



ACT
Government

Chief Minister, Treasury and
Economic Development

Mr John Stanford
The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017
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Dear Mr Stanford

Exposure Draft 64 Leases

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board (IPSASB) on IPSASB Exposure Draft (ED) 64 – *Leases*.

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee comprises the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

HoTARAC broadly agrees with the approach outlined in this ED as being appropriate for the not-for-profit public sector. However, HoTARAC does not agree with the approach proposed for lessors preferring the derecognition approach over the performance obligation approach.

The attachment to this letter sets out HoTARAC's response to the specific matters for comment, as well as some additional comments on other aspects of the ED. If you have any queries regarding our comments, please contact Peter Gibson from the Commonwealth Department of Finance on: +61 2 6215 3551 or by email to peter.gibson@finance.gov.au.

Yours sincerely

David Nicol
Chair

Heads of Treasuries Accounting and Reporting Advisory Committee

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Specific Matters for Comments

Specific Matters 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.

HoTARAC agrees.

The right-of-use model in IFRS 16 has a number of flaws, and IASB adopted it after exposing, and then rejecting, a number of other models, however, the right-of-use model has now been accepted. It will be beneficial for the accounting by lessees to be consistent across private and public sectors, both in user understanding and in ease of accounting and consolidation in “mixed groups” of for-profit and not-for-profit public sector entities.

HoTARAC supports use of the incremental borrowing rate in all lease calculations, for the reasons given in the Basis for Conclusions.

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.

If the right-of-use model is adopted for lessees, a majority of HoTARAC agrees with applying the same model to lessors.

- The economic substance of a lease is broadly the same for lessors and lessees. Further, IPSASB recognises in the Basis for Conclusions that in the public sector, it is much more common for entities to be lessors as well as lessees for the same assets, and a single model does make consolidation easier.
- Conceptually, it is difficult to reconcile a risks and rewards approach to both the IASB and IPSASB Conceptual Frameworks, which favour a control approach to definition and recognition of assets and liabilities.

A HoTARAC minority disagrees with the proposal to diverge from the risks and rewards approach of IFRS 16. The HoTARAC minority is of the view that lessor accounting should be consistent with IFRS.

Specific Matters 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?

HoTARAC does not agree with the model proposed.

Our view is that the derecognition model is more conceptually sound. A derecognition model should not greatly affect the ability to consolidate, if good accounting records are maintained.

An asset embodies a number of rights, derived from the legal system, physical possession, and the physical nature of the asset. The right to use is one of these rights. Others include the right to sell the asset and the right to pledge the asset as security. In our view, a lease transfers the right to use the asset to the lessee, and the lessor retains only the remaining rights. The right-of-use asset is not a new asset created at the time of the lease.

Specific Matters for Comment 3 - Continued

HoTARAC suggests that IPSASB should reconsider the model for lessors, noting that the derecognition approach has at least two practical flaws:

- It may potentially still lead to confusion among some users with regards to the nature of the asset and its value; and
- It may be practically difficult if the underlying asset is measured at cost, yet the derecognised right-of-use is measured at fair value. The derecognised amount may of itself exceed the cost of the whole underlying asset.

Specific Matters for Comment 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?

HoTARAC agrees in principle with measuring concessionary leases at fair value. This is consistent with recognition of donated assets at fair value under IPSAS 23, and provides the economically soundest measure of the value of the subsidy provided by the lessor to the lessee. HoTARAC agrees that the revenue for the lessee should be measured in accordance with IPSAS 23, because in some circumstances there may be conditions within the lease having the effect that the subsidy is not all earned at the commencement of the lease.

HoTARAC also agrees that leases for no or nominal consideration are in substance grants, and should be accounted for as grants.

However, HoTARAC does not agree that concessionary leases are conceptually equivalent to concessionary loans in all respects. This could result in an argument that the subsidy expense of the lessor should be recognised progressively rather than all on day-one, under conditions existing for some leases. HoTARAC notes that this could be covered by the non-exchange expense standard that is currently work in progress.

Other Comments

Practicality

While HoTARAC broadly supports the approach to accounting for leases, as discussed above, we note that the proposed approach considerably complicates accounting for leases. Practical experience with adopting IFRS 16 indicates a considerable administrative burden for entities with many leases.

Furthermore, determination of fair value for some transactions (particularly concessionary leases) may not be straightforward and thus requiring professional valuation services. This could result in considerable cost for some entities, as acknowledged in the Basis for Conclusions (e.g. BC95).

Cost and effort may be a burden for countries with limited resources, including in situations where they are considering a transition to accrual accounting.

Given that cost/benefit is a standard-setting consideration in the IPSASB Conceptual Framework, HoTARAC asks that IPSASB carefully consider the costs imposed by the various features of the proposed approach, and the benefits derived by users.

Mismatch

HoTARAC's view is that where an entity acts as both lessee and lessor, the proposed standard should allow the entity to adopt an approach that matches the accounting by the lessee and lessor. This would overcome a situation where there otherwise would be an accounting mismatch. A similar option is provided for some financial instruments. This could apply, for example to:

- low value assets (which may be excluded by lessees but not lessors);
- the assumptions about matters such as lease terms and interest rates where the terms; and to conditions of the two leases are different; and
- concessionary leases (where the revenue/expense recognition pattern may be different for lessors and lessees).

In HoTARAC's view this approach would not seriously impair information for users of financial reports.

Sale and Leaseback

HoTARAC agrees with the IPSASB approach to sale and leaseback transactions, subject to our other comments.

Distinguishing Leases

HoTARAC supports the guidance to distinguish leases from asset sales, service agreements and service concessions. In particular, the distinction between leases and service concessions may otherwise be difficult to determine for marginal cases, based on IASB literature.