refers to discussion at BC45 and BC46 which imply that this credit entry is not of a type allowed by IPSAS 1. However, in considering the four types of entry allowed by IPSAS 1, BC 46 (c) merely notes that reserves are defined in specific IPSAS, and those reserves which have already been defined in existing IPSAS are not of this type. CIPFA considers that as a standard setter, IPSASB is specifically empowered to decide whether items should be considered to be reserves.

We therefore suggest that the determination of whether to adopt Option 2 or Option 3 should reflect the merits of the information presented under each approach, and the extent to which these provide useful information and support the objectives of general purpose financial information.

A key aspect of this determination is what the 'liability' in respect of 'unearned' items should represent. We suggest that applying this to IPSASB's extension of the right of use model to lessors is not completely straightforward.

In an exchange transaction, we would expect the values of the underlying asset and the lease liability to roughly balance out at the inception of the lease, except in respect of residual value. The ongoing value to the lessor is mainly through the lease receivable.

However, it is less clear whether this is the appropriate presentation in a public sector non-exchange transaction. The underlying asset is providing value to the lessor both through the lease receivable, and through service potential which it is providing to the lessee, in line with the service objectives of the lessor. This additional value would generally equate to at least the non-market component of the lease.

We can therefore see arguments for the measurement of the 'liability' having regard to contractual flows in line with Option 3 and this would have a number of advantages. It would for example address concerns over the presentation of an ongoing liability which will be in excess of the receivable for the duration of the lease. It would also actually equate to 'unearned revenue'.

It is of course important that the subsidy is recognised, and Option 3 achieves this by recognising an expense in the same way as Option 2, and by an adjustment to net assets/equity.

In the event that the Board does choose to pursue Option 2 as outlined in the Exposure Draft, we suggest that some changes to the terminology should be made. In particular, we suggest that if the liability is measured at market value, it should not be articulated purely in terms of unearned revenue. Option 2 extinguishes the liability through a combination of revenue cash flows in future periods, taken together with the unwinding of the subsidy in future periods. Using the term 'revenue' for this internal lessor transaction seems both unnatural and confusing.