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RÉPUBLIQUE FRANÇAISE

Paris, le 13/07/18

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Référence : 2018/07/3315

Subject : Response to Exposure Draft 64 "*Leases*".

I am writing you on behalf of the French Directorate of Public Finances (hereinafter mentioned as DGFiP) to express our views on the mentioned above exposure draft (hereinafter mentioned as ED).

Head of Central Government Accounting Department

François Tanguy

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This consultation relates to the complex issue of Leases.

The DGFiP contributed to the drafting of the reply and accordingly shares the position expressed by the Public Sector Accounting Standard Concil (CNoCP or The Concil) annexed to this dossier.

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Version française

Cette consultation est relative à la question complexe des contrats de location.

La DGFiP a contribué à la rédaction de la réponse et partage en conséquence la position exprimée par le Conseil de normalisation des comptes publics (CNoCP ou le Conseil) jointe en annexe au présent dossier.

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Re: Response to Exposure Draft 64 *Leases*

Dear Mr Stanford,

The French Public Sector Accounting Standards Council (CNoCP) welcomes the opportunity to comment on the Exposure Draft 64 *Leases* published in January 2018 (ED64).

The CNoCP welcomes the efforts put in developing the proposals, essentially in ensuring the consistency between lessor and lessee accounting treatments, as well as in dealing with concessionary leases that are specific to the public sector.

The CNoCP understands the need to explore convergence with the principles set out for the private sector on leases. Because IFRS 16 was commented upon extensively as part of the IASB's process, we do not comment upon the merits or drawbacks of its application. However, we note that IFRS 16 is effective as of 1 January 2019 in the private sector; hence as of now, even if some entities chose to early adopt the new standard, no thorough feedback exists on its application. This makes it difficult to assess the impact and efficiency of its adaptation to the public sector.

In addition, we question the usefulness of a complex accounting solution. We are concerned that the cost of implementing the proposed accounting treatment might outweigh the benefits.

Therefore, we would appreciate if the Board could consider exempting public sector entities from applying the accounting requirements of the future standard for leases between entities from the public sector. The standard would then only apply mandatorily to lease arrangements between private and public entities.

For lessor accounting, we understand the objective of consistency between lessor and lessee accounting, but we would encourage the IPSAS *Board* to perform a thorough cost-benefit analysis as this section is specific to the public sector (IFRS 16 retains IAS 17 accounting requirements for the lessor). Moreover, we would recommend that the IPSAS *Board* should underline that arrangements that transfer control of the underlying asset are out of scope in the future standard, and not only in the Basis for Conclusions. Additional guidance on when arrangements transfer control would also be welcome.

Given the volume of issues that could possibly arise, we would recommend that the *Board* should carry out an effect analysis with a view to envisage all consequences of the proposed approach.

With respect to concessionary leases, we would like to call the Board's attention to a risk of inconsistency in the accounting treatments of transactions that might be in substance similar, only because they are covered by different standards.

Responses to the detailed questions set out in ED64 are presented in the following appendix.

Yours sincerely,

Michel Prada

APPENDIX

Specific Matter for Comment 1 (SMC 1)

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting. 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.

From a conceptual perspective and a convergence standpoint, we understand the IPSASB's decision to adopt the IFRS 16 right-of-use model for lessee accounting. Conceptually, it seems sound to recognise the right to use an underlying asset distinctly from that asset as long as that right of use meets the definition of an identifiable asset (i.e. separable or arising from contractual or other legal rights). Similarly, recognising the corresponding liability, that is essential from the point of debt measurement, is in line with the IPSASB Conceptual framework.

From a practical viewpoint however, we believe that applying the proposed requirements to lease arrangements between public sector entities would entail costs that would outweigh the benefits of providing high quality financial information:

- IFRS 16 is effective as of 1st January 2019 and most entities in the private sector have not yet fully implemented the new requirements. This means that many application issues may surface in the coming years. Our understanding is that the application of IFRS 16 requires reviewing all contracts that may include a lease agreement and, as a first step, assessing them against the new definition of a lease. Adopting IFRS 16 is therefore highly demanding in terms of resources for certain entities and may require the development of new IT systems, processes and controls. This often proves challenging in the private sector, and would be even more challenging and burdensome for the public sector. With respect to the accounting treatment, determining the lease term, the discount rate and the relevant disclosures is of significant concern to our constituents.
- We also note that some constituents are concerned that additional liabilities in public sector entities' financial statements may impact reporting under national systems of accounts and may affect for instance the scope of the public debt.
- Another concern revolves around the effect of the new model on liability recognition: entering into lease agreements for entities that are restrained from borrowing would generate additional liabilities.

For the reasons above, we would appreciate if the Board could consider exempting public sector entities from applying the proposed accounting requirements for leases between entities of the public sector. The standard would then only apply mandatorily to lease arrangements between private and public entities We believe that such an exemption would fit the cost-benefit constraint, while respecting an appropriate balance among the qualitative characteristics.

In addition, we are of the opinion that the future standard should discuss the recognition of a right-of-use asset in those cases where the underlying asset is not recognised. Such issues might arise from public sector arrangements that grant a right-of-use of the public domain.

Given the volume of issues that could possibly arise, we would recommend that the *Board* should carry out an effect analysis with a view to envisage all consequences of the proposed approach.

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. 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.

We agree that the "risks and rewards" approach should no longer be retained to assess recognition of assets in the accounts of reporting entities party to a transaction. The definition of an asset in the Conceptual Framework makes it clear that control, as the power to direct the use of the asset, is the key factor to consider, while the risks and rewards of ownership is not of itself an indicator of the party that controls the asset.

We observe that the notion of control is well understood amongst our constituents when applied to property, plant and equipment or well-identified intangible assets. However, we note that it appears to be more difficult to apply in practice to a right-of-use, mainly because the asset seems to them to be recognised twice. We note that BC9(c)(ii) mentions that a lease conveys the right to use an underlying asset for a period of time and does not transfer control of the underlying asset. We would strongly recommend that the scope of the future standard should clearly state that where the arrangement leads in substance to transferring control of the underlying asset to another party it does not meet the definition of a lease; in other words, such arrangement should be out of the scope of this standard. Additional guidance on when arrangements transfer control would also be welcome.

Additionally, because the new lessor's model is a significant change from previous IPSAS requirements, we would recommend that further disclosures should be required in the financial statements to explain that lease arrangements in the scope of the future standard give rise to a right-of-use that meets the definition of an asset. Such additional disclosure could be only temporary, required during a transition period, and would state that the lease arrangement is considered a separate economic phenomenon from the underlying asset. We believe that this explanation would be in the public interest.

Specific Matter for Comment 3

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting. Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, please explain the reasons. If not, what changes would you make to those requirements?

We acknowledge that a single model for lessors and lessees would ease communication: it is simpler than having to explain why a different accounting treatment should be retained, depending on whether the lease arrangement is analysed from the perspective of the lessor or of the lessee. Additionally, we firmly believe that, conceptually, the notion of control applies to the asset as a whole and that an accounting solution for the lessor that would have the asset partitioned would only raise complex implementation and measurement issues.

However, as for lessee accounting, in instances where lease arrangements are between public sector entities, we would question the need to introduce a complex accounting solution. In those cases, we would advocate that usefulness of information and the cost/benefit constraint should call for an exemption.

Specific Matter for Comment 4

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with the concessionary loans. For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise revenue in accordance with IPSAS 23. 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?

While we have sympathy for retaining an accounting treatment for concessionary leases that is consistent with that of concessionary loans, we would like to express reservations especially as to the distinction between leases with below market term and zero consideration leases, the latter being excluded from the definition of a lease.

First of all, the accounting treatment for the non-exchange component would have to be consistent with the accounting treatment set out for non-exchange revenue and expenses. We note that the IPSASB is currently discussing the issue under the in-process revenue and non-exchange transactions project. As a matter of fact, issuing accounting requirements for the concessionary leases transactions might have repercussions on Board's decisions on a much wider area of transactions, for instance transactions such as universally accessible services.

Another difficulty we see is that in some instances in the public sector, fair valuing the liability as at the commencement date is impossible. This might be for instance because the underlying asset is a heritage asset or because it is so specific that there is no market lease payment available.

Lastly, we observe that, in the public sector, agreements that create enforceable rights and obligations and more specifically that convey a right to use an asset may take several forms. While ED64 addresses the issue of concessionary leases, we believe that there are many other forms of agreements specific to the public sector. To name a few, transfers of mission and competence and the use of the public domain may be considered similar to leases by our constituents, especially in that they contain an element of financing. We are concerned that leaving those topics aside may lead to different accounting treatments for similar transactions. We would therefore suggest that those other topics should be added to the IPSASB's agenda to ensure consistency.