

28 May 2024

Mr Ian Carruthers
Chair
International Public Sector Accounting Standards Board
277 Wellington Street West
Toronto, ON M5V 3H2
CANADA

Dear Mr Carruthers

IPSASB Exposure Draft ED 88 *Arrangements Conveying Rights over Assets (Amendments to IPSAS 47 and IPSAS 48)*

On behalf of the Australasian Council of Auditors-General (ACAG/We/our), thank you for the opportunity to comment on IPSASB Exposure Draft ED 88 *Arrangements Conveying Rights over Assets (Amendments to IPSAS 47 and IPSAS 48)*.

ACAG's detailed response is attached, addressing 'specific matters for comment' requested by the IPSASB. Additionally, ACAG has included concerns under 'Other issues – Implementation issues'.

Overarching feedback

ACAG agrees with how the concession in a concessionary lease is treated under IPSAS 47.

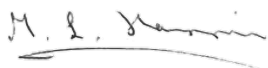
ACAG has identified various problems with the illustrative examples.

ACAG recommends that the IPSASB reconsider the approach to the project.

ACAG believes that the IPSASB has not adequately addressed numerous issues raised in ACAG's submission on ED84. Based on what the IPSASB has decided so far in its re-deliberations on ED84, ACAG believes that there is a risk that the project will not achieve its objectives. These issues are included below under 'Other issues – Implementation issues'.

Once again, thank you for the opportunity to comment on this important change. I hope you will find ACAG's comments, which represent the views of all members of ACAG unless specifically identified, helpful as you move to progress the new standards.

Yours sincerely



Michael Harris
Chair
ACAG Financial Reporting and Accounting Committee

IPSASB SPECIFIC MATTERS FOR COMMENT

Specific Matter for Comment 1

The IPSASB decided to carry over the proposals in ED 84 in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* related to the concession in concessionary leases to IPSAS 47 (see paragraphs IPSAS 47.BC141-BC145). Do you agree with the proposed amendments to IPSAS 47? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

ACAG agrees with how the concession in a concessionary lease is treated under IPSAS 47.

However, ACAG believes that the IPSASB has not adequately addressed numerous issues raised in ACAG's submission on ED84. These issues are discussed further under 'Implementation Issues'.

Specific Matter for Comment 2

The IPSASB decided to propose non-authoritative guidance for arrangements conveying rights over assets in IPSAS 47 (see paragraphs IPSAS 47.BC146-BC150). Do you agree with the proposed non-authoritative amendments to IPSAS 47? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

ACAG has identified the following problems with the illustrative examples.

Illustrative examples 0A – 0C

1. The illustrative examples are given in the context of the supplier (potential lessor). It would be more useful for the analysis to be from the perspective of the customer (potential lessee). Particularly given that there is no change in accounting by lessors for concessionary leases. In addition, it would be useful if the IPSASB confirm that, from the perspective of the customer, if no consideration is paid in the arrangement, the customer would not recognise a right-of-use asset in-kind as the arrangement would not meet the requirements for identifying a lease (with the necessary adaptations in the absence of payments).

2. Example 0C.

While we acknowledge the objective of IPSASB to demonstrate accounting for shared properties, in our view, the current example does not appear to be realistic as it seems to imply that the Municipality / Entity will share the whole floor with Government Agency B / Customer on some sort of alternating basis over 3 years.

In our experience, sharing office space is often based on a defined floor plan, with each party having their own rights to their own defined areas. In these situations, the definition of a lease is often met.

In other arrangements, the sharing may be based on (say) 7 / 3 offices each out of 10 offices, where the offices are shared from day to day, but each party is only entitled to their respective allocation (i.e. any 3 offices). In these situations, the definition of a lease is not met, as there is substitution from one day to another.

In other arrangements, the Entity may have substitution rights to move the Customer from (say) 3 allocated offices to a different allocated 3 offices. In these situations, the definition of a lease is often not met, as there is a right of substitution from one day to another.

Illustrative examples 0A – 0D

We could not identify example 0D mentioned in paragraph IE1A.

Examples 54A, 59

In the journal entries, it may be better to refer to the 'liability' as the 'binding arrangement liability' to provide clarity.

Example 59

This is not considered a realistic or practical example for the following reasons:

1. We would expect that for an arrangement providing free usage, that there is a corresponding obligation to maintain the sports field, and accompanying buildings (seating, changing rooms, scoreboard). This would be in addition to the obligation for scheduling users of the sports field for events and training sessions etc.
2. The example needs to clarify that the arrangement is not for shared access. If it was for shared access, the arrangement is likely not to be a lease.
3. We disagree that information on a single entity's website represents market data and therefore 'market rates'. We also disagree that the full terms of the agreement (to make direct comparisons of the terms and conditions of the leases) would usually be publicly available.

Other issues relating to 'market rates' include that:

- It is not realistic to have a similar sporting field built at a similar time for the same entity.
- Sporting fields at different locations are likely to have different 'market rates', similar to different locations have different housing rentals.
- Restricting access to only youth is unlikely to be on the same terms as allowing access to all community members.

Treating the arrangement as having 'market rates', when there are no 'market rates' for arrangements on the same terms and conditions will likely cause confusion. Refer below under 'Other issues – Implementation issue' to our concerns relating to 'market rates'.

4. Case B – We do not agree that requiring the sports field to be open to the community is not an enforceable obligation. As noted above, for free access we would also expect maintenance and / or operating obligations.

Paragraph AG202C

We found this paragraph confusing and potentially misleading. The paragraph could be interpreted such that the recognition of revenue depends on whether there is a binding arrangement. Revenue is recognised whether or not there is a binding arrangement, although there would be different timing.

Specific Matter for Comment 3

The IPSASB decided to propose non-authoritative guidance for arrangements conveying rights over assets without consideration in IPSAS 48 (see paragraphs IPSAS 48.BC41-BC44). Do you agree with the proposed non-authoritative amendments to IPSAS 48? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

ACAG has no comment on the IPSAS 48 accounting.

Other issues – Implementation issues

ACAG recommends that the IPSASB reconsider the issues raised in ACAG's submission on ED 84.

ACAG believes that the IPSASB has not adequately addressed numerous issues raised in that submission. These issues include those relating to implementation and differences in interpretation. Based on what the IPSASB has decided so far in its redeliberation on ED84, ACAG believes that there is a risk that the project will not achieve its objectives.

These issues include:

- market rates
- usefulness of concessionary gross-ups
- definition of a lease
- Australian experience with lease accounting for the public and not-for-profit sectors
- threshold filter
- disclosures
- sale and leaseback.

Market rates

The proposed standard is based on the premise of identifying a concession by reference to market rates. As ACAG noted in our response to ED84, we had not identified a source of 'market data' for leases that is available publicly at nil or nominal cost or was available through a subscription service.

Some offices believe that consequently there are no market rates available with a reasonable level of effort. Some offices also believe that it is unlikely that the terms and conditions of leases from any available data would be equivalent from lease to lease. Differences will include factors such as location (for example, being close to the train station, or near the central CBD shopping compared to the edge of the CBD). Other differences might also include lease term, floor level and compliance obligations.

Therefore, these offices believe that, given the lack of market rates (which are not available with a reasonable level of effort), no concession would be recognised for any concessionary leases. These offices interpret this outcome as being consistent with staff and IPSASB redeliberations, particularly those related to cost and benefit, and reasonable levels of effort.

However, some offices believe that despite the inability to obtain directly observable market rates readily from publicly available information for the particular lease, an estimate of a market rate is required. This includes inferences from the following extract from the draft final pronouncement (December 2023 IPSASB meeting):

BC168...

- (b) Part 2: "at market rates"—This requirement intends to obtain the market lease payments as if the lease was made at market terms. The term "market rates" can be seen as a proxy or a way to **estimate** the how much the lessee would have to pay the lease was made at market rates.
(emphasis added)

These offices believe in certain circumstances the use of a valuer may be required. These offices believe that the final standard (if issued based on current proposals) should require disclosures of the significant assumptions used in estimating the market rates. Offices with the previous view believe that such disclosure would be unnecessary, given the lack of market rates for leases with similar terms and conditions, and consequently no estimates and no significant assumptions are required to be made.

Single entity website

As stated above under SMC2, we disagree that information on a single entity represents market data. We also disagree that sufficient disclosure of the terms and conditions of the agreement (to assess comparability of terms and conditions from lease to lease) would usually be publicly available.

Reference to for-profit private sector and resource limited not-for-profit recipients

In our ED84 submission, we noted that concessionary leases (and right-of-use assets in-kind) are often granted by public sector entities because the recipient does not have sufficient funds to pay a for-profit private sector commercial rate or where for-profit private sector entities do not operate.

If there are market rates, then the market rate would be for what an equivalent recipient (for example a not-for-profit recipient with resource constraints) would pay, and the market rate is likely to be the concessionary consideration per the lease agreement. Consequently, the recipient would have incurred costs for no change to using the contracted rate.

Usefulness of concessionary gross-ups

In our ED84 submission we highlighted grossing up of the asset values resulting in upfront income recognition and reduction in future results, was one of the reasons why the Australian Accounting Standards Board (AASB) provided the NFP private sector entities with a permanent choice.

However, we disagree with staff analysis during redeliberations rejecting to take an evidence-based approach to support the usefulness of the information to users. In its analysis, staff noted that no information would be available as IPSAS 43 was only recently introduced. In our view, this does not reflect that concessionary operating leases have been in place for many years under the former leasing standard and an outreach may provide insights into user needs.

Some ACAG jurisdictions also noted that the consequences of grossing up revenue and expenses may lead to real-life implications, as reporting obligations thresholds are often linked to reported revenue.

Definition of a lease

The draft final pronouncement paragraphs BC112 to BC125 (ED84 paragraphs BC105 to BC115) states that IPSAS 43 applies to arrangements that are in substance a contract rather than having the legal form of a contract. The draft final pronouncement paragraph BC114(b)(i) states that such arrangements also have to be between willing parties. ACAG also notes ED88 paragraph AG202A that a right-of-use asset in-kind needs to meet the requirements of a lease under IPSAS 43, with the necessary adaptations in the absence of payments.

Based on this, ACAG believes that many public sector arrangements involving right-of-use assets will be excluded from the scope of the changes. In particular, arrangements involving unwilling recipients. In ACAG's view, this outcome is not consistent with the objectives of the project. In Australia, these arrangements are often under legislation between state and local governments, and although they are not contractual, they are considered sufficient for an agreement to be enforceable by a separate party through legal or equivalent means.

However, ACAG notes that this outcome is consistent with the other decisions by the IPSASB relating to IPSAS 43 for leases and contractual arrangements noted in the draft final pronouncement paragraphs BC112 to BC125. Specifically, the exclusion from IPSAS 43 of arrangements enforced by 'equivalent means'. ACAG's interpretation is that IPSAS 43 would exclude many intra-government transactions, such as department to department, as such arrangements are within the same legal entity, and are therefore not contractual and are not enforceable at law. It appears that such arrangements are not included within the scope of IPSAS 43 as in-substance contracts.

Australian experience with lease accounting for the public sectors

In our ED84 submission, we highlighted the experience and difficulties the AASB encountered when applying lease accounting under the equivalent of IFRS 16. Given that IPSAS 43 is also based on IFRS 16, we believe that staff did not sufficiently consider the Australian experience.

This experience resulted in the introduction of a choice to 'gross-up' to fair value (as used in Australia) or use cost. Similar to the IPSASB, the AASB do not lightly introduce options. However, for concessionary leases, the AASB decided that a choice was appropriate.

Threshold filter

In our ED84 submission, we suggested that the IPSASB consider including a similar filter to that introduced by the AASB to reduce costs. The Australian application of IFRS 16 to concessionary leases includes a threshold filter, to only classify leases as concessionary when the consideration is 'significantly less' than fair value (i.e. 'market rates' for ED84 / ED88). The filter includes an additional qualifier that the discount is principally to enable the entity to further its objectives.

ACAG disagrees with the staff response that the 'significantly below' is drawing a bright line. The filter is used in Australia to reduce costs by avoiding extra work.

Disclosures

One jurisdiction believes that their suggestion in the ED84 submission is relevant:

One jurisdiction has highlighted what they believe to be an anomaly with the option to initially measure right-of-use assets in concessionary leases at the present value of contractual payments for the lease, for example, accounting for transactions within the same government. Where the lessor provides the asset under a finance lease (therefore derecognises the asset) and the lessee follows the cost option (and therefore recognises the asset at a nominal consideration), significant assets are not recorded in either the lessor or the lessee's financial statements (as it measures the ROU assets at nominal consideration).

Although the assets appear at the whole of government (consolidated) financial statements there is significant information loss at the Department/agency level. One option to explore is if the assets are given on a finance lease, then whether the fair value of the asset prior to it being given on lease could represent the fair value of the right of use asset at initial recognition. This jurisdiction believes, while there may be complexity when valuing very unique (specialised) assets where a market may not be present, experts may be used who would be able to consider appropriate unobservable inputs to strike a valuation. However, in rare circumstances when fair valuation may not be possible, this jurisdiction recommends IPSASB should consider requiring either the lessor or lessee to make robust disclosures in their financial statements on an ongoing basis to address the above anomaly. That jurisdiction believes that although the disclosures in para 96A are reasonable for the year in which lease is granted, there should be some disclosures on an ongoing basis to cater for the information loss. Such disclosures could possibly include the fair value of the assets given under finance leases which do not appear in their financial statements and referring to the consolidated financial report. This information should be readily available as either the lessee or the lessor has to undertake this exercise to account for the transaction at the whole of government level.

Sale and leaseback

In our ED84 submission, we did not comment specifically on the sale and leaseback provisions. Instead, we noted that the provisions would need to be updated in accordance with the IPSASB approach for alignment with IFRS, following the issue by the IASB of amendments to IFRS 16 *Lease Liability in a Sale and Leaseback* (September 2022).

We have subsequently reviewed the proposed changes relating to sale and leaseback as published in the draft final pronouncement (December 2023 IPSASB meeting).

We find Example 25 very confusing and unrealistic. In particular, the building being classified as a sale by the Seller-Lessee to the Buyer-Lessor, and then a finance lease (which is effectively a sale) from the Buyer-Lessor back to the Seller-Lessee. We suggest that the IPSASB specifically explain why the transaction is a sale to be recognised by Seller-Lessee, when there is an interdependent effective purchase (finance lease) by Seller-Lessee.

If the example is retained, we also suggest that the IPSASB review the accounting for the unguaranteed residual value by Buyer-Lessor – being the value of the land 'coming back' to Buyer-Lessor at the end of the finance lease. This is measured at \$340,801 being the difference between the fair value of the 25.5 year building of \$1,800,000 and the NPV of the market rentals over 18 years of \$1,459,199.

This is recognised in the accounting entries as part of the financial asset. ACAG does not believe that the unguaranteed residual value represents a financial asset, as it does not represent a contractual right to cash.

We also find the accounting entries for Example 23B and Example 25 inconsistent and potentially confusing. Example 23B recognises the concession 'gift' (difference between carrying value and the finance lease receivable) as 'surplus or deficit'. Example 25 recognises the same difference as 'concession expense'. We expected that in both situations, of a finance lease receivable concession, that the concession would be treated the same way. If it is intended that there is a difference between the two examples, this difference should be explained.