



LEASES

Issued 30 June 2018

ICAEW welcomes the opportunity to comment on International Public Sector Financial Reporting Board's (IPSASB) Exposure Draft 64 *Leases* published by IPSASB in January 2018, a copy of which is available from this [link](#).

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MAJOR POINTS

Support for the exposure draft

1. We welcome the opportunity to comment on IPSASB's exposure draft (ED) on Leases. We support the proposals which align IPSASs with IFRSs but disagree with the approach to lessor accounting.

Lessor Accounting

2. IPSASB are proposing a right-of-use model for lessor accounting where the lessor would continue to recognise the entire underlying asset as well as creating a new lease receivable. We do not agree with this approach since we believe that this would inflate the lessors gross assets. We question how one set of cash flows (received from the lessee) could relate to both the lease receivable and the underlying asset.
3. In our view the leased asset is double counted by the lessor under the current proposals. The ED attempts to explain why it is not a double count in BC66 but this explanation is not clear or convincing. In our view, since the underlying asset would continue to be subsequently measured using IPSAS 16 Property, Plant and Equipment, the cash flows from the lessee would only be available to support the lease receivable and the residual interest in the underlying asset; they cannot also be used to support the whole carrying value of the asset. Thus the underlying asset would be impaired and the assets would no longer be grossed up. The ED does not discuss this point, which is in our view regrettable as it is not clear how the impairment of the asset would be calculated and whether amendment of the impairment standard would be necessary.
4. The IASB proposed a similar approach in their 2010 consultation on IFRS 16 Leases and received little support from respondents, mainly for the above reasons. We cannot see why this approach would be acceptable for the public sector yet not for the private. The IASB also proposed the de-recognition of the proportion of the underlying asset that is being leased. This was rejected primarily on cost/benefit grounds (especially in relation to multi-occupancy office buildings). In our view the IPSASB has not produced a convincing case why the public sector should not face the same issues.
5. We believe that more confusion would be caused by having a different accounting treatment compared to IFRS than by having two different models for lessors and lessees. Our strong preference is for IPSASB to follow IFRS and only make adjustments were necessary, such as for concessionary leases. It is worth noting that the UK government is looking to adopt IFRS 16 with only minor amendments.

RESPONSES TO SPECIFIC QUESTIONS 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.

6. Adopting the IFRS 16 right-of-use model will lead to more accountability and transparency as more lease arrangements go on balance sheet. Recognition of these assets and liabilities should, among other things, provide users with a better picture of an entity's gearing. We therefore agree with the adoption of the IFRS 16 right-of-use model for lessee accounting.
7. Furthermore, adopting the IFRS 16 right-of-use model for lessee accounting will also align the accounting treatment between central government entities and Government Business Enterprises, which tend to apply private sector accounting standards such as IFRS. This should benefit users, who will only need to understand one set of lessee accounting rules.

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.

8. SMC 2 cannot be answered without considering SMC 3, since a departure from the risks and rewards based lessor model would imply the availability of a more appropriate alternative. We do not believe that the proposed single right-of-use model for lessor accounting is an appropriate alternative. See our response to SMC 3 for more detail.
9. We do not believe that the arguments put forward to depart from IFRS for lessor accounting, as detailed in BC9 to BC13, are persuasive enough to warrant a departure for reasons listed below.
10. BC9 puts forward arguments against continued application of a risks and rewards model. We believe that the level of economic consumption of the underlying asset by the lessee plays an important role in the accounting treatment of the lease by the lessor, yet there is no evidence that this has been considered. For example, BC9 (c) (ii) argues against the derecognition of the underlying asset since the lessor maintains control. However, if the lessee uses up all or most of the economic benefits of the underlying asset, the asset would have little economic value to the lessor. It is difficult to imagine how the lessor could reasonably justify the continued recognition of the underlying asset if the lessee uses up most of its economic benefits during the lease term as the substance of the transaction is more akin to a sale. See paragraph 15 for more detail.
11. BC10 argues that practical issues may arise from the application of inconsistent accounting models by lessors and lessees. Whilst we do not dispute this, we believe that the arguments put forward are somewhat overstated. BC10 (a) highlights some consolidation issues and the need to maintain additional records. However, many public sector entities need to maintain additional records such as cash transactions/balances, accruals-based information, budgeting information and statistical information for GFS requirements. Furthermore, a

lessee and a lessor that are part of the same group would simply reverse intra-group transactions as part of normal consolidation adjustments rather than trying to match these off.

12. Additionally, BC10 (b) states that the use of two different accounting models may make leasing transactions less understandable. We believe that diverging from IFRS could lead to more confusion than having two different accounting models for leases. The same paragraph also states that it may be difficult to distinguish between a lease and the sale of an asset in the lessor's financial statements. We do not agree with this assertion.
13. We agree with BC11 in that it is common for a centralised entity to undertake most or all of the property management for a government. As described above, the entities that have internal leases and are part of the same group would be required to put through consolidation adjustments to reverse out their positions. At the whole of government level for example, one would expect these types of adjustments to be common and whilst they are consolidation issues, we do not think they are insoluble and rely on normal good practices of record-keeping.

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

14. Whilst we sympathise with the idea of having symmetrical accounting between lessor and lessees, we do not agree with the single right-of-use model proposed by the ED for lessor accounting. We believe that IPSASB should follow IFRS 16 for both lessor and lessee accounting because we are not convinced that the arguments put forward in the ED are sufficient to warrant divergence from IFRS and we do not believe that the proposals for lessor accounting are a conceptually sound alternative.
15. We believe that the recognition of the underlying asset in its entirety, as well as a lease receivable, inappropriately inflates the lessor's assets and as such is imprudent. We do not believe that a single cash flow from the lessee can support both the underlying asset as well as the lease receivable. Consequently the recoverable amount of the underlying asset could be less than the carrying amount, potentially leading to impairments to be recognised. Should the underlying asset be impaired (cost model) or revalued to its reversionary interest (revaluation model) then there would no longer be a double count. The ED fails to debate this point and the explanations provided in BC66 to suggest that there is no double-counting are difficult to follow, should be clarified and are unconvincing.
16. In the basis for conclusions for lessor accounting (BC20-61) there are two sub-headings that review the recognition of the lease receivable (BC41-43) and liability (BC44-53). However, the ED does not discuss the continued recognition of the underlying asset. It would be useful to understand IPSASB's application of the Conceptual Framework to the underlying asset.
17. BC35 describes two approaches for lessor accounting. We prefer Approach 2 over Approach 1 since the second approach derecognises the component of the underlying asset that is being transferred. However, we do not believe that requiring a lessor to recognise a lease receivable for all leases, as is currently being proposed, would improve financial reporting to the extent that the benefits would outweigh the costs associated with such a change.

Furthermore, Approach 2 would be complicated to apply when one asset is leased to multiple parties concurrently.

18. In addition to cost/benefit considerations, users of the accounts may find it difficult to understand the differences between private and public sector accounting treatment for leases. This may be exacerbated by Government Business Enterprises that could be applying IFRS yet are still within the public sector boundary.
19. For the reasons outlined above we do not agree with IPSASB's proposed lessor accounting model and recommend that IFRS 16 be adopted with minor changes where necessary. It is worth noting that the UK government is currently going through the process of adopting IFRS 16 with only minor adaptations.

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 concessionary loans (see paragraphs BC77 - BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognise 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?

20. We support IPSASB's proposals to show the subsidy component in both the lessor's and lessee's financial statements. Given the prevalence of concessionary leases in the public sector, we welcome the additional guidance in the ED.
21. For lessors, we share the concerns raised in BC94 that recognising lease revenue in excess of the lease receivable may seem counter-intuitive. Alternative options outlined in the ED are either not to show the subsidy element at all (option 1 in BC84 (a)) or to recognise the credit entry directly in net assets/equity (option 3 in BC84 (c)). We believe that users will find the information on the subsidy element useful and therefore do not agree with option 1. We agree with IPSASB that the non-exchange component of the credit entry does not meet the definition of net assets/equity and therefore reject option 3 in BC84. We have not identified any other possible options to account for the credit entry and therefore agree with the proposed approach in the ED (option 2 in BC84 (b)).
22. We agree with the proposed treatment of concessionary leases for lessees.

Further observations

23. The definition of a concessionary lease states that it is a lease at below market terms. BC21 makes it clear that leases for zero or nominal consideration are in substance grants in kind and therefore out of scope of the draft standard. We recommend that the definition of a concessionary lease should also include the exclusion of leases for zero or nominal consideration and that BC21 should say that grants in kind are in scope of IPSAS 23 Revenue from non-exchange transactions.