

AC-2

2 December 2022

Ms April MacKenzie
Chief Executive
External Reporting Board
PO Box 11 250
Manners Street Central
Wellington 6142

Dear April

NEW LEASES STANDARD FOR PBES

Thank you for the opportunity to comment on the proposed new lease accounting standard for Tier 1 & 2 Public Benefit Entities PBE IPSAS 43 *Leases*.

Treasury is supportive of the proposed standard. We note and endorse NZASB's proposals not to include specific requirements for the accounting for the 'concessionary portion' of concessionary leases and similar arrangements as an interim measure, pending further examination by the IPSASB and the NZASB. In our response to your request on the scope of the standard and for "any other comments" we suggest two lines of enquiry that may be worth pursuing as this phase two work progresses.

Our response to NZASB's specific questions is provided in the enclosure.

We are very happy to discuss these suggestions with the NZASB and staff further.

Yours sincerely

Jayne Winfield
Chief Government Accountant

Treasury's Response to Questions in Consultation Document on PBE IPSAS 43

1. Do you agree with the proposed scope clarification with respect to concessionary leases? That is, do you agree with the clarification that:
 - Concessionary leases that meet the definition of a lease are in the scope of the proposed PBE IPSAS 43;
 - Arrangements that convey the right to use an asset for a specified period of time for no consideration do not meet the definition of a lease in the proposed PBE IPSAS 43; and
 - In applying the measurement requirements in PBE IPSAS 43, an entity takes into account the lease payments as per the lease agreement, and not the lease payments that would have been charged had the lease been on market terms?

The Treasury agrees with the proposed scope clarification as an interim position.

However, we believe Phase Two of the IPSASB leases project is critical in respect of assessing whether a concessionary lease is in scope of the standard and therefore, we would like to take this opportunity to share some views on this.

We note that in PBE IPSAS 43, the assessment of whether a contract is, or contains, a lease, requires entities to work through a checklist of IFRS 16 contract components (AG32 flow diagram refers) with a clarification that if the consideration component is missing, it does not meet the definition of lease contract. This means concessionary leases go through the same checklist and the same guidance as a commercial lease contract.

We believe most concessional leases will tick all the boxes of each contract component set out in AG32, especially when it's common under public sector right-of-use arrangements to have some consideration, which is often a nominal amount, or an agreed amount not referenced to a market (often because there is no relevant market) and therefore will likely be labelled "below-market" by standard setters. However, we believe this approach to scope does not acknowledge the substance of a range of concessionary lease arrangements in the public sector. For example, a lease arrangement that conveys the right to use an asset for a period of time, but there is nil consideration, is out of scope of the standard, while the same lease arrangement with a nominal consideration of \$1 per annum is in scope.

While we can see the attractions of this simple contractual tick-box approach to the scope of PBE IPSAS 43, we urge standard setters to unpack and test whether the foundational presumption under IFRS 16, which is that leases are financing arrangements, makes sense as a principle in public sector concessionary lease or lease-like arrangements.

We provide further thoughts on concessionary leases under Question 5, referencing to two main topics:

- *It may not be appropriate to treat some concessional leases as leases*
- *The public sector is involved in right of use arrangements that warrant inclusion in the forthcoming "Other Lease-type Arrangements" guidance*

We agree with the clarification that in applying the measurement requirements in PBE IPSAS 43, an entity takes into account the lease payments as per the lease agreement, and not the lease payments that would have been charged had the lease been on market terms.

2. Do you agree that the assessment of whether a leased asset is of 'low value' should be performed on an absolute value basis for each individual leased asset, as proposed in the ED? If not, on what basis should this assessment be performed?.

The Treasury prefers the IPSASB solution of low value without the "US\$5,000 or less" guidance provided by the IASB, given these uncertain inflationary times and foreign exchange fluctuations. The example of small office items but not cars being considered low value provides sufficient guidance. Nor can we envisage any mixed group accounting issues from this divergence. Therefore, the Treasury agrees with the NZ ASB's proposal not to modify the requirements of IPSAS 43 for leases of low value assets.

3. Do you agree with the proposed RDR concessions for Tier 2 PBEs?

The Treasury acknowledges that this is not an issue of direct relevance to it, and that we have not taken soundings from those entities directly affected. The proposed concessions look sensible; however we suspect that the NZ ASB could go further in reducing disclosures. It is not clear to us why any information more than the carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset, and the carrying amount of lease liabilities is justified for a Tier 2 PBE.

4. Do you agree with the proposed effective date of 1 January 2027?

There are significant system changes and public sector management issues to be worked through in adopting this standard. Both the private sector experience and the experience of the UK and Australian government implementing this standard has demonstrated that a significant lead-in period is required. Therefore, Treasury agrees with the proposed effective date at this stage and cautions that the transition period should not be truncated.

5. Do you have any other comments on the ED?

Yes. We note that the project is somewhat unfinished due to further consideration being required for concessional leases. To assist in this further work in Phase Two of the leases project, we suggest below some lines of thinking.

It may not be appropriate to treat some concessional leases as leases

We note in BC 2 of IPSAS 43:

Consistently with IFRS 16, IPSAS 43 introduces a new lease accounting model for lessees – the 'right-of-use' model. The right-of-use model is based on the foundational principle that leases are financings of the right to use an underlying asset [emphasis added].

It is this foundational principle underpinning the right-of-use model, and its transferability to the public sector, which we feel has not been analysed and addressed satisfactorily so far in the scope of PBE IPSAS 43, and we hope it will be in Phase Two of the project. In our view, many concessional leases should not be characterised as financing transactions.

Currently, the proposed standard defines a lease as a:

“contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”.

That raises in our minds whether a ...

“contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for a commitment to carry out an activity from which the lessor benefits indirectly (e.g. a complementary activity to the lessor’s activity) but not directly (e.g. nil or nominal consideration, or consideration set without reference to markets or where the lessor does not seek a financial return, is received) ...

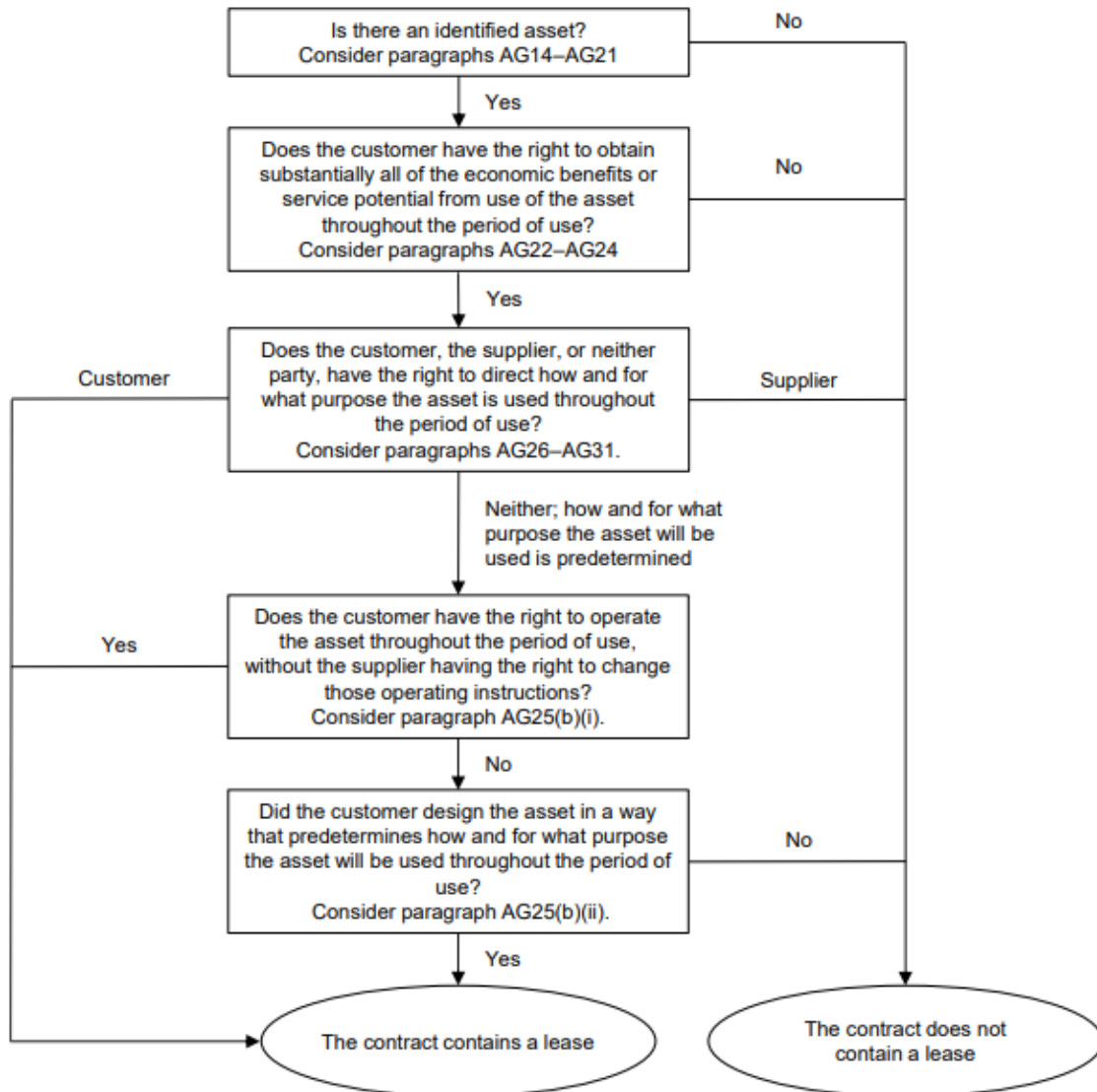
... is appropriately thought of as a lease at all?

We would consider the latter to generally be a more appropriate description of most public sector concessionary ‘leases’. We believe that this is of particular importance because in the latter case no ‘debt-like liabilities’ are created, even where there is some form of consideration in the arrangement.

As financing through a ‘debt-like liability’ was the primary factor behind the original IASB decision to adopt the right-of-use model for leases it seems questionable that a concessionary lease should be considered a financing item rather than an operating item. In substance, Treasury would therefore suggest that characterising a concessional lease as an operating subsidy is a more fair reflection of its economic substance than reporting it as a financial obligation.

We think that the application guidance and flow chart in AG32 is an example where these public sector difference should be drawn out and addressed.

AG32. The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.



In addition to our concerns that certain concessionary leases would be incorrectly referenced as in-substance financing transactions under PBE IPSAS 43, we note that all AG32 questions focus on whether the “customer” has various rights to an identifiable asset. We are concerned that PBE IPSAS 43 and AG32 omits critical public sector differences in respect of various “rights” to assets, and that these too should be considered in the development of the standard under Phase Two of the leases project. We submit that more reflection is required here and have provided some lines of thinking on “rights” below

The public sector is involved in use right of use arrangements that warrant inclusion in the forthcoming “Other Lease-type Arrangements” guidance.

Lease type arrangements typically involve the provision of a right to use an asset. However rights-of-use fit into an overall schema of property rights best identified by Edella Schlager and Nobel Prize winning economist Elinor Ostrom:

- Access the right to enter a defined physical property
- Withdrawal the right to obtain the “products” of a resource
- Management the right to regulate internal use patterns and transform the resource by making improvements
- Exclusion the right to determine who will have an access right, and how that right may be transferred
- Alienation the right to sell or lease the above rights

This is a property rights framework characterized by nested, cumulative attributes. It has become arguably the most ubiquitous framework for analysis of natural resources and property rights. Discriminating between these rights is particularly important for assets providing non-private goods, where aspects of non-rivalry and non-excludability require collective management structures, and to recognise indigenous world views. The framework can be summarised in the following chart.

Bundles of Rights Associated with Persons				
English Concept	Owner	Proprietor	Lessee	Authorised User
Closest Maori Concept	Rangatira?	Kaitiaki?	Kareihi?	Kaiwhakamahi?
Access and withdrawal	X	X	X	X
Management	X	X	X	
Exclusion	X	X		
Alienation	X			

In this framework, an owner may transfer:

- rights of direction-of-use and rights-of-use to a kaitiaki or lessee, and
- rights-of-use, but not rights-to-direct-use to an authorised user.

Lease contracts are just one way to reflect a transfer of rights of use from an owner or kaititaki to a lessee. Other arrangements besides lease contracts may be used to transfer similar rights in the public sector. If financial reports are to fairly reflect the rights of a public sector entity, other bundles of rights than access, withdrawal and management should be provided for.

A holistic approach that fully reflects the attributes of rules and rights that apply over the use of assets in the public sector is likely to be a much better fit for purpose than an accounting approach derived simply from private sector lease contracts. We briefly highlight some benefits below.

Authorised users, and not the reporting entity managing many infrastructure and natural resource assets controlled by the state, have access and withdrawal rights, (e.g. road users in fact use the roads of a roading authority managing state-owned roads). The property rights framework thus copes better than the contractual leasing approach for the awkward fact that many lessees in the public sector are not in fact users of the asset.

The framework helps clarify the distinction between operators of concession arrangements and lessees. The concept of authorised users that do not have the right to regulate use patterns is also likely to be useful when considering natural resource rights, such as access to the radio spectrum. Some so called 'concessional leases' where the lease is conditional on a prescribed use of the asset, may in fact be better reflected as 'authorised use' agreements and accounted for differently than leases.

Claimants appear similar to lessees, in that they have both a "right-of-use" and a "right to direct" the use but notably without sub-leasing rights. The private sector standard setter's analysis of rights to direct however seems limited to shipping containers and assets requiring specialised skills to operate. The public sector standard setter must consider more deeply the common situation where assets that are provided for the use only of another entity, whose objective the 'lessor' supports. We submit that more thinking that is refined is required here.

For example, the accommodation lease that a school makes available to a health operator on school premises so that health care can be provided to pupils, is different in substance to an accommodation lease that the same health provider might receive from a property management company. A judgement is required as to whether the health provider is an authorised user or a claimant (lessee). The proposed guidance is currently not up to this task. In another example, a better accounting outcome is likely to be achieved if the IPSASB seeks to best reflect a rail operating company paying a rail access charge as a claimant on the rail asset rather than as a lessee, and the infrastructure owner as an asset provider than a lessor.

Finally, the differentiation between kaitiaki and owners may be useful when considering the assets that the reporting entity is charged for maintaining and preserving for future generations. Are heritage assets effectively on 'lease' to public sector entities to look after them on behalf of the public?

Another possible use for this concept is the common practice of governments providing property rights to other governments for embassy and consulate purposes, but where if the embassy were to be withdrawn, the property would revert to the host government. The IPSAS conceptual framework has stated that service recipients and resource providers will need information that supports the assessment of the capacity of the entity to adapt to changing circumstances.

The adaptive capacity of an entity with alienation rights is quite different to an entity without those rights. In New Zealand, both our Public Works Act, and arrangements with Māori who have provided property for public purposes, provide residual rights back to the original owners if the property is no longer required for those public purposes.

Those examples illustrate that the allocation of withdrawal rights in the public sector is not such a simple matter as the public sector where leases are ubiquitous and simply a type of contract law and property can be described as either freehold or leasehold. The Treasury is not contesting that the right-of-use approach may be appropriate for many lease arrangements, but rather is arguing that they omit critical public sector differences that should be considered in the development of the standard.

We would urge that such considerations inform the development of the forthcoming "Other Lease-type Arrangements" guidance.