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The International Public Sector Accounting Standards Board

277 Wellington St. West
Toronto, ON
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Submission via website

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Dear Ross

COMMENTS ON REQUEST FOR INFORMATION *CONCESSIONARY LEASES AND OTHER ARRANGEMENTS SIMILAR TO LEASES*

We welcome the opportunity to provide comments on the Request for Information *Concessionary Leases and Other Arrangements Similar to Leases.*

We issued the Request for Information and Exposure Draft 75 for comment in our jurisdiction. We arranged a series of education sessions (three) and roundtable discussions (five) to solicit views from preparers, auditors, technical experts, academics, consultants, professional bodies, and users. The comments outlined in this response have been developed by the Secretariat of the ASB and not the Board.

We agree that an IFRS-aligned IPSAS should be developed, however, we do not support the phased approach dealing with IFRS 16-aligned requirements and public sector specific arrangements separately. We are concerned that finalising the IFRS 16-aligned IPSAS, without any guidance on public sector specific lease arrangements will not be beneficial to preparers as they will need to consider significant amendments to that IPSAS after implementing the IFRS 16-aligned requirements.

We suggest that the IPSASB does not rush the process to implement IFRS 16 in the public sector but considers issuing a final IPSAS with public sector specific requirements once Phase Two is complete.

Our response to the Request for Information is set out in Annexure A – Responses to specific matters for comment.

Our comments on the Exposure Draft 75 are provided separately.

If you have any questions regarding our responses, please feel free to contact me.

Yours sincerely

Jeanine Poggiolini

Technical Director

ANNEXURE A – RESPONSES TO SPECIFIC MATTERS FOR COMMENT

Question 1: **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.**

Leases at below market terms are common in our jurisdiction. There is no clear definition or distinction between leases that are considered concessionary and those at zero or nominal consideration. Some stakeholders indicated that they would classify leases at below market terms when the leases are negotiated outside of the normal supply chain processes. As there is currently no specific guidance to distinguish concessionary leases from leases at zero or nominal consideration, there is uncertainty about whether such leases are in substance a lease as defined in ED 75.

Examples include:

- Nature of leases: Leases of office buildings, buildings used by defence, police stations use of community assets for recreational, educational, cultural activities; sports facilities, rental spaces (land).
- Lease term: no term or termination date, month-to-month, 1 to 100 years.
- Consideration: below the market – zero, R1, or other nominal amount per month/annum, no fixed escalation clauses.

Accounting treatment

Our stakeholders shared the following possible accounting treatments which demonstrate the divergence in practice:

Lessee accounting	**Lessor accounting**
<u>Account for the concession applying IPSAS 23 principles</u> Recognise the lease expense based on the market-related rent. The difference between the consideration and the market-related lease expense is recognised as revenue (concession/subsidy). This accounting can also be applied when no consideration is payable. In other instances, a right-of-use asset is recognised in accordance with IPSAS 23. This	<u>Account for the concession applying IPSAS 23 principles</u> Recognise the lease income based on the market-related rent. The difference between the consideration and the market-related lease income is recognised as an expense (benefit granted).

is explained in detail in our response to Question 4 below.	
<u>Do not account for the concession</u> Recognise the lease expense based on the consideration payable and no concession is recognised as there is no guidance in IPSAS 13.	<u>Do not account for the concession</u> Recognise the lease income based on the consideration receivable and no concession is recognised as there is no guidance in IPSAS 13.
<u>Do not account for the lease</u> When no consideration is payable, nothing is recorded or disclosed in the financial statements.	<u>Do not account for the lease</u> When no consideration is receivable, nothing is recorded or disclosed in the financial statements.

Challenges

The following challenges were shared:

No active market: Depending on the nature of the leased asset, there may be difficulties determining market-related rental where there is no active market for that asset. In such cases, professional valuers are involved to assist with determining the market-related rates of “similar” assets.

Contract management: Some arrangements have no contracts or in some cases contract management is poor and there is no way to keep track of lease terms or payment of the consideration. In other cases, there are contracts however the term of the lease is unclear.

Question 2:

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.

See response to Question 1.

Question 3:

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.

In our jurisdiction, property owners may grant rights to entities or other individuals to use a property for certain purposes, such as the right of access to the property, or to construct assets on/over the property (i.e., servitudes). Examples provided included access to land and dams.

Accounting treatment

We received questions on the accounting treatment of servitudes in our jurisdiction which led us to provide guidance in a Frequently Asked Question issued by the ASB staff to explain the accounting treatment. The FAQ states that, depending on how the servitudes were acquired, there may or may not be consideration payable and GRAP 31 on *Intangible Assets*[1] may or may not be applied:

- If acquired through legislation, the property owner does not receive compensation. No intangible asset is recognised as legal rights granted by statute do not meet the identifiability criterion and such rights are scoped out of GRAP 31 (see IPSAS 31 (paragraph .03(g)).
- If acquired through a binding arrangement, the property owner receives compensation. The rights meet the identifiability criterion, and if material, an intangible asset is recognised at cost (i.e., the compensation and any other directly attributable costs).

Entities should apply judgement to determine whether the servitude is recognised as a separate intangible or included in the cost of a tangible asset.
Since issuing the FAQ, there has been uniformity in the accounting of servitudes in our jurisdiction.

Question 4:

In your jurisdiction, do you have arrangements allowing right-of-use 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.

Stakeholders shared examples of the lease of a convention centre for a nominal amount over a period of 20 years, and the lease of a stadium for R100 per annum for a period of 49 years. The consideration paid for the lease period is significantly less than the fair value of the properties being leased.

Accounting treatment

In accordance with IPSAS 23, the entity that leases the property recognises a free/concessionary use of the premises as a “right-of-use” asset in its financial statements, measured at fair value The fair value is calculated by reference to present value of the market lease payments for other properties with similar characteristics, in similar circumstances and location.

[1] Our Standard of GRAP on *Intangible Assets* is the equivalent of IPSAS 31.

- The “right-of-use” asset is the services-in-kind received by the entity i.e., the free/concessionary use of the property. The fair value of the “right-of-use” assets for the fee/concessionary use of the premises is not the same as the fair value of the underlying property.
- A non-exchange revenue (i.e., services-in-kind) is recognised as the corresponding entry.
- The “right-of-use” represents the benefit received for the lease term.

The entity that owns the properties would recognise the market-related rental income and recognise an expense for the benefit granted to the entity using the properties.

Challenges

The following challenges were shared:

No active market: There may be difficulties in determining a market-related rental where there is no active market for the property. In such cases, professional valuers are involved to assist with determining market-related rates of “similar” assets.

Discount rates: As the fair value of the “right-of-use” asset is based on the present value of the market-related rent, determining an appropriate discount rate is difficult.

Tax implications: Because of recognising revenue for the services received in-kind, questions have been raised about whether taxes should be paid on the revenue.

Impairment: Assessing impairment of the “right-of-use” asset is challenging as it is unclear what triggers the assessment of impairment. For example, it was questioned whether the fluctuations in the market rates would be an indicator to assess impairment.

Question 5:

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.

An example is:

- The provision of social housing to communities at no consideration or nominal amount with no specific lease term or termination date.

Due to poor contract management, stakeholders noted that it is difficult to keep track of lease terms or payments. For some entities, the arrangements are on a month-to-month basis.

Accounting treatment

The accounting for these arrangements varies from entity to entity, and materiality is considered. Stakeholders indicated that any of the accounting treatments provided in our response to Question 1 could apply. However, most stakeholders indicated that the arrangement is not usually reflected in the financial statements, and the lease income is recognised at the nominal consideration, if payable.

Question 6:

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.

We are aware of arrangements involving the sharing of properties and/or provision of accommodation between related parties for zero or nominal consideration. The accounting varies, and could include any of the accounting treatments provided in our response to Question 1. It is common for any of the arrangements discussed in the RFI to not have a formal lease agreement in place. In our jurisdiction, the lack of contracts is due to the arrangements being historical arrangements and/or poor contract management as explained in our earlier responses. In the absence of lease contracts, entities account for such arrangements based on past history or on a month-to-month basis.

Question 7:

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.

No information was provided about other types of arrangements.