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Ian Carruthers
Chair
International Public Sector Accounting Standards Board
277 Wellington Street West
Toronto, ON M5V 3H2

Lodged via website

Dear Mr. Carruthers

Exposure Draft ED 64 Leases

I am currently involved in applying IFRS 16 in the public sector in Australia (through AASB 16).

I was involved in contributing to the Australasian Council of Auditors-General (ACAG) submission, as part of my role as Technical Director at Queensland Audit Office.

I support that submission and submit the attached comments covering:

- Specific Matter for Comment 2 – Additional consolidation processes under ED 64
- Specific Matter for Comment 3 – The lessor lease receivable is not a financial asset
- Other Matters
 - Definition of lease – expansion to agreements
 - Definition of lease – statutory leases
 - Improvement in lessor finance lease accounting.

I provide expert, authoritative leadership on public sector financial reporting and the audit response in the not-for-profit and for-profit sectors.

I have extensive experience in accounting advisory functions of large accounting firms providing advice, insights and explanations on Australian accounting and International Financial Reporting Standards (IFRS and AIFRS) and external financial reporting requirements for the public and private sectors.

Yours sincerely,

David Hardidge

IPSASB Exposure Draft ED 64 Leases

Specific Matter for Comment 2

As stated in the ACAG submission, ACAG believes that the ED 64 proposals would require greater consolidation processes.

The following illustrative entries demonstrate this:

Operating lease to controlled entity	
IFRS 16	ED 64
<p>Lessee - Reverse lessee accounting in controlled entity</p> <p style="padding-left: 40px;">Right-of-use asset</p> <p style="padding-left: 40px;">Lease liability</p> <p style="padding-left: 40px;">Right-of-use asset depreciation</p> <p style="padding-left: 40px;">Lease liability interest</p> <p style="padding-left: 40px;">Intra-group cash flows (offset)</p> <p>Lessor</p> <p style="padding-left: 40px;">Nil balance sheet and income statement entries – underlying PPE still on balance sheet</p> <p style="padding-left: 40px;">Intra-group cash flows (offset)</p>	<p>Lessee – Reverse lessee accounting in controlled entity</p> <p style="padding-left: 40px;">Right-of-use asset</p> <p style="padding-left: 40px;">Lease liability (offset*)</p> <p style="padding-left: 40px;">Right-of-use asset depreciation</p> <p style="padding-left: 40px;">Lease liability interest (offset*)</p> <p style="padding-left: 40px;">Intra-group cash flows (offset)</p> <p>Lessor - Reverse ED64 lease accounting</p> <p style="padding-left: 40px;">Lessor lease receivable (offset*)</p> <p style="padding-left: 40px;">Unearned revenue / credit</p> <p style="padding-left: 40px;">Lease receivable interest (offset*)</p> <p style="padding-left: 40px;">Unearned revenue / credit amortisation</p> <p style="padding-left: 40px;">Intra-group cash flows (offset)</p> <p>offset* - offset is equal if underlying assumption on lease term and discount rate are the same</p>
Finance lease (e.g. back-to-back sublease) to controlled entity	
IFRS 16	ED64
<p>Lessee – Reversal some of the lessee accounting in controlled entity</p> <p style="padding-left: 40px;">Right-of-use asset - Do not need to reverse right-of-use asset as it would flow through on consolidation to group - assuming that finance lease would mean carrying value of right-to-use asset in controlled entity would be substantially the same as</p>	<p>Lessee – Reverse lessee accounting in controlled entity</p> <p style="padding-left: 40px;">Right-of-use asset</p> <p style="padding-left: 40px;">Lease liability (offset*)</p> <p style="padding-left: 40px;">Right-of-use asset depreciation (not needed)</p> <p style="padding-left: 40px;">Lease liability interest (offset*)</p>

<p>carrying value of the parent (if reinstated)</p> <p>Lease liability (offset*)</p> <p>Right-of-use asset depreciation (not needed – see above)</p> <p>Lease liability interest (offset*)</p> <p>Intra-group cash flows (offset)</p> <p>Lessor – Reverse lessor accounting</p> <p> Lessor lease receivable (offset*)</p> <p> Lease receivable interest (offset*)</p> <p> Intra-group cash flows (offset)</p>	<p>Intra-group cash flows (offset)</p> <p>Lessor - Reverse ED64 lease accounting</p> <p> Lessor lease receivable (offset*)</p> <p> Unearned revenue / credit</p> <p> Lease receivable interest (offset*)</p> <p> Unearned revenue / credit amortisation</p> <p> Intra-group cash flows (offset)</p>
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Specific Matter for Comment 3

As noted in the ACAG submission, ACAG does not believe that the lease receivable meets the definition of a financial asset. ACAG noted that leases are often subject to termination because of the failure of the lessee or lessor to meet their contracted responsibilities.

Examples of situations where the lessee can terminate a lease agreement is when the lessor fails to meet its contractual obligations to:

- pay local council rates, land tax etc.
- pay for structural repairs and capital improvements
- pay property insurance (building structure).

This situation differs from a financial asset as the lessor is not unconditionally entitled to future rental payments. Further, the lessor will forfeit the future rental payments if it fails to meet the contractual obligations.

Also, the lessor can recover the underlying property if the lessee fails to meet its contracted obligations (for example to):

- pay and maintain insurance (e.g. public liability, loss of profits insurance / business continuity)
- pay all services (e.g. utilities)
- provide financial information (as required under the lease agreement)
- maintain premises to defined standards, including lighting, plate glass, gardens and lawns, and fire prevention and safety equipment.

This situation differs from a basic lending arrangement where lenders usually only have a right to the underlying property if the borrower fails to make loan repayments.

Other Matters

Definition of lease – expansion to agreements

I note that ED 64 proposes to expand the definition of contract to include agreements. I believe that this will be particularly useful for the public sector. For example, where state government departmental financial statements are prepared and one department enters into a lease with another department. In this situation, both are the same legal entity, and (in Australia) there is no legal contract between them.

Definition of lease – statutory leases

I am still assessing situations where a statutory lease may exist. For example, land under roads in Queensland, where the roads are recognised by the Department of Transport and Main Roads and the land under roads is administered by a different department, being the Department of Natural Resources, Mines and Energy. This might be regarded as being the statutory right to use an identified asset. As there is no payment for this arrangement, the definition of concessionary lease may also be met.

I am yet to assess other rights to use land (often for no or nominal value) through statutory arrangements.

Improvement in lessor finance lease accounting

An area of diversity in Australia for lessor accounting is for the subsequent residual for a finance lease. For example, the return of the infrastructure assets under “99 year” leases / “government entity privatisations” mentioned in ACAG’s submission. At least one state, New South Wales¹, recognises the accrual for a residual, while at least one state, Queensland, does not on the basis the estimate is not reliable.

¹ New South Wales TPP 06-08
https://www.treasury.nsw.gov.au/sites/default/files/pdf/TPP06-8_Accounting_Policy_-_Accounting_for_Privately_Financed_Projects.pdf