

29 June 2018

Mr. John Stanford
International Public Sector Accounting
Standards Board
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NY 10017, USA

submitted electronically through the IPSASB website

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Re.: ED 64, Proposed International Public Sector Accounting Standard - Leases

Dear Mr. Stanford,

We would like to thank you for the opportunity to provide the IPSASB with our comments on the draft proposed International Public Sector Accounting Standard – Leases (referred to hereinafter as “ED 64”).

The IDW supports the approach taken developing ED 64 and, subject to points raised in our response to Specific Matter for Comment 3, specifically agrees with the proposed departure from IFRS 16 in respect to lessor accounting.

We respond to each of the Specific Matters for Comment as follows:

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. In our view the reasoning provided in the BCs is comprehensive.

We have one comment on the wording of BC7.(b): “The right of use asset is recognized when the lessee controls the asset”. We would like to point out that

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Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
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Page 2 of 5 to the comment letter to the IPSASB dated 29 June 2018

control of the underlying asset itself is only passed from the lessor to the lessee in the event of a sale, or a sale and leaseback arrangement. In our opinion this text should be amended to read: “The right of use asset is recognized when the lessee controls the use of the underlying lease asset as conveyed by the lease contract)”.

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’s decision to depart from the IFRS 16 risks and rewards model for lessor accounting. In our view the reasoning provided in the BCs is comprehensive.

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?

In its letter to the IASB dated 13 September 2013, the IDW clearly stated its disagreement with the IASB’s then proposed dual model in respect of lessee and lessor accounting. In addition to the IDW’s technical reservations that led it to take this stance, we agree that public sector specifics justify this difference in lessor accounting in the public sector, for the reasons explained in BCs 9-13.

We support the proposed single right-of-use model for lessor accounting consistent with lessee accounting. We specifically agree that a lease is the sale of an unrecognized “right-of-use asset” and agree that the lessor shall recognize the lease receivable as an asset, as a separate economic phenomenon from the underlying asset.

However, we note some confusion and inconsistency in ED 64 surrounding the nature of the corresponding credit entry recognized by the lessor. Specifically, AG 39 and BCs 44-53 are highly confusing in explaining the IPSASB’s

Page 3 of 5 to the comment letter to the IPSASB dated 29 June 2018

deliberations regarding the nature of this credit entry, as well as being inconsistent with the explanation in the first sentence of BC 91.

BC 53 states: “ ... recognizing the credit entry as a liability until revenue recognition criteria are met may not be consistent with the *Conceptual Framework* definition of a liability.” and also “ ... recognizing revenue directly in the statement of financial position, while consistent with the *Conceptual Framework*, would not be consistent with the current requirements in IPSAS.”. BC 53 further states: “The IPSASB ... decided these inconsistencies should be addressed in a future IPSASB project to revise existing IPSASs for consistency with the *Conceptual Framework*”. This unresolved situation is less than satisfactory for the finalization of ED 64.

The IDW does not support the explanation that the lessor’s liability should be denoted as an unearned revenue liability. However, we do agree with the IPSASB’s explanation (in the first sentence of BC 91) that the credit entry represents a performance obligation to provide access to the underlying asset throughout the lease period. The lessor is contractually bound to forego any alternative use, i.e., to forego service potential. In our view this represents a commitment to an outflow of resources because the lessor cannot benefit from the service potential (i.e., use the underlying asset for its own purposes, including leasing it to another party to receive cash) but has committed to provide this service potential to the lessee. From the lessor’s viewpoint this foregoing of a right of use thus equates to a continuative outflow of service potential throughout the lease period. On this basis the credit entry constitutes a liability for the lessor to perform; i.e., a performance obligation. It follows that it is only over the ongoing “delivery” throughout this performance period that the liability for performance is reduced as revenue is earned and recognized in the statement of performance.

Since we contend that the credit entry represents the lessor’s performance obligation, we disagree that the liability will, in every case, need to be adjusted by the same amount as the change resulting from the measurement of the lease receivable (paragraph 44). Not all factors impacting the measurement of the lease receivable have an equivalent impact on the measurement of the performance obligation.

In conclusion, in finalizing ED 64, the IPSASB will need to address the inconsistency we outline above. Should the IPSASB decide on the interpretation given in the first sentence of BC 91, i.e., that the credit entry is a performance obligation, there would be no unresolved issue concerning consistency with the *Conceptual Framework* as discussed in BC 53. However, appropriate revision to

Page 4 of 5 to the comment letter to the IPSASB dated 29 June 2018

ED 64 would need to be made, especially to paragraph 44 in respect of subsequent measurement of the liability.

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 IPSSB 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 that a lease contract at below-market terms includes a non-exchange component (concessionary lease) and will generally not constitute a lease agreed at a "bargain price" for the lessee. Unless there are clear indications to the contrary (e.g., the arrangements constitute a financing transaction), the non-exchange part of a lease represents a grant or subsidy from a lessor to a lessee. We agree that to meet the needs of financial statement users, under the IPSASB's Conceptual Framework, such grants or subsidies should be transparent.

However, we also appreciate that there may be some degree of discomfort as to ED 64's proposed treatment of concessionary leases as explained in BCs 94-96. In our view, the IPSASB could require an appropriate note disclosure, to both explain the nature of the respective asset and liability and value of the concession. Alternatively, differentiated presentation on the face of the financial statement might address the discomfort with the notion of recognizing lease income in excess of cash received, as the fact that an entity elects to lease an asset at a price below market value (assuming there would be a market) means it is "giving away" service potential of that asset for a specific purpose, which needs to be sufficiently transparent.

In addition, factors such as the lessor's intention in agreeing to concessionary terms, or either party's ability to withdraw from the contract may need to be reflected in the accounting treatment, i.e., in certain circumstances there may be valid arguments for recognizing the expense and income over the lease period, rather than as a day-one transaction.

Page 5 of 5 to the comment letter to the IPSASB dated 29 June 2018

A specific disclosure support provided by lessors and received by lessees by way of concessionary leases is in the public interest and essential in terms of accountability. Without such information and disclosures support measures provided and received would not be transparent. In our view, appropriate application guidance to support para. 61 of ED 64 might be helpful in this respect.

We would be pleased to provide you with further information if you have any additional questions about our response and would be pleased to be able to discuss our views with you.

Yours truly,

Klaus-Peter Naumann
Chief Executive Director

Gillian G. Waldbauer
Head of International Affairs