MINISTRY OF EDUCATION
TE TĀHUHU O TE MĀTAURANGA

28 April 2021

New Zealand Accounting Standards Board
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Tēnā koe

Request for comments Exposure Draft 75 Leases

Thank you for the opportunity to comment on Exposure Draft 75 Leases (ED 75).

We appreciate that the International Public Sector Accounting Standards Board (IPSASB) has undertaken this project to update the accounting for leases and the opportunity to make this submission to assist New Zealand Accounting Standard Board (NZASB) with this consultation process.

While we are aware of the merits for the Public Financial Management and alignment with NZ IFRS 16, we have some concerns of its adoption for the Ministry of Education (MOE) which may also impact the wider public sector. These are:

- Concessionary Leases are prevalent in the public sector, and guidance on these transactions is not included in ED75. Although IPSASB has proposed to deal with this matter in the second phase of the Lease project, accounting for concessionary leases is linked to the fundamental principles in ED 75 and therefore, it is difficult to support ED75 without visibility of what ED 75 would mean for concessionary leases.
- While we recognise NZ IFRS 16 was developed to address the issue of off-balance sheet financial assets and liabilities and the lack of comparability in financial statement which has benefits for financial analysts, particularly in respect of entities listed on stock exchanges (e.g. updated financial ratios, performance metrics and loan covenants), these are not necessarily the relevant measurements of the service outcome or performance indicators for the Public sector entities.
- We are concerned that the cost of adopting ED 75 and its implementation challenges for MOE and the schools will exceed its benefits.

Due to the uniqueness of the education service provided by MOE/schools and the special characteristics of right or use or “lease-like” transactions in the sector, we anticipate some major implementation (and possibly costly) challenges. We are also concerned that unnecessary costs will be imposed on individual schools to account for right of use assets from MOE, which on consolidation are eliminated because the transactions occur within the Crown.

Some of the challenges can be found in the following type of transactions and there is no clear guidance in ED 75.

- Treaty settlement sales and leaseback: Under the Crown's Treaty settlement programme, designated land is sold to an iwi and leased back with no specific lease term or termination date; the Ministry can keep leasing the land for as long as it is needed for education purposes (or any other public work) and only the Ministry can end the lease. Also, depending on values attributed to the sale, and the subsequent rental amount, it's possible some of those values and terms may be consider as "below the market".
- Notional lease of land and buildings to schools: while there is no payment and no specific lease term between MOE and individual schools, state schools in their separate financial statements recognise a notional lease expense and corresponding grant income based on 8% p.a. of the valuation of the land and building held my MOE.
- Lease of houses to teachers under a variety or terms and conditions, including discounted rents with no lease terms.
- Peppercorn leases (26 approximately) where MOE leases property from various not-for-profit organisations or other public sector entities such as District Health Boards.
- Perpetual Leases (26 approximately) with various organisations where there are no lease term or end dates.

There will also likely be implications for the department appropriations. As the operating lease expenses for lessees will be replaced by the recognition of a right-of-use assets initially (capital expenditure), depreciation of the right -of-use asset and corresponding finance costs, our existing expense appropriations would need to be reassessed.

We recommend the NZASB:

- do not proceed with implementing ED 75 in New Zealand until the Public Sector impact for concessionary leases is more fully understood, and
- carefully consider the cost associated with implementing ED 75 and provide guidance on additional exemptions for the public sector.

Our responses to the Specific Matters for Comments are set out in the Appendix to this letter. We are giving our consent to publish our submission.

Should you have any queries or require clarification of any matter in this letter, please contact me.

Nāku noa nā

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Appendix: Response to Specific Matters for Comment

Specific Matter for Comment 1:

The IPSASB decided to propose an IFRS 16-aligned Standard in ED 75 (see paragraphs BC21–BC36). Do you agree with how the IPSASB has modified IFRS 16 for the public sector (see paragraphs BC37– BC60)? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

We would like to see further guidance on the 'special' lease arrangement in public sector (described in the RFI).

Concessionary leases are prevalent in the public sector and the guidance is not included in ED75. Possible Concessionary Leases at MOE are the 'lease-back' land from Treaty sales, Notional lease, lease of teacher's house, and various Peppercorn leases. Although IPSASB has proposed to deal with accounting for concessionary leases in the second phase of the Lease project, we are of the view it is linked to the fundamental principles in ED 75 therefore, it is difficult to support the implementation of ED75 without visibility of the guidance on Concessionary Lease.

Further, we do not see sufficient guidance and exclusions have been provided to deal with the circumstances in the Public sector, especially on the lease term for perpetual lease and concessionary leases.

Specific Matter for Comment 2:

The IPSASB decided to propose the retention of the fair value definition from IFRS 16 and IPSAS 13, Leases, which differs from the definition proposed in ED 77, Measurement1 (see paragraphs BC43– 1 The fair value definition under development in ED 77, Measurement is aligned with the fair value definition in IFRS 13 Fair Value Measurement. EXPOSURE DRAFT 75, LEASES BC45). Do you agree with the 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.

We agree in principle with the proposed definition in ED75.
However, we suggest further guidance to be considered for the designated asset to address the issue in Treaty sales and lease back transactions which may be considered as "below the market" rates

Specific Matter for Comment 3:

The IPSASB decided to propose to refer to both "economic benefits" and "service potential", where appropriate, in the application guidance section of ED 75 on identifying a lease (see paragraphs BC46– BC48). Do you agree with the 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.

We agree with IPSASB's proposal to refer to both "economic benefits" and "service potential" and support the reasons which were provided in BC47-48