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New Zealand Accounting Standards Board  
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Tēnā koe

**Feedback for Consultation PBE IPSAS 43 – Lease.**

Thank you for the opportunity to submit our feedback of proposed PBE IPSAS 43 – Lease.

In responding, we have provided the appendix one to address the specific questions in the consultation document.

We are giving our consent to publish our submission as part of the NZASB consultation process.

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 One

**Questions 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?

Answer: We agree with the proposed scope clarification with respect to concessionary leases and support the decision that PBEs are not required to measure the 'concessionary portion' of their concessionary leases at fair value. If the decision is reverse, it would have a significant impact to the Ministry and may not be practical to determine the market fair value for all the leases which are listed in appendix two.

**Question 2:** Do you think 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?

Answer: We agree the assessment of a leased asset is of 'low value' should be performed on an absolute value basis for each individual leased asset which and this is consistent to NZ IFRS 16.

However, a specific monetary threshold would be helpful for making decisions for the 'low value' leased assets.

**Question 3:** Do you agree with the proposed RDR concessions?

Answer: We agree with the proposed RDR concessions.

**Questions 4:** Do you agree with the proposed effective date of 1 January 2027, with early adoption permitted?

Answer: We agree with the proposed effective date of 1 January 2027, with early adoption permitted.

**Question 5:** Do you have any other comments on the ED?

Answer: As the proposed PBE IPSAS 43 does not require PBEs to measure the 'concessionary portion' of their concessionary leases at fair value, but rather measure the lease at amounts of lease payments as per the lease agreement. Are PBEs still required to follow paragraph 100 and 101 under the circumstances that payments for the lease are not at market rates (i.e., fair value)? we recommend revising the following two paragraphs to reflect the recent change in the proposed PBE IPSAS 43.

100. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:

- (a) Any below-market terms shall be accounted for as a prepayment of lease payments; and
- (b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

101. The entity shall measure any potential adjustment required by paragraph 100 on the basis of the more readily determinable of:

- (a) The difference between the fair value of the consideration for the sale and the fair value of the asset; and
- (b) The difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

As PBEs are not required to follow IFRS which are designed for the “for-profit” entities, for determining whether the transfer of an asset is a sale, we agree with NZASB’s intention to develop the IPSAS standards and include them into IPSAS 43, rather than refer to NZ IFRS 15 per paragraph 99.

In addition, we suggest the NZASB/representatives from New Zealand Treasury to consider the following practical issues to the Ministry of Education or other PBEs.

### **Notional Lease**

Ministry of Education owns and provides the land and buildings to schools to be used for education purpose with no end term. The schools do not pay any rents for this arrangement.

Currently no accounting entry has been recorded in the Ministry’s financial statement however, schools recognise the grant income and operating lease expenses in the financial statements. Both entries are calculated at 8% of the annual land and building valuations, plus the adjustments that the Ministry made to 3rd parties.

The proposals in ED PBE IPSAS 43 clarify that while concessionary leases that involve the lessee paying consideration are within the scope of the standard (as they meet the definition of a lease, which a contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for consideration).

Page 13 staff note of the consultation document explains that “an arrangement that conveys a right to use an asset for a period of time for no consideration does not meet the definition of a lease and is outside the scope of the proposed PBE IPSAS 43. The term ‘consideration’ in the definition of a lease includes consideration at below-market terms (even if it is nominal).”

Our interpretation of the meaning for “nominal” is very small and far below the market value of the lease. However, as the schools doesn’t pay any consideration for using Ministry of Education’s assets, we are seeking clarification if the Notional Lease arrangement is still within the scope of the lease under PBE IPSAS 43?

Please note, if the Notional Lease arrangement is within the scope of PBE IPSAS 43, we anticipate the following complications for the schools which most of them are tier 1 and 2.

- Difficult to determine the lease term, the fair value of assets and liabilities as all Notional Leases are perpetual to the schools.
- Administrative burdens for schools who have limited financial resource.
- All school financial statements templates need to be amended and communicated.

If the Notional lease is not within the scope of PBE IPSAS 43, we are seeking clarification if the current operating lease accounting entries recognising the grant income and operating lease expenses in school’s financial statements are still needed?

### **Appropriation implications**

Currently all finance leases are treated as borrowings and must be signed by the Minister of Finance in accordance with the Public Finance Act. We are seeking clarification from the Treasury representative if the operating lease arrangements under the proposed PBE IPSAS 43 will be treated the same way which requires the sign-off from the Minister of Finance.

Currently operating leases are accounted through the operating output or other expense appropriations. With transition of leases to the balance sheet, agencies will require to consider if they have existing capital expenditure appropriations with a scope wide enough to accommodate the lease costs or whether the creation of new appropriations will be necessary. Implementation timeframe should take into account the public sector budgeting and planning cycle to allow agencies to work through the appropriation implications.

## **Discount rate**

The standard defines a discount rate as “the interest rate that the lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment”. Public sector would benefit from a single discount rate as most departments and agencies will not have any borrowings and may use different methodology for determining their discount rate, leading to differences in the valuation of the finance lease asset and liability for the same class of assets across the sector. This may also distort the balance sheet of New Zealand government when Treasury consolidating all PBEs financials.

## **Key ratios analysis**

Change in the standard will have a significant impact on the key balance sheet ratios (such as leverage and liquidity ratios). This may have a negative impact on the public sector entities with borrowings and any related covenants as well on the fiscal ratios monitored at the all-of-government level (such as debt to GDP ratio). If PBE IPSAS 43 is implemented, we suggest to re-consider the threshold for the key balance sheet ratios for borrowings.

## Appendix two

Nature of the concessionary leases	Accounting treatment
<p><b>Notional Leases for School's land and buildings</b> MOE owns and provides the land and buildings to schools to be used for education purpose with no end term. The schools do not pay any rents for this arrangement.</p>	<p><b>MOE:</b> no accounting entry has been made to the financial statements.</p> <p><b>Schools:</b> recognise the grant income and rent expenses entries in the financial statements. Both entries are calculated at 8% of the annual land and building valuations.</p>
<p><b>Lease of houses to teachers</b> MOE owns houses and provides accommodation to schools/teachers in certain communities under a variety of terms and conditions, including discounted rents and in some cases no end term.</p> <p>Please refer to the website for further details: <a href="https://www.education.govt.nz/school/property-and-transport/school-facilities/teacher-caretaker-housing/">https://www.education.govt.nz/school/property-and-transport/school-facilities/teacher-caretaker-housing/</a></p>	<p><b>MOE:</b> recognise rental income in the financial statements.</p> <p><b>Schools/teacher:</b> recognise lease expense in the financial statements.</p>
<p><b>Peppercorn Leases (MOE as "lessee")</b> These (26 approximately) are leases with a nil, nominal or a token payment.</p> <p>Various local governments or 'not for profit' organisations 'lease' their premises to MOE to support communities and education services with varied terms. MOE does not typically pay any rent for these arrangements or pays only a nominal or token amount.</p>	<p><b>MOE:</b> no accounting entry has been made to the financial statements (other than the cash entry if a nominal amount is paid).</p> <p><b>Not for profit' organisations:</b> most likely no accounting entry has been made to the financial statements.</p>
<p><b>Sale and lease back of land from Treaty settlements</b> Under the Ministry's Treaty Settlements Property Redress 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".</p> <p>Please refer to the website for further details: <a href="https://www.education.govt.nz/school/property-and-transport/leasing-and-hiring/iwi-leased-school-sites/">https://www.education.govt.nz/school/property-and-transport/leasing-and-hiring/iwi-leased-school-sites/</a></p>	<p><b>MOE:</b> Sells of land: de-recognises the land per the carrying value, recognises the cash received and the difference between the selling price and carry value as a gain. Lease: recognises the lease as an operating lease and a lease expense in the financial statements.</p> <p><b>Iwi:</b> Purchases of land: most likely recognise the land per purchase price, and the cash paid. Lease: most likely recognises the lease as an operating lease and a lease revenue in the financial statements.</p>
<p>MOE has a mixture of formal and informal arrangements (26 approximately) with various entities and the terms vary widely – for example terms can be monthly, fixed terms like 21 years with perpetual renewal options, or perpetual leases as long as MOE determine they need the property (as is the case with Treaty sales and leasebacks)</p>	<p><b>MOE:</b> recognise as an operating leases expense if paying the lease, otherwise, no accounting entry has been made to the financial statements.</p> <p><b>Other parties:</b> most likely recognise as an operating leases income if receiving the lease, otherwise, no accounting entry has been made to the financial statements.</p>