The Chartered Institute of
Public Finance & Accountancy

IPSASB

Exposure Draft 75, *Leases*

Request for Information, *Concessionary Leases and Other Arrangements Similar to Leases*

A response from the Chartered Institute of Public Finance and Accountancy

17 May 2021

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

Any questions arising from this submission should be directed to:

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CIPFA is pleased to present its comments on these consultations which have been reviewed by CIPFA's Accounting and Auditing Standards Panel.

As noted in various responses to consultations, including IPSASB's consultation on its strategy and workplan, CIPFA strongly supports the approach which IPSASB has taken to maintaining alignment with international frameworks.

General comments on Exposure Draft 75

CIPFA responded in 2018 to IPSASB Exposure Draft 64, *Leases,* generally supporting the proposed approach which aligned with the well-founded improvements to lessee accounting set out in IFRS 16, while proposing a more conceptually consistent and symmetric approach to lessor accounting, even though this introduced a degree of non-alignment with IFRS 16.

However, we note the explanation at BC16 to BC23 setting out the difficulties in progressing a non-aligned standard. In the light of these points, we are inclined to support the full alignment approach proposed in ED 75, albeit with a degree of disappointment.

Responses to the Specific Matters for Comment are set out in Annex A.

General comments on the Request for Information

CIPFA agrees that there are public sector specific issues around leases and arrangements similar to leases and it is important to explore these.

Some exploration of such issues has already been undertaken in the United Kingdom. UK public sector financial reporting is framed as being in accordance with International Financial Reporting Standards (IFRS) which have been adopted for use in the UK, adapted and interpreted for the public sector context. In some cases, the adaptations and interpretations reference similar considerations in IPSAS, and in some cases they directly implement IPSAS treatments. Recent consideration of the financial reporting of leases has been in the context of the planned implementation of IFRS 16 in the UK public sector. After some delays the implementation of that standard is expected to occur in 2022-23.

Most of the information which we have on public sector leasing reflects the current treatments which generally speaking follow IAS 17, but some other information has surfaced in the planning phase for the implementation of IFRS 16. In many cases we do not have a comprehensive knowledge base to comment on the points raised in the IPSASB Request For Information, especially where our data has been obtained as a by-product of other enquiries, or in UK consultations which have been responded to by a small number of respondents, or in resolving queries in arrangements which are subject to commercial confidentiality. If you would like to know more about some of these issues, we would be happy to provide further comment, subject to appropriate caveats on the limitations of this information. Please contact Steven Cain if you wish to discuss this further.

Responses to the questions in the Request for Information are set out in Annex B.

ANNEX A

ED 75 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.
CIPFA agrees with how the IPSASB has modified IFRS 16 for the public sector, in relation to leases under essentially commercial terms.
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, Measurement (see paragraphs BC43– 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.
CIPFA agrees with the decision to maintain straightforward alignment by retaining the fair value definition in IFRS 16, in line with the reasons set out in BC43-BC45.
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.
CIPFA agrees with the IPSASB's decision which, whilst retaining the requirement that the lease is on commercial terms, recognises that the use of the asset by the lessee might be for its service potential rather than to generate economic benefits

ANNEX B

Request for Information **Responses to Questions**

Question 1: In your jurisdiction, do you have concessionary leases (or similar arrangements) as described in this RFI? If yes, please: (a) Describe the nature of these leases (or similar arrangements) and their concessionary characteristics; and (b) Describe the accounting treatment applied by both parties to the arrangement to these types of leases (or similar arrangements), including whether the value of the concession is reflected in the financial statements.
CIPFA does not have strong data on the prevalence of concessionary leases or similar arrangements except for some categories of arrangement which we comment on in responses to other questions. We are aware that there are concessionary leases (or similar arrangements) in UK central government, local government and health entities. The current treatment for many of these reflects the IAS 17 operating lease treatment whereby rental payments are expensed. An analogous treatment (expensing) will generally apply to arrangements which are not considered to be leases under IAS 17. The issue of application of leasing standards to wider categories of arrangement than contracts has been considered as part of the UK implementation of IFRS 16, and the draft manuals and local authority code through which standards are implemented include wider arrangements where contracts are not in place – for example, arrangements between government departments which cannot be structured as contracts. The proposed treatment for concessionary leases in the UK public sector under IFRS 16 is in line with the discussion in the RFI paras 10 and 11 in those cases where a donation has been deemed to have taken place. Consideration during the run up to implementation has identified commercial leases which include concessionary or peppercorn leases, where ‘donation’ may not be the substance of the arrangement. Having regard to these issues, the draft code for UK local authority accounting only specifies this treatment where it is determined that there is a donation.
Question 2: In your jurisdiction, do you have leases for zero or nominal consideration as described in this RFI? If yes, please: (a) Describe the nature and characteristics of this type of lease (or similar arrangement); and (b) Describe if and how the value of the concession is reflected in the financial statements of both parties to the arrangement
<u>Long leases in UK local government</u> Very long leases (for example 999 year leases) with peppercorn rents are very common in UK local government. They allow local authorities effectively to dispose of property but specify or restrict through the lease terms how the asset might be used, thus securing continuing benefit for the local population. These are generally accounted for as an in-substance disposal.

There has been debate about whether such assets continue to provide service potential to the local authority, as the assets are used for the provision of services that the authority might otherwise have been required to provide itself or to achieve outcomes that reduce the demand for the authority's services.

Embedded in commercial contracts

Peppercorn leases can be embedded in commercial contracts between private sector entities, and as far as we are aware, these are not normally recognised as leases for accounting purposes as there is no consideration involved. In other cases, using the cost basis under IFRS 16 would achieve essentially the same result.

Examples are many, but an area which has come to our attention and potentially affects public sector reporting is leases between train operating companies and railway infrastructure companies. In the overall contracts, the main charges are framed in terms of access to the rail network, but clarity over access rights to stations to pick up and set down passengers is set out in peppercorn leases between the infrastructure company and a 'lead' train operating company.

Where train operating companies are operating on behalf of public sector entities the question has been raised as to whether these should be recognised as leases for the purposes of consolidation, and whether a non-zero value should be attributed to the associated transactions and balances. A final determination was not obtained on this issue, as in the case under consideration the amounts involved were not deemed material.

Question 3: Does your jurisdiction have arrangements that provide access rights for a period of time in exchange for consideration? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.

Examples of such arrangements include:

Wayleaves – contracts that allow access to land owned by another party for the installation of equipment and its subsequent maintenance. Pipes, cables, transformers, pylons, masts, etc.

Easements – rights held by a landowner over adjoining land relating to such things as access, utilities connections, light, etc.

Our understanding is that the amounts involved are generally not material, and the arrangements are not recognised as leases

Question 4: In your jurisdiction, do you have arrangements with the same or similar characteristics to the one identified above[1]? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.
In the UK there are some arrangements in relation to church schools, where premises are occupied by governors on little more than promises from the owners. As far as we are aware, these premises have not been shown in local authority balance sheets. Nor have they been recorded in other reporting on leases.
Question 5: In your jurisdiction, do you have arrangements involving social housing with lease-type clauses or other types of lease-like arrangements with no end terms? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of the social housing provider
Arrangements of this type arise in the UK public sector. The current interpretation under IFRS is that these are leases. This is how a substantial proportion of UK local authority rented housing operates. Tenancies are secured with no fixed end point and some rights for tenants to pass tenancies on to family members. Further complication is introduced where tenants have a 'right to buy' the property which they occupy. These are presumed to be operating leases from the perspective of the lessor. Tenants have a right to terminate a tenancy with four weeks' notice. Under IAS 17 rules, this would limit the term to four weeks. IFRS 16 requires more detailed analysis of whether it is reasonably certain that a termination option would not be exercised. Having said this, there are arguments that an authority continues to derive full service potential from a social housing asset whilst it is being occupied by a tenant. Once service potential is included as a basis for recognising and measuring assets, it can be the case that both the apparent lessee and apparent lessor secure all their individual objectives from the arrangement. More generally this raises questions around contractual arrangements which do not diminish the achievement of the asset holder's objectives, and whether these should be deemed to be a lease for financial reporting purposes.
Question 6: In your jurisdiction, do you have arrangements involving the sharing of properties without a formal lease contract? If yes, please describe the nature of these arrangements and how they are reflected in the financial statements of both parties to the arrangement.
The most common example in UK local government is probably sports halls with shared use between two authorities with differing remits. During the daytime, an authority with responsibility for education will have the right for its schools to use the facilities, and during evenings and weekends the authority with responsibility for leisure will open the facilities to the public. The assets are usually accounted for by the authority holding legal title, with a contribution to costs

[1] The text referred to in the question is as follows:'*There are cases where public sector entities deliver services (for example, education services) using properties provided by third parties (for example, trusts and non-government entities). In some cases, these entities can substitute the properties, and in other cases they cannot. Often, there is no written arrangement, but the public sector entity can only use the properties for their specific service*

from the other party being accounted for as income. Occasionally, full joint operation accounting might be applied. We can also envisage that there may be embedded leases in some shared services arrangements, particularly between co-located or geographically closely located local authorities. These could include IT services and refuse collection. Contracts for such services would need to be analysed to determine whether there might be embedded leases for the authorities that are not the operator.
Question 7: In your jurisdiction, do you have other types of arrangements similar to leases not mentioned in this RFI? If so, please describe the characteristics of these arrangements and how they are presently being reflected in the financial statements of both parties to the arrangement.
It is quite possible there are further types of less formal arrangements which are not shown in financial statements. The circumstances which give rise to less formal and unrecorded arrangements may in practice be ones which mean that it is not beneficial to carry out detailed accounting. It is however difficult to comment on this without such information. One example being considered recently relates to church schools, where in contrast to our response to Question 4, the arrangements are not altogether informal, but are captured in 'mere licenses' that are not leases. These are not currently reflected in financial statements.