

Mr. Ian Carruthers
Chairman
International Public Sector Accounting Stand-
ards Board

Submitted via website

30 June 2018

Comments to the Exposure Draft 64 - Proposed International Public Sector Accounting Standard Leases

Dear Mr. Carruthers:

We would like to thank you for the opportunity to provide our comments to the Exposure Draft 64 on the Proposed International Public Sector Accounting Standard Leases. We are pleased to contribute to the improvement of this draft responding to each specific matter for comment.

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.

We agree with the IPSASB's decision to adopt the IFRS 16 right-of-use model for lessee accounting. The right-of-use model would facilitate the identification of lease arrangements in the balance sheet of the lessee when recognizing among the entity's other assets the right-of-use of the underlying asset. The paragraph BC7 addresses the compatibility of the right-of-use of the asset definition with the Conceptual Framework, therefore, we would suggest to also addressing the IPSASB's view concerning the compatibility of the recognition of the liability (i.e. unearned revenue) at the lessor side with the Conceptual Framework.

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.

We agree with the IPSASB decision to depart from the IFRS 16 risks and rewards model for lessor accounting. The reasons explained are comprehensive in our view, especially the inconsistencies issues that the risks and rewards model could produce when the lessor and lessee are part of the same accounting entity. As some constituents are concerned about a potential "accounting duplicity" with the approach taken by the IPSASB, we suggest to include in the BCs an explanation in regards to this matter.

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?

We support the IPSASB decision to develop a single right-of-use model for lessor accounting that is consistent with lessee accounting criteria. The approach suggested by the IPSASB might be difficult and costly for the lessor to apply in practice. A lessor would have to analyse and start accounting for all the former operating lease contracts. It is worth to dedicate a few more lines in explaining the reasoning of including in the lessors' accounting not only a lease receivable but also a liability representing the unearned revenue. It is important to also evaluate the consistency of this liability definition with the Conceptual Framework.

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?

We agree with the IPSASB's proposition to measure concessionary leases at fair value and to recognize the subsidy granted to lessees as an expense in the lessor accounting and as a revenue in the lessee accounting and thereby ensuring consistency with the approach to concessionary loans. The Exposure Draft requires the lessor to measure the liability (unearned revenue) recognized through a concessionary lease at fair value. The fair value of the right-of-use asset transferred to the lessee shall be measured by discounting market lease payments using a market interest rate. Conceptually, the accounting treatment seems sound, this may however be complex to apply in practice. The IPSASB should consider providing some additional guidance to aid entities determining what would constitute a market lease payment. For example:

If an entity has a 10 years lease, which market lease payments should be used to determine the concessionary amount? One possibility might be to use the market lease payments as at day one (inception of the lease), another possibility might be to estimate the market lease payments over the lease term. If the market lease payments over the lease term must be estimated, this may be a very complex calculation for entities to perform. On the other hand, should entities only refer to the market lease payments as at inception of the lease, a significant portion of the concession could potentially not be taken into account.

E.g. (simplified example with no market interest rate)

	Year 1	Year 2	Year 3	Total
Market lease payments	10	12 (estimated)	14 (estimated)	36
Contractual payment	5	6	7	18

Using the simplified example above, if you determine the concession amount using the day one market rental, the concession total will be CU12 (10*3 years [assuming market lease payments at inception for the entire lease term] - CU18 contractual rental). Using the market lease payments estimated over the term, the concession would be CU 18 (36 market lease payments - 18 contractual rental). The concession could thus potentially be understated if the day one market lease

payments is used. In contrast to that, an entity may not be able to accurately determine the estimated market lease payments over the lease term.

This calculation may also be more complex in situations where entities enter into long term leases (e.g. 99 year leases or even 999 year leases). Some guidance on how an entity should approach the measurement of the concessionary element in these instances would be helpful.

Guidance should in our view be provided on the process an entity should follow in the absence of market lease payments. This can be in instances where the market does not lease similar assets (e.g. specialised assets or equipment such as military assets). In absence of market lease payments, it might be argued that the “market lease payments” could be equal to the rent that the government entity is charging, given the fact that there is no comparable market transaction. Another alternative would be to follow the three step approach of IFRS 13 to identify a fair value in cases where no open market with observable transactions exists. Therefore, some guidance and clarification in this regard would be helpful.

A further question may also arise on the market interest rate. Is the market interest rate the interest rate available to any party in the market, or the rate available to a similar party in the market (similar type of entity, similar term, similar size, similar risk profile etc.)? If the market rate refers to a similar entity in the market, this could be difficult to determine in certain instances as there may not be a comparable entity or where the market may not be willing to provide financing to an entity of a similar nature. In certain jurisdictions there are instances where the only party willing to transact with the counter party is a government entity due to the mandate of said government entity. A commercial institution may not be willing to finance the counter party. The Board might want to consider giving some guidance on how to determine a market interest rate under these circumstances.

We hope our comments are useful for the IPSASB. Should you need any further information, please do not hesitate to contact us.

Best Regards,



Thomas Müller-Marqués Berger
Partner and Global Leader of International Public Sector Accounting

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft