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Mr John Stanford
Technical Director
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International Federation of Accountants
277 Wellington Street West
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CANADA
Submitted to: www.ifac.org

Dear John

Exposure Draft 64 *Leases*

We appreciate the opportunity to comment on the Exposure Draft 64 *Leases*.

Our responses to the IPSASB's Specific Matters for Comment are attached.

If you have any questions about our submission, please phone Sara Moonlight, Director, Accounting Policy on +64 21 244 0545 or email her at Sara.Moonlight@oag.govt.nz.

Yours sincerely

Greg Schollum
Deputy Controller and Auditor-General

Appendix 1: Responses to the Specific Matters for Comment in Exposure Draft 64:

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. We agree that the right-of-use asset and the lease liability meet the definition of, and the recognition criteria for, an asset and a liability respectively in the IPSASB's Conceptual Framework.

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.**

No, we do not agree with the IPSASB's decision to depart from the IFRS 16 risks and rewards model for lessor accounting. We disagree with the IPSASB's arguments regarding consistency with the Conceptual Framework, and we disagree that the proposals are an improvement on IFRS 16.

We believe there needs to be a persuasive reason to depart from IFRS 16, and, in our opinion, the IPSASB has not provided a persuasive reason. For example, the IPSASB presents arguments in paragraph BC10 surrounding consolidation issues. We do not consider the arguments to be that different in the public sector compared to the private sector, to warrant a departure from IFRS 16.

We are not convinced that consistency in accounting treatment between two parties to a lease is a reason for departing from IFRS 16. There should be no difference in the accounting treatment for the same lease entered into by a private sector lessor and public sector lessor.

Using a different lessor accounting model compared to the private sector is likely to be confusing to users of financial statements, particularly where users attempt to compare lease information between the public and private sectors.

Further, the right of use model does not necessarily resolve consolidation issues as the lease balances between the lessee and lessor in a mixed group context may not be the same. For example, the lessee and lessor may recognise different amounts for initial direct costs, different discount rates may be used in discounting the cash flows (lessor may use the rate implicit in the lease agreement as it has the information to do this, but lessee uses its incremental borrowing rate as it cannot determine the rate implicit in the lease), or different assumptions around lease terms, termination rights.

We also note that there is likely to be significant effort required by entities that are part of mixed groups if the ED 64 approach proceeds. We are aware of examples of airports that are profit oriented entities, which are majority owned by local government entities, and have significant numbers of leases. These airports would be required to maintain two sets of accounting records to be able to do the lease accounting required by ED 64.

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?**

No, we do not agree with the IPSASB's decision to propose a single right-of-use model for lessor accounting consistent with lessee accounting. If the ED 64 approach was to be taken specific guidance needs to be provided to eliminate the possibility of a double-counting issue, i.e. plant, property & equipment asset plus a lease receivable right-of-use asset.

We are unclear how a lessor who has transferred the right to use the underlying asset to the lessee for the term of the lease controls the asset for accounting purposes during the term of the lease.

Currently it is unclear how the fair value of a leased asset is affected, if this is how the asset is valued in the financial statements. Fair value may be based on rental inflows but may also be based on comparable sales method (such as for residential properties that are leased). Specific guidance on dealing with this issue is needed, both for plant, property & equipment and investment property. There is some double counting guidance in IPSAS 16, there is none in IPSAS 17. The guidance in IPSAS 16 is not sufficient.

Conceptually, there are good arguments for the transaction to be accounted for by the deconsolidation method, where the value of the asset is split between a receivable and the asset itself. However, we note that this approach was not adopted in IFRS 16 or proposed in ED 64. In our view, the approach in IFRS 16 is closer to the conceptual position than the approach in ED 64.

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?

We are pleased the IPSASB is looking to address the accounting for concessionary leases, as it is not covered by an existing IPSAS. Consequently, there is diversity in practice in this challenging area of accounting.

However, we do not agree with the IPSASB's proposal that lessors measure concessionary leases at fair value, and that lessors recognise the subsidy granted to lessees as a day-one expense and recognise an increased amount of revenue over the lease term consistent with concessionary loans.

We are strongly of the view that an accounting model for concessionary leases should focus on the financial performance of the lessor, rather than one that focuses on the balance sheet. We consider the most meaningful accounting is where the subsidy provided by the lessor is recognised over the term of the lease. If it is recognised on day one, the on-going subsidy is not reflected in subsequent reporting periods, and therefore the substance of the transaction is not reflected.

Further, we think the expense/revenue recognition for the subsidy component should be broadly comparable between the lessee and lessor. ED 64 does not achieve this.

We strongly disagree with the expense recognition accounting being based on that of concessionary loans in IPSAS 29 as they are different transactions. The up-front expense that arises on a concessionary loan is very much linked to the derecognition of cash.

It is likely to be complex to estimate a fair value for long-term concessionary leases where the lessee is fulfilling the lessor's purpose, and if the assets have restricted use. It would be more practicable to determine fair value each year, particularly in the case of an indefinite lease period. In either case, guidance needs to be provided on how to determine fair value, such as that provided by IPSAS 29 for concessionary loans and guarantees.

5. Other comments

1. We note that ED 64 defines leases in such a way that no or nominal leases are not within its scope. This could result in inconsistent accounting between no or nominal leases and other concessionary leases. The discussion in paragraphs BC 20-23 is not persuasive about why no or nominal leases have been scoped out. We recommend that all leases are dealt with within the scope of the leases standard.

2. Further, there is no definition of the terms **nominal** or **consideration**, which may lead to inconsistent interpretation.