



THE TREASURY
Kaitohutohu Kaupapa Rawa

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The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017
United States of America

Attention: Mr John Stanford

Consultation Paper: Recognition and Measurement of Leases

The New Zealand Treasury welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board on the ED 64: Leases.

We have attached our responses to the specified matters for comment.

Yours sincerely

A handwritten signature in blue ink that reads "Jayne Winfield".

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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.

The New Zealand Treasury considers the right-of-use model for lessee accounting by itself is inadequate for public sector reporting.

We believe the IPSASB has missed an important opportunity to consider more deeply the allocations of rights, which pertain to physical and intangible assets, which are prevalent in the public sector. A fuller consideration would make it more likely all such rights, not just right-of-use, are accorded appropriate and transparent accounting treatment. That would ensure that different decisions over the assets (including right-of-use) are better informed by accounting, and that accounting enables those decisions to be better assessed.

To illustrate our concerns, consider the schema of property rights identified by Edella Schlager and Nobel Prize winning economist Elinor Ostrom¹:

- Access the right to enter a defined physical property
- Withdrawal the right to obtain the “products” of a resource
- Management the right to regulate internal use patterns and transform the resource by making improvements
- Exclusion the right to determine who will have an access right, and how that right may be transferred
- Alienation the right to sell or lease the above rights

This is a property rights framework characterized by nested, cumulative attributes. It has become arguably the most ubiquitous framework for analysis of natural resources and property rights.² Discriminating between these rights is particularly important for assets providing non-private goods, where aspects of non-rivalry and non-excludability require collective management structures. Such structures are in fact often separate public sector reporting entities themselves. The framework can be summarised in the following chart from their paper.

¹ Schlager E, Ostrom E. Property-Rights Regimes and Natural Resources: A Conceptual Analysis. *Land Economics* [serial online]. August 1992;68(3):249-262. Available from: EconLit with Full Text,

² Galik C, Jagger P. Bundles, Duties, and Rights: A Revised Framework for Analysis of Natural Resource Property Rights Regimes. *Land Economics* [serial online]. February 2015;91(1):76-90

Bundles of Rights Associated with Persons				
	<i>Owner</i>	<i>Proprietor</i>	<i>Claimant</i>	<i>Authorised User</i>
Access and withdrawal	X	X	X	X
Management	X	X	X	
Exclusion	X	X		
Alienation	X			

In this framework, an owner may transfer rights of direction-of-use and rights-of-use to a proprietor or claimant, and rights-of-use, but not rights-to-direct-use to an authorised user. Lease contracts are just one way to reflect a transfer of rights of use from an owner (lessor) to a claimant (lessee). Not only may other arrangements than lease contracts be used, but if financial reports are to fairly reflect the rights of a public sector entity, and then other bundles of rights than access, withdrawal and management should be provided for.

A holistic approach that fully reflects the attributes of rules and rights that apply over the use of assets in the public sector is likely to be a much better fit for purpose than an accounting approach derived simply from private sector lease contracts. We briefly highlight some benefits below.

Authorised users, and not the reporting entity managing many infrastructure and natural resource assets controlled by the state, have access and withdrawal rights, (e.g. road users in fact use the roads of a road authority managing state-owned roads). The property rights framework thus copes better than the contractual leasing approach for the awkward fact that many lessees in the public sector are not in fact users of the asset.

The framework helps clarify the distinction between operators of concession arrangements and lessees. The concept of authorised users that do not have the right to regulate use patterns is also likely to be useful when the IPSASB comes to consider natural resource rights, such as access to the radio spectrum. Some so called 'concessional leases' where the lease is conditional on a prescribed use of the asset, may in fact be better reflected as 'authorised use' agreements and accounted for differently than leases,

Claimants appear similar to lessees, in that they have both a "right-of-use" and a "right to direct" the use but notably without sub-leasing rights. The private sector standard setter's analysis of rights to direct however seems limited to shipping containers and assets requiring specialised skills to operate. The public sector standard setter must consider more deeply the common situation where assets that are provided for the use only of another entity, whose objective the 'lessor' supports. We submit that more thinking that is refined is required here.

For example, the accommodation lease that a school makes available to a health operator on school premises so that health care can be provided to pupils, is different in substance to an accommodation lease that the same health provider might receive from a property management company. A judgement is required as to whether the health provider is an authorised user or a claimant. The proposed guidance in AG19 -22 is not up to this task. In another example, a better accounting outcome is likely to be achieved if the IPSASB seeks to best reflect a rail operating company paying a rail access charge as a claimant on the rail asset rather than as a lessee, and the infrastructure owner as an asset provider than a lessor.

Finally, the differentiation between proprietors and owners may be useful when considering the assets that the reporting entity is charged for maintaining and preserving for future generations. Are heritage assets effectively on 'lease' to public sector entities to look after them on behalf of the public?

Another possible use for this concept is the common practice of governments providing property rights to other governments for embassy and consulate purposes, but where if the embassy were to be withdrawn the property would revert to the host government. The IPSAS conceptual framework has stated that service recipients and resource providers will need information that supports the assessment of the capacity of the entity to adapt to changing circumstances.

The adaptive capacity of an entity with alienation rights is quite different to an entity without those rights. In New Zealand, both our Public Works Act, and arrangements with Māori who have provided property for public purposes, provide residual rights back to the original owners if the property is no longer required for those public purposes.

Those examples illustrate that the allocation of withdrawal rights in the public sector is not such a simple matter as the public sector where leases are ubiquitous and simply a type of contract law and property can be described as either freehold or leasehold. The Treasury is not contesting the assertions made in paragraphs BC 7, nor indeed that the right-of-use approach may be appropriate for many lease arrangements, but rather is arguing that they omit critical public sector differences that should affect the development of the standard.

The Treasury would therefore propose that the IPSASB withdraw the exposure draft, and prepare a consultation paper that makes use of the property rights literature that has developed in the twenty-five years since the Schlager and Ostrom paper, in an effort to ensure that allocations for bundles of rights over assets are most appropriately accounted for in the correct context. We would particularly urge this, should the IPSASB get significant pushback on other proposals in this standard.

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.

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?

The Treasury shares the Board’s dissatisfaction with the current IFRS 16 risk and rewards approach and its disconnect with both the IFRS and IPSAS Conceptual Frameworks, and we share the Board’s concern with a derecognition approach that seems to ignore the alienation rights remaining with the owner. However, there are significant problems with the proposed approach to the lessor accounting:

- There is no justification for the “credit entry in the statement of financial position”. The lessor has no obligation to report.
- The recognition of both the underlying asset and the lease receivable in the statement of financial position means the lessor is double counting the economic benefits it expects to receive from the asset.

The proposals would therefore distort the statement of financial position, so that it no longer fairly reflects the rights and obligations of the lessor.

The proposals are derived from the idea that the right-of-use asset is a separate economic phenomenon to the underlying asset, and that assets cannot be derecognised and derecognised as portions (slices) of individually controlled rights.

Yet as noted above the property rights literature recognises the nested, cumulative attributes of rights over assets. If accounting fails to recognise this, it fails to reflect economic substance. The solution requires the Board to go back to that literature and reflect how it can best make those nested cumulative rights transparent to users of financial statements.

The Treasury also has some concern with the logic for the different accounting approach for the public sector expressed in BC 10 and BC 1. In particular, the IPSASB view that “In many jurisdictions, a centralised entity will undertake most or all of the property management for a government. The entity will own all the government’s property assets, and lease them to other government entities. As a consequence the prevalence of consolidation issues may be greater in the public sector than in the private sector”

If such an arrangement is in place, that centralised entity’s financial performance is likely to be assessed against those of profit-oriented property management companies. It is therefore more than possible they will be required to follow IFRS rather than IPSAS, particularly if the government has leveraged their ownership by enabling that entity to trade some of its shares on a listed exchange. The table below compares the consolidation difficulties if the IFRS 16 lessor accounting approach was retained, or if the ED 64 proposals were adopted, under a number of possible scenarios.

	If IPSAS takes the ED 64 Approach (right-of-use for lessees, lease receivable and separate credit entry)	If IPSAS takes the IFRS 16 Approach (right of use for lessees, no changes for lessors from IAS 17 / IPSAS 13)
Both Lessor and Lessee apply IPSAS e.g. Both entities in General Govt. Sector	Lessees incur transition cost of change, Lessors incur transition cost of change Consolidation unit eliminates lease receivables and lease payables. Consolidation unit eliminates right of use asset with lessor "credit entry"	Lessees incur transition cost of change, need to identify whether lessor reports the lease as operating or finance. Lessors incur no transition cost of change Consolidation unit eliminates "finance lease" receivables and "finance lease" payables Consolidation unit eliminates "operating lease" receivables with right of use assets Consolidation unit eliminates remaining right of use asset with "operating lease" liabilities
Lessor Applies IFRS and Lessee applies IPSAS e.g. Property Mgmt Co a Public Corporation, and Lessee in General Govt Sector	Lessees incur transition cost of change Lessors must keep two books, one for consolidation purposes, and one for their own accounts. Consolidation unit eliminates lease receivables and lease payables. Consolidation unit eliminates right of use asset with lessor "credit entry"	Lessees incur transition cost of change, need to identify whether lessor reports the lease as operating or finance. Lessors incur no transition cost of change Consolidation unit eliminates "finance lease" receivables and "finance lease" payables Consolidation unit eliminates "operating lease" receivables with right of use assets Consolidation unit eliminates remaining right of use asset with "operating lease" liabilities
Lessor Applies IPSAS and Lessee applies IFRS e.g. Rail Owning Co in General Govt Sector leases track to Rail Operating Co, a Public Corporation at a concessionary rate	Lessees incur transition cost of change, Lessors incur transition cost of change Consolidation unit eliminates lease receivables and lease payables. Consolidation unit eliminates right of use asset with lessor "credit entry"	Lessees incur transition cost of change, Lessors incur transition cost of change Consolidation unit eliminates lease receivables and lease payables. Consolidation unit eliminates right of use asset with lessor "credit entry"

What this table reveals is that the proposed ED 64 approach eases the consolidation load when both the lessor and lessee adopt IPSAS, as different elimination entries are not required for leases in the finance and operating categories. However, the proposed ED64 approach makes the consolidation approach much more onerous when the consolidated group has lessors that account under IFRS.

If lessors adopt IFRS but have a public sector parent, they will be required to keep two sets of books under the current proposal. However, if the public sector standard were to take the approach of the private sector standard, then what is required is the identification or tagging of leases to either a finance or operating lease category, so the necessary consolidation entries can be made. The Treasury submits that this is a far less onerous accounting process. We submit therefore that the current proposals could have the unintended consequence of making typical consolidations in the public sector more onerous rather than less onerous.

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?

The Treasury understands from the Basis of Conclusions that the IPSASB regards leases as the financings of the right to use an underlying asset, and because an outstanding loan and a lease receivable have the same economic nature, the financing component of loans and leases are comparable transactions.

The Treasury considers this conclusion incorrect. The great majority of concessionary or ‘peppercorn’ leases do not attract any lease receivable or payable. The lessee does not have to finance their right to use the asset, and the statement of financial position should not reflect such a fiction. Entities receiving a concessionary loan do not have a liability

Consequently, the Treasury considers that a concessionary lease is not comparable to a loan, nor that accounting requirements should be derived from the financial instruments guidance. Rather, the Treasury considers that concessional leases are comparable to grants, and the accounting guidance should be derived from the non-exchange revenue guidance.

As we noted under Specific Matter for Comment 1, the Treasury considers also that a differentiation is necessary when a ‘leasing’ entity has limited right to direct the use of an asset. Many concessionary leases would fall into this category.

Consider for example a local council wishing to promote sport, providing land for a tennis club, so long as the club maintains tennis courts on it. It is firstly not clear whether this is a lease as the club may not have the right-to-direct use, and secondly it is not clear that there is in fact a concession, given the maintenance obligations the club accepts for use of the owner’s property. Given the ubiquity of such arrangements in the public sector, clarity is needed from this proposed standard.

The Treasury is also concerned about the measurement of a concession. The standard describes concessionary leases as leases below market terms, and a non-exchange component of concessionary loans. The difficulty is that in the public sector concessionary leases are generally concessional for a reason. Often the leased asset will be a non-cash generating asset and there will be little or no 'market' for it. In the previous example of land leased only for tennis courts, the market value of nearby unencumbered land leases cannot be used as a market value for such encumbered rights.

Where the service potential the asset provides is better realised if it is used by the lessee than the lessor, and that service potential is in the nature of a public good, then we submit the 'market' is an unreliable basis for any concession to be determined.

An illustration of measurement difficulty in applying the proposed standard is demonstrated in the current 'market' of European cities seeking to host regulatory agencies that have been located in the United Kingdom as a consequence of Brexit. A lease that is won in this competition would thus appear to be at market terms, even if significantly concessional compared to similar other accommodations in the same city. Paragraph 15 of the proposed ED does not provide sufficient guidance to provide consistent, comparable accounting judgements for such leases.

As a consequence of these concerns, the Treasury proposes that concessionary leases be removed from this standard, and incorporated in the forthcoming guidance on non-exchange expenses and (exchange and non-exchange) revenue.