Ref. Ares(2021)3481508 - 26/05/2021

EUROPEAN COMMISSION
BUDGET

The Accounting Officer of the Commission

Brussels
BUDG.DGA1/RAB

Subject: **Comment letter on Exposure Draft 75 'Leases'/ Response to Request for Information 'Concessionary Leases and Other Arrangements Similar to Leases'**

Dear Mr Carruthers,

I welcome the opportunity to comment on the above mentioned Exposure Draft 75 'Leases' ('ED'), and to provide you with our response to the Request for Information 'Concessionary Leases and Other Arrangements Similar to Leases'.

The comments are made in my capacity as the Accounting Officer of the European Commission as well as more than 20 other EU entities (see list in Annex 1).

I am responsible for, amongst other tasks, the preparation of the consolidated annual accounts of the European Union ('EU'), which comprise more than 50 European institutions, agencies and European bodies with an annual budget of more than EUR 140 billion, as well as the adoption of the accounting rules applicable by entities preparing annual accounts in the EU context (the 'EU Accounting Rules')[1].

According to the Financial Regulation applicable to the general budget of the Union, the EU Accounting Rules applied to prepare the EU consolidated annual accounts, as well as the separate annual accounts of the consolidated entities, should be based on internationally accepted accounting standards for the public sector, i. e. the IPSAS.

I am pleased to provide you with my comments with the aim of improving the transparency, relevance and comparability of the financial statements across jurisdictions.

I generally support the IPSASB's approach to the convergence of public sector accounting standards with International Financial Reporting Standards ('the IFRS') applied in the private sector, whenever the nature of the transaction is economically similar, and any public sector specific issue is addressed separately.

[1] For the sake of clarity, the views presented in this comment letter do not represent the views of the EU Member States, or the views of the European Public Sector Accounting Standards ('EPSAS') Team, and are without prejudice to future decisions which may be taken in the context of the EPSAS project.

Mr Ian Carruthers
Chairman
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I thus agree with the proposed approach to develop a Standard aligned with IFRS 16 as well as the proposed punctual modifications in order to adjust it to the specific requirements of the public sector. Please find or comments on the questions raised in the Exposure Draft in Annex 2.

As regards the Request for Information 'Concessionary Leases and Other Arrangements Similar to Leases', I am pleased to provide you with the most prevalent fact patterns we have identified after liaising with EU Institutions and EU Agencies (see Annex 3). We hope that our contribution will support you in Phase II of the leases project.

If you would like to discuss our comments further, please do not hesitate to contact me.

[e-signed]

Rosa ALDEA BUSQUETS

Enclosure:	Annex 1: List of entities supporting the comment letter Annex 2: Response to the questions raised in the ED Annex 3: Responses to Request for Information
c.c.:	Nicole Smith, Director BUDG C, Derek Dunphy, Lars Ruberg, Vyara Ivanova, BUDG C2

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Annex 1 – List of entities supporting comment letter

Entities under the responsibility of the Accounting Officer of the European Commission

European Institutions
European External Action Service
European Data Protection Supervisor
European Agencies
Agency for the Cooperation of Energy Regulators (ACER)
European Union Agency for Law Enforcement Training (CEPOL)
Body of European Regulators for Electronic Communications (BEREC Office)
European Institute for Gender Equality (EIGE)
European Agency for Safety and Health at Work (EU-OSHA)
European Global Navigation Satellite Systems Agency (GSA)
European Joint Undertakings
Bio-based Industries Joint Undertaking (BBI-JU)
Shift2Rail Joint Undertaking (Shift2Rail JU)
Fuel Cells and Hydrogen Joint Undertaking (FCH JU)
Single European Sky ATM Research Joint Undertaking (SESAR JU)
Innovative Medicines Initiative Joint Undertaking (IMI JU)
Electronic Components and Systems for European Leadership Joint Undertaking (ECSEL JU)
The European High Performance Computing Joint Undertaking (EuroHPC)
EU Trust Funds
EU Emergency Trust Fund for Africa (EUTF Africa)
EU Trust Fund Bêkou for the Central African Republic (EUTF Bêkou)
EU Trust Fund for Colombia (EUTF Colombia)
EU Regional Trust Fund in Response to the Syrian crisis (EUTF Madad)
Other entities
European Development Fund
European Institute of Innovation & Technology (EIT)

Request for Information: Concessionary Leases and Other Arrangements Similar to Leases

Entity: European Union

Question 1: Concessionary Leases

In your jurisdiction, do you have concessionary leases (or similar arrangements) as described in this RFI? If yes, please:

(a) Describe the nature of these leases (or similar arrangements) and their concessionary characteristics; and

(b) Describe the accounting treatment applied by both parties to the arrangement to these types of leases (or similar arrangements), including whether the value of the concession is reflected in the financial statements.

Answer:

Introductory comment

We understand the Request for Information distinguishes between two types of leases entered into by an entity at below-market terms: concessionary leases (or similar arrangements), which are addressed by Question 1, and leases (or similar arrangements) at zero or nominal consideration, which are addressed by Question 2. From our point of view, the latter group can be understood as a specific subset of concessionary leases, where the exchange component of the lease has been reduced to a negligible amount or even to zero.

Although both types of leases (or similar arrangements) are prevalent in the European Union, the most widespread fact pattern are leases (or similar arrangements) at a nominal or zero consideration, usually entered by an EU entity as the lessee and the respective host state as the lessor.

We note that the EU Accounting Rules, which are based on IPSAS, do not differentiate between concessionary leases (or similar arrangements) and leases (or similar arrangements) at zero or nominal consideration. This is because we think that the accounting treatment should not depend on the absolute amount or the relative size of the the non-exchange component as compared to the exchange component.

(a) Concessionary leases (or similar arrangements): most typical fact patterns

The most typical fact pattern of a concessionary lease (or similar arrangement) with a non-negligible non-exchange component can be summarised as follows:

- An EU entity, usually an EU Agency (the lessee), enters into a lease arrangement with the respective host state (the lessor) establishing the right to use a specific building as its headquarters (e.g. 40%).
- The parties agree that the host state will cover a part of the rental fees. Accordingly, the lease arrangement specifies the total annual rent, as well as the annual payment obligations of the EU entity (40 % of the total annual rent) and the Host State (60% of the total annual rent).
- The total annual rent may or may not be indexed (e.g. based on the alteration of the monthly Consumer Price Indexed published by the respective national statistics office).
- The lease arrangement does not foresee that the legal title passes to the EU entity

A variation of this fact pattern are cases where the first part of the agreed lease term is at a nominal or zero rent, and the remaining part of the agreed lease term is at a reduced rent (e.g. 25% of the estimated market rent).

(b) Accountin treatment based on the interpretation of EU Accounting Rules 'Non-exchange transactions: goods and services in-kind'

The accounting treatment for concessionary leases (or similar arrangements) follows the *interpretation of EU Accounting Rules 'Non-exchange transactions: goods and services in-kind'. This interpretation addresses the most typical fact patterns prevalent in the European Union as follows.*

1. *Accounting for the use of office space in non-exchange transactions:*

    - *The EU entity (lessee) applies the criteria in EU Accounting Rule 8 'Leases' (the equivalent of IPSAS 13 'Leases') to determine whether the lease arrangement constitutes an operating lease or a finance lease.*
    - *If it is determined that the lease arrangement constitutes an operating lease, the non-exchange component is considered a service-in-kind in the meaning of EAR 17 'Revenue from Non-Exchange Transactions (Taxes and Transfers)', the equivalent of IPSAS 23 'Revenue from Non-Exchange Transactions (Taxes and Transfers)'). A non-recognition approach is followed, by which no accounting entry for the non-exchange component is done, but disclosure of the nature of the non-exchange transaction in the notes to the financial statements is required (if they can be reliably measured).*
    - *If it is determined that the lease arrangement constitutes a finance lease the non-exchange component is considered a good-in-kind in the meaning of EAR 17. An asset is recognised at the lower of fair value and net present value of the lease payments at arm's length, with the credit entry consisting of the lease liability (determined as the net present value of future lease payments) and the non-exchange component. The non-exchange component is recognised as revenue at commencement of the lease or to the extent and in the periods where the conditions attached are met.*

2. *Accounting for buildings in non-exchange transactions:*

    - *The accounting treatment of buildings in non-exchange transactions depends on if the legal ownership and/or the economic ownership has been transferred to the EU entity, or not.*
    - *If the legal title has passed to the EU entity, the transaction falls in the scope of EAR 7 'Tangible fixed assets' (equivalent of IPSAS 17 'Property, Plant and Equipment'). The asset is recognised at cost for the exchange component and at fair value for the non-exchange component, with the fair value normally equalling the transaction price (market price) of the building. The non-exchange component is recognised as revenue in the period of acquisition or, in the case of conditions attached, to the extent and in the periods where the EU entity fulfils its performance obligations.*
    - *If the legal title has not passed to the EU entity, the transaction falls in the scope of EAR 8 'Leases'. Consequently, it needs to be assessed whether or not the economic ownership lies with the EU entity. In case the EU entity is the economic owner of the asset, the accounting treatment for goods in-kind described in section 1. above applies (finance lease). In case the lessor retains the economic ownership, the accounting treatment for services in-kind described in section 1. above applies (operating lease).*

Based on the above accounting principles, it is determined that the the lease arrangements (base case and variation) fall in the scope of EAR 8 leases and constitute an operate leasing. Accordingly, the value of the concession is not recognised in the financial statements, but disclosed as a service in-kind.

Question 2: Leases for Zero or Nominal Consideration

In your jurisdiction, do you have leases for zero or nominal consideration as described in this RFI? If yes, please:

(a) Describe the nature and characteristics of this type of lease (or similar arrangement); and

(b) Describe if and how the value of the concession is reflected in the financial statements of both parties to the arrangement.

Answer:

Introductory comment

As already pointed out above, the EU Accounting Rules do not differentiate between concessionary leases (or similar arrangements) and leases (or similar arrangements) where the non-exchange component of the lease has been reduced to a negligible amount or even to zero. For a detailed description of the applicable accounting principles, as laid out in the interpretation 'Non-exchange *transactions: goods and services in-kind', please refer to our answer to Question 1 of the RFI.*

(a) Leases (or similar arrangements) for zero or nominal consideration

The most typical fact patterns of leases (or similar arrangements) at zero or nominal consideration comprise the following cases:

Group 1: Free rent (with or without free building services)

The most typical fact pattern of leases (or similar arrangements) for zero or nominal consideration are cases in which an EU entity, usually an EU Agency (the lessee), enters into a lease arrangement with the respective host state (the lessor) establishing the right to use a specific building as its headquarters for free. Some leases (or similar arrangements) may also include the free provision of services such as utilities, maintenance and security.

Group 2: Donation of a piece of land, including the legal title, with conditions

In specific cases a host state may donate a piece of land, including the legal title, to an EU entity, subject to the condition that the EU entity constructs its headquarter building on that piece of land within a specific timeframe, and actually uses the building for that purpose. If any of these conditions is not met, the EU entity is obliged to return the piece of land, including the legal title, to the host state for free, with the value of the building constructed by the EU entity reimbursed by the host state.

Group 3: Historical objects

In some cases an EU entities enter into arrangements establishing the right to temporarily or indefinitely exhibit historical objects without any consideration, with the cost of transportation, installation, insurance and safeguarding borne by the EU entity.

(b) Accounting treatment

Group 1: Free rent (with or without free building services)

The accounting treatment of these cases is the same as for concessionary leases (or similar arrangements), i.e. the value of the concession is not recognised in the financial statements, but disclosed as a service in-kind (see our answer to Question 1).

Group 2: Donation of a piece of land, including the legal title, with conditions

The fact pattern is specifically addressed in the following section of the interpretation 'Non-exchange transactions: goods and services in-kind':

> *Accounting for land in non-exchange transactions*

- *For arrangements conveying the use of land to EU entities, the same principles as for buildings apply. However, as land normally has an indefinite economic life, such arrangements typically qualify as operating leases, unless the legal title is expected to pass to the EU entity by the end of the lease term.*
- *Another type of transaction which qualifies as an operating lease is when a host state donates a piece of land, including its legal title, to an EU entity, but restricts the rights of the EU entity in such a way that the economic ownership remains with the host state. An example of such a restriction is an obligation to resell the leased land for a nominal amount to the host state when the EU Entity abandons the site. As the transaction takes on, in substance, the form of an operating lease or service in-kind, the accounting treatment in section 1. above applies (i.e. no accounting entry for the non-exchange component, but disclosure of the nature of the non-exchange transaction in the notes to the financial statements).*

In line with these principles, it is concluded that the EU entity's obligation to transfer the piece of land, including the legal title, to the host state in case the conditions included in the arrangement are not met results in the economic ownership of the piece of land remaining with the host state. Accordingly, the transaction takes on, in substance, the form of a service in-kind, with no accounting entry being made for the non-exchange component, which is only being disclosed.

Group 3: Historical objects

In line with the interpretation 'Non-exchange transactions: goods and services in-kind', the value of the concession is not recognised in the annual accounts. A disclosure as service in-kind is made

unless the value of the concession is not material (which is usually the case).
Question 3: Access Rights (or Rights of Access to Property and/or Land) Does your jurisdiction have arrangements that provide access rights for a period of time in exchange for consideration? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.
Answer (please fill in or designate as 'n.a.') *N/A*
Question 4: Arrangements Allowing Right-of-Use In your jurisdiction, do you have arrangements with the same or similar characteristics to the one identified above? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.
N/A
Question 5: Social Housing Rental Arrangements In your jurisdiction, do you have arrangements involving social housing with lease-type clauses or other types of lease-like arrangements with no end terms? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of the social housing provider.
Answer (please fill in or designate as 'n.a.'): *N/A*
Question 6: Shared Properties with or without a Lease-Arrangement in Place In your jurisdiction, do you have arrangements involving the sharing of properties without a formal lease contract? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.
Answer (please fill in or designate as 'n.a.'): *N/A*
Question 7: Other Arrangements Similar to Leases In your jurisdiction, do you have other types of arrangements similar to leases not mentioned in this RFI? If so, please describe the characteristics of these arrangements and how they are presently being reflected in the financial statements of both parties to the arrangement.
Answer (please fill in or designate as 'n.a.'): *N/A*