

Swiss Comment to

ED 75 Leases

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1. Introduction

The Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP) was established in 2008 by the Swiss Federal Ministry of Finance together with the cantonal Ministers of Finance. One of its aims is to provide the IPSAS Board with a consolidated statement for all three Swiss levels of government (municipalities, cantons and Confederation).

The SRS-CSPCP has discussed ED 75 Leases.

2. General Remarks

The SRS-CSPCP's attitude to this ED is highly critical. However, we acknowledge that also in the public sector lease agreements and therefore the related lease liabilities are increasing. This ED provides a certain transparency for such business transactions and, in view of the debt situation, this is to be regarded positively.

In Switzerland, with a few exceptions, public enterprises do not account in accordance with IFRS, but with national, private sector accounting principles, which have not adopted the IFRS16 principles. Hence, the ED may result in difficulties on consolidation.

The standard proposed results in unnecessary inflation of the statement of financial position, both on the assets and the liabilities side, which does not have a positive influence on transparency.

The adoption of IFRS 16 seems unfortunate and premature, because the IPSASB is not planning to define the characteristics of leasing agreements in the public sector until a later date, after reviewing the responses to its questionnaire (Request for Information, Concessionary Leases and Other Arrangements Similar to Leases). The question arises in what form and when a new standard is to be adapted to the specific characteristics of the public sector. The SRS-CSPCP is of the view that the Standard should be published only after definition of the specific elements for the public sector and should first be issued as a comprehensive ED for approval.

The SRS-CSPCP also fears that with the adoption of IFRS 16 considerably more work for accounting is to be expected, above all in the introductory phase. In addition, the disclosure requirements are broad and complex. As IFRS 16 has only recently been introduced, the SRS-CSPCP would have welcomed that before publishing its Leasing Standard the IPSASB had waited for first experiences of the private sector with IFRS 16. The SRS-CSPCP also points out that ED 75 is focussed too narrowly on fixed assets. With progressing digitization, the definition of service elements of software agreements should not be forgotten.

Furthermore, the SRS-CSPCP also finds that with the introduction of this leasing standard from an accounting aspect a rental agreement is equated with a purchase contract. The SRS-CSPCP wishes this to be further clarified. It also fears that given the high complexity of the new leasing standard the public sector could be tempted to develop avoidance strategies.

The Swiss comments on ED 64 are still applicable; the SRS-CSPCP therefore takes the liberty of once again here including its comments/responses on that ED:

The SRS-CSPCP notes that in the proposed ED the symmetry between lessor and lessee in respect of booking is given. This symmetry is very important for consolidation purposes and also for financial statistics.

However, leasing agreements are already very difficult to reflect technically. This ED makes everything even more complicated. The SRS-CSPCP wonders why long-term rental agreements are to be treated differently from long-term insurance contracts (executory contracts). Liabilities under long term insurance contracts are not reflected in the statement of financial position. In the Notes also there is no reference to these contracts. Furthermore, the SRS-CSPCP wonders whether the model for the lessor is suitable for long-term rental of land contracts (e.g. a leasehold agreement covering 70 years). Under certain circumstances two

identical assets are reflected in the lessor (Property and Receivable from right of use). The SRS-CSPCP wonders whether this presentation is true and fair and serves as a better basis for decisions.

The SRS-CSPCP criticizes capitalization of the right of use: does one have the right to sell it? The SRS-CSPCP wonders what additional benefit the new model brings the public sector compared with the present model under IPSAS 13. It is of the opinion that the capitalization of all rental contracts as Rights-of-Use (RoU) achieves no additional benefit. Rather it unnecessarily blows up the statement of financial position. For example, in public entities with centralized property management, where all government units are tenants. Depending on the choice of accounts (stand-alone or consolidated accounts and calculation basis for key figures) a different picture is given, which is hardly comprehensible for the stakeholder.

In the statement of financial performance, instead of rental costs, amortization of the RoU and interest would be recorded. The informative value of the statement of financial performance is thereby diminished. The budget debate would also be made more difficult, because in public authorities it is carried out from a cash aspect. The fact that no cash flow is associated with traditional amortization, but that with the amortization of the RoU there is indirectly no cash outflow in the form of leasing instalments, would require explanation.

The proposed leasing model creates very high costs in the public sector, while compared with the present model the benefit is questionable. The Conceptual Framework talks of a favorable cost-benefit ratio. This is not considered in this proposal by the IPSASB.

The SRS-CSPCP would like the SRS-CSPCP to find a solution, which is more practical and less complicated.

In principle the SRS-CSPCP agrees that the IPSAS standards accord with those of the private sector (IFRS). However, this principle should not be at the expense of the public sector (see also response to CP Strategy and Work Plan 2019-2023).

Specific Matter for Comment 1 (The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting)

The SRS-CSPCP is not in agreement with the decision of the IPSASB. The reasons are the following:

- 1) This model is simpler in the use of rental contracts by decentralized entities (Australia, New Zealand). In the Swiss public sector, and also in other countries, properties are often managed centrally, which separates the management of the property and its use.
- 2) For government's operation it is important to differentiate the different types of cost (e.g. rental or occupation costs). In Switzerland, budgetary effects are different for different types of cost. In the private sector on the other hand, the focus is more on the financial result and profit distribution. If the public sector starts to recognize the amortization (of the RoU) of rental costs, the statement of financial performance loses its informative value.
- 3) The SRS-CSPCP is of the opinion that the focus of the proposed model is too much focussed on the statement of financial position. However, in the public sector the statement of financial performance is the key statement.
- 4) Because the introduction of this model is complicated and costly, there is a risk that the governments will try to deviate from this standard in some way or not to adopt it. It could possibly become another obstacle to adopting IPSAS.
- 5) In some small government units in Switzerland, the application of IFRS 16 led to difficulties. We expect even more difficulties if larger units.
- 6) The current IPSAS 13 discloses the liability from operating leases in the Notes of the lessee. In the new standard this is no longer possible for most leasing liabilities. It is hardly comprehensible that in addition in the new standard the liability on unrealized income in the lessor must be carried among the liabilities in the statement of financial position.

7) *The RoU model can result in valuation problems. For example, determination of the duration of the right of use can become a challenge, if grant of the rental contract is governed only by law. The accountant in the lessee and the accountant in the lessor must make estimates, which politically is extremely delicate. The power of decision lies with the legislator, i.e. the Parliament. Estimates are conceivable between one year (budget year, approval of expenditure), four years (legislative period) and 150 years (possible duration of use). Clear guidance would be necessary in the standard as a decision-making aid.*

3. Specific Matter for Comment 1

Do you agree with the proposed additional implementation guidance and illustrative examples? If not, what changes would you make?

The SRS-CSPCP is of the view that public sector specific concepts should be included in a new lease standard. With the attached questionnaire, the IPSASB is making an effort to collect information about existing accounting practices for concessionary leases in the public sector and is planning to include the findings later into the standard. As already stated in the general comments, the processing of the responses in the questionnaire comes (too) late. The public sector's specific elements should be included in the new leasing standard from the very beginning.

The SRS-CSPCP asks the IPSASB not to forget that in the public sector the statement of financial performance is more significant than the statement of financial position. This should also be acknowledged in the new standard. Furthermore, the recording on the lessor's side and on the lessee's side under IFRS 16 is not synchronous. This raises a problem, if the stand-alone and not the consolidated accounts are considered and used for management. For example, certain buildings (e. g. university buildings, which are property of a centralized asset management entity and not of the university in Switzerland) would be reported in the government's (lessor) individual financial statements at zero and appear only in the consolidated accounts once the university is consolidated. This problem arises for various cantons in Switzerland, but also for several countries, in which state buildings are not used by the unit, which owns and manages them. The public sector specific control and ownership situation is therefore not adequately considered.

The SRS-CSPCP wonders also to what extent the cost-benefit relationship of the Conceptual Framework is sufficiently considered. The implementation of sub-leases also seems complicated.

4. 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.

The SRS-CSPCP agrees that the currently applicable definition of Fair Value from IFRS 16 and IPSAS 13 should be retained in the new standard. But if in the discussion of the measurement project Fair Value is defined in accordance with the *Highest- and Best Use Model*, the SRS-CSPCP wishes that there be no subsequent alteration of the new leasing standard. However, the uncertainty about the future applicable Fair Value definition would be a reason to delay the introduction of the new leasing standard. The SRS-CSPCP finds it inadvisable to work with two different definitions of Fair Value in the IPSAS literature. Such variances lead to enormous uncertainty in practical implementation. Frequently, the auditors tend to require the details from the new definition even when the definition is retained, which is not the real intention. In

addition, the recipients of the accounts are disconcerted when different definitions apply for the same facts. The transparency and understanding of the accounts suffer.

5. 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.

The SRS-CSPCP agrees that both «economic benefits" and also "service potential" should be considered to identify a lease. This is consistent with the usual definition of an asset in IPSAS literature.

Lausanne, May 7, 2021