NZ ACCOUNTING STANDARDS BOARD

17 May 2021

Mr Ross Smith
Program and Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA

Submitted to: www.ifac.org

Dear Ross

IPSASB ED 75 *Leases*

Thank you for the opportunity to comment on the IPSASB's proposals in relation to leases in ED 75.

As the ED has been exposed for comment in New Zealand, some New Zealand constituents may comment directly to you.

We strongly support the development of an IPSAS based on IFRS 16 *Leases*.

In our comment letter on ED 64 *Leases* we recommended that the IPSASB:

(a) proceed with the proposals for lessee accounting;

(b) not proceed with the proposals for lessor accounting and instead develop proposals based on IFRS 16; and

(c) not proceed with the proposals for concessionary leases until progress has been made on related on-going projects (such as *Revenue*, *Transfer Expenses* and *Measurement*).

We are pleased with how our comments on ED 64 have been addressed in ED 75.

Developing an IPSAS based on IFRS 16 would put the IPSASB in a position to benefit from the detailed analysis and lengthy debates that occurred during the development of IFRS 16. The final requirements in IFRS 16 were determined after due consideration of both the conceptual and the practical arguments identified by the IASB's constituents.

We have not identified any public sector-specific reasons to diverge from the requirements in IFRS 16. However, we are concerned that the scope of ED 75 is not clear enough regarding concessionary leases and leases for nominal consideration which will be considered further under Phase 2 of the project. We have outlined our rationale for this in the response to SMC 1.

We are also concerned about the significant costs of implementing a standard based on IFRS 16 for the public sector and the risk that costs for preparers may outweigh the benefits to users. We therefore encourage the IPSASB to develop additional guidance on two specific areas that will require the application of significant judgement by preparers and consideration by auditors:

(a) identifying leases for which the underlying asset is of low value; and

(b) determining the interest rate implicit in the lease or the lessee's incremental borrowing rate.

Our responses to the Specific Matters for Comment are set out in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Vanessa Sealy-Fisher (vanessa.sealy-fisher@xrb.govt.nz) or me.

Yours sincerely

Carolyn Cordery
Chair – New Zealand Accounting Standards Board

APPENDIX

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.

We agree with the way the IPSASB has modified IFRS 16 for the public sector, subject to our comments below. We have not identified any public sector-specific reasons to diverge from the requirements in IFRS 16.

Manufacturer or dealer lessors

We agree with not including in ED 75 the requirements from IFRS 16 for manufacturer or dealer lessors as explained in the Basis for Conclusions, and the subsequent amendment made to the definition of initial direct costs as a consequence of excluding these requirements.

Concessionary leases and leases for nominal consideration

We are of the view that the scope of ED 75 needs to be clarified regarding concessionary leases and leases for nominal consideration (hereafter referred to as concessionary leases for ease of reading). We have received feedback that some constituents are of the view that concessionary leases are <u>not</u> in scope because the Request for Information is seeking feedback on these types of leases. We are also aware that some constituents support a specific scope exclusion for all concessionary leases, which we do not support.

We agree with not including in ED 75 an explicit scope exclusion for concessionary leases because this would result in <u>all</u> leases at below market-terms being excluded from a new standard. Our interpretation of the scope is that a concessionary lease meets the definition of a lease in ED 75: it conveys the right to use an asset for a period of time in exchange for consideration, even if the consideration is less than normal market terms. Until specific requirements are developed for concessionary leases (as part of Phase 2 of the project) we think it is appropriate that any arrangement that meets the definition of a lease be accounted for in accordance with the proposals in ED 75. We support a lease for nominal consideration being recognised at the amount of the consideration exchanged until proposals regarding concessionary leases are further considered and finalised in Phase 2 of the project. Including leases for nominal consideration within the scope of ED 75 also avoids subjective decisions (and consequential discussions with auditors) regarding what is ‘nominal’.

However, we are of the view that, until Phase 2 of the project has been completed, the accounting for the concessionary component of the lease should be explicitly excluded from the scope of the standard based on ED 75. We are also of the view that the scope of IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* needs to be amended to exclude leases within the scope of ED 75.[1] The IPSAS 23 scope exclusion for leases would make it clear that the concessionary component of a lease is not required to be accounted for in accordance with IPSAS 23 (that is, at fair

[1] We note IFRS 15 *Revenue from Contracts with Customers* excludes from its scope lease contracts within the scope of IFRS 16.

value like other assets acquired through non-exchange transactions). We also note that ED 64 *Leases* proposed that concessionary leases be recognised at fair value, and this proposal was not supported by most respondents.

Both ED 75 and IPSAS 23 need to be clear that the accounting for the concessionary component of a lease will be addressed under Phase 2 of the project. As a consequence, all concessionary leases including leases for nominal consideration would be accounted for at cost rather than fair value until Phase 2 of the project is completed. Furthermore, until Phase 2 of the project is completed it should be made clear that the accounting requirements for "leases for nil consideration" have not yet been developed.

Contractual arrangements

We have received some feedback that the refence to 'binding arrangement' rather than 'contract' in the definition of a lease would better reflect the public sector context and ensure all leasing arrangements are caught within the scope. Despite this feedback, we agree with the IPSASB's decision to use the term 'contract' rather than the term 'binding arrangement' – a contract is a type of binding arrangement. We also agree with the proposal to include additional application guidance explaining the factors an entity considers in assessing whether an arrangement is contractual or non-contractual. This approach maintains alignment between ED 75 and IFRS 16 and avoids debates about the types of arrangements within the scope of ED 75 while Phase 2 of the project is progressed. Whether other types of 'lease-like' arrangements should be accounted for as leases will be considered under Phase 2 of the project.

We note that paragraph BC41 refers to the definition of binding arrangement in IPSAS 32 *Service Concession Arrangements*. We also note that this definition in IPSAS 32 is not the same as the definition of binding arrangement proposed in ED 70 *Revenue with Performance Obligations*, which could be confusing for constituents. The definitions are:

IPSAS 32:	contracts and other arrangements that confer *similar rights and obligations* [emphasis added] on the parties to it as if they were in the form of a contract
ED 70:	an arrangement that confers both *enforceable rights and obligations* [emphasis added] on both parties to the arrangement. A <u>contract</u> is a type of <u>binding arrangement.</u>

We recommend that the IPSASB consider making the definition the same in IPSAS 32 and the final IPSAS based on ED 70.

A further question raised by constituents is whether a Memorandum of Understanding (MoU) meets the definition of a contract. Guidance on this matter would be helpful for constituents in one of the phases of this project.

Discount rates

We agree with the proposed requirement for the lessee to measure the lease liability at the present value, by discounting the expected lease payments using the interest rate implicit in the lease, or if that rate cannot be readily determined using the lessee's incremental borrowing rate. We note these requirements are consistent with the requirements in IFRS 16.

We have received feedback that determining an appropriate discount rate will be a significant implementation issue for many public sector entities. Although we are aware that for-profit entities encounter similar difficulties, we think this is an area where the IPSASB should develop additional guidance to ensure the cost of implementing the new standard does not exceed the benefits. The determination of an appropriate discount rate could be different depending on one's perspective – i.e. an individual public sector entity or whole of government. Practice from jurisdictions already using an IFRS 16 equivalent standard in the public sector may assist in developing guidance for determining the discount rate for leases held at different levels of the public sector.

Recognition exemption

We agree with the IPSASB's decision not to include in ED 75 or the Basis for Conclusions a specific monetary amount for assets of low value. However, we have the followingthree concerns:

(a) additional guidance is needed when identifying, on materiality principles, whether the underlying asset in the lease is of low value;

(b) the IPSASB's Basis for Conclusions is inconsistent with the Application Guidance; and

(c) the lack of justification in the Basis for Conclusions for the approach proposed by the IPSASB.

Additional guidance on applying materiality principles when identifying whether the underlying asset in the lease is of low value

We agree in principle that the assessment of whether an underlying asset is of low value should be based on the materiality of the leasing transaction in relation to the reporting entity's financial statements. However, we are aware that there are often time-consuming debates about whether particular types of leased assets are considered to be low-value or not. Additional guidance to avoid these debates across the whole of the public sector would be welcomed. It would be helpful if the IPSASB provided some examples of the types of assets that might be low value and to emphasise that the materiality assessment will depend on the reporting entity.

Inconsistency between Basis for Conclusions and Application Guidance

The IPSASB's Basis for Conclusions is inconsistent with the Application Guidance in paragraphs AG4–AG9 – in particular, paragraph AG5 which states that "The assessment [of whether an underlying asset is of low value] is not affected by the size, nature or circumstances of the lessee. Accordingly, different lessees are expected to reach the same conclusions about whether a particular underlying asset is of low value."

Paragraph BC53 states that "If entities decide to apply the exemption, they should use a threshold for determining leases of low-value assets considering the materiality of leasing transactions in relation to their financial statements. In assessing materiality, preparers consider whether the omission of information could influence financial statement users' assessments of accountability or their decision-making."

If entities are considering the materiality of leasing transactions in relation to their financial statements to assess whether an underlying asset is of low value, this means that the assessment <u>is</u>

affected by the size, nature or circumstances of the entity. However, paragraph AG5 states that the assessment is not affected by the size, nature or circumstances of the lessee.

If the IPSASB does not want to provide guidance on a specific monetary amount, paragraphs AG4–AG9 need to be reconsidered and amended to reflect this.

Lack of justification for the proposed approach

We are of the view that the IPSASB's Basis for Conclusions is inadequate in justifying the IPSASB's conclusions for not proposing a specific monetary amount for assessing whether a leased asset is of low value. There is neither an adequate discussion of the advantages and disadvantages of the IASB's approach and the IPSASB's approach nor an adequate explanation of the public sector-specific reason(s) for the difference.

For example, not applying a specific monetary amount:

(a) results in differing conclusions as to whether a leasing transaction is material (which increases the likelihood of discussions between preparers and auditors);

(b) has consequences for mixed groups – for-profit entities within the group would be applying a specific dollar amount for assessing low-value leased assets whereas public sector entities would be applying materiality; and

(c) leads to less comparability of financial information.

We are also aware that some constituents are questioning the reasons to exclude explanatory guidance relating to the threshold for which the underlying asset is of low value.

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.

* The fair value definition under development in ED 77, *Measurement* is aligned with the fair value definition in IFRS 13 *Fair Value Measurement*.

We agree with retaining the definition of fair value from IFRS 16 and IPSAS 13 in the IPSAS to be based on ED 75, for the reasons given in paragraph BC45 of the Basis for Conclusions on ED 75.

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.

We agree with the proposal to refer to both 'economic benefits' and 'service potential', where appropriate, in the application guidance on identifying a lease. Referring to both of these terms when considering the use for which the leased asset is used:

(a) is consistent with the IPSASB's Conceptual Framework; and

(b) includes within the scope of ED 75 leases where an entity derives service potential, rather than economic benefits, from the use of the asset.