

Dr Keith Kendall
Chair, Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Dear Dr Kendall

Exposure Draft ED 84 – *Concessionary Leases and Right-of-Use Assets in-Kind*

Response to IPSASB by the Heads of Treasuries' Accounting and Reporting Advisory Committee (HoTARAC)

Please find attached a copy of the HoTARAC submission to the IPSASB on their exposure draft 84. HoTARAC does not support ED 84 for the reasons set out in the attachment, and thus does not support its adoption in Australia. In addition to the reasons given, HoTARAC notes that:

- There is no conceptual reason why the accounting for concessionary leases in Australia should differ between private and public sector not-for-profit entities; and
- The IPSASB proposals may create audit difficulties due to the absence of market-based information as audit evidence, and the degree of judgement required.

HoTARAC retains the view that public sector not-for-profit entities should be permitted to account for right-of-use assets for concessionary leases based on the present value of the actual lease payments.

If you require any further information or explanations, please in the first instance contact me at the Australian Government Department of Finance on peter.gibson@finance.gov.au.

Yours sincerely



Peter Gibson

For the Heads of Treasuries Accounting and Reporting Advisory Committee

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Specific Matter for Comment 1: The IPSASB decided to propose new accounting guidance for lessees and right-of-use assets in-kind. Do you agree with the proposed amendments to IPSAS 43 and IPSAS 23? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

HoTARAC does not support the proposals in ED 84.

1. Arrangements not intended to give a right to use, but simply to provide access for other activities, should be excluded (see paragraph 6 below);
2. The consideration for a concessionary lease may include items other than the lease payments, such as obligations on the lessee to provide services. This is not reflected in the calculation model (see paragraph 7 below);
3. The model is not the most practical method of addressing the disclosure objective (see paragraphs 8-16 below);
4. The impact on key government financial aggregates such as gross/net debt and net financial liabilities is potentially misleading (see paragraphs 17-18 below); and
5. There are a range of technical issues affecting scope, definitions and lease accounting issues that either need revision or clarification (see the Appendix to this submission).

While HoTARAC does not support the proposal overall, it does support those features that make implementation easier, such as exemptions for short-term and low value leases, and considering the leased asset in its current use rather than a higher or better use.

However, if the proposal as exposed does proceed, HoTARAC's view is that existing leases should be "grandfathered" for both lessees and lessors i.e. it should apply to leases entered into after initial application. Retrospective application, particularly for right-of-use assets in kind and embedded leases, would be impracticable.

Right-to-use and access:

6. Concessionary arrangements in the public sector are of two distinct types:
 - i. Those that genuinely convey the right to use an asset, similar to a non-concessionary arrangement; and
 - ii. Those that are structured as leases, but which are only in place to give rights to access for a specific purpose (for instance temporary access to a roadway to enable construction of a hospital) such that the agreement is a mechanism for providing legal access as opposed to conveying a substantive right to use.
 - iii. Arrangements of type ii. should be excluded from these amendments¹.
7. The *de-facto*, but not stated, definition of concessionary leases specifies that the consideration for the lease will be on below-market terms, where consideration may be in a form other than lease payments. For example, a requirement that the lessee provide specified services at its own expense that otherwise might be provided by the lessor or another entity. However, the proposed methods of calculating the right-of-use asset are inconsistent with this because they exclude consideration other than lease payments.

Practicality:

8. HoTARAC agrees that the model proposed is less onerous than requiring the ROU asset to be measured at its market value.
9. Application will be more difficult for more complex arrangements that require judgement. Some of the complexities are set out in this submission. Given the nature of concessionary

¹ This is particularly important for right-of-use assets received in kind, many of which may be embedded in contracts not described as leases.

leases and similar arrangements in the public sector, we believe complex arrangements will be common.

10. Our view is that practical problems in obtaining information for use in the calculations are likely to be enhanced for concessionary leases. At the extreme, a lessee entity may be in a position where all its leases are recorded using only actual lease payments and the entity's incremental cost of borrowing. This will also increase the need for judgement, often for very long periods of time.
11. Our view is that the costs of implementation will exceed the benefits to the users of public sector financial statements:
 - a. We observe that government entities would have to undertake an extensive search for arrangements that may qualify as ROU assets in-kind and undertake analysis to determine whether they should be accounted for under these proposals;
 - b. This will be in addition to the already complex ongoing assessment and accounting for such leases required by IPSAS 43;
 - c. With many such arrangements between public sector entities within the same government, there will be additional workload in eliminating transactions on consolidation, bearing in mind the mismatch between accounting for lessees and lessors;
12. We have a concern whether public-sector entities in jurisdictions with less-developed accounting and information systems capabilities will be able to readily apply the amendments.
13. In Australia, the predominant public sector method of accounting for leases has been to discount actual lease payments to arrive at the amount of the lease liability and the ROU asset. This has been in place for several years and there has been commentary that government financial statements are deficient.

HoTARAC's view is that IPSASB should implement an alternative proposal that is simpler to apply, but continues to achieve the core of the disclosure objectives of IPSAS's 23 and 43:

14. Address issues 1 and 2 above;
15. Apply the cost method to the initial calculation of both the lease liability and the right-of-use asset, by discounting the actual lease payments²; and
16. Require descriptive disclosure of resources significant to entity operations that are provided by other parties through leases and similar arrangements at below market rates.

Impact on financial aggregates

17. Lease liabilities are normally regarded as financial liabilities of a lessee, and hence add to the levels of reported gross/net debt and net financial liabilities, which are key indicators of government financial position. The proposed model will result in a lease liability in excess of the actual lease payments, and thus present a misleading picture to users about a government's financial obligations. This will be particularly pronounced for ROU assets in kind.
18. There may be a similar effect on net debt for governments as lessors, where a lease receivable, unless impaired, would not reflect the amount actually receivable.³

Specific Matter for Comment 2 – for lessors, the IPSASB decided to propose accounting for leases at below-market terms in the same way as for leases at market terms. Do you agree with the proposed

² This would result in no amount being recognised for ROU assets received in kind.

³ HoTARAC has not examined this issue in detail.

amendments to IPSAS 43? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

HOTARAC does not agree that current operational value should be used to measure public sector property, plant and equipment. HOTARAC also notes that the meaning of current operational value needs further clarification. Please refer to the HOTARAC response on AASB Invitation to Comment (ITC) 45 that in part addressed the IPSASB measurement issues. This is available on the AASB web site at [TA21 1602 - HoTARAC Comments to ITC 45 030821 03-08-2021 193614.pdf \(aasb.gov.au\)](#)

Specific Matter for Comment 3 - the IPSASB decided to propose initially measuring right-of-use assets in concessionary leases and right-of-use assets in kind at the present value of payments for the lease at market rates based on the current use of the underlying asset as at the commencement date of the lease. Do you agree with IPSASB's Decision? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

HOTARAC does not agree for the reasons set out in response to Specific Matter for Comment 1.

Specific Matter for Comment 4 – When the payments for the lease at market rates based on the current use of the underlying asset are not readily available, the IPSASB decided to propose initially measuring the right-of-use assets in concessionary leases at present value of the contractual payments for the lease. Do you agree with IPSASB's decision? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

HOTARAC does not support the overall proposal. However, subject to the technical comments under Specific Matter for Comment 1, our view is that this is a practical approach. We expect this method would be predominant for specialised assets for which market rates may not be observable.

Appendix - Technical Matters that should be addressed:

Scope

IPSAS 43 can apply to leases of assets other than property, such as intangibles, non-IP licenses, and biological assets not within the scope of IPSAS 27 (if any). Has IPSASB considered whether there are any issues in applying the amendments to those other types of assets?

Definitions

- Definitions, rather than just descriptions, should be provided for “concessionary lease”, “right-of-use asset in kind”, and “payments for the lease”.⁴
- The “market” to be considered when determining market lease payments needs definition.
- It should be clarified that the Present Value of Payments for the lease at market rates means the lease payments are at market rates, not that the discount rate is at market rates.
- A concessionary lease is described as one at below-market terms. It is unclear how non-market terms other than “lower payments” are to be treated e.g. where the lease is for a longer period than typical in the market, is this at “below-market terms”?

Lease accounting technical issues

⁴ Noting that usage of the term “payments for the lease” appears to be inconsistent with the definition “lease payments” in paragraph 5 of IPSAS 43

- The interest rate implicit in the actual lease without adjustment⁵ would be highly negative, because it is the rate at which the present value of the lease payments equals the fair value of the underlying asset.⁶ This is counter-intuitive and will result in an initial lease liability in excess of the actual lease payments. The portion of the enhanced liability representing the deferred income resulting from the concession, should be shown separately.
- Examples 10B and 10C should include more description about why one is a lease incentive, and the other is a lease concession.
- We recommend that IPSAS add an illustrative example of impairment of a ROU asset under a concessionary lease.
- For both lessees and lessors, unless clear from applying other IPSAS's, it should be confirmed that impairment will not result in a negative number for the asset.
- HoTARAC assumes that remeasurements occur at a revised discount rate. However, paragraph 27 of IPSAS 43, mentioned in the amendment, inconsistently refers only to the discount rate at the commencement of the lease.
- Actual lease payments should be used in calculations where market lease payments are not observable. There should be clear statements in the guidance (a) that this does not require imputing market rates from other information; and (b) about the required approach if some market factors are observable and some are not.
- Further outreach, or specific inclusion in a post-implementation review, should be considered for unintended consequences:
 - impact on calculations of lease/non-lease components in accord with paragraphs 14-17 of IPSAS 43;
 - Interpretation issues and diversity of practice when determining whether an arrangement contains a concessionary lease, or a right-of-use asset in-kind, and in establishing the lease term; and
 - HoTARAC considers that such issues may be more prevalent with concessionary leases and right-of-use assets in kind.

Sale and leaseback

HoTARAC has not considered issues of sale and leaseback involving concessionary leases, because they are uncommon in our jurisdictions.

Lessors

- We presume that an exhaustive search will not be required for fair values of the underlying assets, which may be needed to distinguish between operating and finance leases.
- In our view, application of impairment requirements will nearly always result in accounting for finance lease receivables in effect recording the receivables at the present value of the remaining actual lease payments.
- We presume the proposed amendments only apply to a lessor's lease contracts, since the amendments for lessors only refer to concessionary leases. By implication, arrangements that do not constitute leases⁷ (contracts with consideration) are excluded. If this was not so, the amendments could not be practicably be applied by many governments as lessors, due to the volume of government assets provided free for the use of stakeholders.

Disclosures

⁵ ED 84 paragraph 26B, which references IPSAS 43 paragraph 27.

⁶ A slightly simplified version of the definition in paragraph 5 of IPSAS 43

⁷ i.e. the converse of a ROU asset in kind for a lessee.

IPSASB's intention for the level of aggregation in disclosures under paragraphs 64A and 96A should be clarified. (There is an existing absence of guidance on aggregation in IPSAS 43). HoTARAC supports reasonable aggregation.

Illustrative examples (other than issues referred to in other text)

IE 5 – this does not adequately explain the impact of a change in lease term.

IE 10 – there should be a statement in example 10A that it is an example of an operating lease.