

29 June 2018

Ian Carruthers, Chair
International Public Sector Accounting Standards Board

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Dear Ian

SUBMISSION ON IPSASB ED 64 *LEASES*

Thank you for the opportunity to comment on the exposure draft relating to accounting for leases and disclosing them in the financial statements. Wellington City Council (the Council) is pleased to provide comments on this exposure draft.

The proposals have significant potential impacts for the Council, in particular the sections on concessionary leases. Our specific comments are outlined in the attached appendix 1.

If you would like further clarification on the issues raised in our submissions please don't hesitate to contact me.

Yours sincerely



Richard Marshall
Manager Financial Accounting & Transactional Services
Wellington City Council

Appendix 1. Wellington City Council's comments on IPSASB ED 64 leases

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.

Accounting for leases – right of use asset for lessees

In principle the concept of having a right of use asset from a lessee point of view makes sense. By entering into the lease arrangement the lessee has the right to use an asset over a period of time in return for lease payments. The liability represents the present value of the lease payments and in our opinion presents the readers of the accounts with useful information.

We are of the opinion that the right to use assets should be presented separately to other assets in the notes to the financial statements to distinguish them from normal purchased assets.

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.

Accounting for leases – right of use asset for lessors

We are supportive of using the right of use model for lessor accounting so it is consistent with the treatment for lessees.

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?

Accounting for leases – departure from IFRS 16 for lessor accounting

We support the departure from IFRS 16 which means that the lessor and lessee accounting are done on a consistent basis using the right of use model. We believe that it would be confusing for readers of the accounts to have two entities accounting for the lease in different ways and it would also make consolidation between groups of public sector entities unnecessarily complicated.

Specific Matter for Comment 4:

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognise 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 recognise revenue in accordance with IPSASB 23 (see paragraphs BC112-BC114 for IPSASB's reasons). Do you agree with the requirements for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Accounting for leases – concessionary leases

The accounting for concessionary lease in the ED requires the lease to be measured at market value in order to separate out the exchange and non-exchange portions of the lease. While in principle this would seem like a good idea, in practice it could be a complicated and expensive process, especially if there are lots of leases involved, as it would likely require the expertise of external valuers. For the Council in particular we have many of these types of leases to community groups and not for profit organisations but the values of the lease payments are usually small. These leases often involve heritage assets, limited or restricted use assets or restricted land and are often to non-commercial organisations. We will certainly be looking to work with our auditors to determine whether any of these leases are material enough (individually or in aggregate) to warrant the additional time and cost of calculating the market value.

We also feel that any non-exchange portion i.e. the subsidy should be spread over the term of the lease and not recognised on the commencement of the lease. This is because in substance by entering into a lease at below market terms the Council is agreeing to provide an annual “subsidy” to the lessee. This means that we can recognise, on an annual basis, the value that we provide to these community organisations. Recognition on commencement of the lease results in the potential for large year on year fluctuations in the statement of financial performance which are non-cash in nature and we believe this would be difficult for readers of the accounts to understand.

It is also noted that there is no clarification between what is nominal and what is below market value to trigger whether the lease would be recognised under this proposed standard.

General comment

While Council agrees with the proposed direction of this standard in regards to Accounting for leases – right of use asset, it has concerns with the proposed accounting treatment for concessionary leases. Apart from the difficulty of obtaining the market valuations for such leases, the impact of recognising the non-cash difference between market value of the lease and actual lease value which may result in potentially inflating the expenditure of public sector entities such as Councils. This may have an unintended consequence on the social outcomes that they are trying to achieve. For instance local authorities in New Zealand are governed by the Local Government Act 2002, which under section 100 “Balanced Budget” requirement states:

“A local authority must ensure that each year’s projected operating revenues are set at a level sufficient to meet that year’s projected operating expenses.”

While local authorities can resolve to operate outside of that requirement, over time they may come under pressure to adhere to it. Thus loading an additional cash burden on local communities through increases in rates or other revenues to fund the shortfall created by a non cash theoretical recognition of the difference and thereby potentially undermine the social outcomes they are trying to achieve. For example, a sporting club that isn’t being charged a “peppercorn” rental but an amount below market value to help achieve a social outcome of “healthier communities” would incur for that Council an increase in expenditure whereas a Council that doesn’t have the same social outcome, charges market rates to the same type of sporting club will result in higher revenue.

