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International Public Sector Accounting Standards Board
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CANADA

Submitted to: www.ipsasb.org

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

We appreciate the opportunity to provide comments to the International Public Sector Accounting Standards Board on the *Request for Information – Concessionary Leases and Other Arrangements Similar to Leases*.

Our responses to the questions contained in the Request for Information (the RFI) are contained in the appendix to this letter.

Our comments in this submission are in the context of the New Zealand Public Sector. Note that this is not an exhaustive list of these types of arrangements within our jurisdiction. If you would like more information on any additional arrangements, please let us know. We will be happy to provide any further information you may require.

If you would like to discuss our comments, please phone me on +64 21 222 6107 or email me at robert.cox@auditnz.parliament.nz. Alternatively, you may contact Brett Story on +64 21 222 6247 or at brett.story@auditnz.parliament.nz.

Yours sincerely,



Robert Cox
Director and Head of Accounting

Appendix 1: Our responses to the questions for respondents

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.

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.

Response:

We have combined our responses to questions 1 and 2 as both types of leases are on below market terms. We would prefer that all below market leases, including those with no or nominal consideration, are referred to as concessionary leases. Separating concessionary leases into a no or nominal consideration category could be problematic as assessing whether consideration is 'nominal' may require significant judgement.

Leases on below market terms are prevalent in the New Zealand Public Sector, particularly for property related leases of land and buildings.

There is diversity in practice on how entities account for such leases.

For lessees, we have observed the following accounting treatments for the concessionary component of a concessionary lease:

1. No accounting. This accounting is on the basis that there is no prescribed treatment for concessionary leases.
2. Record the annual value of the concession received during the financial year. This results in an annual rental expense and associated lease concession grant recorded each year with no items recorded in the balance sheet. This accounting is on the basis it reflects the principles of IPSAS 17 for operating leases of recording the use of property, and that recording nothing in the financial statements would be neither relevant nor reliable for users.
3. Record the concession over the lease term at fair value at inception of the lease as an intangible asset. The deferred credit entry is released to revenue over the lease term. This accounting is on the basis of applying IPSAS 31 *Intangible Assets* and IPSAS 23 *Revenue from Non-exchange Transactions* to the non-exchange component of the lease arrangement.
4. Where the concessionary lease is long term and has transferred the substantive risk and rewards of ownership to the lessee, the lessee recognises the underlying asset as property, plant, and equipment. For example, some long-term concessionary property leases will be assessed as a finance lease. The treatment of a concessionary finance lease is unclear. As the consideration provided is often nominal, the finance lease balances determined under IPSAS 13 are immaterial. In these situations, it can be argued that an entity is essentially being gifted an asset at nominal cost and that this should be accounted for as an asset of the lessee.

For lessors, the primary accounting treatment we observe for the concessionary component is to do no accounting. In some cases, for long term property leases, the lease may be assessed as a finance lease as the substantive risks and rewards of ownership of the asset have transferred to the lessee. The treatment of a concessionary finance lease is unclear.

When a concessionary lease is assessed as a finance lease, the lessor may derecognise the physical asset and recognise a finance asset instead. That would result in an expense to write-down the value of the asset to the value of the lease receivable asset (which could be immaterial). However, in some situations the lessor continues to recognise the property as normal. Such as where it can be argued that the leased properties are being used by the lessee in a manner that helps the lessor achieve its objectives and thus continue to embody service potential and continue to satisfy the criteria for recognition as an asset of the lessor.

Below are some examples of concessionary leases we have observed in the public sector. Social housing related concessionary leases are discussed in question 5.

Non-integrated state schools

In a non-integrated state school, the way land and buildings are conveyed for use by the Board of a school (the Board) is by way of a mandated property occupancy document. The Crown has legal ownership of the land and buildings and does not charge the Board for use of the land and buildings.

The Board is responsible for all operating and maintenance costs associated with the land and buildings, which is funded by the Crown. The Crown bears all the responsibilities for other costs

associated with the land and buildings, including insurance and replacement costs. The property occupancy document provides no timeframes on the period of use of the land and buildings, but it allows the Crown to give the Board three months' written notice to vacate the school premises. Past practice has indicated that the property owned by the Crown reverts to the Crown on closure of a school.

A consistent sector approach has been taken to the accounting for the property occupancy document.

The Board as lessee recognises in its financial statements the annual value of the use of the land and buildings as an occupancy expense and associated government grant revenue.

The land and the Crown's buildings are recognised in the Crown's financial statements (via the Ministry of Education). The Ministry of Education does no accounting in its financial statements for the value of the concession provided to Boards.

Tertiary education institutions

Some tertiary education institutions (TEIs) lease Crown-owned land and buildings from the Crown under long-term lease arrangements (such as 99 years) at a nominal rental of \$1 per year.

There is a policy that:

- The ownership of Crown owned assets managed by TEIs can be transferred to TEIs where there is an ongoing educational need for those assets.
- TEIs can dispose of Crown title assets where these assets no longer meet their needs, with 80% (potentially more) of the net sale proceeds available for TEIs to reinvest in other assets, subject to Ministers approving a business case.

In these arrangements, the TEI is responsible for all costs associated with the use of the land and buildings.

A consistent sector approach has been taken to the accounting for such leases.

TEIs currently account for Crown-owned land and buildings as property, plant, and equipment on their balance sheet as though they own the land and buildings. This is because TEIs consider they have assumed all the normal risks and rewards of ownership of the property despite legal ownership not being transferred, and accordingly it would be misleading to exclude these assets from the financial statements.

Consistent with TEI accounting, the Crown (lessor) has derecognised in its financial statements the Crown-owned land and buildings leased to TEIs.

The accounting by TEIs is different to schools because the land and buildings are largely left to the TEI to manage and maintain, as opposed to the Crown.

Other concessionary leases

There are numerous other concessionary leases of property in the New Zealand Public Sector. The lease arrangements usually are typical property rental agreements, other than the rental charged may be nominal (commonly \$1 per annum, if demanded), and the use of the property may be restricted for a specific purpose. The leases can also span several decades.

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.

Response:

We are not aware of many arrangements that provide access rights for a period of time in exchange for consideration in the New Zealand Public Sector. Most access rights in the public sector are for no consideration, such as local authorities with an easement to access property where its infrastructure assets are located (such as underground pipes). Such easements may be recorded on the property title. These easements are not accounted for. We note that such easements do not reflect a right to use an asset.

We are aware that some local authorities will provide contributions to a community capital project (such as a community recreational centre) and in return secure specified free access rights to the public. In these cases, provided the access rights are sufficiently identifiable, the contribution may be recorded as an intangible asset by the Council. The intangible asset will then be amortised over the term of the identifiable access rights.

Similarly, an organisation may construct a building on another organisation's land with nominal monetary consideration charged for use of the land. However, non-monetary consideration may be provided for use of the land, such as the building owner agreeing to provide the landowner specific access rights to the building. An example is where a local authority builds a recreational facility on school land and the school is provided free access to the building at certain times. Depending on the circumstances, the non-monetary consideration may be viewed as akin to a barter transaction involving dissimilar items that gives rise to revenue under *IPSAS 9 Revenue from Exchange Transactions* paragraph 17.

To obtain access across public conservation land for a business or private property, a member of the public must have a concession from the Department of Conservation (this includes activities such as distributing electricity, telecommunications, water and gas or right of way for vehicles or stock). Upon successful application and a once-off application fee, the applicant will be issued with a contract. There are ongoing annual concession fees, depending on the type of easement. Revenue from these arrangements are recognised when earned.

Question 4:

In your jurisdiction, do you have arrangements with the same or similar characteristics to the one identified above (arrangements allowing right-to-use)?

If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.

Response:

Arrangements of this type do not occur often in the New Zealand Public Sector and tend to be found mostly in the education sector.

Integrated state schools

An integrated state school is usually a former private school, established to provide education with a special character (usually of a religious nature), that has become part of the State system of education through an integration agreement between the Crown (through the Ministry of Education) and the proprietor. Under the deed of agreement, a proprietor remains the legal owner of the land and buildings that are conveyed to the school board as school premises. There is no charge for the use of the proprietor's premises. The proprietor also has the responsibility for all mortgages, insurance and other charges on the land and buildings conveyed. The Crown is responsible for maintaining the school premises and associated facilities. The deed of agreement does not set out any termination or timeframes for use of a proprietor's land and buildings by the school. However, local legislation allows cancellation of the agreement by the Crown, the proprietor or mutual agreement. Cancellation by a proprietor requires four months' notice. There are no timeframes set for cancellation by the Crown or mutual agreement.

Where the proprietor provides the board with land and buildings, the school recognises the use of the land and buildings as an occupancy expense and recognises as grant revenue the provision of the land and buildings used without charge by the proprietor. This accounting is consistent with that explained above in question 1 and 2 for non-integrated state schools.

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.

Response:

The New Zealand government provides subsidised rental housing through the state-owned housing agency, Kāinga Ora. There are also community housing providers in the public and not-for-profit sectors that provide social housing and receive income related rent subsidies from the government.

Some local councils also provide a range of social housing, including pensioner housing, that is separate from central government's subsidised rental housing system.

Kāinga Ora and other community housing providers

The tenancy arrangements do not have end dates (i.e. periodic tenancy) and the tenants occupy the premises for the duration of their housing need. These tenancies can only be terminated in specific instances and 90 days' notice is given by the provider to the tenant. The tenant may give 21 days' notice if they wish to end their tenancy.

Tenants pay an income-related rent (IRR) that is reviewed annually and reflects the tenant's ability to pay. The government subsidises as an income related rent subsidy (IRRS) the difference between the market-related rental and the IRR. The subsidy is paid directly from the government to the housing provider.

The amount reflected as revenue in the financial statements of the housing provider is the IRR plus the IRRS, which overall achieves a market-related rental. The accounting policy is to recognise this on a straight-line basis over the term of the rental.

As Kāinga Ora is consolidated into the Financial Statement of Government of New Zealand (FSG), the IRRS paid to Kāinga Ora is eliminated on consolidation into the FSG. This means at the FSG level, only the IRR received from the tenant is recognised as rental revenue. The FSG does not account for the concessionary element (the IRRS) in the consolidated financial statements.

Local councils

Councils that operate social housing typically charge rental below market (e.g. 70% of market) with only the rent charged from the tenants being recorded in the financial statements. There is no accounting for the concessionary rental.

This rental revenue charged is recognised as revenue on a straight-line basis over the rental term. The lease agreement usually does not include a termination date (i.e. periodic tenancy).

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.

Response:

There are examples in the public sector of entities sharing properties, mainly office space. There are three types of documentation in place:

- Standard lease documentation;
- Documentation as part of a broader shared services agreement; and
- No documentation of the arrangement.

These arrangements would usually relate to entities in the same group for reporting purposes. There is usually a lead agency that is the head lessor of the property.

A shared services agreement or a memorandum of agreement (such as for government agencies who cannot contract with each other) usually sets out a fee for the financial year. It may not set out any term for the period of use of the office space. This fee may be supported by a fee schedule which breaks down the fee charged for each service, including that relating to property. The total fee for the year is accounted for in one general ledger account (e.g. "shared services") and it is not split out per function as contained in the fee schedule. The "lessee" accounts for it under expenditure and the "lessor" under revenue in their financial statements.

When there is no documentation in place, there usually is consideration being paid for use of the office space.

The consideration in the arrangements above are usually on a cost recovery basis.

We are not aware of any arrangements that involve sharing of properties for no consideration.

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.

Response:

We have nothing further to add.